IICLE®

Illinois Institute *for* Continuing Legal Education

COMMERCIAL LANDLORD-TENANT PRACTICE

2023 EDITION

IICLE® ONLINE SUBSCRIPTIONS

Access Our Handbooks, Programs, and Automated Forms Online

Any Device. Anytime. Anywhere.

IICLE® ONLINE LIBRARY

- 140+ Titles
- 4,000+ Forms
- 40% Off Print Titles
- Formulaw Online — NOT AVAILABLE
- On-Demand CLE — NOT AVAILABLE
- 50% Off Live Events — NOT AVAILABLE

- 24/7 Access to 140+ Online Titles
- 4,000+ Editable Forms
- Browse by Title or Practice Area
- Search by Keyword
- 40% Off Print Titles

IICLE® ONLINE ALL-ACCESS

- 140+ Titles
- 4,000+ Forms
- 40% Off Print Titles
- Formulaw Online
- On-Demand CLE
- 50% Off Live Events

- All the Benefits of the Online Library PLUS:
- 24/7 Access to 300+ Online On-Demand Programs
- 50% Off Live Event Tuition
- Access to Formulaw Online Automated Forms

IICLE® Formulaw™ ONLINE

24/7 Access to the Entire Online Database of Automated Forms.

Forms are added regularly and reviewed annually.

For more information, visit www.iicle.com/subscriptions.

COMMERCIAL LANDLORD-TENANT PRACTICE (IICLE®, 2023):

This handbook revises and replaces the 2020 edition.

IICLE® is grateful to the chapter authors for their dedication to this project. We can continue to publish current, accurate, and thorough practice handbooks because of the generous donation of time and expertise of volunteer authors like them.

Any tax information or written tax advice contained herein (including any forms or attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. This notice has been affixed pursuant to U.S. Treasury Regulations governing tax practice.

We would be interested in your comments on this handbook. Please address any comments to Co-Executive Director and Director of Publications, IICLE®, 3161 West White Oaks Drive, Suite 101, Springfield, IL 62704; call Amy McFadden at 800-252-8062, ext. 102; fax comments to Ms. McFadden at 217-546-6096; or e-mail comments to amcfadden@iicle.com. Call IICLE® Customer Representatives at 800-252-8062 for information regarding other available and upcoming publications and courses.

HOW TO CITE THIS BOOK

This handbook may be cited as COMMERCIAL LANDLORD-TENANT PRACTICE (IICLE®, 2023).

Publication Date: April 27, 2023

IICLE®

Illinois Institute *for* Continuing Legal Education

NOTICE RE: ACCESSING EDITABLE FORMS FILES FOR THIS PUBLICATION

Thank you for purchasing COMMERCIAL LANDLORD-TENANT PRACTICE (IICLE®, 2023). In response to customer demand and technological advances, we are now offering a web link to deliver editable forms files that accompany IICLE® publications in lieu of a Forms CD.

PLEASE NOTE: IICLE® FORMS ARE NOT INTENDED TO TAKE THE PLACE OF PROFESSIONAL JUDGMENT AS TO THE LEGAL SUFFICIENCY AND LEGAL ACCURACY OF ANY MATERIAL CONTAINED IN THE FORM. ALWAYS PERFORM INDEPENDENT RESEARCH TO VERIFY THE APPLICABILITY OF ANY FORM TO THE SPECIFIC FACTS AND CIRCUMSTANCES OF YOUR MATTER BEFORE USING AN IICLE® FORM.

To access the Rich Text Format files for this book, please follow the instructions below:

1. Type this exact URL into the address bar of your Internet browser (*e.g.,* Google Chrome, Internet Explorer, Firefox):

   http://www.iicle.com/download/forms/cltp23.zip

   **Please note that the ".zip" extension must be included in the URL for the download to work. Without it, you will receive an error message.*

2. Once you have entered the link, a download notification will appear in your browser (the location of which varies depending on your browser of choice) and may prompt you to decide what to do with the file. In that event, please choose the "Save" or "Save As" option, give the file a name, and save it to your directory of choice.

3. Clicking on the zip file itself will automatically open a window displaying the files in your computer directory. The file name of the form corresponds to the section in the handbook where the form is found. Simply double-click the subfolder of the chapter of, then the particular file for, the form you are looking for. Once you click on the form file name, it will automatically open in your word processing program, where you may then edit the form to your specifications.

Alternatively, you can access the forms by clicking on the "Start" button on your desktop. Choose the "Documents" option, and a window will open. Select the "Downloads" folder option on the left of the window. Within the "Downloads" folder, you will see the forms files and may select the particular file you wish to open by clicking on it.

If you are unable to access the forms files using these instructions, please contact IICLE® for technical support, at **800-252-8062** between 8:30 a.m. and 4:30 p.m. CST.

COMMERCIAL LANDLORD-TENANT PRACTICE

2023

Chapter authors:

James C. Brescoll
Catherine A. Cooke
William J. Dorsey
Lawrence C. Eppley
R. Kymn Harp
Thomas C. Homburger
Jennifer L. Johnson
Karl L. Marschel
Susan I. Matejcak
Joseph R. Podlewski, Jr
John M. Rafkin
David P. Resnick
Michael J. Roth Jr.
Joseph B. VanFleet
Brian P. Welch

This 2023 handbook revises and replaces the 2020 edition.

ILLINOIS INSTITUTE FOR CONTINUING LEGAL EDUCATION
3161 West White Oaks Drive, Suite 300
Springfield, IL 62704
www.iicle.com

Owner: _____

IICLE® is a not-for-profit 501(c)(3) organization dedicated to supporting the professional development of Illinois attorneys through Illinois-focused practice guidance.

IICLE®'s publications and programs are intended to provide current and accurate information about the subject matter covered and are designed to help attorneys maintain their professional competence. Publications are distributed and oral programs presented with the understanding that neither IICLE® nor the authors render any legal, accounting, or other professional service. Attorneys using IICLE® publications or orally conveyed information in dealing with a specific client's or their own legal matters should also research original and fully current sources of authority.

Printed in the United States of America.

23CLTP:4-23(776)CS
PRD: 4-27-23 (1:CBP)

Table of Contents

About the Authors

James C. Brescoll is a Partner with Bryan Cave Leighton Paisner LLP, in Chicago, where he focuses his practice on representing commercial real estate and commercial real estate finance. He also has extensive experience drafting and negotiating retail, office, and industrial leases for both landlords and tenants, with a specific focus on retail leasing involving shopping-center owners and tenants. Brescoll is a member of the Chicago and Illinois State Bar Associations and the Urban Land Institute. He earned his B.A. from Columbia University and his J.D. from DePaul University.

Catherine A. Cooke is a Partner with Latimer LeVay Fyock LLC, in Chicago, where she focuses her practice on banking and finance transactions and commercial litigation. Cooke has authored numerous columns published in the IDC Quarterly, the flagship publication of the Illinois Defense Counsel, and served on its Editorial Board beginning in 2015, including as the Editor-In-Chief (2019 – 2020). She also served as the Editor-in-Chief of the 2020 IDC Survey of Law. Cooke earned her B.A. from Indiana University-Bloomington and her J.D. from The John Marshall Law School.

William J. Dorsey is a Partner with Blank Rome LLP, in Chicago, where he focuses his practice on high-stakes commercial disputes involving commercial finance, real estate, mergers and acquisitions, and intellectual property. He has been listed in Super Lawyers (2012 – present) and is a member of the American Bankruptcy Institute. He also serves as a faculty member of the Practicing Law Institute's Commercial Real Estate Law Institute. Dorsey earned his B.A. from Claremont McKenna College and his J.D. from the University of Michigan Law School.

Lawrence C. Eppley is a Partner of Sheppard, Mullin, Richter & Hampton LLP, in Chicago, where he concentrates his practice in hospitality. Eppley is a Law 360, Hospitality Editorial Advisory Board Member (2016 – 2023) and Chair of the Board of Directors of Chicagoland Entrepreneurial Center/1871, a nonprofit that operates an incubator that provides programming and services for entrepreneurs and start-ups. Eppley earned his B.S. from the University of Illinois, his M.A.S. from the University of Illinois, and his J.D. magna cum laude from the University of Illinois College of Law.

R. Kymn Harp is a Shareholder and member of the Executive Committee at Robbins DiMonte Ltd., in Chicago, and has years of service as Chair of the firm's Business and Real Estate Transactions Group. Harp has over 40 years of experience representing investors, developers, business owners, and other stakeholders in all aspects of commercial real estate transactions and development. He is a frequent presenter at IICLE® programs and ISBA programs on topics related to commercial real estate, and he is the author and moderator for www.Harp-OnThis.com, a commercial real estate and business blog. Harp has received awards and recognitions including the Martindale-Hubbell Peer Review (Rated AV – Preeminent, for Ethical Standards and Legal Ability), a multiyear selection as an Illinois Super Lawyer, and the Illinois Lincoln Award for Excellence in Legal Writing. He is a member of the Illinois, Indiana, and New Mexico State Bar Associations, and is an appointed member of the Illinois State Bar Association Real Estate Law Section Council. Harp earned his B.A. from Wabash College and his J.D. from University of Illinois – Chicago (John Marshall Law School).

Thomas C. Homburger has written for this handbook for more than 35 years and has written for numerous journals, including the ABA Real Property, Probate, and Trust Journal and The John Marshall Law Review. He has lectured for organizations including the Institute of Real Estate Management, the International Real Estate Institute, and the American Land Title Association and is an adjunct professor at The John Marshall Law School. He earned his B.A. from Columbia University and his J.D. cum laude from Columbia University School of Law.

Jennifer L. Johnson is a Partner with Zanck, Coen, Wright & Saladin, P.C., in Crystal Lake, where she focuses on real estate, general civil litigation, and construction/mechanics liens. Johnson is Past President of the McHenry County Bar Association and Recipient of the Prairie State Legal Services Pro Bono Award in 2018. She received her B.A. from Marshall University and her J.D. cum laude from Thomas M. Cooley Law School (now known as Western Michigan Law School).

Karl L. Marschel is a Partner at Bryan Cave Leighton Paisner LLP, in Chicago, where he concentrates his practice in commercial real estate, brownfield redevelopment, and public finance. Marschel earned his B.A. from the University of Missouri-Columbia and his J.D. from Washington University School of Law, where he was the Associate Managing Editor of the Journal of Law & Policy.

Susan I. Matejcak is a Partner at Quarles & Brady LLP, in Chicago, and focuses on real estate. Matejcak is a Fellow of the American College of Real Estate Lawyers and Past President of the Chicago chapter of Commercial Real Estate Women (CREW). She was a Bisnow Power Women Chicago Honoree in 2022. She received her B.A. magna cum laude from Northern Illinois University, where she was a member of the Sigma Tau Delta honor society. She received her J.D. from Loyola University of Chicago School of Law, where she was Editor of the Law Journal.

Joseph R. Podlewski, Jr., is in private practice with Podlewski & Hanson P.C., in Western Springs. Podlewski represents clients on a wide variety of environmental matters (including contested matters in state and federal court) and has appeared before numerous environmental agencies. He also provides advice and counsel to clients on environmental issues arising in commercial real estate transactions. He is a member of the Chicago and Illinois State Bar Associations. He is Past Chair of both ISBA's Environmental Law Section Council and the CBA's Environmental Law Committee and was appointed to the Governor's Small Business Environmental Task Force in 1994. He was selected as both an Illinois Super Lawyer and Leading Lawyer and was featured in 2013 in Chicago's Legal Leaders as among the "Top Rated Lawyers in Chicago" in the practice areas of environmental law and land use. He earned his B.A. from Northern Illinois University and his J.D. with honors from IIT/Chicago-Kent College of Law, where he was a Lead Articles Editor of the Chicago-Kent Law Review.

John M. Rafkin is a Partner with Jones Day in Chicago, where he concentrates his practice in real estate finance. Rafkin represents individual lenders, bank groups, agents, and borrowers in single-and multi-asset financings of commercial real estate. He is experienced with all types of real estate, including office, retail, student and senior housing, multi-family and industrial, and has particularly deep experience with hospitality financing. His practice often focuses on the workout of troubled loans, including complex, multi-tiered loan restructurings, deeds-in-lieu,

debt for equity swaps, bankruptcy, deficiency notes, and other settlement structures. He has been included in the U.S. edition of THE LEGAL 500 since 2010. He received his A.B. cum laude from Harvard University and his J.D. cum laude and Order of the Coif from Northwestern Pritzker School of Law.

David P. Resnick is a Shareholder at Robbins DiMonte, Ltd., in Chicago, and has over 22 years of experience overseeing commercial real estate transactions. He provides legal counsel in all facets of commercial real estate business, including the acquisition, sale, financing, operation, and development of hotel, industrial, office, multifamily, retail, and mixed-use properties as well as the formation of real estate ventures and related strategic matters. Resnick maintains a robust commercial leasing practice in which he counsels owners, tenants, retailers, and hospitality firms in leasing matters across all sectors. Resnick received his B.A. from the University of Michigan and his J.D. from Northwestern University Pritzker School of Law.

Michael J. Roth Jr. is a Partner at Sheppard, Mullin, Richter & Hampton LLP, in Chicago, where he is in the firm's Real Estate, Energy, Land Use & Environmental Practice Group and concentrates his practice in real estate. Roth earned his B.A. from Truman State University and his J.D. from Washington University School of Law.

Joseph B. VanFleet is a Managing Partner of Howard & Howard Attorneys PLLC, in Peoria, where he concentrates his practice in commercial banking. VanFleet is a Litigation Counsel of America Fellow and a member of the American and Illinois State Bar Association. He earned his B.S. with highest honors from the University of Illinois College of Commerce and Business Administration and his J.D. from the University of Illinois at Urbana-Champaign, College of Law.

Brian P. Welch is a Partner at Burke, Warren, MacKay & Serritella, P.C., in Chicago, where he focuses his practice on bankruptcy, business reorganization, debtor's and creditor's rights, insolvency, and commercial litigation. He has been recognized as a "Rising Star" in the field of Business Bankruptcy by Illinois Super Lawyers Magazine and as an "Emerging Lawyer" in the field of Bankruptcy & Workout Law by Illinois Emerging Lawyers Magazine. He earned his B.A. from the University of Illinois, Urbana-Champaign, where he was on the Dean's List, and his J.D. cum laude from The John Marshall Law School, where he worked on The John Marshall Law Review, was in the Moot Court Honors Program (Executive Board), and was on the Dean's List.

IICLE® Board of Directors

Chair
Bradley L. Cohn, Pattishall, McAuliffe, Newbury, Hilliard & Geraldson LLP, Chicago*

Vice Chair
Hon. Ronald D. Spears, Spears Dispute Resolution, Taylorville*

Treasurer
Hal R. Morris, Saul Ewing Arnstein & Lehr LLP, Chicago*

Secretary
Stacy E. Singer, Northern Trust, Chicago*

Immediate Past Chair
LaVon M. Johns, Quintairos, Prieto, Wood & Boyer, P.A., Chicago*

Aurora Austriaco, Valentine Austriaco & Bueschel, P.C., Chicago
Gunnar J. Gitlin, The Gitlin Law Firm, Woodstock
Mitchell B. Gordon, Bradford & Gordon LLC, Chicago
Thomas G. Hamill, Harrison & Held, LLP, Springfield
Ray J. Koenig III, Clark Hill PLC, Chicago
Richard L. Miller II, CTM Legal Group, Chicago
Ava George Stewart, Law Office of Ava George Stewart, P.C., Chicago
Julie A. Tappendorf, Ancel Glink, Chicago
Upneet S. Teji, Greensfelder, Hemker & Gale, P.C., Chicago*
Heather E. Voorn, Voorn, Jaworski, & Preston, PLLC, New Lenox
Sonni Choi Williams, City of Lockport, Lockport

Executive Committee Members

IICLE® Board of Directors Past Chairs

H. Ogden Brainard (1962 – 1969)
John S. Pennell (1969 – 1971)
William K. Stevens (1971 – 1972)
J. Gordon Henry (1972 – 1973)
Roger J. Fruin (1973 – 1974)
Joseph J. Strasburger (1974 – 1975)
William J. Voelker (1975 – 1976)
Harold W. Sullivan (1976 – 1977)
John J. Vassen (1977 – 1978)
James M. (Mack) Trapp (1978 – 1979)
Theodore A. Pasquesi (1979 – 1980)
George W. Overton (1980 – 1981)
Peter H. Lousberg (1981 – 1982)
Kenneth C. Prince (1982 – 1983)
Edward J. Kionka (1983 – 1984)
Joseph L. Stone (1984 – 1985)
Thomas S. Johnson (1985 – 1986)
Richard William Austin (1986 – 1987)
J. William Elwin, Jr. (1987 – 1988)
Donald E. Weihl (1988 – 1989)
Tomas M. Russell (1989 – 1990)
John K. Notz, Jr. (1990 – 1991)
Michael J. Rooney (1991 – 1992)
Willis R. Tribler (1992 – 1993)
Thomas Y. Mandler (1993 – 1994)
Ralph T. Turner (1994 – 1995)
Robert E. Bouma (1995 – 1996)
Patrick B. Mathis (1996 – 1997)
Michael H. Postilion (1997 – 1998)
Robert V. Dewey, Jr. (1998 – 1999)
Roma Jones Stewart (1999 – 2000)
Hon. John A. Gorman (2000 – 2001)
Michael L. Weissman (2001 – 2002)
George W. Howard III (2002 – 2003)
Robert E. Hamilton (2003 – 2004)
Patricia A. Hoke (2004 – 2005)
Thomas M. Hamilton, Jr. (2005 – 2006)
Hon. Dale A. Cini (2006 – 2007)
Susan T. Bart (2007 – 2008)
Adrianne C. Mazura (2008 – 2009)
George F. Mahoney, III (2009 – 2010)
Robert G. Markoff (2010 – 2011)
Hon. Leonard Murray (2011 – 2012)
Donald P. Seberger (2012 – 2013)
Lorraine K. Cavataio (2013 – 2014)
William J. Anaya (2015)
Thomas A. Lilien (2016)
Robert Z. Slaughter (2017)
Ben Neiburger (2018)
Paul E. Bateman (2019)
Jane N. Denes (2020)
James M. Lestikow (2021)
LaVon M. Johns (2022)

IICLE® Staff

Amy L. McFadden, *Co-Executive Director & Director of Publications*

Megan K. Moore, *Co-Executive Director & Director of Programs*

Publications

Shanna Hull, *Managing Editor and Document Automation Specialist*
Ben Levin, *Managing Editor*
Matthew Lund, *Managing Editor and Document Automation Specialist*
Lindy Manuel, *Publications Marketing Coordinator*
Angela Moody, *Managing Editor*
Darryl Parr, *Editor-in-Chief*
Kim Rouland, *Publications Compositor*
Jennifer Routson, *Publications and Subscriptions Coordinator*
Courtney Smith, *Managing Editor and Document Automation Specialist*
Claire Starling, *Legal Editor*
Doug Urbanski, *Managing Editor*

Programs

Angela Alaria, *Program Planner*
David Biggs, *Programs Marketing Coordinator*
Daymon Kiliman, *Online Content Development Manager*
Stephanie Laffey, *Program Planner*
Doug Liberati, *Online Content Producer*
Kelli Trump, *Programs Administrative Assistant*

Administrative Services

Hayley Simpkins, *Client Services Specialist*

Readers may contact staff members via e-mail at info@iicle.com or [first initial][last name]@iicle.com (*e.g.,* amcfadden@iicle.com)

1 Retail Leases

SUSAN I. MATEJCAK
Quarles & Brady LLP
Chicago

The author thanks Stephen E. Ross for his assistance in the preparation of this chapter.

IICLE® gratefully acknowledges Theodore I. Yi and Sara A. Cooper, who provided this chapter for the previous edition and on whose material this edition is based.

I. [1.1] OVERVIEW

In any lease, the landlord surrenders to the tenant the landlord's most obvious property right — the right to occupancy. The lease sets forth the parameters for the relationship intended to benefit both parties. The parties and their counsel should seek to anticipate the realm of changed circumstances that could arise during the lease term. To prepare for this, the attorney must have a working knowledge of numerous practice areas, potentially including real property and personal property rights and both the legal and practical aspects of construction, including mechanics liens, secured and unsecured creditors' rights and expectations, public sector financing, real estate taxes, tax exemptions, accounting treatment of leasehold interests, casualty and liability insurance, zoning regulations, building codes, brokerage rights and claims, and laws governing bankruptcy and insolvency. Custom plays an important part in completing this process. This chapter is designed to acquaint the Illinois practitioner with these subjects in the context of a retail lease transaction.

The retail landlord has three primary goals: (a) a steady income stream (as well as payment of operating expenses and taxes); (b) a contract that increases the value and marketability of its property; and (c) a tenant use that complements, or at least does not disturb, the landlord's other tenants. The retail tenant also has three primary goals: (a) affordable and predictable occupancy costs given its business operations; (b) sufficient customer traffic into the shopping area and hopefully its store; and (c) the right to operate its business without significant interference in accordance with reasonable rules. If counsel for both parties to a retail lease keep these goals in mind, even the most cumbersome provisions of the lease document will be understood and can provide the basis for a mutually satisfactory lease transaction.

II. [1.2] GENERALLY USED TERMINOLOGY

The practitioner should be familiar with the following terms used in retail leases:

Additional rent: Additional rent is payments paid by a tenant in excess of base rent or minimum rent. Additional rent includes but is not limited to percentage rent, tenant's proportionate share of real estate taxes and assessments, common area maintenance (CAM) expenses, insurance, and utilities, all of which are generally reconciled sometime after each year of the term or upon issuance of the final bills.

Anchor tenants: Anchor tenants are the entities that occupy the largest stores in a shopping center and generally are the largest driver of customer volume at the shopping center. The anchor tenants dominate in terms of parking, signage, and sometimes the minimum hours tenants must remain open for business. The anchor tenant often determines the clientele visiting the location. A regional shopping center may have more than one anchor tenant, while a neighborhood shopping center may have none.

Base rent or minimum rent: Base rent, or minimum rent, is the primary component of total rent paid for the use of the premises. It often is expressed in dollars per square foot per year and is intended to provide the landlord with a net income, as opposed to additional rent, which is a pass-through to the tenant of the landlord's payment of real estate taxes, insurance, and other operating expenses.

Blackout period: A period or periods in which the tenant is not obligated to open and commence operations. Many tenants' sales are seasonal, and a blackout period or periods is designated to protect the tenant from being obligated to open during a slow period and commence paying rent when there are limited opportunities for sales.

Breakpoint and natural breakpoint: Breakpoint and natural breakpoint are the annual sales amounts that trigger the tenant's obligation, if applicable, to start paying percentage rent. A natural breakpoint occurs when the tenant's annual sales reach a level equal to the product of the tenant's annual base rent and the agreed-on percentage.

CAM charges: Common area maintenance (CAM) charges are the costs incurred by the landlord to manage, operate, and maintain all portions of the shopping center not occupied by the individual tenants.

Community shopping center: A community shopping center is a retail facility that is usually 100,000 to 250,000 square feet in size and typically includes a supermarket, variety store, junior department store, or low-price discount store as the anchor tenant. There are also 10 to 20 smaller tenants, a few of which might be national or regional operations but are more commonly local, independent merchants.

Continuous operation: Continuous operation is a requirement that a tenant stay open for business for certain specified time periods, usually seven days per week. If a lease requires continuous operation, the tenant defaults under its lease if the store closes or the tenant fails to maintain the required hours of operation, even if it continues to pay rent and otherwise complies with its lease obligations.

Cotenancy requirement: A requirement that a minimum number of other retailers, such as key anchor tenants and a percentage of non-anchor tenants, are open and operating. There may be an opening cotenancy requirement in connection with a new center development as well as an ongoing or continuous cotenancy requirement. Cotenancy requirements are designed to protect the tenant from being obligated to operate in an empty or near empty center.

Destination tenants: Destination tenants are those tenants that draw a larger number of customers to the shopping center due to the retailer's trade name or merchandise mix.

Exclusive use: An exclusive-use provision gives one tenant in the shopping center the sole right to sell certain categories of merchandise or services.

Go-dark clause: These clauses are typically paired with an opening covenant and are an alternative to a full operating covenant. These clauses give the landlord the right to terminate the lease if the tenant does not operate in the premises for a specified period of time.

Gross leasable area (GLA): GLA is the total square footage of all of the space available to tenants in the shopping center.

HVAC: HVACs are the heating, ventilating, and air-conditioning systems supplied to the tenants and common areas.

In-line store: An in-line store is a store that shares a common wall with another tenant along a row of stores in the shopping center.

Kick-out clause: A kick-out clause is a clause that gives a tenant or a landlord, or both, the right to early termination if the store does not achieve a stated sales milestone.

Linear feet: Linear feet is the term of measurement for shelf space of merchandise.

Line of site: The line of site is the view of the front of the store from the road.

Merchants' association: A merchants' association is an organization of retail store merchants organized by the shopping center operator for advertising or otherwise marketing the shopping center.

Neighborhood shopping center: Neighborhood shopping centers are designed for the sale of convenience goods and to meet daily neighborhood needs and are generally 30,000 to 100,000 square feet in size. Other than the anchor store, spaces are usually 1,500 square feet to 5,000 square feet. Retailers are typically local and sell convenience foods or offer local services.

Opening covenant: An opening covenant is a tenant covenant to open for the conduct of business by a specified deadline after execution of the lease.

Operating covenant: An operating covenant is similar to the concept of "continuous operation." The obligation imposed on most retail tenants under an operating covenant is to use the store for a stated number of hours per day and week, often seven days per week, with reduced hours on Sunday.

Outlet centers: An outlet center is similar to a regional shopping center or a community shopping center but most of the tenants are required to offer branded merchandise, usually at a discount from the usual selling prices. Most tenants operate under the name of recognized consumer product manufacturers. While there may be some larger-space tenants, there is usually no anchor tenant.

Out-lot: An out-lot is a freestanding pad used for a single restaurant, banking facility, or store, sometimes with dedicated parking, and is generally located at the corners or boundaries of the shopping center.

Percentage rent: Percentage rent, when applicable, is a component of the total rent paid by the tenant. After a tenant's business achieves a certain threshold amount of sales in a given period, usually annually, the tenant pays additional rent based on a percentage of the additional sales made during such period after the threshold or breakpoint is reached.

Pylon sign: A pylon sign is a freestanding advertising sign located on the street intersections or main entrances to the shopping center. Usually, the anchor tenant's identification is permanently affixed at the top and, depending on size and available space, some or all of the other tenants are listed on smaller individual panels. Some centers have monument signs as an alternative or supplement to the pylon signage.

Radius restriction: A radius restriction is an area around the store or center where the tenant is prohibited from operating another store. The radius restriction is designed to protect sales generated at the premises from being diverted to the other location.

Reciprocal easement agreement (REA): An REA is a recorded document setting forth the easements benefiting and burdening the shopping center and adjacent property to provide for joint access, parking, or other use. Cost allocations among the affected property owners, insurance requirements, and indemnity obligations are also included.

Regional shopping center: A regional shopping center has at least one full-line department store, and sometimes multiple full-line department stores, measuring at least 250,000 square feet. The balance of these shopping centers is populated by stores with similar rentable areas, some of which are destination tenants. Regional or national chain retailers typically lease many of the smaller stores, offering convenience and recognized branded goods.

Specialty malls: Specialty malls are facilities characterized by a narrow tenant mix in which one can expect to see tenants gathered by category or by the special nature of their customers (*i.e.,* bridal goods, jewelry, antiques, or art). The common areas of these malls are designed to service or highlight the mall's product line focus and might include special display spaces or auditoriums.

Tenant's proportionate share: A tenant's proportionate share is calculated by dividing the square footage of the tenant's store by the GLA for the shopping center. The anchor tenant's square footage is sometimes extracted from this calculation since the anchor tenant often pays a fixed amount towards CAM, which is generally less per square foot than the remaining tenants have to pay.

Term sheet or letter of intent: A term sheet, or letter of intent, is a nonbinding letter signed by the parties that sets forth the major economic and business terms of the deal prior to the delivery and negotiation of the lease.

Vanilla box: A "vanilla box" is the term used to describe the condition in which retail premises are generally delivered to the tenant for the build-out of the tenant's store. A vanilla box is clean, with all the prior tenant's fixtures and improvements removed, with available utilities in place, but without finished floors, walls, ceilings, or lighting.

Work letter: A "work letter" is an exhibit to the lease that describes the proposed modifications to the premises that the tenant will need in order to conduct its business; the method for obtaining approvals for, and carrying out the construction of, the work; and provisions for how payment will be made. The form of work letter will differ depending on whether the landlord or the tenant will be responsible for performing the construction work.

III. [1.3] ATTACHED FORM LEASE

Section 1.29 below contains a sample form of a retail lease to provide an illustration of the provisions typically contained in the retail lease document for a store located in a shopping center.

Most of the sample form is assumed to result from a negotiation between a large commercial landlord in a shopping center and a tenant with some bargaining strength due to a strong balance sheet. However, the authors have included some alternative provisions to address certain points made in this chapter. The lease does not reflect the typical agreement with an anchor tenant who has significantly greater bargaining leverage and often requires the use of its own lease form. Some of the provisions will not apply to a situation in which a single tenant occupies the entire property or to smaller strip centers.

Certain non-anchor tenants also may have sufficient bargaining power to obtain greater lease benefits. These tenants would include tenants using a significant portion of the leasable area or those national, regional, or, occasionally, local retailers that have significant brand-name recognition and that may be expected to generate significant sales and traffic for the shopping center.

IV. [1.4] BEFORE THE DRAFTING BEGINS

The prospective tenant usually seeks out potential locations using a broker, and the lawyer is called only after the tenant has negotiated and signed the term sheet or is presented with the first draft of the lease.

If counsel has a long-term relationship with the prospective tenant or is otherwise aware that the client is looking for space, counsel should inform the client that counsel also should review the term sheet or letter of intent prior to its final execution. Since the term sheet is to contain the major business terms, counsel should advise the tenant to include all of the tenant's more important conditions and concerns in the term sheet. In addition to lease duration and rental rates, these terms might include (a) exclusive use rights, (b) caps or other control on CAM charges, (c) cotenancy requirements, (d) signage rights, (e) prohibition on relocation, (f) early termination rights, and (g) options to extend or expand, or similar options, such as rights of first offer or of first refusal on adjacent space. One additional right to consider as part of the term sheet is a requirement that the landlord's mortgagees provide the tenant with a non-disturbance agreement.

When the site has been selected, the tenant expects the attorney to negotiate a fair lease that reflects the agreed on terms and otherwise does not expose it to any extraordinary risks. Even under circumstances in which counsel is brought into the transaction after the term sheet is negotiated, the tenant's counsel should conduct its due-diligence investigation of certain matters that are beyond the four corners of the lease document and discuss the results of this investigation with the client. Sections 1.5 – 1.9 below discuss important areas to consider.

A. [1.5] Control of the Site

A shopping center lease typically includes, as an exhibit, a site plan for the shopping center, with the premises to be leased marked by crosshatching or similar identifying marks. If the tenant has sufficient bargaining strength, the tenant may be able to negotiate certain site plan controls to protect such things as its location in the shopping center, visibility of its premises from common roadways, and important parking fields in front of the premises (as well as the sidewalk or mall area immediately in front of the premises).

The tenant's counsel cannot simply assume from the site plan that the landlord named in the lease controls the entire site and can bestow on the tenant all the benefits that the tenant anticipates. The anchor tenant or tenants of the out-lots may not be tenants at all. They may own their parcels in fee simple and may not be contributing to common area maintenance. Even if they do not own their parcel, an anchor tenant might not have the obligation to fully contribute to insurance, taxes, or CAM. In these cases, the landlord will seek to make up the shortfall from the remaining tenants. The anchor tenant may have the right to "go dark," which could be disastrous for the other tenants in the shopping center who are depending on the anchor tenant to draw customers to the shopping center.

If the tenant is to be situated near the boundary of the shopping center, it is possible that the owner of an adjacent shopping center that is not shown on the site plan may have reciprocal parking rights that limit available parking for the tenant's customers. If requested in advance, the landlord's broker or attorney will generally supply the underlying documents dealing with these matters.

The underlying documents may include reciprocal easement agreements and/or declarations of covenants, conditions, and restrictions. The tenant's counsel should request the documents early in the process and take time to provide for a timely review of the recorded versions of these documents, particularly the parking provisions, the use restrictions, and the allocation of common area expenses and real estate taxes. If certain provisions appear to be problematic, counsel should raise these issues promptly because the landlord is more likely to address the issues if raised early in the negotiations rather than just prior to lease execution when pending deadlines may be looming.

B. [1.6] Future Tenant Mix

The prospective tenant might be attracted to a particular location in part because of the absence of close competitors or because of the foot traffic generated by the surrounding retail tenants. However, the lease document typically provides no commitment from the landlord that this favorable situation will continue.

If the tenant has sufficient bargaining strength, it might request an exclusive-use provision. Alternatively, if an exclusive use is not feasible for the shopping center, depending on bargaining power and the type of retail use, the tenant may seek to obtain a restriction limiting the landlord's ability to place other tenants with identical or similar product lines in close proximity to the tenant's premises. As discussed in §§1.18 and 1.19 below, the language must be carefully drafted to avoid unintended consequences. In addition to exclusive-use provisions, center owners often protect the tenants by including a list of prohibited uses, such as obnoxious uses not usually found in a shopping center or those that would unduly burden the common areas, such as excessive parking use.

Unless the center is in an advantageous location, a tenant has no assurance that the shopping center will remain a thriving retail location throughout the lease term. However, if the tenant has sufficient bargaining strength, it may be able to negotiate cotenancy requirements to protect itself in the event of future vacancies in the center.

In some situations, the landlord may be unable to lease some of the available space to a retail user. In a slow economy or if the shopping center is in a less desirable location, the landlord may decide to rent space in the shopping center to non-retail users, such as educational institutions, driving schools, medical clinics, offices, and other uses that do not typically attract retail customers. In lieu of a prohibition regarding non-retail uses, one alternative to address this potential problem is to bargain for a lease provision that permits the tenant to terminate if a percentage of the gross leasable area of the shopping center (*e.g.,* 35 percent) is no longer in retail use. The landlord may refuse to agree to this right unless the tenant is a highly desirable destination tenant that brings shoppers to the center.

C. [1.7] Parking Rights

In almost all retail centers, readily available parking is essential. Yet many lease documents are silent regarding parking or say little more than identifying the customer parking areas and the right of a tenant's customers to use it in common with the customers of other tenants. The tenant's counsel must investigate whether any other tenant can take over a portion of the parking lot, if other tenants have reserved spaces, or if the landlord can reduce the available parking (such as by building into the parking lot or dedicating a portion of it to use as a staging area for future expansion of the shopping center). Counsel might also consider whether parking is shared, legally or otherwise, with adjacent retail property. Again, appropriate inquiries to the landlord's broker or attorney might produce documentation and provide answers. If informed that a tenant has such parking concerns, the landlord may be willing to make a representation and warranty as to available parking or alternatively permit the tenant to terminate the lease if parking spaces are reduced below an agreed-on ratio of parking spaces to square foot of GLA.

D. [1.8] Panel Identification on Pylon Sign

The term sheet and the first draft of the lease may be silent regarding a tenant's right to place the tenant's trade name on a panel on the pylon or monument sign at the entrance to the shopping center. Yet the tenant may be expecting this signage as a matter of course or may have received an oral commitment from the landlord's broker that such signage would be available. This could be a deal point for the tenant since its successful operation may depend on visible signage due to the size of the shopping center. For a non-destination tenant that depends on customers being able to identify its premises, the tenant's counsel should immediately ascertain the client's expectation and raise the signage issue in the initial negotiations. If there is no meeting of the minds, counsel may save both parties significant time and expense by avoiding further negotiations or by identifying the landlord's position on signage up front.

To the extent feasible, the tenant should seek to clarify signage rights in the term sheet. Signage is often such a critical component of the tenant's success that the tenant must focus not only on the pylon or monument sign but also on its signage on the exterior of the premises, particularly if the tenant has an identifiable or attractive logo that it wants to include on its building or premises exterior. Counsel should suggest that the tenant's designer or graphics artist submit the requested signage as soon as possible after the term sheet is finalized and before the lease is signed. Retail leases generally require the landlord's approval for all signage and may include uniform signage

criteria for the center. Even if this consent is not to be unreasonably withheld, the landlord may refuse signage based on its incompatibility with standard signage throughout the shopping center. However, landlords are sometimes more willing to agree to alternative signage if the issue is raised prior to the completion of the lease negotiations to finalize the lease.

Directional signage may also be important for tenants whose premises are located in the less traveled areas in the shopping center. In these cases, counsel should request that the tenant's name and, if possible, location, be identified on all shopping center directories.

E. [1.9] Summary of Tenant's Pre-Leasing Inquiries

As a list of issues discussed in §§1.5 – 1.8 above, the tenant's counsel should request that the landlord's counsel or broker provide the following items:

1. identification of all parties who control the shopping center site, including any portions that are owned by anchor tenants or out-lot tenants;

2. any reciprocal easement agreements affecting the site;

3. a list of exclusive uses granted for the shopping center;

4. a list of prohibited uses in the shopping center;

5. language from leases of any anchor tenants concerning any rights of the anchor tenant to terminate its lease or to close its store;

6. a confirmation that no tenant has the right to reduce the parking area and that the landlord will not reduce available parking; and

7. confirmation that the tenant has the right to have an identification panel placed on the pylon sign or building façade plus additional signage and rights to advertise, including the use of the name and/or location of the shopping center in the tenant's advertising and marketing materials.

The landlord's broker and counsel are accustomed to providing this information to tenants who request it. The tenant should also request the identification of any tenants, including anchor tenants, out-lot tenants, or non-retail tenants, that may not be obligated to fully contribute to common area maintenance expenses, real estate taxes, and merchants' association expenses. If the landlord has granted such abatements to numerous tenants or to a few tenants with large leasable square footage, it may significantly impact the tenant's expenses since the remaining tenants may need to make up the shortfall to the landlord.

V. LANDLORD AND TENANT CONSTRUCTION AND THE COMMENCEMENT DATE

A. [1.10] In General

A retail lease will have three target dates established in relation to the date the lease is signed: the delivery date, the rent commencement date, and the opening date. The delivery date (sometimes referred to as the "commencement date") is the date when the landlord is required to deliver the premises to the tenant in vanilla box condition. If the premises are currently occupied, the lease may provide for a target delivery date to allow for possible delays in regaining possession of the space. As the name implies, the rent commencement date is the date when the tenant is to start paying rent, regardless of whether the tenant has opened for business. It is typically defined as the earlier of (1) the date the tenant first opens for business or (2) a set period of days after the delivery date, depending on the time needed to build out the space for the tenant's use. It may also include a free-rent inducement at the outset of the term. Finally, the retail lease will generally provide a date upon which the opening covenant and operating covenant, if either is applicable, will become active and that the tenant will be in default if it is not open for business by that date. In initial drafts, it is often the anticipated time for construction. The landlord and the tenant each want the tenant to open for business as soon as possible. Since each side is partially responsible for what happens during this process, each side must protect itself from delays caused by the other.

The tenant's counsel should consider the business timing needs of the client and develop appropriate remedies in the event of a late delivery of the premises by the landlord. Remedies may include additional rent abatement and eventually a termination right if delivery is delayed for an extended period of time.

B. [1.11] Commencement Date

If the tenant will be responsible for building out the premises, the tenant should develop a timeline in order to identify a realistic rent commencement date. During lease negotiations, the tenant should retain its own architect, contractor, or consultant to provide reliable estimates of the time needed to (1) prepare the plans and specifications sufficient to obtain building permits and contractor bids, (2) obtain building permits from the local municipality, and (3) complete the construction of the premises after receipt of building permits and the landlord's approval. Although the time period for the landlord's approval is generally included in the work letter, the tenant should consider this time period in its timeline plus a contingency period if revisions of the plans are necessary due to rejection by the landlord or the municipality.

If the premises are already vacant and the landlord has restored them to vanilla box condition, the landlord will be in a position to immediately deliver possession of the premises upon lease execution. This will start the free-rent period, whether tied to construction or with an extended abatement in lieu of a tenant improvement allowance. If the premises are still occupied, the delivery of possession will not occur until the current tenant has vacated the space, the existing improvements are demolished, and the premises are restored to a vanilla box condition. If the space is currently occupied, the tenant must protect itself from delays in delivery. This is especially

important for a retail tenant who often generates a large percentage of its sales at certain times. For example, a store that is not fully operational by November 1, or certainly no later than Thanksgiving, will have poor Christmas holiday sales. Florists and candy stores that commence just after Valentine's Day or Easter will fail to take advantage of peak buying seasons.

The tenant needs to try to determine whether the existing tenant might hold over. For example, is the existing tenant going out of business? Has its term already expired, and if so, is it paying double rent, with a consequential damage clause if the new tenant terminates? Is the occupant relocating to a new but as of yet unfinished replacement site? The tenant also must estimate and include the time needed by the landlord for demolition permits and actual demolition so that the work can commence to prepare the premises for the tenant's work. If the premises are currently occupied, the tenant should seek to impose on the landlord an obligation to use commercially reasonable efforts to cause the occupant to vacate on a timely basis, including but not limited to the filing of an eviction action. As the tenant's counsel, one can bargain for a right to terminate the lease after a date certain for delivery of possession or for a financial remedy for a delay in delivery of possession (*e.g.,* one or two days' rent abatement for every day of delay in delivering possession, in addition to a delay in the rent commencement date). However, as a practical matter, sometimes only large or highly desirable tenants are successful in negotiating the former and sometimes the latter remedies. For other tenants, counsel should determine a firm, reasonable outside date as a drop-dead date and bargain for day-for-day rent abatement if delivery of possession is delayed before this date. A sample clause providing for this remedy reads:

Landlord shall deliver the Premises to Tenant on or before _____, 20__ (the "Anticipated Commencement Date"). If Landlord is unable to deliver possession of the Premises on or before the Anticipated Commencement Date, the Rent Commencement Date shall be extended by ____ day[s] for each day after the Anticipated Commencement Date until the Premises are so delivered, unless the delay was solely due to the acts or inaction of Tenant, in which case there shall be no such extension. Further, if the Premises are not delivered to Tenant by _____, 20___, then Tenant, at its sole option, shall have the right to terminate this Lease by written notice to Landlord.

C. [1.12] Vanilla Box Criteria

The initial draft of a retail lease typically provides:

Landlord will remove the existing improvements in the Premises, repair and paint the walls, and prepare the floor for Tenant's floor covering. By taking possession of the Premises, Tenant shall be deemed to have accepted possession of the Premises in "as is," "where is" condition without representation or warranty of any kind by Landlord.

A landlord will rarely make representations or warranties concerning the suitability of the premises for a tenant's use, but the landlord may be willing to represent or warrant that the premises comply with building codes or that it has not received notice from the municipality of building code violations. The tenant may request, but the landlord may not be willing to provide, a statement as to latent defects. The tenant typically will not know everything it needs to know about the condition of the premises simply from an initial inspection. In any lease negotiations, counsel should keep in

mind that no matter the level of due diligence, there are certain items that cannot be discovered by the investigation. The tenant will know more once its contractors complete work on the premises and the tenant actually occupies the space for its intended use. Also, the tenant may not be able to identify all building system problems until it has completed a full year of weather patterns. At best, the landlord may be willing to remedy patent defects identified by the tenant within a certain limited period of time after delivery of possession and sometimes latent defects (*e.g.,* HVAC issues) for an extended period of time with respect to nonstructural items located within the premises for which the tenant is to have primary responsibility. For example, the roof may leak only during periods of heavy rain or snow melt, the air conditioning cannot be tested in winter, and the heat cannot be tested in summer. Given these parameters, the following provision may be the best a tenant with limited bargaining power might expect to achieve:

Prior to the Commencement Date, Landlord will complete the work set forth on [Exhibit**] attached hereto and made a part hereof ("Landlord's Work"). Except as set forth below, by taking possession of the Premises, Tenant accepts the Premises in "as is," "where is" condition without representation or warranty by Landlord. Notwithstanding the foregoing, Landlord represents and warrants to Tenant that Landlord has received no notice in the last three years from any governmental authority having jurisdiction over the Premises that the Premises are in violation of any applicable building laws or codes. If code violations are found during the period of Tenant's Work relating to base building work that are Landlord's and not Tenant's responsibility, Landlord shall promptly correct such violations at Landlord's expense. In addition, Tenant shall have the right to identify and Landlord shall correct patent defects in the heating, ventilation, air-conditioning, electrical, and/or plumbing systems (collectively "Building Systems") identified by Tenant within thirty (30) days of delivery of the Premises and latent defects in Building Systems identified by Tenant within twelve (12) months of the delivery of possession to Tenant for Tenant's Work.**

The landlord and tenant should attempt to agree on the exact criteria for the condition of the premises upon delivery by the landlord to the tenant. The authors suggest that a more expansive list of landlord obligations be set forth in an exhibit or schedule to the lease. This not only limits potential arguments but also provides the tenant's architect with better information to estimate timing and pricing for the construction project. The parties should also agree on their respective responsibilities if unexpected problems are discovered during the tenant's construction.

An example of a lease exhibit identifying landlord responsibilities is as follows:

EXHIBIT ____

LANDLORD'S WORK

1. All existing construction demolished to base building. Walls, floors, and ceilings patched.

2. Install all demising partitions.

3. Sanitary sewer, domestic water, venting, and natural gas service stubbed at the Premises.

4. **[**200-amp, 3-phase, 4-wire**] electric service. Panel in the Premises.**

5. **[**One**] T-1 line and [**25**] twisted pairs of telephone lines.**

6. **Rooftop heating and air-conditioning units.**

7. **Suspended ceiling and lighting. __′ × __″ recessed fluorescent fixtures.**

8. **ADA-compliant bathroom.**

D. [1.13] Tenant Construction

For office leases, the landlord will generally have significant input regarding the design and will likely perform the construction work directly or indirectly through contractors. In retail leases, the landlord typically gives the tenant more control. The landlord will approve the store design and then supervise the tenant's crew to ensure that the work is being performed properly and in accordance with codes. However, the landlord usually will not be the general contractor or directly retain the general contractor. This is due in part to the recognition that a retail tenant's success is more highly dependent on a creative design suitable for the tenant's particular use. The risk for the unsophisticated retail tenant is that the risk in project delays is passed through to the tenant. The tenant will be obligated to pay rent by a date certain regardless of whether it is open for business. However, the landlord will exercise greater control over any work that affects the building's structure, systems, or roof. This arrangement has the effect of shifting the risk of cost overruns and delays onto the tenant so that the tenant's counsel needs to be more protective when the tenant is responsible for the build-out.

Tenant construction delays are generally of three types: (1) delays caused by the failure of the tenant to timely or sufficiently monitor its architect or general contractor or to make timely decisions regarding design or materials; (2) delays caused by the general contractor; and (3) delays caused by the municipality or the landlord in approving the tenant's plans. Normally, the initial draft will impose all responsibility for the delays on the tenant. The tenant will bear the risk of all such delays except those caused by the landlord. Tenant delays need to be stressed to the client at the start of the negotiation process. Dealing with the general contractor is beyond the scope of this chapter but is covered in CONSTRUCTION LAW: TRANSACTIONAL CONSIDERATIONS (IICLE®, 2021), CONSTRUCTION LAW DISPUTES (IICLE®, 2022), and MECHANICS LIENS IN ILLINOIS (IICLE®, 2023). The tenant's counsel can do little to protect against municipality-caused delays beyond advising the architect or general contractor to get in to the building department with preliminary plans as soon as possible and identify necessary approvals. In many municipalities, including the City of Chicago, there are consultants known as "expeditors" who are familiar with the process and can facilitate the municipal approvals. Expeditors are not architects but rather individuals who know the local building department employees and know how to streamline the approval process. Even the best and most experienced architects may only work with certain municipalities from time to time. Counsel should realize that unless there is sufficient lead time for the leased premises to become available, the tenant generally must engage its architect prior to completing lease negotiations. Once the letter of intent is signed, even if there are remaining open issues, counsel should try to get a sense of the likelihood of final execution as soon as possible. The tenant may find that retaining the architect to start drawings early in the process will save money due to the delayed opening of the premises.

Normally, the initial draft will impose the burden of all delays on the tenant. To protect against approval delays by the landlord, the tenant's counsel should propose language that is similar to that contained in the following sample clause:

Landlord has approved Tenant's preliminary plans for Tenant's Work. Within ____ days after the date hereof, Tenant will submit to Landlord Tenant's final plans and specifications (the "Plans"). Landlord is to approve or disapprove the Plans within ____ business days after submittal. Any Plans that are neither approved nor disapproved by Landlord within such ____-day period shall be deemed to be approved. If the Plans or any portions thereof are disapproved, Landlord shall state with specificity the reasons for such disapproval. The foregoing provisions shall also apply to any resubmittal of Plans. Any delay in construction due to Landlord's failure to respond to Tenant-requested approval of the Plans shall extend the Rent Commencement Date by ____ day[s] for each day's delay.

E. [1.14] Heating, Ventilating, and Air-Conditioning System Units and Roof Work

In shopping centers, each retail space frequently has a separate heating, ventilating, and air-conditioning system unit serving the premises. The landlord usually will insist that the tenant is responsible for the maintenance and repair of the unit, if not its replacement when necessary. At a minimum, the tenant should have the HVAC system inspected and obligate the landlord to service the unit prior to the commencement date. If the unit is not new, the tenant should seek a warranty for at least the first year, if not several years. The lease language may also include the word "replace" after the words "maintain, service, and repair." The tenant's counsel should attempt to strike the word "replace" and resist this obligation unless the lease is for a long term (*e.g.,* ten years). If the tenant remains responsible for replacement, the tenant's counsel should seek to amortize the replacement cost over the useful life of the unit. Otherwise, the tenant may have to provide a new unit in the last year or two of the lease term. This is not only a substantial financial burden to the tenant but would otherwise provide the landlord with a windfall.

In addition to roof access for the HVAC work, the tenant may need access to the roof to install and maintain specialized equipment, such as an antenna or satellite dish. The landlord may insist that this work be performed by its contractor. This is generally an appropriate requirement since any work by another contractor may invalidate the landlord's roof warranty. The tenant might also consider having a qualified inspector or roofer perform a roof inspection and inquire regarding the age of the roof and recent maintenance prior to executing the lease. If the tenant has access to the premises prior to its return to a vanilla box, the tenant should inspect the premises' interior for signs of any roof leaks in the unit or elsewhere since staining or warping may disclose potential roof problems that the landlord should remedy before the tenant improves the premises.

F. [1.15] Construction Allowance

As in office or industrial leases, retail leases often provide that the landlord contribute to the cost of the tenant's improvements in the form of a tenant improvement (TI) allowance. This is especially important to smaller tenants since it reduces the initial expenses during the first year of operation when its product and name may not be known. The landlord's TI allowance is repaid by the tenant as a component of its base rent, which the landlord recoups by amortizing its investment along with a return on the investment through the term of the lease.

The landlord prefers to write a check to the tenant for the TI allowance after the work has been completed and after sworn statements, architect certifications, lien waivers, certificates of occupancy, and other agreed-on documentation are presented by the tenant to the landlord. In some cases, however, the landlord may agree, if requested by a tenant with sufficient leverage, to make proportional disbursements as work progresses. Proportional disbursements are preferable for the tenant because they will reduce the tenant's financing costs or initial equity contribution. The tenant should expect to agree to bear the cost of a construction escrow, generally with a title insurance company or lender, in exchange for these distributions.

Although seemingly neutral, if the tenant is unable to receive proportional distributions for the TI allowance in lieu of the rent credit, this alternative imposes a greater financial burden on the tenant at the outset because the tenant will have paid for the entire build-out prior to receipt of any sales revenue. The savings to the tenant are generated over the life of the lease in the form of lower rental payment since the base rent does not include a component for the amortization of the TI allowance. For example, a $50-per-square-foot TI allowance amortized at nine percent over a ten-year lease is equal to $7.60 per square foot per year, or $22,800 per year for a 3,000-square-foot store. The TI allowance alternative is generally spelled out in the original term sheet or letter of intent. Some landlords may be willing to revise the approach, depending on the landlord's own available capital and the creditworthiness of the tenant and its guarantor, if applicable.

No matter how the TI allowance is paid or credited, the tenant's construction contract must incorporate all relevant lease provisions governing the build-out, which may be included in the tenant work letter, usually in the form of a lease exhibit. Also, the tenant should include in the construction contract applicable provisions in the section on alterations. For example, the lease may require delivery of certain documents in order to receive distributions from the escrow. These provisions generally require that the tenant provide (1) lien waivers from contractors, subcontractors, and sub-subcontractors; (2) contractor, and possibly tenant, sworn statements; (3) specific forms for requests for payment; (4) tenant or architectural certifications regarding completion of the work to date in compliance with the plans and specifications and the schedule of values; and (5) minimal insurance coverage and certificates. If the tenant fails to include the documents required of its architect or contractor in its architect and construction contracts, the tenant may have to advance the funds until completion of the project and until all final lien waivers, sworn statements, etc., have been delivered. The tenant also may have difficulty getting payments from the landlord if the contractor or architect fails to provide the required paperwork after completion of the work.

Some leases provide that if a rent abatement is provided to reimburse the tenant for its initial build-out, the landlord is entitled to add this abatement to the amount due from the tenant in the event of a tenant default. This is not inappropriate, but if set forth in the lease drafts, an equitable compromise is to provide that this abatement should be amortized over the initial term of the lease.

VI. USE PROVISIONS AND OPERATING COVENANTS

A. [1.16] In General

Depending on the type of retail facility, the retail lease use clauses are generally much more restrictive than those found in other commercial leases since they are intended to limit the tenant's business activities to particular product lines or types of stores. If appropriately drafted and administered by a thoughtful landlord, the clause might generate greater returns for the landlord and most of the tenants. If not thoughtfully administered, the landlord's control might work to reduce its percentage rent returns and might significantly and detrimentally impact the retail tenants. In some cases, tenants can achieve an exclusive-use provision in which the landlord voluntarily agrees to insert in its leases with other tenants in the shopping center exclusive use or product line limitations that will protect the tenant from competition in the shopping center. To achieve the best lease terms for the client, the tenant's counsel needs to fully understand the tenant's product line and the relevant provisions that might increase the likelihood of the tenant's success at the particular facility, as well as the motivation of the landlord in seeking to limit the tenant's flexibility governing the use of and sales from its premises.

The tenant's counsel should inquire if there are any existing exclusives and, if so, review them carefully to confirm they do not interfere with the tenant's contemplated use of the premises. The tenant's counsel may also be able to procure restrictions on future exclusives that might prohibit or impair the tenant's ability to conduct its business.

The use provision included in the lease draft delivered for review may be acceptable for the tenant's current intended use, but the tenant's counsel should be aware that an overly restrictive use provision may limit the tenant's ability to assign the lease or sublet the premises if the tenant's business prospects change. These changing conditions are usually not apparent at the time of lease execution but may arise due to the tenant's need to expand to a larger space due to business growth or to downsize or to close the business due to lagging sales. The restrictive use provisions may also limit the tenant's ability to expand product lines, all of which might lead tenant's counsel to seek to broaden the exclusive use clause. However, the desire to expand the use restriction must be balanced with the landlord's desire to promote a vibrant and successful shopping center with complimentary uses that provide synergy throughout the shopping center. Counsel needs to understand that it is often the landlord's goal to maximize revenue generated from the entire property, either directly due to a desire to increase its percentage rent or indirectly due to significant sales receipts in the shopping center, which then increase its ability to lease available stores at higher base rents.

Although these restrictions may have an impact on the tenant's ability to increase its product line or assign its lease in the event of a need to vacate the facility, these provisions, if appropriately drafted and administered by the landlord, can have a beneficial impact. The phrase "a rising tide lifts all boats" not only applies to the stock market and housing values but to stores in a successfully managed retail shopping center. Each of the stores may garner the benefits of a shopping center with increased customer traffic. Alternatively, rigid adherence to use limitations in an otherwise well-drafted lease by a short-sighted landlord can negatively impact not only individual stores but the entire shopping center or retail mall.

The use limitations should vary among the types of retail facilities. For example, stricter use limitations that might be appropriate in a regional shopping center, outlet mall, or specialty mall are not as relevant for a neighborhood shopping center, a strip mall, or a freestanding store. In a regional shopping center, the landlord depends on the anchor tenants and nationally known or destination retailers with brand-name merchandise to provide customer traffic in part because it is anticipated that customers are willing to travel greater distances to shop at these facilities. In outlet malls, the retailers are expected to provide name-brand merchandise at discounted prices, while specialty malls tailor their retail mix to a more narrowly focused product line so that the use restrictions are necessary. By contrast, in a neighborhood shopping center, the tenants (other than the anchor tenant) are usually local in nature and meet local needs. The name brand recognition is not as important, so the list of suitable replacement tenants should be broader as long as there is no significant cannibalization of sales from existing tenants. Finally, in a freestanding store, the landlord's most significant concern should be the tenant's ability to continue a successful retail operation while maintaining the property in good condition, so the use limitation is not as critical and can allow much more flexibility for the tenant.

B. [1.17] Recorded Restrictive Covenants Not in the Lease Documents

Most regional shopping centers, specialty malls, and community shopping centers and even some neighborhood shopping centers have recorded restrictions prohibiting certain types of uses perceived to conflict with attracting shoppers, such as funeral homes, secondhand or surplus stores, gambling operations, dance studios, amusement or video arcades, and pool halls. These restrictions provide comfort to tenants that the center will continue to operate as a retail facility without some of the negative uses or stigma to the shopping center that these prohibited uses might imply. While these restrictions need to be identified and reviewed, they ordinarily do not directly impede the tenant's business. Thus, they might be overlooked in the negotiation. However, if there are no such limitations or if the landlord fails to enforce these limitations, the center and the tenant's business may suffer in the long term. If a shopping center has significant vacancy, the landlord may be tempted to bring in non-retail tenants to maximize its income. The tenant suffers as a lack of synergy decreases retail customer foot traffic. To protect against these problems, the tenant's counsel can request a termination clause as discussed in §1.18 below. If the declaration does not provide for enforcement by tenants, counsel for a tenant with significant bargaining power can sometimes obtain the right to enforce the restrictions. If granted, counsel should attempt to include the right in any recorded memorandum of lease to provide at least constructive notice to prospective tenants, purchasers, and lenders.

C. [1.18] Rights Contained in Other Tenants' Leases

Anchor tenants and some of the larger tenants require lease provisions that not only grant these tenants exclusive rights to sell certain categories of merchandise but also impose prohibitions regarding occupancy by possible competitors. The landlord's counsel should incorporate these restrictions verbatim in every other lease in the shopping center either as part of the base document or as an addendum thereto. If no such restrictions appear in the document and there are national retailers in the shopping center, the tenant's counsel should ask whether any other restrictions exist that might impact or interfere with the tenant's operations. The analysis is not yet complete since an anchor tenant might have the right to occupy its space for any use permitted by applicable law.

As a consequence, an anchor tenant space may close down and a new tenant reoccupy with a different retail product line and pricing. Your client may not be able to compete with the new tenant. Alternatively, a large vacant retail store or the use of significant portions of available retail space for non-retail uses might reduce foot traffic by potential retail customers and, ultimately, reduce the tenant's sales receipts.

Other tenants' leases may have what are commonly known as "cotenancy clauses," "escape clauses," or "early termination clauses," which allow the tenant to terminate early based on certain subsequent conditions that may arise with respect to the building or shopping area. The clauses could be based on different factors, such as occupancy levels of the retail building or shopping center or a threshold of sales. If a major or anchor tenant should close its store, this will have a detrimental effect on a smaller tenant relying on the commercial traffic brought in by the major tenant. Counsel for a tenant whose operations could be decimated should request a right to terminate upon the closing by one or more of the major or anchor tenants. If the landlord agrees to such a clause, the landlord will include a time period to replace this major tenant. At the very least, counsel for the smaller tenant should seek a reduction of the rent during any period that the major tenant's premises are unoccupied. In any event, the client should be informed of the possibility so that it can conduct its own risk assessment.

Anchor tenants may have exclusive-use provisions, or the declaration governing the entire center might actually or arguably prohibit a tenant's intended use of the premises. If a tenant's use is a prohibited use or falls into a gray area, the tenant needs to make sure that the landlord obtains all necessary consents and waivers. Consent may be needed from anchor tenants or the landlord's lenders. In some situations, portions of the shopping center may be owned by others so that their consent may also be required.

D. [1.19] Exclusive-Use Clauses

Exclusive-use provisions in leases need to be drafted precisely to avoid ambiguity and unintended future consequences. For example, the grant of an exclusive right to operate "a sporting goods store" would not prohibit a lease to a department store that sells sporting goods. Also, the grant of an exclusive use to a florist or candy store would not likely prevent a grocery store from opening a floral section or selling various candies. However, a prohibition against any tenant selling fresh-cut flowers, plants, or confectionary goods probably would prevent a grocery store from offering such product lines. During lease negotiations, the tenant's counsel should keep in mind that it does not have to be an all-or-nothing proposition. While a landlord might not be willing to grant a bakery exclusive right to sell fresh bakery goods, it might be willing to restrict other tenants' shelf space for these goods to 100 linear feet.

In addition, the tenant needs to understand that if a landlord grants an exclusive use to a tenant, this restriction will not restrict existing tenant. The clause will not prevent an existing tenant from expanding or changing their product lines or prohibit future assignees of existing tenants that might be direct competitors. The tenant's counsel should inform the tenant that the landlord's obligations to enforce the exclusive-use provision will apply only to future tenants.

E. [1.20] Operating Covenants; Open Covenants; Go-Dark Clauses

Although operating covenants are sometimes included in non-retail leases, they are most important for landlords with retail leases. Their multi-tenant facility depends on the foot traffic generated by each tenant to assist in generating multi-stop customers and, hence, sales to the other stores and to protect percentage rent. Although the courts may decide that it might be inappropriate to specifically enforce an operating covenant, they have agreed that the breach of an operating covenant is the grounds for a damage claim in favor of the landlord against the tenant. In *Rouse-Randhurst Shopping Center, Inc. v. J.C. Penney Co.,* 171 F.Supp.2d 824 (N.D.Ill. 2001), the court found that the landlord was entitled to seek damages against an anchor tenant for breaching an operating covenant even though the operating covenant survived for four years after the lease term expiration date.

If an ongoing operating covenant is not included, the landlord may include an opening covenant that requires the tenant to open and operate for at least one day in the premises. Typically, the landlord will also include a go-dark clause. Even if the tenant has the right to not operate, the landlord has an interest in not having a dark premises within the center. A go-dark clause will typically give the landlord the right to terminate this lease and take back the premises.

VII. CASUALTY AND LIABILITY INSURANCE

A. [1.21] Landlord's Insurance

The initial lease draft generally includes at least one or two pages setting forth the types and amounts of insurance required of the tenant, but the lease is often silent concerning the landlord's insurance obligations. This is based in part on the general desire in modern leases to limit landlord obligations and potential defaults. In addition, landlords recognize that the new owners may decide to provide different levels or types of insurance. As a practical matter, however, prudence requires that landlords obtain (and a lender will require) casualty and liability coverage. By request, the tenant's counsel can and should seek that the landlord maintains these types of insurance.

The landlord will generally agree to provide all-risk, replacement-cost coverage for property damage and will generally agree to provide liability coverage covering the common areas of the center. Depending on its financial strength and size, the landlord sometimes elects to carry significant deductibles on the liability or casualty policies or may provide for the right to self-insure. If applicable, self-insurance should be limited to landlords with very significant net worth and with a reasonable program of self-retention.

B. [1.22] Tenant's Insurance

The lease will, at a minimum, require that the tenant maintain general-liability insurance and property insurance covering the tenant's improvements regardless of whether all or a portion of the improvements were financed by the landlord. Even if the lease is silent on some required coverage, which is unlikely, the tenant should obtain adequate insurance coverage for its merchandise and coverage for liability claims appropriate for the market in which the tenant operates. Before turning

over the keys, the landlord will require that the tenant deliver a certificate of insurance naming the landlord and its lender as additional insureds and, at least with respect to casualty coverage, loss payees. The level of liability insurance is sometimes negotiable for smaller tenants. Some landlords might agree to $1 million or $2 million in a single incident with aggregate coverage of $5 million even if the first draft calls for a higher amount. A tenant should be expressly permitted to provide an umbrella policy for the higher amounts or as part of its blanket policy if the tenant operates from multiple sites. This might achieve cost savings in premiums for the client. The landlord often requires other types of coverage, such as business-interruption insurance, for one year. The landlord's counsel will likely hold firm on these points since it will need an income stream to pay its mortgage, taxes, and expenses after a casualty. The tenant's counsel should make sure that the client has priced the premiums for the additional coverage so that there are no surprises. Although one might think that these premiums are significant due to the potential payouts, if the tenant has a decent credit history, the premiums are often less than anticipated since the likelihood of the payment is low.

Promptly upon receipt of the initial lease draft, counsel should require that the tenant provide all relevant lease provisions relating to insurance, casualty, subrogation, and indemnification to its insurance advisor. Counsel should seek confirmation that this advisor is in a position to provide the coverage requested from the types of companies required under the lease. Landlords will sometimes permit tenants to provide coverage from companies of a lesser grade than that identified in the initial draft of the lease. However, counsel may need to request that during negotiations.

If the lease states that coverage will be from companies and in amounts satisfactory to the landlord and/or its lender, counsel should seek to make this standard "reasonably" acceptable or "with companies and coverage customarily provided in the vicinity of the premises." Alternatively, counsel might refer to companies identified in BEST'S INSURANCE REPORTS. The letter (*e.g.,* the letter A of A-VII) indicates the insurance company's relative financial strength. In all cases, the tenant should consult its insurance advisor to confirm that the company currently underwriting the tenant's insurance and possibly alternative insurance carriers are able to meet the required rating.

The tenant should make sure that the insurance coverage obtained not only complies with minimum requirements for this coverage but that the coverage is sufficient to protect the tenant against potential liability claims made by those entering the premises. Liability coverage levels that are sufficient for Boone County, Sangamon County, or Jo Daviess County may not be sufficient for facilities in Cook County or St. Clair County, which have a history of higher jury verdicts. Further, the tenant needs to verify that, in the event of damage to the premises as the result of a casualty, the tenant has sufficient insurance coverage to pay for the restoration of all improvements made to the premises and also pay to replace all furniture, fixtures, equipment, and inventory located therein. The coverage from the landlord's policy will likely only cover the shell and core. If it does, the tenant must look to its insurance coverage to pay for the replacement of all other items, including the tenant's improvements, regardless of whether these improvements were originally made by or paid for either by the landlord or the tenant. The author suggests that the tenant's agent work with the landlord's agent or at least review the landlord's coverage to ensure that there are no deficiencies in the form of gaps in coverage and, if possible, no duplication in coverage.

C. [1.23] Waiver of Subrogation Clauses

The lease will usually require that the insurance coverage contain waivers of subrogation. Many carriers will agree to these waivers as a matter of course. The tenant's counsel should confirm this with the client or directly with the agent or carrier prior to execution to avoid an inadvertent breach of the lease, which might otherwise be discovered only after a major casualty or accident when the tenant can least afford it. Although not preferred, the tenant's counsel can add to the lease a provision reciting that the tenant's insurance coverage will contain a waiver of subrogation clause "to the extent permitted under applicable insurance coverage or available at commercially reasonable rates."

Waiver of subrogation provisions are not always available under a tenant's base insurance policies but may require an endorsement that is generally available from sophisticated insurance companies. If the tenant's carrier does not agree to provide this coverage, the tenant should contact another carrier in an attempt to obtain this coverage. The tenant should request that the landlord's insurance coverage also include a waiver of subrogation so that the tenant is not liable in the event of an accident or a casualty resulting in injury to persons or due to the negligence of one of the tenant's employees or invitees. Since the waiver of subrogation prohibits the parties and their insurers from making a claim against the party responsible for a casualty or accident, it can be devastating to a party that does not have the benefit of this waiver. The risk of loss reimbursement should be on the insurer, the one whom the parties have agreed should bear this risk. The additional cost, if any, is usually minimal but provides much greater protection to both parties.

VIII. ASSIGNMENT AND SUBLETTING

A. [1.24] In General

Just as the use provisions in retail leases are often more tightly structured than in other commercial leases, assignment and subletting are often more tightly controlled in the leases due to the potential impact on the profitability of the retail facility and its individual tenants. The landlord obviously wants to be able to approve not only the creditworthiness of the proposed replacement tenant but also the type of business it conducts. The lease often includes change-of-control provisions that deem the sale of stock, membership interests, or partnership interests, whether in one or a series of transactions, as an assignment of the lease. Assuming that change-of-control provisions are included, the landlord may have the ability to prohibit the sale of the tenant's business as a going concern. The tenant's counsel should not expect success in negotiating the elimination of these limitations. At best, the tenant must satisfy the reasonableness standards referred to below in this section not only as relates to the creditworthiness of the proposed assignee, but also as a substitute operator of a business that otherwise advances or compliments the other tenants in the shopping center.

Illinois law holds that, when the landlord's consent to assignment or subletting is required by the terms of a lease, the landlord cannot unreasonably withhold its consent. *Golf Management Co. v. Evening Tides Waterbeds, Inc.,* 213 Ill.App.3d 355, 572 N.E.2d 1000, 157 Ill.Dec. 536 (1st Dist. 1991). Further, as a condition precedent to the landlord's consent, the tenant must present the

landlord with a suitable assignee. Illinois courts will apply a standard of commercial reasonableness to determine whether a potential assignee or subtenant is appropriate. The commercial reasonableness review is based in part on the financial status of the assignee or subtenant, the type of subtenant's business and intended use of the premises, the threat of competition by the assignee or subtenant against the landlord's existing tenants, and whether the subtenant or assignee is ready, willing, and able to take over the lease.

The caselaw in Illinois and other jurisdictions does not reveal a clear pattern concerning whether it is unreasonable for a landlord to reject an assignee that is perfectly creditworthy but that proposes a different use or type of operation than that of the original tenant. In *Reget v. Dempsey-Tegler & Co.,* 70 Ill.App.2d 32, 216 N.E.2d 500 (5th Dist. 1966), the lease stipulated the use as a brokerage house, and the use by the proposed assignee was for a beauty parlor. The court held that a landlord's consent was not unreasonably withheld when the new use of the property would place different burdens on the premises and the landlord reasonably believed that the new use could damage the premises.

Similarly, courts in other jurisdictions have also found landlords' refusals to consent to proposed assignees not to be unreasonable. *Norville v. Carr-Gottstein Foods Co.,* 84 P.3d 996 (Alaska 2004) (subtenant's gross sales for percentage rent would be impaired); *Warmack v. Merchants National Bank of Fort Smith,* 272 Ark. 166, 612 S.W.2d 733 (1981) (prior use was banking, and proposed assignee was existing tenant in center); *Jonas v. Prutaub Joint Venture,* 237 N.J.Super. 137, 567 A.2d 230 (1989) (franchisor sought to substitute inexperienced franchisee for original tenant who was experienced and successful franchisee); *Gladliz, Inc. v. Castiron Court Corp.,* 177 Misc.2d 392, 677 N.Y.S.2d 662 (1998) (tenant was in default, and lease provided that lessor's refusal to consent to assignment would not be unreasonable while tenant was in default).

The Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* provides that a landlord owes a duty to take reasonable measures to mitigate its recoverable damages from a defaulting tenant. 735 ILCS 5/9-213.1. The reasonableness of a landlord's attempts to mitigate its damages is a question of fact. *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 970 – 971, 178 Ill.Dec. 444 (3d Dist. 1992). Courts applying this standard have held that a landlord's efforts to mitigate are not reasonable when the landlord (1) sought a rental rate higher than both the rent of the defaulting lease and the then-current market rent, (2) did not take reasonable steps to improve the condition of the property for reletting, and (3) delayed retaining a broker to relet the premises. *Kallman v. Radioshack Corp.,* 315 F.3d 731 (7th Cir. 2002). The court in *Kallman* held that the landlord's attempt to obtain increased rent in lieu of finalizing a new lease was strong evidence of its unreasonable conduct but that this was not in itself proof that the landlord was unreasonable. In *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 332 Ill.Dec. 438 (2d Dist. 2009), the appellate court held that the landlord failed to mitigate its damages by insisting that a replacement tenant sign a lease with a 60-day termination provision. The lease provisions governing assignment and subletting should be reviewed in conjunction with those governing the use of the premises since the same incentives governing compatible or synergetic uses are relevant when considering whether a landlord is reasonable in denying consent to the assignment of a retail lease or subletting the retail premises.

Finally, a tenant considering abandoning its premises must be careful when it seeks to rely on the landlord's obligation to mitigate its damages since it may take a long time to relet vacant space. Also, the rent need not be at the rental rate set forth in the original lease, the space to be relet need not be for the entire premises, and the landlord need not take steps to replace the tenant when it first discovers a potential vacancy. In *JMB, supra,* the reletting of an abandoned space within seven months for one half of the rent paid by the defaulting tenant was reasonable. 604 N.E.2d at 970 – 971. In *Becknell Development, L.L.C. v. Linamar Corp.,* No. 07 C 5455, 2008 WL 576334 (N.D.Ill. Feb. 28, 2008), a landlord's efforts to assist its tenant in finding a replacement subtenant to take more than one half of the space at a similar rate was deemed to be a reasonable attempt at mitigation. In *Block 418, LLC v. Uni-Tel Communications Group, Inc.,* 398 Ill.App.3d 586, 925 N.E.2d 253, 338 Ill.Dec. 756 (2d Dist. 2010), the court held that the landlord had no obligation to mitigate its damages until the tenant abandoned the premises.

B. [1.25] Sub-Uses Not Equating to Subtenancies; Franchises

Despite the broad sweep of the assignment and sublease language in typical retail leases, these leases are often silent on certain business situations that might arise. For example, in retail leasing, a tenant may contract with third parties for arrangements that do not rise to the level of subtenancies and thus may not require landlord approval. Examples are concessionaires who might exhibit their wares from time to time marketing limited products or product lines, espresso stands, and separate providers such as opticians, banks, and camera shops. In the absence of specific language, the landlord's consent might not be required. The landlord's counsel should draft the lease document so that the tenant needs approval if these vendors or part-time occupants are not the tenant's employees.

From the tenant's perspective, the tenant's counsel should take time to learn the tenant's business to determine whether the tenant might permit nonemployee concessionaires or vendors to use the premises as part of its intended use. If so, and if the lease provisions governing use or assignment and subletting prohibit these activities, counsel should seek to obtain the landlord's consent to these activities during the initial lease negotiations.

If the tenant is a franchise operation, the franchisor will want the right to assume the lease and to transfer to replacement bona fide franchisees. Often the franchisor will require that other provisions be included in the lease, including notices to the franchisor and an opportunity to cure franchisee defaults.

IX. [1.26] PERCENTAGE RENT

Retail leases have long included provisions permitting the landlord to share in the sales proceeds arguably generated due to the synergy created to by an appropriate tenant mix and the efforts of the landlord, the tenants, and the merchants' association, if applicable. The retail lease often provides that the landlord receives a percentage of the tenant's gross sales or receipts once an annual milestone, or "breakpoint," is reached. The natural breakpoint occurs when the tenant achieves annual sales in the amount equal to annual base rent multiplied by the agreed-on percentage. Landlords have developed comprehensive language intended to capture all gross sales

and to require full record-keeping by tenants. Tenants, or their counsel, new to retail leasing may find the entire notion of additional rent offensive, even if the breakpoint number is sufficiently large so that the tenant will end up paying nothing. However, the landlord will not generally forgo these payments. In these cases, the tenant's counsel should advise the client in many situations that it is typical and that the tenant may have a partner sharing in the proceeds even if higher sales do not always equate to greater profits or margins to the retailer. In these cases, the tenant's counsel should focus on the appropriate level of sales generated by the tenant's retail operation at the premises.

The tenant's counsel should realize that the definition of "gross sales" in the lease may not be limited to sales at the premises as identified in the lease, and the landlord may include, intentionally or otherwise, off-site and Internet sales filled at the premises as part of gross sales revenues. If the tenant has more than one location from which products are shipped, sales from these alternative locations, as well as the tenant's telephone, mail order, and internet sales not directly generated by or shipped from the premises, should be excluded from the definition of "gross sales." If the definition of the gross sales includes any consignment sales or sales by third parties made at the premises, the tenant's counsel must make sure that the tenant has a right to payment of the corresponding percentage from any third party receiving the benefit of these sales. Further, trade-ins, returned items, and donated items should either be deducted from or not included in gross sales or gross receipts.

Counsel for a landlord using percentage rent should include a lease provision negating any partnership or joint venture relationship between the landlord and the tenant so as to prevent any landlord liability for liabilities of the tenant's business. A form of the definition of "gross sales" used in a percentage rent obligation is set forth below:

Gross Sales Reports. **Within ____ days after the end of each calendar quarter during the term hereof, Tenant shall furnish to Landlord a statement in writing, certified to be correct, showing the total gross sales by months made in, on, or from the Premises during the preceding calendar quarter. The term "Gross Sales" as used in this Lease shall include the entire gross receipts of every kind and nature from sales and services made in, on, or from the Premises, whether on credit or for cash, in every department operating in the Premises, whether operated by Tenant or by a subtenant or subtenants, or by a concessionaire or concessionaires, excepting therefrom any rebates and/or refunds to customers and the amount of all sales tax receipts that has to be accounted for by Tenant to any government or any governmental agency. Sales on credit shall be deemed cash sales and shall be included in the gross sales for the period during which the merchandise is delivered to the customer, whether title to the merchandise passes with delivery. For the purposes of this Section ____, Gross Sales shall not include the following: (a) the selling price of all merchandise returned by customers for credit; (b) sums and credits received in the settlement of claims for loss of or damage to merchandise; (c) charges to customers for repairs to merchandise and delivery charges; (d) interest, service, or sales carrying charges or other charges, paid by customers for extension of credit on sales, when not included in the merchandise sales price; (e) receipts from public telephones, stamp machines, or vending machines installed for use by Tenant's employees; (f) sales taxes, use taxes, consumers' excise taxes, gross receipts taxes, and other similar taxes now or hereafter imposed on the sale of merchandise or services; (g) gift certificates, or like vouchers, until such times as the same shall have been converted into a sale by redemption; (h) returns to shippers or manufacturers; (i) fees charged on bank cards and credit cards; (j) bad debts; and (k) insurance proceeds.**

X. [1.27] MISCELLANEOUS RETAIL PROVISIONS

A retail lease may contain various provisions relating to the operation of the facility in which the premises are located. These provisions often do not appear in other commercial leases. For example, the landlord may provide for a merchants' association that is funded by all of the tenants by contribution to a common fund appropriately intended to market the entire shopping center as opposed to the marketing of individual stores.

The landlord may also require every tenant to participate in an occasional weekend sidewalk sale, in which merchandise will be displayed in the common areas or in the parking lots so that the base lease might include provisions requiring participation in certain special events. The landlord may reserve the right to put kiosks in common areas or in the parking lot and may also reserve the right to build a food court. The landlord may permit the tenant or other retailers in the center to have special events intended to market the center or individual shops. If the tenant's marketing plans contemplate the use of common areas, the tenant's counsel should seek consent during initial negotiations. In these cases, counsel should attempt to explain the practical effect on its business operation.

XI. [1.28] THE IMPACT OF COVID-19 ON RETAIL LEASES

The COVID-19 pandemic had a tremendous impact on retail leasing, especially at the outset when mandatory closures were widespread. Media reports estimate that at least 15,000 stores closed nationwide in 2020 alone. See https://www.forbes.com/sites/walterloeb/2020/07/06/9274-stores-are-closing-in-2020--its-the-pandemic-and-high-debt--more-will-close/?sh=2dfe98c8729f. These closures, together with an overall decrease in foot traffic to retail locations, caused significant re-negotiations and new negotiation tactics on the part of both retail tenants and landlords with respect to their existing and future lease obligations.

When the pandemic first began, tenants initially requested short-term abatements and rent deferrals. With the future uncertain, many landlords were receptive to these requests. However, as soon as it became clear that COVID-19 was not as temporary as originally believed, tenants began to make more acute requests for relief such as longer abatements, modified rent arrangements (such as paying only percentage rent), and the ability to terminate their leases early. Landlords, on the other hand, responded to the changing dynamic by waiving cotenancy requirements and exclusives and reconfiguring shopping centers to, among other things, do away with the need for anchor tenants. At this point, the permanence of COVID-19 has been recognized as a grim reality by both landlords and tenants.

Prior to 2020, few, if any, leases expressly included things such as pandemics or epidemics in the recitation of force majeure events. While tenants with significant bargaining power have sometimes been successful in negotiating provisions providing rent relief in the event of a governmental shutdown for COVID-19 or other public health emergencies, most retail landlords have been resistant to accepting COVID-19 as an event of force majeure in the absence of specific language. Illinois courts often interpret force majeure clauses narrowly without giving them expansive meaning so as to not remove the effect of other provisions in the agreement. (*See*

Dearborn Maple venture, LLC v. SCI Illinois Services, Inc., 2012 IL App (1st) 103513, 968 N.E.2d 1222, 360 Ill.Dec. 469 (holding that court's primary objective in contract interpretation is to not render any provision of contract meaningless by (a) looking to intent of parties and (b) viewing each provision in light of other parts of contract). *See also Atwood v. St. Paul Fire and Marine Insurance Co.,* 363 Ill.App.3d 861, 845 N.E.2d 68, 300 Ill.Dec. 647 (2d Dist. 2006)). In that regard, Illinois courts look to the four corners of the contract and are more likely to enforce a force majeure provision that explicitly addresses specific situations, such as pandemics. (*See Commonwealth Edison Co. v. Allied-General Nuclear Services,* 731 F.Supp.850 (N.D.Ill 1990)). Without a firm justification, courts will not typically interpret a contract's force majeure clause to relieve a party of its bargained-for obligations. These days, tenant's counsel routinely seeks to insert pandemics or epidemics as a force majeure event. Counsel for landlord should allow it but only to the extent such an event directly impacts the tenant in the performance of its obligations and so long as it is acknowledged that force majeure events, however defined, do not affect the tenant's obligation to pay rent and other monetary amounts due under the lease.

In addition to addressing COVID-19 in the force majeure provision, some landlords are inserting in their form leases an express waiver of claims from the tenant for damages resulting from COVID-19 shutdowns (including constructive eviction claims). Others are reserving the right to impose additional rules, regulations, or restrictions as the landlord may deem appropriate to implement governmental guidelines or recommendations relating to the pandemic.

XII. [1.29] SAMPLE FORM OF RETAIL LEASE

Illustrations of drafting solutions to the problems discussed in this chapter are included in the sample retail lease form that follows. The form also includes other matters relating to commercial leases in general. However, the form should be only a starting point for the practitioner's analysis and should not be viewed as definitive with respect to what the practitioner can achieve since that analysis depends on the relative bargaining strength of the parties and the issues deemed important to the landlord and the tenant in each negotiation.

SHOPPING CENTER LEASE

This shopping center lease (Lease) is made and entered into as of _____, 20___ (the Effective Date), by and between _____ (Landlord) and _____ (Tenant).

1. PREMISES.

In consideration of the mutual promises, covenants, and conditions herein set forth, Landlord hereby leases to Tenant and Tenant hereby leases from Landlord the premises (Premises), which are deemed to contain _____ square feet of Floor Area that are located in the shopping center commonly known as _____ Shopping Center (the Shopping Center), and which Premises are approximately as shown by crosshatching on Exhibit A hereto. "Floor Area" means all areas designated by Landlord in a building for the exclusive use of a tenant (other than the Common Area (as defined in §5.1 below)) measured from the exterior surface of exterior walls (and extensions, in the case of openings), excluding any mezzanine, balcony, subterranean, or basement space.

Landlord expressly reserves (a) the use of the exterior rear and side walls and roof of the Premises and the exclusive use of any space between the ceiling of the Premises and the floor above or the roof of the Building(s) and (b) the right to install, maintain, use, repair, and replace the pipes, ducts, conduits, and wires leading into or running through the Premises (in locations which will not materially interfere with Tenant's use of the Premises).

2. TERM.

2.1 *Term.* The Initial Term of this Lease shall be for the period of ____ years commencing (along with all obligations under this Lease, except Tenant's obligation to pay Minimum Rent and all other monetary charges) on the Rent Commencement Date and terminating on the last day of the last month of the Term. "Lease Term" or "Term" shall mean the Initial Term and any exercised Option Periods (as defined in §2.3 below).

2.1.1 Landlord agrees to deliver and Tenant agrees to accept from Landlord possession of the Premises upon substantial completion of Landlord's Work as described in Exhibit B. Within ____ days after notice from Landlord, Tenant shall execute and deliver to Landlord a confirmation letter similar to the form attached hereto as Exhibit C confirming Tenant's possession of the Premises, the Rental Commencement Date, and any other terms reasonably requested by Landlord. All obligations with respect to construction of the Premises are set forth in Exhibit B, and all work not specified as Landlord's Work therein (Tenant's Work) shall be performed by Tenant at Tenant's sole cost and expense, except as may be expressly stated to the contrary.

2.1.2 Landlord's Work shall be deemed approved by Tenant on the Term Commencement Date, unless prior to the Rent Term Commencement Date, Landlord receives written notice from Tenant of a defect in the work as to patent defects and within ____ of the Rent Commencement Date as to latent defects. Any disagreement arising between Landlord and Tenant about the work to be performed by Landlord shall be resolved by the decisions of Landlord's architect.

2.1.3 Tenant releases Landlord and Landlord's contractor and architect from any claim for damages against Landlord or Landlord's contractor or architect for any delay in the date on which Landlord's Work is completed. Notwithstanding the Term Commencement Date occurring after the date hereof, (a) this Lease shall be a binding contractual obligation effective upon the execution and delivery hereof by Landlord and Tenant and (b) as of the first date following such full execution and delivery that either Tenant or any contractor, subcontractor, employee, agent, licensee, or invitee of Tenant enters the Premises or the Shopping Center for any purpose whatsoever, including, without limitation, for moving into the Premises or performing any Tenant's Work, all of the terms and provisions of this Lease (except as excluded by this Lease) shall apply with respect thereto.

2.1.4 Tenant shall diligently prosecute and complete Tenant's Work pursuant to the terms of Exhibit B. Upon completion of Tenant's Work, Tenant shall submit to Landlord the notices, certificates, and releases described in §2.8 of Exhibit B. The lien releases shall be in

a form and detail satisfactory to Landlord, in recordable form, and in conformance with the requirements of Illinois law. All Tenant's Work shall, for purposes of this Lease, be conclusively deemed to constitute alterations, changes, and improvements made to the Premises by Tenant.

2.2 ***Lease Year.*** **For the purpose of this Lease and the anniversary dates for rental adjustments, the first Lease Year shall be defined as follows:**

(a) If the Term commences on the first day of a calendar month, the first Lease Year shall end on the day immediately preceding the first anniversary of the Term Commencement Date;

(b) If the Term commences on a day other than the first day of a calendar month, the first Lease Year shall be the partial month of the Term Commencement Date and the next 12 full calendar months;

For the purpose of the remainder of the Term, "Lease Year" shall mean each consecutive 12-month period following the first Lease Year.

2.3 ***Option Periods.*** **Provided (a) Tenant has not during the Term been in default in the payment of Rent or (b) Tenant is not in default as of the first day of the then-occurring Option Period in the payment of Rent and (c) Tenant is then occupying the Premises, Tenant may extend the Term for ____ Option Periods by giving notice of exercise thereof (Option Notice) to Landlord at least ____ full months, but not more than ____, before the date the Lease Term would otherwise expire. If Tenant is in default on the date of giving an Option Notice, such Option Notice shall be null and void; and if Tenant is in default on the date the Option Period is to commence, such Option Period shall not commence, and this Lease shall expire at the end of the Lease Term. If Tenant delivers a valid Option Notice, the Term shall thereby be extended on all the terms and provisions contained in this Lease, except that the number of Option Periods remaining shall in each instance be reduced by one. Tenant's failure to timely exercise any option granted to Tenant hereunder on the terms set forth herein shall cause the automatic extinguishment of the option (and any subsequent options), time being of the essence. The Minimum Rent for the applicable years of the Option Period(s) shall be the greater of the amounts set forth for Minimum Rent in the Lease Summary or the Fair Market Rent (as defined in §2.4 below) for the Premises.**

2.4 ***Fair Market Rent.*** **"Fair Market Rent" means the annual amount per square foot (exclusive of Occupancy Costs) that a willing tenant would pay and a willing landlord would accept in arm's-length negotiations, without any additional inducements, for a lease of the applicable space on the applicable terms and conditions (including the Percentage Rent terms) for the applicable period of time. Fair Market Rent shall be determined by considering the most recent new leases (and market renewals and extensions, if applicable) in the Shopping Center and in comparable retail centers in the vicinity of the Premises. No allowance shall be made for the value of any existing improvements and finishes provided by Tenant.**

2.4.1 ***Determination by Landlord.*** **Landlord shall initially determine the Fair Market Rent in each instance and shall give Tenant notice (the Market Rent Notice) of such determination and the basis on which such determination was made on or before the ____ day prior to the date on which such determination is to take effect or as soon thereafter as is reasonably practicable.**

2.4.2 ***Disputes Regarding Fair Market Rent.*** **If Tenant notifies Landlord in writing, on or before the ____ business day following any Market Rent Notice, that Tenant disagrees with the applicable determination, Landlord and Tenant shall negotiate in good faith to resolve such dispute within ____ business days thereafter. (The ____ business day after any Market Rent Notice is referred to herein as the Outside Agreement Date.) If not resolved by the Outside Agreement Date, each party shall submit to the other its determination of Fair Market Rent, and the dispute shall be submitted to arbitration in accordance with §2.4.3 below. Until any such dispute is resolved, any applicable payments due under this Lease shall correspond to Landlord's determination, and, if Tenant's determination becomes the final determination, Landlord shall refund any overpayments to Tenant within ____ business days following the final resolution of the dispute.**

2.4.3 ***Arbitration Procedures.***

(a) Landlord and Tenant shall each appoint one arbitrator who shall by profession be a real estate broker/appraiser who shall have been active over the five-year period ending on the date of such appointment in the leasing of properties similar to the Project in the Area. The determination of the arbitrators shall be limited solely to the issue of whether Landlord's or Tenant's submitted Fair Market Rent for the Premises is the closest to the actual Fair Market Rent for the Premises as determined by the arbitrators, taking into account the requirements of this paragraph (a) of §2.4.3 regarding the same. Each such arbitrator shall be appointed within ____ days after the Outside Agreement Date. Landlord and Tenant may not consult with either such arbitrator prior to resolution.

(b) The two arbitrators so appointed shall, within ____ days of the date of the appointment of the last appointed arbitrator, meet and attempt to reach a decision as to whether the parties shall use Landlord's or Tenant's submitted Fair Market Rent and shall notify Landlord and Tenant of their decision, if any.

(c) If the two arbitrators are unable to reach a decision, the two arbitrators shall, within ____ days of the date of the appointment of the last appointed arbitrator, agree on and appoint a third arbitrator who shall be a broker and who shall be qualified under the same criteria set forth hereinabove for qualification of the initial two arbitrators.

(d) The three arbitrators shall, within ____ days of the appointment of the third arbitrator, reach a decision as to whether the parties shall use Landlord's or Tenant's submitted Fair Market Rent and shall notify Landlord and Tenant thereof.

(e) The decision of the majority of the three arbitrators shall be binding on Landlord and Tenant.

(f) If either Landlord or Tenant fails to appoint an arbitrator within ____ days after the Outside Agreement Date, the arbitrator appointed by one of them shall reach a decision, notify Landlord and Tenant thereof, and such arbitrator's decision shall be binding on Landlord and Tenant.

(g) If the two arbitrators fail to agree on and to appoint a third arbitrator, then the chief presiding judge of the local circuit court shall appoint the third arbitrator.

(h) The cost of arbitration shall be paid by Landlord and Tenant equally.

3. RENT.

3.1 ***Rental Payment.*** **Tenant shall pay to Landlord the Minimum Rent set forth in Exhibit D attached hereto and made a part hereof, in the Lease Summary in advance in monthly installments on or before the first day of each and every month of the Lease Term from and after the Rental Commencement Date; provided, however, the first month's Minimum Rent shall be payable by Tenant upon execution of this Lease. Minimum Rent for any period during the Term, which is for less than a full calendar month, shall be prorated based on the number of actual days in the month. Minimum Rent adjustments set forth herein shall occur on the ____ day of the Lease Year specified in §2.2 above. All Rent shall be payable without demand, deduction, or offset to Landlord at the address stated in the Lease Summary or to such other persons or at such other places as Landlord may designate in writing. In addition to Minimum Rent hereunder, Tenant shall pay, as Additional Rent (whether or not so designated herein), in a manner and at the place provided in this Lease, all sums of money required to be paid by Tenant under this Lease. All amounts of Minimum Rent and Additional Rent (also collectively "Rent" or "Rental") payable in a given month shall be deemed to comprise a single rental obligation of Tenant to Landlord.**

3.2 ***Security Deposit.*** **Concurrent with Tenant's execution of this Lease, Tenant shall furnish Landlord with a security deposit in the amount set forth in the Lease Summary. If Tenant defaults in the performance of any provision hereof, Landlord may use, apply, or retain any part thereof for the payment of any Rent or other sum in default; for the payment of any other amount which Landlord may spend or become obligated to spend by reason of Tenant's default; or to compensate Landlord for any loss or damage which Landlord may suffer by reason of Tenant's default. If any portion of said deposit is so used or applied, Tenant shall, within ____ days after receipt of written demand therefor, deposit cash with Landlord in an amount sufficient to restore the Security Deposit to its original amount. Landlord shall not be required to keep the Security Deposit separate from its general funds, and Tenant shall not be entitled to interest on such deposit. Provided Tenant is not in default under this Lease, the Security Deposit or any balance thereof shall be returned to Tenant at the expiration or sooner termination of the Lease Term and after delivery of exclusive possession of the Premises to Landlord in the condition required by this Lease. Upon the annual anniversary of any Lease Year hereunder, Landlord shall have the right to increase said Security Deposit to the then-current Minimum Rent. Within ____ days after receipt of such notice, Tenant shall deposit said increase with Landlord. If Landlord transfers its**

interest in the Premises during the Term, Landlord may assign the Security Deposit to the transferee and, upon delivery to Tenant of notice thereof, Landlord shall be discharged from any further liability relative thereto, and Tenant shall look solely to the transferee for return of the Security Deposit.

4. PRO RATA SHARE OF COMMON AREA EXPENSES, TAXES, AND INSURANCE. Commencing the earlier of Tenant's opening for business or the Rental Commencement Date, Tenant shall pay to Landlord, as Additional Rent, 1/12 of an amount reasonably estimated by Landlord to be Tenant's Pro Rata Share (as defined in this Article 4) of the total annual Common Area Expenses, Real Property Taxes and assessments, and the costs of Landlord's Insurance (as defined in Articles 5, 6, and 7, respectively, of this Lease); provided, however, the first month's estimated Common Area Expenses, Real Property Taxes and assessments, and the costs of Landlord's Insurance shall be payable by Tenant upon execution of this Lease. "Tenant's Pro Rata Share" shall equal the ratio of the total square feet of the Floor Area of the Premises to the total square feet of the Floor Area of the Shopping Center as of the end of each calendar year. Tenant's Pro Rata Share shall be subject to adjustment by Landlord to reflect Tenant's share of a particular cost that is not applicable to all the tenants within the Shopping Center. Landlord may adjust its estimate of such expenses at the end of any calendar quarter on the basis of Landlord's experience and reasonably anticipated costs. Following the end of each calendar year (and after the date of expiration or sooner termination of this Lease), Landlord shall furnish to Tenant a statement showing in reasonable detail the Common Area Expenses, Real Property Taxes and assessments, and cost of Landlord's Insurance during such calendar year (or portion thereof prior to the expiration or sooner termination of this Lease). If Tenant's share of such costs exceeds Tenant's payments so made, Tenant shall pay Landlord the deficiency within ____ days after receipt of such statement. If such payments exceed Tenant's share of such costs, Tenant shall be entitled to credit the excess against payments for such costs next thereafter to become due Landlord as set forth above. Upon termination of this Lease, if Tenant is not in default hereunder, Landlord shall promptly refund to Tenant the amount of any excess.

Tenant's Pro Rata Share may be adjusted by Landlord from time to time for changes in the physical size of the Premises and the Shopping Center. If any tenant or other occupant occupying space within the Shopping Center performs its own Common Area maintenance, obtains casualty insurance on its premises, or pays the real property taxes on its premises, the Floor Area contained in such premises shall be excluded from the denominator of the aforementioned ratio determining Tenant's Pro Rata Share. Without limitation of the foregoing, (a) with respect to Common Area costs for the Premises, appropriate adjustment of Tenant's Pro Rata Share shall be made with respect to those Common Area costs which pertain to and benefit only certain buildings of the Shopping Center; (b) with respect to Real Property Taxes, appropriate adjustment of Tenant's Pro Rata Share may be made to allocate real property taxes among separately assessed tax parcels (*i.e.,* the tax parcels comprising the Shopping Center), in which event the denominator of the ratio used for calculating Tenant's Pro Rata Share will be the Floor Area of the appropriate tax parcels of which the Premises are a part; and (c) with respect to Landlord's Insurance, appropriate adjustment of Tenant's Pro Rata Share of such insurance premiums may be made based on the Floor Areas of the buildings covered under said insurance.

5. COMMON AREA.

5.1 ***Common Area.*** **"Common Area" is defined as all areas and facilities within the Shopping Center not appropriated to the exclusive occupancy of tenants and facilities, utilities, or equipment outside the Shopping Center that serve the Shopping Center, including, but not limited to, all vehicle parking spaces or areas, roads, traffic lanes, driveways, sidewalks, pedestrian walkways, landscaped areas, signs, service delivery facilities, common storage areas, common utility facilities, and all other areas for nonexclusive use in the Shopping Center that may from time to time exist. Common Areas shall include the roofs and exterior walls (other than storefronts) of buildings in the Shopping Center, all shared utility systems to the point of entry to any individual leased premises, and all utility systems that are exterior to the buildings other than (a) heating, ventilating, and cooling system components or elements that serve individual tenants and (b) sewer laterals to the point of junction with a common sewer line, which shall be the responsibility of individual tenants whose premises are served by such lateral.**

5.2 ***Common Area Expenses.*** **The term "Common Area Expenses" shall include, without limitation, all amounts paid by Landlord for the maintenance, repair, replacement, operation, and management of the Common Area and the Shopping Center, including insurance covering the Common Area and the Shopping Center, together with an administrative fee equal to ____ percent of all such amounts and shall include, without limitation, the costs of gardening; landscaping; repaving; resurfacing; restriping; security; alarm systems; signage; property management; repairs, maintenance, and replacements of bumpers, directional signs, and other markers; painting; lighting and other utilities (including, but not limited to, electricity, gas, water, and telephone); cleaning; Common Area trash removal; Tenant's trash removal (if contracted by the Shopping Center); any contracts for services or supplies to be provided with the maintenance, management, operation, repair, and replacement of such Common Area; third-party management fees; any lien or encumbrance levied against the Common Area and discharged by Landlord; accounting and legal fees; and any other cost of operation of the improvements on the Common Area including all assessments, charges, association fees, and the like levied or assessed pursuant to any declaration of covenants, conditions, and restrictions, reciprocal easement agreement, or comparable document encumbering all or any portion of the Shopping Center; depreciation and replacement of equipment; and the costs of public liability and all-risk property damage insurance covering the Shopping Center (including earthquake insurance, if purchased by Landlord). Landlord has the right to include in the Common Area Expenses, and to establish as a reserve, such amounts (and for such periods of time) as Landlord deems reasonable for the maintenance and repair of capital improvements, including without limitation the restoration of the roofs of the buildings and the paving of the Shopping Center.**

5.3 ***Control of the Common Area.*** **Landlord shall have exclusive control of the Common Area and may exclude any person from use thereof except bona fide customers and service suppliers of Tenant. Tenant acknowledges that Landlord may change the shape, size, location, number, and extent of the improvements to any portion of the Shopping Center without Tenant's consent. Tenant and its agents, employees, subtenants, assignees, contractors, and invitees shall observe faithfully and comply with the rules and regulations**

for the Shopping Center attached hereto as Exhibit E and any amendments thereto or other reasonable rules and regulations governing the Shopping Center. Tenant agrees to keep the Common Area free and clear of any obstructions created or permitted by Tenant or resulting from Tenant's operation and to use the Common Area only for normal activities: parking, ingress, and egress by Tenant and its employees, agents, representatives, licensees, and invitees to and from the Premises and Shopping Center. If, in the opinion of Landlord, unauthorized persons are using the Common Area by reason of the presence of Tenant in the Premises, Tenant, upon demand of Landlord, shall correct such situation by appropriate action and proceedings against all such unauthorized persons. Nothing herein shall affect the rights of Landlord at any time to remove any such unauthorized persons from said areas or to prevent the use of said areas by such unauthorized persons.

6. TAXES. The term "Real Property Taxes" shall include, without limitation, any general or special assessment tax, commercial rental tax, in lieu tax, levy, charge, or similar imposition imposed by any authority, including any government or any school, agricultural, lighting, fire protection, police protection, street, sidewalk and road maintenance, refuse removal, sewer, storm drain, or recycled water facilities, or governmental services previously provided without charge (or for a lesser charge) to property owners and occupants or other improvement or special assessment district or any agency or public body, as against any legal or equitable interest of Landlord in the Premises and/or the Shopping Center or arising out of Tenant's use, occupancy, or possession of the Premises or that are attributable to the Premises, together with the reasonable costs of professional consultants and/or counsel to analyze tax bills and prosecute any protests, refunds, and appeals for the period covered during the Lease Term. Tenant's liability with respect to such taxes and assessments shall be prorated on the basis of a 365-day year to account for any fractional portion of a fiscal tax year included in the Lease Term at its commencement or expiration (or sooner termination).

7. INSURANCE; INDEMNITY; SUBROGATION.

7.1 *General.* All insurance policies required to be carried by Tenant under this Lease shall (a) be written by companies rated A-VIII or better in the most recent edition of BEST'S INSURANCE REPORTS and authorized to do business in the state in which the Premises are located and (b) name Landlord and any parties designated by Landlord as additional insureds. Any deductible amounts under any insurance policies required hereunder shall be subject to Landlord's prior written approval, which shall not be unreasonably withheld. Tenant shall deliver to Landlord certified copies of its insurance policies, or an original certificate evidencing that such coverage is in effect, on the Term Commencement Date and thereafter at least ____ days before the expiration dates of expiring policies. Coverage shall not be canceled or materially reduced (and the certificate of insurance furnished by Tenant shall verify same), except after ____ days' prior written notice has been given to Landlord's property administrator. Tenant's coverage shall be primary insurance with respect to Landlord and its property administrator, and the officers, directors, and employees of both of them. Any insurance or self-insurance maintained by Landlord and/or its property administrator shall be in excess of, and not contributing with, Tenant's insurance. Coverage shall apply separately to each insured against whom a claim is made or suit is brought, except with respect to any aggregate limit applicable to the insuring party's policy.

7.2 *Tenant's Liability Insurance.* Tenant shall keep in force during the term of this Lease a policy of commercial general-liability insurance insuring against any liability arising out of Tenant's use, occupancy, or maintenance of the Premises and the acts, omissions, and negligence of Tenant, its agents, employees, contractors, and invitees in and about the Premises and the Shopping Center. As of the Term Commencement Date, such insurance shall provide coverage for and shall be in the amount of not less than $_____ per occurrence for bodily injury and property damage. Landlord shall have the right to increase the amount of insurance required hereunder to reflect changing market conditions or industry standards. Tenant's coverage shall be primary insurance as respects Landlord, its officers, agents, and employees. Any insurance or self-insurance maintained by Landlord shall be excess of the Tenant's insurance and shall not contribute with it. Coverage shall apply separately to each insured against whom a claim is made or suit is brought, except with respect to the limits of the insurer's liability. Tenant also shall obtain and keep in force a policy or policies naming Landlord as an additional insured with loss payable to Landlord and any Landlord mortgagee, insuring the loss of the full Rent payable hereunder for ____ with an extended period of indemnity for an additional ____ days (Rental Value Insurance). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent payable by Tenant for the next ____-month period. Notwithstanding the foregoing, Landlord shall have the right to elect to maintain the Rental Value Insurance directly, in which event (a) the Rental Value Insurance will be included as a part of Landlord's Insurance (as defined herein) and the cost thereof shall be reimbursable by Tenant to Landlord pursuant to Article 4 of this Lease and (b) during such time as Landlord maintains the Rental Value Insurance directly, Tenant shall not be required to maintain Rental Value Insurance.

7.3 *Tenant's Other Insurance.* Tenant shall maintain special-form property coverage, with sprinkler leakage, vandalism, and malicious mischief endorsements on all of Tenant's fixtures, including tenant improvements and betterments, equipment, and personal property on the Premises, in an amount not less than 100 percent of their full guaranteed replacement value, the proceeds of which shall, as long as the Lease is in effect, be used for the repair or replacement of the property so insured. Tenant shall maintain workers' compensation insurance in accordance with the laws of the State of Illinois in which the Premises are located and employer's liability insurance with a limit of not less than $_____ per accident. Tenant shall maintain plate glass insurance, sufficient to pay for the replacement of and any or all damages to exterior plate glass and storefront supports in the Premises. If Tenant sells alcoholic beverages from the Premises, tenant shall maintain a customary policy of liquor liability insurance with limits no less than those required above with respect to Tenant's commercial general-liability insurance under §7.2 above. If Tenant uses vehicles, owned and non-owned, in any way to carry out business on or about the Shopping Center, Tenant shall maintain automotive liability insurance with a limit of not less than $_____ combined single limit for bodily injury and property damage.

7.4 *Landlord's Insurance.* Landlord shall keep and maintain, in full force and effect, a policy of fire insurance, including special-form coverage, in an amount not less than ____ percent of the full replacement value of the Premises and the Shopping Center as such value may exist from time to time, including foundations, footings, and excavations. The term

"Landlord's Insurance" shall mean any and all insurance maintained by Landlord, including fire insurance and extended coverage or all-risk, public-liability, and any other policy that may be carried by Landlord (including Rental Value Insurance or earthquake and flood insurance, if purchased by Landlord) insuring the Shopping Center or portions thereof. Tenant shall reimburse Landlord, as Additional Rent, for the cost of such insurance for the Premises, within ____ days after receipt of invoice therefor. The cost of such insurance for the Premises to be paid by Tenant to Landlord hereunder shall be determined on a proportionate share basis determined by the ratio that the total square feet of the Floor Area of the Premises bears to the total square feet of the Floor Area of all the space in such building. If Tenant's use of the Premises increases the premium for any insurance carried by Landlord over that charged for normal retail uses, then Tenant shall pay to Landlord, as Additional Rent, the full amount of such increase in premium.

7.5 ***Waiver of Subrogation.*** **Neither Landlord nor Tenant shall be liable to the other or to any insurance company (by way of subrogation or otherwise) insuring the other party for any loss or damage to any building, structure, or other tangible property or any resulting loss of income and benefits (even though such loss or damage might have been occasioned by the negligence of such party, its agents, or employees) if such loss or damage is covered by insurance benefiting the party suffering such loss or damage or was required to be covered by insurance pursuant to this Lease. Landlord and Tenant shall require their respective insurance companies to include a standard waiver of subrogation provision in their respective policies.**

7.6 ***Indemnification and Waiver by Tenant.*** **To the fullest extent permitted by law and except to the extent that any damage to property or injury is caused by the gross negligence or willful misconduct of Landlord, Tenant agrees (and Tenant shall cause its contractors and subcontractors to agree) that neither Landlord, its parent, affiliated, or subsidiary companies, and its and their officers, directors, shareholders, partners, agents, and employees nor Landlord's employees, agents, representatives, and contractors, and each of their successors and assigns (each, "Landlord Party" and collectively, "Landlord Parties") shall be liable for any injury to or death of persons or damage to property of Tenant (or its contractors and subcontractors) or any other person from the date of this Lease. Tenant shall defend, indemnify, and hold Landlord and Landlord Parties harmless against and from any and all claims, liabilities, losses, damages, suits, costs, and expenses of any kind or nature including without limitation reasonable attorneys' fees (Claims) arising from or relating to (a) Tenant's use of the Premises or the Common Areas or (b) any acts, omissions, negligence, or default of Tenant or Tenant's agents, employees, members, partners, officers, directors, contractors, and invitees (each, "Tenant Party" and collectively, "Tenant Parties"), except to the extent that any such Claim is caused by the gross negligence or willful misconduct of Landlord. The terms of the indemnification by Tenant set forth in this §7.6 shall survive the expiration or earlier termination of this Lease.**

8. USE.

8.1 ***Use Defined.*** **The Premises shall be used for sales of _____ only and for no other purpose or use. Tenant shall operate its business at the Premises in a first-class manner under the trade name _____ and shall not change its trade name without Landlord's**

prior written consent, nor shall Tenant operate its business in a manner or for such a use as would be inconsistent with first-class shopping facilities. Tenant shall not conduct any sidewalk sale, auction, distress sale, or going-out-of-business sale on the Premises without the prior written consent of Landlord. Tenant shall use the Premises in such a way as not to create a nuisance or cause the cancellation of any insurance policy covering the Premises. Tenant shall keep the Premises, front and rear walkways adjacent to the Premises, and any service delivery facilities allocated for the use of Tenant clean and free from rubbish and dirt at all times and shall store all trash and garbage within the Premises or in designated refuse areas. The failure by Tenant to use the Premises pursuant to this Article 8 shall be considered a default under this Lease, and Landlord shall have the right to exercise any and all rights and remedies provided herein or by law.

8.2 ***Exclusive Use.*** **Notwithstanding anything to the contrary set forth in the Lease, after the Effective Date of Lease, Landlord shall not execute any lease for premises located within the Shopping Center to any other Competitive Store, as defined in paragraph (e) of this §8.2 (Exclusive Use), subject to the following terms and the satisfaction of each and all of the following conditions:**

(a) _____ is Tenant under the Lease and has not made a Transfer of the Lease or Tenant's interest in the Premises that requires Landlord's prior written consent in accordance with the terms of Article 12.

(b) The Exclusive Use is not applicable to (i) any premises containing 10,000 or more square feet of Floor Area; (ii) any Shopping Center leases entered into on or before the Effective Date of this Lease; (iii) any tenants or occupants, including their successors and assigns, existing in the Shopping Center on or before the Effective Date of this Lease, even if such occupants complete construction and/or open for business after the Effective Date of Lease (Existing Tenants); and (iv) any new Shopping Center leases or extensions of existing leases entered into with Existing Tenants.

(c) The Exclusive-Use restrictions shall automatically terminate if Tenant fails to continuously operate its business in the entire Premises in accordance with this Lease, excepting closures for reasonable periods of time for remodeling as permitted under this Lease (not to exceed ____ days in any ____-month period), closures due to rebuilding and repair after casualty, and closures due to force majeure that prevents Tenant from operating its business in the Premises.

(d) The Exclusive-Use restrictions shall automatically terminate without notice to Tenant and be of no further force or effect, effective as of the date that is the earliest of (i) a Transfer of the Lease that requires Landlord's prior written consent; (ii) a change in the Permitted Use set forth in the Lease Summary; (iii) the effective date of any default by Tenant under the Lease; or (iv) the expiration or earlier termination of the Lease. The Exclusive-Use restrictions shall cease to apply to any products that Tenant discontinues selling.

(e) The term "Competitive Store" shall mean the business operation of a new tenant whose primary business is the retail sales or marketing of _____ products or services, if the gross sales derived from the sale of such goods and/or services constitute more than ____ percent of such tenant's total annual gross sales.

(f) Unless a right to an exclusive use is expressly provided in this §8.2, Tenant shall have no right to an exclusive use.

Notwithstanding anything contained herein to the contrary, Landlord shall not be obligated to maintain or enforce the terms of this §8.2 or any similar provisions of the Lease to the extent that same would be in violation of any antitrust law. If such antitrust violation is the basis of a claim or counterclaim against Landlord with Landlord's attempted enforcement of this exclusive use, then Landlord shall promptly consult with Tenant regarding Tenant's desire to further pursue enforcement of this exclusive use, at Tenant's sole risk, cost, and expense and subject to Tenant's obligations as set forth in this §8.2. In addition, Tenant shall defend, indemnify, and save Landlord and its employees, agents, and assigns harmless from and against any and all losses, damages, actions, causes of action, claims, liabilities, demands, costs, and expenses, including, without limitation, attorneys' fees, arising out of the exclusive-use restrictions set forth herein or arising out of the enforcement of such restrictions.

8.3 ***Continuous and Full Operation.*** **Tenant shall open for business in the Premises not later than ____ days after the Term Commencement Date, and Tenant shall thereafter remain open for business continuously and uninterruptedly during the Lease Term operating from the entirety of the Premises.**

8.4 ***Minimum Business Hours.*** **Tenant shall keep the Premises open for business during the required Minimum Business Hours of Monday through Friday ____ a.m. to ____ p.m., Saturday ____ a.m. to ____ p.m., and Sunday ____ a.m. to ____ p.m., as set forth in the Lease Summary and Extended Holiday Hours (as determined in Landlord's sole discretion) of which Tenant is notified from time to time. If Tenant is found not to be open during the Minimum Business Hours (and/or Extended Holiday Hours, as the case may be) more than ____ time[**s**] in any Lease Year, then Tenant agrees to pay to Landlord, in addition to all other Rents payable hereunder, a charge equal to [**one-half day's**] Minimum Rent for each such day that the Premises are not operated during the required hours.**

8.5 ***Conditions of Record.*** **Landlord's title is subject to (a) the effect of any covenants, conditions, restrictions, easements, development agreements, mortgages or deeds of trust, ground leases, rights of way, and any other matters or documents of record now or hereafter recorded against Landlord's title and expressly including that certain Operation and Easement Agreement (OEA) for _____ Shopping Center recorded _____, 20__, as Instrument No. ____ with the _____ County Recorder's Office by and between Landlord and _____ (or its successors and assigns) with respect to and affecting the Shopping Center; (b) the effects of any zoning laws of the city, county, and state where the Shopping Center is situated; and (c) general and special taxes and assessments not delinquent. Tenant agrees that it will conform to and will not violate said matters of record and that this Lease is and shall be subordinate to said matters of record and any amendments or modifications thereto. Tenant acknowledges that this Lease is and shall automatically be subordinate to the OEA, and Tenant further hereby covenants and agrees that, within ____ days following Landlord's written request, Tenant shall execute and deliver to Landlord a subordination agreement (in recordable form) relative to the OEA and any amendment thereof.**

Tenant acknowledges that after the Effective Date, Landlord may sell or transfer all or any part of Landlord's interest in the Shopping Center (including the Premises) to a third party. Tenant further acknowledges that Landlord does not and will not have control over any portions of the Shopping Center that are not owned by Landlord and that Landlord's rights relative to such portions of the Shopping Center [are**] [**will be**] limited to any rights Landlord may have under the OEA applicable thereto. Accordingly, notwithstanding any terms to the contrary in this Lease, any obligations, restrictions, representations, or warranties of Landlord in this Lease and any rights granted to Tenant in this Lease, which pertain to portions of the Shopping Center that are not owned by Landlord, shall be enforceable against Landlord only to the extent that Landlord has the right to perform such obligations or enforce such restrictions, representations, warranties, or rights (or has the right to require any other party to the OEA to perform such obligations or enforce such restrictions, representations, warranties, or rights) under the OEA. In addition, if and as long as the Shopping Center is not owned by a single owner, then, at the election of Landlord, (a) the Common Area (or such portions and/or elements thereof as may be designated by Landlord) shall be operated, maintained, and repaired in accordance with the terms of the OEA; (b) Landlord shall be relieved of its obligations under this Lease to operate, maintain, and repair the Common Area (or such portions and/or elements thereof as may be designated by Landlord) unless the owner of the Premises retains such responsibility under the OEA; and (c) Tenant shall pay to Landlord, as part of the Common Area Expenses payable by Tenant pursuant to this Lease, the full amount of all Common Area and other expenses allocated to the Premises pursuant to the OEA (OEA Pass-Through Expenses); provided, however, that for any calendar year during the Term, in no event shall the sum of the OEA Pass-Through Expenses allocated to the Premises plus all other Common Area Expenses payable by Tenant exceed the total Common Area Expenses that would have been payable by Tenant pursuant to this Lease if the Shopping Center had been owned by a single owner and Tenant had not been required to pay any OEA Pass-Through Expenses.**

8.6 ***Prohibited Uses.*** **The Premises shall not be used for any use that is inconsistent with the operation of a first-class retail shopping center. Without limiting the generality of the foregoing, the following uses shall not be permitted in the Premises: (a) any use that emits an obnoxious odor, noise, or sound that can be heard or smelled outside any Building in the Shopping Center; (b) use as a storage warehouse operation (including but not limited to a self-storage facility) and any assembling, manufacturing, distilling, drilling, refining, smelting, agricultural, mining, or other industrial operation; (c) any secondhand store or surplus store, flea market, swap meet, or similar operation primarily selling used goods (provided, however, that the foregoing secondhand or surplus store restriction shall not apply to the sale of high-end secondhand clothing, apparel, and sporting equipment, whether on consignment or otherwise, such as sold by [**T.J. Maxx, Play It Again Sports, Marshalls**], and other similar stores); (d) any mobile home park, trailer court, labor camp, junkyard, or stockyard (except that this provision shall not prohibit the temporary use of construction trailers during periods of construction, reconstruction, or maintenance, in accordance with Landlord's regulations and approval in such regard); (e) any dumping, disposing, incineration, or reduction of garbage (exclusive of garbage compactors located near the rear of the Premises, if any, and any recycling facility required by applicable law, code, regulation, requirement, or ordinance with an otherwise permitted use); (f) any fire sale, bankruptcy sale**

(unless pursuant to a court order), or auction house operation; (g) any central laundry, dry-cleaning plant, or laundromat (provided, however, that as long as such facilities do not have an on-site dry-cleaning plant or facility, this prohibition shall not be applicable to nominal supportive facilities for on-site service oriented to pickup and delivery by the ultimate consumer, as the case may be, found in retail shopping centers in the metropolitan area where the Shopping Center is located); (h) any automobile, truck, trailer, or recreational vehicle service or body shop repair operation or sales or leasing operation (including any automobile service center or lubrication facility); (i) any residential use or lodging, including but not limited to single-family dwellings, townhouses, condominiums, other multifamily units, hotels, motels, and other forms of living quarters, sleeping apartments, or lodging rooms; (j) any veterinary hospital or animal raising or boarding facilities (except as specifically allowed in the OEA); (k) any mortuary or funeral home; (*l*) any establishment selling or exhibiting pornographic materials or drug-related paraphernalia (including any so-called "headshop") or that exhibits live, or by other means to any degree, nude or partially clothed dancers or waitstaff, and/or any massage parlors or similar establishments; (m) any bar, tavern, restaurant, or other establishment whose reasonably projected annual gross revenues for the sale of alcoholic beverages for on-premises consumption exceeds ____ percent of the gross revenues of such business; (n) any carwash; (*o*) any pool or billiard hall; (p) any training or educational facility, including but not limited to beauty schools, barber colleges, library, or reading rooms (except as incidental to the retail sale of books, magazines, and newspapers), places of instruction, or other operations catering primarily to students or trainees rather than to customers (except as specifically allowed in the OEA); or (q) any of the prohibited uses or exclusive uses set forth in leases of future tenants of the Shopping Center (provided that such prohibited uses and exclusive uses shall not prohibit Tenant from engaging in the Permitted Use).

8.7 ***Prohibited Uses of Shopping Center Systems.*** **Tenant shall not use any Shopping Center system in excess of its capacity or in any other manner that may damage such system or the Shopping Center. Machinery and mechanical equipment shall be placed and maintained by Tenant, at Tenant's expense, in locations and in settings sufficient in Landlord's reasonable judgment to absorb and prevent vibration, noise, and annoyance.**

9. MAINTENANCE, REPAIRS, ALTERATIONS.

9.1 ***Tenant's Obligations.*** **Subject to Landlord's obligations as expressly set forth in this Lease, Tenant, at its sole cost and expense, shall make all repairs and/or replacements to the Premises and shall keep at all times the Premises in good order and repair, including without limitation the storefront; all doors; plate glass; all plumbing, heating, ventilating, and air-conditioning (HVAC); electrical; and lighting facilities and equipment within the Premises or exclusively serving the Premises. Tenant shall keep and maintain the Premises in accordance with the requirements of applicable laws concerning the manner, usage, and condition of the Premises and appurtenances to the Premises, as the same shall be in effect from time to time. Subject to §7.5 above, Tenant shall also be responsible for the repair of any and all damage to the Premises and/or Shopping Center caused by any act of Tenant or its employees, agents, or contractors and for any repairs necessitated by alterations, additions, or improvements made by or on behalf of Tenant. If Tenant fails to perform any of its obligations, Landlord**

may, at its option, after ____ days' written notice to Tenant, enter the Premises and put the same in good order and repair, and the cost of Landlord's work, together with an administrative fee of ____ percent of such costs, shall become due and payable as Additional Rent by Tenant to Landlord. Tenant shall enter into a service contract within ____ days after the Term Commencement Date with a maintenance contractor approved by Landlord for the monthly servicing of HVAC systems and equipment within the Premises. The service contract shall include all scheduled maintenance as recommended by the equipment manufacturer as set forth in the operation/maintenance manual. Notwithstanding the foregoing, Landlord may (but shall not be obligated to) elect to maintain the HVAC equipment serving the Premises, in which event Tenant shall pay to Landlord on the ____ day of each month all costs and expenses for the repair, maintenance, and replacement of all HVAC equipment for the Premises. Notwithstanding any provision of this Lease to the contrary, neither Tenant nor any sublessee, licensee, contractor, customer, agent, employee, or representative of Tenant shall penetrate the walls or roof of the Premises for any purpose at any time without Landlord's prior written consent, which may be withheld in Landlord's sole and absolute discretion, and then only in strict conformance with any conditions of such consent (including, without limitation, the use of such contractors as Landlord shall require), as Landlord shall impose.

9.2 ***Landlord's Obligations.*** **Subject to the foregoing, Landlord shall keep and maintain in good condition and repair (or replace, if necessary) all aspects of the Shopping Center, including but not limited to the roof, exterior walls, structural parts, and structural floor of the Premises; fire protection services; and pipes and conduits outside the Premises for the furnishing to the Premises of various utilities (except to the extent that the same are the obligation of the appropriate public utility company); provided, however, that notwithstanding anything to the contrary set forth hereinabove, Tenant shall be responsible for the maintenance and repair of the Premises as set forth in §9.1 above. Notwithstanding anything to the contrary contained in this Lease, Landlord shall not be liable to Tenant for failure to make repairs as herein specifically required of Landlord, unless Tenant has previously notified Landlord in writing of the need for such repairs and Landlord has failed to commence and complete said repairs within the time periods set forth in §13.3 below, and in such event, Landlord's sole liability for such failure shall be limited to the cost of the repairs. Tenant shall reimburse Landlord for all costs and expenses incurred by Landlord pursuant to this §9.2, together with a management and administrative fee of ____ percent of the amount thereof, which amounts Landlord may collect together with and in the same manner as Common Area Expenses.**

9.3 ***Surrender.*** **Upon the expiration or termination of this Lease, Tenant shall surrender the Premises to Landlord in good and broom-clean condition, with all of Tenant's trade fixtures, signs, and personality removed, excepting ordinary wear and tear and damage that is caused by fire or other casualty that Landlord is obligated to repair. Tenant shall also remove any Tenant-installed improvements that Landlord may require to be removed.**

9.4 ***Alterations.*** **Tenant shall not make any structural repairs or alterations of the Premises. Tenant shall not make any nonstructural repairs or modifications of the Premises costing in excess of $_____ in the aggregate without Landlord's prior written consent.**

In addition, Tenant shall not make any repair or alteration that affects the storefront of the Premises, the electrical, HVAC, or other utility or mechanical systems serving the Premises, or the exterior walls or roof of the Premises (including roof penetrations), nor shall Tenant erect any mezzanine or increase the size of same, if one shall be initially constructed, without the prior written consent of Landlord. Upon the prior written approval of Landlord, Tenant shall have the right during the Term to make interior alterations, changes, and improvements in the Premises (except structural, electrical, mechanical, or roof alterations, changes, and improvements) that are necessary for the conduct of Tenant's business and for full beneficial use of the Premises, provided Tenant shall (a) pay all costs and expenses; (b) make the alterations, changes, and improvements in a good and workmanlike manner, with new materials of first-class quality and in accordance with Landlord's specifications with respect thereto and otherwise in accordance with applicable Laws; (c) provide Landlord reasonable assurances, prior to beginning the alterations, changes, and improvements, that payment for the same shall be timely made by Tenant; (d) obtain and maintain during construction the proper insurance coverages commonly required therefor; and (e) cooperate and coordinate the work to be constructed with Landlord and pursuant to the governing rules and regulations of the Shopping Center to minimize interference with the Shopping Center's operation and the use thereof by the other tenants.

9.5 ***Security Interest in Personal Property.*** **To the extent allowed from time to time under applicable Law, Tenant grants Landlord a lien on and security interest in the personal and business property of Tenant now or later placed in or on the Premises (including furniture, fixtures, equipment, and inventory). The property shall be and remain subject to the lien and security interest of Landlord for payment of all Rent and other sums agreed to be paid by Tenant. Landlord's lien, however, shall not be superior to a lien from a lending institution, supplier, or leasing company, if the lending institution, supplier, or leasing company has a perfected security interest in the equipment, furniture, or other tangible personal property that originated in a transaction in which Tenant acquired the same. The provisions of this Section relating to the lien and security interest shall constitute a security agreement under and subject to the Uniform Commercial Code of the state where the Shopping Center is located, so that Landlord shall have and may enforce a security interest on all property of Tenant now or later placed in or on the Premises, in addition to and cumulative of Landlord's liens and rights provided by law or by the other terms and provisions of this Lease. Tenant agrees to execute, as debtor, a financing statement or statements and any other documents that Landlord may now or later request to protect or further perfect Landlord's security interest. Notwithstanding the above, Landlord shall neither sell nor withhold from Tenant Tenant's business records.**

10. UTILITIES.

10.1 ***Obligation To Pay.*** **Tenant shall pay for all water, gas, electricity, and other utilities used by Tenant during the Lease Term, all of which shall be measured through meters or submeters to be installed by Landlord and maintained by Tenant; provided, if any such services cannot be separately metered or submetered to Tenant, Tenant shall pay its proportionate share (as equitably determined by Landlord) of all charges for utilities jointly metered with other premises.**

10.2 ***Landlord's Responsibility.*** **Landlord shall not be liable for, and Tenant shall not be entitled to, any damages, abatement, or reduction in Rent by reason of any interruption or failure in the supply of utilities. Tenant agrees that it shall not install any equipment that exceeds or overloads the capacity of the utility facilities serving the Premises, and that if equipment installed by Tenant requires additional utility facilities, installation of the same shall be at Tenant's expense, but only after Landlord's written approval of same. Landlord shall be entitled to cooperate with the energy and water conservation efforts of governmental agencies or utility suppliers. No failure, stoppage, or interruption of any utility or service shall be construed as an eviction of Tenant, nor shall it relieve Tenant from any obligation to perform any covenant or agreement under this Lease. In the event of any failure, stoppage, or interruption of utilities or services, Landlord shall use its reasonable efforts to attempt to restore all services promptly. No representation is made by Landlord with respect to the adequacy or fitness of the Shopping Center's HVAC system or other systems to maintain temperatures as may be required for the operation of any computer, film processing, printing, or other special trade fixtures or equipment of Tenant. Landlord reserves the right from time to time to make reasonable and nondiscriminatory modifications to the utility systems serving the Shopping Center.**

11. MECHANICS LIENS. Tenant shall keep the Premises and the Shopping Center free and clear of all encumbrances, mechanics liens, stop notices, demands, and claims arising from work done by or for Tenant or for persons claiming under Tenant, and Tenant shall indemnify and save Landlord free and harmless from and against any Claims arising from or relating to the same. If Tenant fails to remove, insure over, bond over, or satisfy any such encumbrance, mechanics lien, stop notice, or claim with work performed by or on behalf of Tenant within ____ days after written notice by Landlord, Landlord shall have the right (but not the obligation), in addition to any other rights or remedies of Landlord, to use whatever means in its discretion it may deem appropriate to cause said encumbrance, claim, stop notice, or lien to be rescinded, discharged, compromised, dismissed, or removed, including, without limitation, posting a bond. Any such sums paid by Landlord, including attorneys' fees and bond premiums, shall be immediately due and payable to Landlord by Tenant. Tenant shall immediately give Landlord notice of any encumbrance, claim, demand, stop notice, or lien made or filed against the Premises or the Shopping Center and/or any action affecting title to the Premises or Shopping Center.

12. ASSIGNMENT AND SUBLETTING.

12.1 ***Landlord's Right of Consent.*** **Tenant shall not transfer; assign; sublet; enter into any franchise, license, or concession agreements; change ownership or voting control; mortgage; encumber; pledge; or hypothecate all or any part of this Lease, Tenant's interest in the Premises, or Tenant's business (collectively "Transfer") without first obtaining Landlord's written consent, which shall not be unreasonably withheld. Should Tenant desire to make a Transfer hereunder, Tenant shall give Landlord ____ days' prior written notice thereof (Tenant's Notice), which shall (a) state that Tenant intends to Transfer the Lease as of a specific date (Transfer Date); (b) identify the proposed transferee; (c) set forth all material terms and conditions of the proposed Transfer; (d) provide a description of the proposed use of the Premises by the proposed transferee, including any required or desired**

alterations or improvements of the Premises that may be undertaken by such transferee to facilitate its proposed use; (e) be accompanied by certified financial statements of the proposed transferee or such other documentation or information relating to the financial strength and creditworthiness of the proposed transferee; (f) be accompanied by similar information for any guarantor or other person who will be liable in any manner for the payment of any amounts under the Lease; and (g) be accompanied by any other information, documentation, or evidence that may be reasonably requested and accepted by Landlord. Landlord will exercise its reasonable consent in conjunction with Landlord's evaluation of the contents of the Tenant's Notice, and Landlord's reasonable disapproval thereof shall constitute reasonable grounds for disapproval of the Transfer. Tenant shall pay to Landlord the costs of processing any proposed Transfer, whether the proposed Transfer is consummated. If Landlord consents to a proposed Transfer, Tenant shall pay to Landlord ____ percent of all amounts payable by the transferee to Tenant in excess of the Rent payable hereunder after deducting from the costs incurred by Tenant with such Transfer, including brokers' fees, rent, abatement, tenant improvements, and attorneys' fees, if any. Any Transfer other than as permitted in this §12.1 shall be null and void. Notwithstanding the above, acceptance of any payment of rent and other charges by Landlord from any party other than Tenant named herein shall not be deemed a consent to a Transfer or a waiver of any of Landlord's rights with any proposed Transfer hereunder.

12.2 ***Change in Business Entity.*** **If Tenant is a corporation that is not publicly traded through an exchange or through "over the counter" trading or is a partnership, trust, limited liability partnership, limited liability company, or any other form of business entity or association (collectively "Business Entity"), each of the following shall be deemed an assignment of this Lease for purposes of this Article 12: (a) sale, assignment, or other transfer, voluntarily, involuntarily, or by operation of law, of ____ percent or more, in the aggregate, during any ____-month period, of the capital stock, partnership interests, memberships, interests, or any other form of beneficial interest in such Business Entity; (b) change in voting control of the Business Entity; or (c) dissolution, merger, consolidation, or reorganization of Tenant.**

12.3 ***Permitted Transfers.*** **Notwithstanding anything to the contrary in this Article 12, Tenant shall have the right, without Landlord's consent, to assign the Lease to any parent, affiliate, or subsidiary corporation, provided that within ____ days after the effective date of any such transfer the Transferee executes and delivers to Landlord an instrument containing an express assumption of all of Tenant's obligations under this Lease, such Transferee continues to operate the Premises as required under this Lease, and such Transferee has a net worth sufficient to operate the business and perform its obligations under this Lease.**

12.4 ***No Release of Tenant.*** **Should Tenant make a Transfer as permitted in this Article 12, Tenant shall nevertheless remain primarily liable to Landlord for full payment of the Rent and other charges and full performance of Tenant's other obligations under this Lease. No consent by Landlord to any modification, amendment, or termination of this Lease or extension, waiver, or modification of payment or performance of any obligation under this Lease shall affect the continuing liability of Tenant for its obligations and liabilities hereunder, and Tenant waives any defense arising out of or based thereon. With respect to**

any Transfer permitted in this Article 12, such Transfer shall not be valid or effective unless and until Tenant delivers to Landlord a copy of a written agreement in form and substance satisfactory to Landlord pursuant to which, in the case of an assignment, the assignee assumes all of the obligations and liabilities of the Tenant under this Lease, and, in the case of any other Transfer, the transferee agrees that such Transfer shall be subject to all of the covenants, terms, and conditions of this Lease. Landlord may proceed directly against Tenant without first exhausting any remedies for default that Landlord may have against the assignee, subtenant, or transferee of Tenant.

12.5 ***Guaranty.*** **Any guaranty of Tenant's performance executed as consideration for this Lease shall remain in full force and effect before and after any Transfer; provided, however, that Landlord may, at its option, require each guarantor under any outstanding guaranty of this Lease to reaffirm such guaranty as a condition to giving its consent to any Transfer. Landlord may require Tenant, and Tenant agrees, to execute a guaranty of this Lease before Landlord consents to any assignment of this Lease.**

13. DEFAULTS, REMEDIES.

13.1 ***Tenant's Default.*** **Tenant shall be in default in the event of any of the following: (a) if Tenant fails to make any payment of Rent, Additional Rent, or any other sum or amount payable hereunder and such failure shall continue for ____ days after written notice by Landlord; (b) if Tenant fails to perform any other obligation to be performed by Tenant hereunder and such failure shall continue for ____ days after written notice by Landlord; provided, however, if the nature of such default is such that the same cannot reasonably be cured within a ____-day period, then Tenant shall not be deemed to be in default if it shall commence such cure within such ____-day period and thereafter rectify and cure such default with due diligence; (c) if Tenant abandons or vacates the Premises; (d) if Tenant files a petition or institutes any proceedings under the Bankruptcy Code; (e) if Tenant fails to comply with the Minimum Business Hours requirements or ceases to conduct business; (f) if any guarantor of Tenant's obligations hereunder under any guaranty of this Lease is in default; (g) if any such proceeding of similar kind or character is filed against Tenant; or (h) if Tenant is in monetary default ____ times in any ____-month period. Any notice given by Landlord pursuant to clauses (a) or (b) of this §13.1 shall be in lieu of, and not in addition to, any notice required under the forcible entry and detainer provisions of Article IX of the Code of Civil Procedure, 735 ILCS 5/9-101,** ***et seq.*** **(Forcible Entry and Detainer Statute), or of any similar superseding statute. When this Lease requires service of a notice, that notice shall replace rather than supplement any equivalent or similar statutory notice, including any notices required by the Forcible Entry and Detainer Statute or any similar or successor statute.**

13.2 ***Remedies in Default.***

13.2.1 In the event of a default by Tenant, Landlord, in addition to any other remedies available to it at law or in equity, including injunction, at its option, without further notice or demand of any kind to Tenant or any other person, may (a) terminate this Lease and Tenant's right to possession of the Premises and recover possession of the Premises and remove all

persons therefrom; (b) have the remedies available at law or in equity (Landlord may continue the Lease in effect after Tenant's breach and abandonment and recover Rent as it becomes due, if Tenant has the right to sublet or assign, subject only to reasonable limitations); or (c) even though it may have reentered the Premises, thereafter elect to terminate this Lease and all of the rights of Tenant in or to the Premises.

13.2.2 Tenant's right to possession shall not be deemed to have been terminated by efforts of Landlord to relet the Premises, by its acts of maintenance or preservation with respect to the Premises, including its entry on the Premises, appointment of a receiver to protect Landlord's interests hereunder, or by any action, in unlawful detainer or otherwise, to obtain possession of the Premises, unless Landlord shall have notified Tenant in writing that Landlord has so elected to terminate this Lease. In the event of any entry or taking possession of the Premises as aforesaid, Landlord shall have the right, but not the obligation, to (a) remove therefrom all or any part of the personal property located therein and place the same in storage at the expense and risk of Tenant and/or (b) erect a barricade and partition the Premises at the expense of Tenant.

13.2.3 Should Landlord elect to terminate this Lease pursuant to the provisions of clauses (a) or (c) of §13.2.1 above, Landlord may recover from Tenant as damages the following: (a) the worth at the time of the award of any unpaid Rent and other charges that had been earned at the time of termination; plus (b) the worth at the time of the award of the amount by which the unpaid Rent and other charges that would have been earned after termination until the time of the award exceeds the amount of the loss of such Rent and other charges that Tenant proves could have been reasonably avoided; plus (c) the worth at the time of the award of the amount by which the unpaid Rent and other charges for the balance of the Lease Term after the time of the award exceeds the amount of the loss of such Rent and other charges that Tenant proves could have been reasonably avoided; plus (d) any other amount necessary to compensate Landlord for all of the detriment proximately caused by Tenant's failure to perform its obligations under this Lease or that in the ordinary course of things would be likely to result therefrom.

13.2.4 As used in clauses (a) and (c) of §13.2.3 above, the worth at the time of the award shall be computed by allowing interest at the interest rate specified in Article 19. As used in clause (c) of §13.2.3 above, the worth at the time of the award shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of Chicago at the time of award, plus ____ percent.

13.2.5 If Landlord shall elect to relet, rentals received by Landlord from such reletting shall be applied first to the payment of any indebtedness (other than Rent) due hereunder from Tenant to Landlord; second, to the payment of any cost of such reletting (including brokerage commissions); third, to the payment of the cost of any alterations and repairs to the Premises required to relet the Premises; fourth, to the payment of Rent due and unpaid hereunder; and the residue, if any, shall be held by Landlord and applied in payment of future Rent as the same may become due and payable hereunder. Should reletting, during any month to which such Rent is applied, result in the actual payment of rentals at less than the Rent payable during that month by Tenant hereunder, then Tenant shall pay such

deficiency to Landlord immediately upon demand therefor by Landlord. Such deficiency shall be calculated and paid monthly. Tenant shall also pay to Landlord, as soon as ascertained, any costs and expenses incurred by Landlord in such reletting or in making such alterations and repairs not covered by the rentals received from such reletting.

13.2.6 Tenant hereby waives for Tenant and for all those claiming under Tenant all right, now or hereafter existing, to redeem by order or judgment of any court or by any legal process or writ Tenant's right of occupancy of the Premises after any termination of this Lease.

13.3 ***Default by Landlord.*** **Landlord's failure to perform any of the terms, covenants, conditions, agreements, or provisions of this Lease required to be done by Landlord, within ____ days after written notice by Tenant to Landlord of said failure, shall be deemed a default by Landlord (except that when the nature of Landlord's obligation is such that more than ____ days are reasonably required for its performance, then Landlord shall not be deemed in default if it commences performance within the ____-day period and thereafter diligently pursues the cure to completion). Tenant's sole remedy for breach of this Lease by Landlord shall be an action at law for damages, injunction, specific performance, or termination of this Lease. Except as otherwise specifically provided in this Lease, Tenant shall have no right to terminate this Lease on account of any breach or default by Landlord, unless termination is granted by a court of competent jurisdiction. In no event shall Landlord be liable for consequential damages, nor shall Tenant be excused from the payment of Rent due hereunder as a result of any default by Landlord.**

14. DESTRUCTION.

14.1 ***Landlord's Option to Terminate.*** **In the event of (a) damage to the Premises or Shopping Center caused by an uninsured casualty (or the amount of damage exceeds the applicable insurance coverage(s) available for repair of the damage by more than $_____); (b) a casualty causing damage to the Premises or Shopping Center that cannot be repaired within ____ days from the date of damage or destruction under the laws and regulations of the state, federal, county, and municipal authorities or other authorities with jurisdiction; or (c) a casualty occurring during the last ____ years of the Lease Term (subject to §14.4 below), either Landlord or Tenant may terminate this Lease at the date of the damage upon written notice to the other party given within ____ days following the date of the casualty.**

14.2 ***Repairs; Rental Abatement.*** **In the event of an insured casualty that may be repaired within ____ days from the date of the damage or, in the alternative, in the event that Landlord or Tenant does not elect to terminate this Lease under the terms of §14.1 above, then this Lease shall continue in full force and effect and the Premises shall be reconstructed with the obligations of the parties being as set forth in §14.3 below. Such partial destruction shall in no way annul or void this Lease, except that Tenant shall be entitled to a proportionate reduction of Minimum Rent following the casualty until the time the Premises are restored. Such reduction shall be an amount that reflects the degree of interference with Tenant's business. As long as Tenant conducts its business in the Premises, there shall be no abatement until the parties agree on the amount thereof.**

14.3 ***Limitation on Repairs.*** **In the event of any reconstruction of the Premises under this Article 14, Landlord's obligation to reconstruct the Premises shall be, to the extent reasonably practicable and to the extent of available proceeds, to restore the Premises to the condition in which they were delivered to Tenant. Landlord's repair obligations shall in no way include any construction obligations originally imposed on Tenant or subsequently undertaken by Tenant.**

14.4 ***Waiver of Tenant's Rights of Termination.*** **Tenant hereby waives all statutory or common-law rights of termination in respect to any partial destruction or casualty that Landlord is obligated to repair or may elect to repair under the terms of this Article.**

14.5 ***Shopping Center Damage.*** **If the Shopping Center is destroyed to the extent of not less than ____ percent of the replacement cost thereof, Landlord may elect to terminate this Lease, whether the Premises be injured or not, in the same manner as in §14.1 above. At all events, a total destruction of the Shopping Center or the Premises shall, at Landlord's option, terminate this Lease.**

15. CONDEMNATION.

15.1 ***Taking.*** **If any portion of the building that contains the Premises (Building) or the Common Area shall be taken under any right of eminent domain, or any transfer in lieu thereof, and such taking renders the Premises unsuitable, in the reasonable judgment of Landlord, for Tenant's business operations, then Tenant or Landlord may terminate this Lease by giving written notice to the other within ____ days after such taking. If this Lease is not so terminated, Landlord shall repair and restore the Building and/or the Shopping Center, as the case may be, as practicable (but shall not be required to expend more than the amount of the award received by Landlord for such purpose), and this Lease shall continue in full force and effect, but commencing with the date on which Tenant is deprived of the use of any portion of the Premises, the Minimum Rent shall be proportionately abated to the extent to which Tenant's use of the Premises is impaired, as reasonably determined by Landlord, and Tenant's Pro Rata Share shall be recalculated pursuant to the terms of Article 4 hereof.**

15.2 ***Award.*** **Any and all awards payable by the condemning authority or other governmental agency with a taking under the right of eminent domain shall be the sole property of Landlord. Notwithstanding the foregoing, Tenant shall be entitled to make a separate claim to the condemning authority for the value of merchandise and fixtures purchased and installed by Tenant, if applicable.**

16. ADVERTISING, SIGNS, AND DISPLAYS. Tenant shall not erect or install in, on, or about the Premises any exterior or interior signs or advertising media or window or door lettering or placards without Landlord's consent, which may be withheld in Landlord's sole discretion. All such signs shall comply with all applicable laws, ordinances, rules, and regulations and the Shopping Center's sign criteria attached hereto as Exhibit F. Tenant shall not use any advertising media that can be heard or seen outside the Premises, such as loudspeakers or radio broadcasts. Tenant shall maintain the sign installed hereunder in good

condition during the term of this Lease. Upon expiration of this Lease, Tenant shall promptly remove all signs installed hereunder, "cap off" the electrical wiring thereto, and repair all damage caused thereby. Notwithstanding anything contained hereinabove to the contrary, Tenant shall have the right to construct a sign on the Premises' rear wall, provided that such signage is otherwise in compliance with the terms of this Lease.

17. COMPLIANCE WITH LAWS.

17.1 ***Laws Generally.*** **Tenant, at its sole cost and expense, shall comply with all existing and future laws, ordinances, orders, rules, regulations, and requirements of all governmental and quasi-governmental authorities (including the Americans with Disabilities Act and any amendments thereto) having jurisdiction over the Premises and shall perform all work required to comply therewith. If any such work would involve changes to the structure, exterior, or mechanical, electrical, or plumbing systems of the Building, then such work shall be performed by Landlord, and Tenant shall reimburse Landlord the cost thereof within ____ days after receipt of billing.**

17.2 ***Compliance with Environmental Laws.***

17.2.1 Tenant shall not cause or permit any Hazardous Materials (as defined below) to be brought, stored, used, handled, transported, generated, released, or disposed of, on, in, under, or about the Premises, the Common Areas, or any portion of the Shopping Center by Tenant or any Tenant Parties; provided Tenant shall have the right to maintain on the Premises such Hazardous Materials as are reasonably necessary for the conduct of Tenant's business and the proper maintenance of the Premises as long as such Hazardous Materials are used and stored in compliance with all federal, state, and local laws, statutes, ordinances, orders, rules, regulations, and requirements (Requirements) of all governmental and quasi-governmental authorities (Authorities) with jurisdiction and all regulations relating to Hazardous Materials. At all times and in all respects, Tenant and Tenant Parties shall comply with all Requirements. As used in this Lease, "Hazardous Materials" shall mean any hazardous, toxic, or radioactive substance, material, matter, or waste that is or becomes regulated by any Environmental Regulation and shall include asbestos, petroleum products, radon gas, polychlorinated biphenyls (PCBs), and all substances classified under the terms "Hazardous Substance" and "Hazardous Waste" as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) as amended, 42 U.S.C. §9601, *et seq.;* the Resource Conservation and Recovery Act of 1976 (RCRA) as amended, 42 U.S.C. §6901, *et seq.;* and all environmental protection statutes of the state and municipality in which the Premises are located.

17.2.2 If at any time during or after the Lease Term Hazardous Materials are found to exist in or on the Premises (including the soils and underground water) or to have contaminated the soils, air, or underground water of the Premises, then at Landlord's option either (a) Tenant, at its sole cost and expense, shall promptly remove such Hazardous Materials and take all such remedial action required by all Requirements of all Authorities or (b) Landlord can undertake the foregoing work, and Tenant shall reimburse Landlord for the actual cost thereof, plus an administrative fee of ____ percent, within ____ days after

Landlord's presentation of an invoice to Tenant therefor. Notwithstanding the foregoing, Landlord, at its sole cost and expense, shall arrange for the necessary removal and/or remediation if Tenant can prove that the Hazardous Materials were present in or on the Premises before the date of this Lease and that such removal and/or remediation was not necessitated by any work or any other activity performed by Tenant.

17.2.3 Tenant shall indemnify, defend, protect, and hold Landlord and each Landlord Party free and harmless from and against any and all claims, liabilities, penalties, forfeitures, losses, and expenses (including attorneys' fees), arising from or caused in whole or in part, directly or indirectly, by the failure of Tenant or any Tenant Party to comply with the terms of this Article 17 or the use, analysis, storage, transportation, disposal, release, threatened release, discharge, or generation by Tenant or any Tenant Party of Hazardous Materials to, in, on, under, about, or from the Premises or any portion of the Shopping Center including, without limitation, any buildings located thereon. The terms of the indemnification by Tenant set forth in this §17.2.3 shall survive the expiration or earlier termination of this Lease.

18. HOLDING OVER. If Tenant, with Landlord's consent, remains in possession of the Premises after the expiration or sooner termination of the Lease Term, such possession by Tenant shall be deemed to be a month-to-month tenancy, terminable upon ____ days' prior written notice given at any time by either party. All provisions of this Lease shall apply to the month-to-month tenancy, except those specifying the Lease Term, options to extend, and Monthly Minimum Rent, which shall be equal to ____ percent of the Monthly Minimum Rent paid in the month immediately preceding the month-to-month tenancy. Neither any provision hereof nor acceptance by Landlord of Rent (or partial payment of Rent) after such expiration or earlier termination without Landlord's written consent shall be deemed a consent to a holdover hereunder or result in a renewal of this Lease or an extension of the Term or a waiver of any of Landlord's rights or remedies with respect to such holdover. Notwithstanding any provision to the contrary contained herein, (a) Landlord expressly reserves the right to require Tenant to surrender possession of the Premises upon the expiration of the Term of this Lease or upon the earlier termination hereof or at any time during any holdover, the right to reenter the Premises and the right to assert any remedy at law or in equity to evict Tenant and collect damages with any such holding over and (b) Tenant shall indemnify, defend, and hold Landlord harmless from and against any and all claims, demands, actions, losses, damages, liabilities, obligations, costs, and expenses, including, without limitation, attorneys' fees, consultants' fees, and court costs incurred or suffered by or asserted against Landlord by reason of Tenant's failure to surrender the Premises upon the expiration or earlier termination of this Lease in accordance with the provisions of this Lease. Landlord shall have no duty whatsoever to notify or remind Tenant of any pending expiration of this Lease.

19. LATE CHARGE AND INTEREST.

19.1 *Late Charge.* Tenant hereby acknowledges that late payment by Tenant to Landlord of Rent and other sums due hereunder will cause Landlord to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Accordingly, if any installment of Rent or other sum due from Tenant shall not be received by Landlord's designee on the date such Rent or other sums are due Landlord, Tenant shall

pay to Landlord a late charge equal to ____ percent of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Landlord will incur by reason of late payment by Tenant. In addition, Tenant shall pay to Landlord any attorneys' fees and expenses incurred by Landlord by reason of Tenant's failure to pay Rent and/or other charges when due hereunder.

19.2 ***Interest.*** **Any sum due and payable to Landlord under the terms of this Lease that is not paid when due shall bear interest from the date when the same becomes due and payable by the provisions hereof until paid at a per annum interest rate equal to the lesser of (a) ____ percent per annum or (b) the maximum rate allowed by applicable usury law.**

20. QUIET ENJOYMENT. As long as Tenant is not in default hereunder, then, subject to the other terms and conditions of this Lease, Tenant shall not incur any manner of hindrance or interference with its quiet enjoyment, possession, and use from Landlord, subject to the provisions of this Lease and to the provisions of any (a) easements, licenses, covenants, conditions, and restrictions of record, including without limitation, any and all reciprocal easement agreements, development agreements (including the OEA), declarations of covenants, conditions, and restrictions of record, as the same may be amended or modified from time to time, and (b) any mortgage, ground lease or other lien, or restriction of record to which this Lease is subordinate or may be subordinated (collectively "Superior Encumbrances"). In any case, pursuant to the provisions of §27.1 below, this Lease shall be subordinate to each of the Superior Encumbrances, and Tenant agrees for itself and all persons in possession or holding under it that it and they will comply with and not violate each such Superior Encumbrance. Landlord reserves the right, from time to time, to grant such new or additional easements, rights, and dedications as Landlord deems necessary or desirable and to cause the recordation of parcel maps and covenants, conditions, and restrictions affecting the Premises and/or Shopping Center. At Landlord's request, Tenant shall join in the execution of any of the aforementioned documents.

21. RIGHT OF ENTRY. Landlord and its authorized representatives shall have the right to enter the Premises at all reasonable times upon reasonable notice to make repairs or alterations to the systems serving the Premises or for any other purpose without diminution or abatement of Rent. During the last ____ days of the Lease Term, Landlord shall have the right to show the Premises to prospective tenants upon reasonable notice to Tenant, and Landlord reserves the right to place a "For Lease" sign on the outside of the Premises.

22. WAIVERS. No delay or omission in the exercise of any right or remedy of Landlord with respect to any default by Tenant shall impair such right or remedy or be construed as a waiver. No waiver of any of the terms, provisions, covenants, conditions, rules, and regulations shall be valid unless it shall be in writing signed by Landlord. The receipt and acceptance by Landlord of delinquent Rent or other payments due hereunder shall not constitute a waiver of any other default. Landlord's consent or approval shall not be deemed to render unnecessary the obtaining of Landlord's consent to or approval of any subsequent act by Tenant whether or not similar to the act so consented to or approved.

23. TRANSFER OF LANDLORD'S INTEREST. If Landlord conveys in a sale, exchange, or otherwise all of its interest in the Premises, then Landlord, on consummation of the conveyance, shall thereupon automatically be released from any obligation or liability thereafter accruing under this Lease.

24. ESTOPPEL CERTIFICATES.

24.1 Tenant shall, within ____ business days after notice from Landlord, execute and deliver to Landlord an Estoppel Certificate as Landlord may reasonably require. Failure to deliver the certificate within said ____-business-day period shall be a default under this Lease and an acknowledgment that (a) this Lease is in full force and effect and has not been modified except as represented by Landlord; (b) there are no uncured defaults in Landlord's performance hereunder; (c) not more than [one month's**] Minimum Monthly Rent has been paid in advance; and (d) there is no Security Deposit except as represented by Landlord. Tenant agrees that the foregoing Estoppel Certificate may be relied on by anyone holding or proposing to acquire any interest in the Shopping Center from or through Landlord or by any mortgagee or prospective mortgagee of the Shopping Center or of any interest therein, and, if the prospective lender or purchaser is an institutional entity, the standard form estoppel provided by such entity shall be used instead and may also be relied on by the applicable parties.**

24.2 Upon the request of Landlord, Tenant shall deliver to Landlord or any potential lender or purchaser designated by Landlord such financial statements of Tenant as may be reasonably required by Landlord or such lender or purchaser, including but not limited to Tenant's financial statements for the past ____ years. All such financial statements shall be received by Landlord and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

25. ATTORNEYS' FEES. If either party hereto brings an action at law or in equity to enforce, interpret, or seek redress for the breach of this Lease, then the prevailing party in such action shall be entitled to recover all court costs, witness fees, and reasonable attorneys' fees, at trial or on appeal, in addition to all other appropriate relief.

26. REAL ESTATE BROKER; FINDERS. Except for a separate agreement between Landlord and Tenant's broker, _____, pursuant to which Landlord will pay _____ fees with this Lease, each party represents that it has not had dealings with any real estate broker, finder, or other person with respect to this Lease in any manner. Each party shall indemnify, defend, protect, and hold the other party harmless from and against all claims, costs, demands, action, liabilities, losses, and expenses (including the reasonable attorneys' fees of counsel chosen by the other party) arising out of or resulting from any claims that may be asserted against such other party by any broker, finder, or other person with whom the party bearing the indemnity obligation has or purportedly has dealt, other than any party referenced in this Article 26.

27. SUBORDINATION AND ATTORNMENT.

27.1 ***Subordination.*** **This Lease and all of Tenant's rights and interests in the leasehold estate hereunder shall be subject and subordinate to any mortgages or deeds of trust that now encumber or may hereafter be placed on the Premises and to the rights of the mortgagees or beneficiaries thereunder, any and all advances made or to be made thereunder, the interest thereon and all modifications, renewals, replacements, and extensions thereof. Landlord reserves the right, from time to time, to grant such new or additional mortgages or deeds of trust as Landlord deems necessary or desirable. At Landlord's request, Tenant shall join in the execution of any of the aforementioned documents. If any such mortgagee or beneficiary so elects in writing, then this Lease shall be superior to the lien of the mortgage or deed of trust held by such mortgagee or beneficiary, whether this Lease is dated or recorded before or after such mortgage or trust deed. Any such mortgagee or beneficiary may make such election by executing and recording in the appropriate office of the county where the Premises are situated a notice reciting that this Lease shall be superior to the lien of the mortgage or deed of trust of such mortgagee or beneficiary. From and after the recordation of such notice, this Lease shall be superior to the lien of said mortgage or deed of trust and shall not be extinguished by a foreclosure thereof or any sale thereunder. Upon request, Tenant shall promptly execute and deliver to Landlord, or any such mortgagee or beneficiary, any documents or instruments required by any of them to evidence subordination of this Lease hereunder or to make this Lease prior to the lien of any mortgage or deed of trust as herein specified. Such document shall be in such form as such mortgagee or beneficiary may require; provided, however, that Tenant's agreement to subordinate this Lease under such other document may be conditioned on such document's containing commercially reasonable terms and conditions. If Tenant fails or refuses to do so within ____ business days after written request therefor by Landlord or such mortgagee or beneficiary, such failure or refusal shall constitute an event of default hereunder by Tenant but shall in no way affect the validity or enforceability of the subordination to or by the mortgage or deed of trust held by such mortgagee or beneficiary.**

27.2 ***Attornment by Tenant.*** **Upon enforcement of any rights or remedies under any mortgage or deed of trust to which this Lease is subordinated, Tenant shall, at the election of the purchaser or transferee under such right or remedy, attorn to and recognize such purchaser or transferee as Tenant's landlord under this Lease without any deduction or setoff whatsoever. Tenant shall execute and deliver any document or instrument required by such purchaser or transferee confirming the attornment hereunder.**

28. LIMITATION ON LIABILITY. In consideration of the benefits accruing hereunder, Tenant, on behalf of itself and all successors and assigns of Tenant, covenants and agrees that, in the event of any actual or alleged failure, breach, or default hereunder by Landlord, (a) the sole and exclusive remedy shall be against Landlord's interest in the Shopping Center; (b) no partner or member of Landlord shall be sued or named as a party in any suit or action (except as may be necessary to secure jurisdiction of the partnership); and (c) the obligations under this Lease do not constitute personal obligations of the members, partners, directors, officers, employees, or shareholders of Landlord, and Tenant shall not seek recourse against members, partners, directors, officers, employees, or shareholders of Landlord or any of their personal assets for satisfaction in any liability in respect to this Lease.

29. NO ACCORD AND SATISFACTION. No payment by Tenant, or receipt by Landlord, of a lesser amount than the Rent or other payment herein provided shall be deemed to be other than on account of the earliest Rent or other payment due and payable hereunder, nor shall any endorsement or statement on any check, or letter accompanying any check or payment, as Rent or other payment be deemed an accord and satisfaction. Landlord may accept any such check or payment without prejudice to Landlord's right to recover the balance of such Rent or other payment or pursue any other right or remedy provided in this Lease.

30. NOTICES. Every notice, demand, or request (collectively "Notice") required hereunder or by law to be given by either party to the other shall be in writing and shall be served on the parties at the addresses set forth below the signatures of the parties or such other address as the party to be served may from time to time designate in a Notice to the other party. Any such Notices shall be sent either by (a) United States certified or registered mail, postage prepaid, return receipt requested; (b) overnight delivery using a nationally recognized overnight courier, which shall provide evidence of delivery upon sender's request; (c) personal delivery; or (d) facsimile transmission, in which case Notice shall be deemed delivered upon receipt of confirmation of such facsimile transmission of such Notice (provided a follow-up Notice is (i) mailed by certified or registered United States mail, postage prepaid, return receipt requested; (ii) delivered by overnight courier delivery; or (iii) delivered by personal delivery within ____ business day(s) thereafter). All notices given in the manner specified herein shall be effective upon the earliest to occur of actual receipt, the date of inability to deliver to the intended recipient as evidenced by the United States Postal Service or courier receipt, or the date of refusal by the intended recipient to accept delivery as evidenced by the United States Postal Service or courier.

31. AUTHORITY AND LIABILITY OF TENANT. If Tenant is a corporation or a limited liability company, each individual executing this Lease on behalf of Tenant hereby covenants and warrants that Tenant is a duly authorized and existing corporation or limited liability company, as the case may be, that Tenant has and is qualified to do business in the State of Illinois, that Tenant has full right of power and authority to enter into this Lease, and that each person signing on behalf of the corporation or limited liability company, as the case may be, is authorized to do so in accordance with the terms of such entity's articles or certificate of incorporation, bylaws, or other organizational documents. If Tenant is a partnership or trust, each individual executing this Lease on behalf of Tenant hereby covenants and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of Tenant in accordance with the terms of such entity's partnership or trust agreement. Tenant shall provide Landlord on demand with such evidence of such authority as Landlord shall reasonably request.

32. MISCELLANEOUS.

32.1 *Cumulative Remedies.* No remedy herein conferred on or reserved to Landlord is intended to be exclusive of any other remedy herein or by law provided, but each shall be cumulative and shall be in addition to every other remedy given hereunder or now hereafter existing at law or in equity by statute.

32.2 ***Waiver of Trial by Jury.*** **Landlord and Tenant desire and intend that any disputes arising between them with respect to or with this Lease be subject to expeditious resolution in a court trial without a jury. Therefore, Landlord and Tenant each hereby waive the right to trial by jury of any cause of action, claim, counterclaim, or cross-complaint in any action, proceeding, or other hearing brought by either Landlord against Tenant or Tenant against Landlord or any matter whatsoever arising out of, or in any way connected with, this Lease, the relationship of Landlord and Tenant, Tenant's use or occupancy of the Premises, or any claim of injury or damage, or the enforcement of any remedy under any law, statute, or regulation, emergency or otherwise, now or hereafter in effect.**

32.3 ***Severability.*** **The unenforceability, invalidity, or illegality of any provision of this Lease shall not render the other provisions unenforceable, invalid, or illegal.**

32.4 ***Governing Laws.*** **The laws of the State of Illinois shall govern the validity, performance, and enforcement of this Lease. No conflict-of-law rules of any state or country (including, without limitation, Illinois conflict-of-law rules) shall be applied to result in the application of any substantive or procedural laws of any state or country other than Illinois. All controversies, claims, actions, or causes of action arising between the parties hereto and their respective successors and assigns shall be brought, heard, and adjudicated by the courts of the State of Illinois, with venue in _____ County.**

32.5 ***Force Majeure.*** **If, by reason of any event of force majeure, either party to this Lease is prevented, delayed, or stopped from performing any act that such party is required to perform under this Lease other than the payment of Rent or other sums due hereunder, the deadline for performance of such act by the party obligated to perform shall be extended for a period of time equal to the period of prevention, delay, or stoppage resulting from the force majeure event, unless this Lease specifies that force majeure is not applicable to the particular obligation. As used in this Lease, the term "force majeure" shall include, but not be limited to, fire or other casualty; bad weather; inability to secure materials; strikes or labor disputes (over which the obligated party has no direct or indirect bearing in the resolution thereof, or if said party does have such bearing, said dispute occurs despite said party's good-faith efforts to resolve the same); acts of God; acts of the public enemy or other hostile governmental action; civil commotion; terrorist acts; governmental restrictions, regulations, or controls; judicial orders; governmentally ordered restrictions or shutdowns due to epidemic, pandemic, or other national, state, or municipal health emergency (including, by way of example and not limitation, COVID-19); and/or other events over which the party obligated to perform (or its contractor or subcontractors) has no control.**

32.6 ***Successors and Assigns.*** **Subject to the provisions of Article 12 regarding assignment and subletting, all of the provisions, terms, covenants, and conditions of this Lease shall be binding on and inure to the benefit of the parties and their respective heirs, executors, administrators, successors, and assigns.**

32.7 ***Relationship.*** **Nothing contained in the Lease shall be deemed or construed by the parties or by any third person to create the relationship of principal and agent, of partnership, of joint venture, or of any association between Landlord and Tenant.**

32.8 ***Entire Agreement; Modification.*** **This Lease and all exhibits and/or addendums and/or riders, if any, attached to this Lease are hereby made a part of this Lease, with full force and effect as if set forth herein. This Lease supersedes all prior agreements between the parties and sets forth all the covenants, promises, agreements, conditions, and understandings between Landlord and Tenant concerning the Premises, and there are no actual or implied covenants, promises, agreements, conditions, or understandings, either oral or written, between them other than as are set forth herein and none thereof shall be used to interpret, construe, supplement, or contradict this Lease. No alteration, amendment, change, or addition to this Lease shall be binding on Landlord or Tenant unless reduced to writing and signed by each party.**

32.9 ***Time of Essence.*** **Time is of the essence with respect to the performance of every provision of this Lease in which time performance is specified. If Tenant elects to dispute any billing or reconciliation from Landlord, Tenant must do so within 180 days after Tenant's receipt of such billing or reconciliation or Tenant shall be deemed to have waived all rights to so dispute the same.**

32.10 ***Survival of Obligations.*** **All obligations of Tenant accrued as of the date of acceptance or rejection of this Lease due to the bankruptcy of Tenant, and those accrued as of the date of termination or expiration of this Lease for any reason whatsoever, shall survive such acceptance, rejection, termination, or expiration.**

32.11 ***Memorandum of Lease.*** **Tenant shall not record this Lease. In addition, without the prior written consent of Landlord, which consent Landlord may withhold in its sole and absolute discretion, Tenant shall not record any memorandum of this Lease, short form, or other reference to this Lease.**

32.12 ***Lease Guaranty.*** **Tenant acknowledges that the Guaranty attached hereto as Exhibit G and incorporated herein by reference is a material inducement to the execution of this Lease by Landlord and that if the guarantor fails to perform or otherwise breaches any provision of the guaranty, or if the guarantor is prevented from performing its obligations under the guaranty for any reason, including operation of law, then the same shall constitute a failure of the consideration for the Lease, and the Lease shall be voidable at any time thereafter during the Term at Landlord's sole option.**

IN WITNESS WHEREOF, the parties hereto have executed this Lease as of the date first written above.

LANDLORD:

Address of Landlord

TENANT:

Address of Tenant

EXHIBIT A
DEPICTION OF PREMISES

[insert description of premises]

EXHIBIT B
CONSTRUCTION OBLIGATIONS

1. LANDLORD'S WORK

1.1 Prior to execution of this Lease, Tenant has inspected and is aware of the present condition of the Premises and the Shopping Center. Landlord shall have no obligation with respect to construction within or about the Premises or the Shopping Center, except for the following improvements and/or modifications (referred to in this §1 of Exhibit B as "Landlord's Work"):

New Space:

1. All stud walls to receive gypsum board.

2. Concrete block walls, if any, to be painted.

3. Finished ceiling to be acoustical type as specified by Landlord, unless otherwise specified by Landlord for work areas, toilet rooms, and storage rooms.

4. Interior finishes shall be per Landlord's specifications.

5. Floor to be smooth finish concrete suitable to accept tile floor covering provided by Tenant, except for toilets which shall be vinyl asbestos tile or sheet vinyl.

6. Storefront per Landlord's design, including specific front door locations. Size and location of rear door, if applicable, per Landlord's specifications.

7. HVAC per Landlord's specifications.

8. ____ toilet complete with lavatory and wash sink to be located toward the rear of space in an area designated by Landlord.

9. All shops shall be roughed in only for wall-mounted ____-gallon electrical water heater in toilet room unless otherwise indicated by Landlord.

10. All stores to be provided with a separate electrical meter, ____-AMP single-phase service, and panel per Landlord's specifications unless other specified by Landlord.

11. Fluorescent light fixtures, without lamps, per Landlord's layout.

12. Ceiling per Landlord's specifications, with ____-foot minimum height above finish floor.

1.2 Landlord's Work shall be constructed in compliance with all applicable Laws including the Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. §12101, *et seq.,* and any amendments to the ADA. The Premises, including the electrical, plumbing, fire/life safety, HVAC, and mechanical systems, as the same are turned over by Landlord to Tenant upon the Term Commencement Date, shall be in good working order and shall comply with all applicable laws. Landlord shall provide Tenant with one full set of as-built scaled drawings upon the Term Commencement Date.

2. TENANT'S WORK

2.1 Except for Landlord's Work, Tenant, at Tenant's sole expense, shall be responsible for design, plans, approvals, permits, fees, and construction for all work necessary to conduct Tenant's business in the Premises (including but not limited to demolition, plumbing, concrete slab alterations, electrical power and lighting, natural gas piping and connections, hoods, coolers, HVAC systems, interior framing, drywall, upgrades to occupancy separation walls, interior doors, storefront and exterior door alterations, if any, casework, millwork, floor and wall finishes, fixtures, furnishings, equipment, fire sprinkler alterations, life safety systems, fire extinguishers and fire suppression systems, and signage), and such work shall be referred to hereinafter as "Tenant's Work." Tenant shall immediately commence the preparation of plans for Tenant's Work and, upon receipt of Landlord's design approval and permits from governmental agencies, shall diligently prosecute the construction of Tenant's Work to completion.

2.2 *Drawings and Specifications.* Within ____ days after the Effective Date of this Lease, Tenant shall, at Tenant's expense, submit to Landlord ____ sets of fully detailed working drawings covering all aspects of Tenant's Work. As soon as practicable after receipt thereof, Landlord shall notify Tenant in writing either that the plans are "Approved as Submitted," "Approved Subject to Comments," or "Disapproved," with requirements for changes and/or submittal of supplementary information. Within ____ days of receipt after such disapproval, Tenant shall submit to Landlord three sets of corrected and/or supplemented drawings for final approval. If approved, Landlord shall return to Tenant one set of drawings, bearing Landlord's written approval; these plans shall be the Final Drawings for Tenant's Work. If not approved, the foregoing process shall repeat. Landlord's approval of any plans does not guarantee code compliance, efficiency, safety, or accuracy, for which Tenant is solely responsible.

2.3 *Signage.* Signage shall be reviewed for approval separately, per Exhibit F of the Lease, and Tenant shall not construe Landlord's approval of Tenant's construction plans as approval of any signage that may appear in such construction plans.

2.4 *Permits and Code Compliance.* Tenant shall make timely applications for all governmental approvals and permits necessary for Tenant's Work, including signage, and shall pay for all governmental and utility fees and charges with all of Tenant's Work,

including but not limited to plan check fees, planning review fees, building permit fees, and utility hook-up fees and sewer connection charges for Tenant's specific use. Tenant's Work shall conform to governmental approvals and permits and all applicable local, state, and federal laws; building, health, and safety codes; ordinances; rules; regulations; and standards. When discrepancies exist among the various regulations and Landlord requirements, the strictest standards shall govern, but changes to the Final Drawings required by governmental agencies shall be subject to Landlord's approval. Tenant shall be solely responsible for obtaining timely inspections and approvals by governing agencies as necessary during construction.

2.5 ***Insurance.*** **Tenant agrees to indemnify and hold harmless Landlord and Landlord's partners, employees, and agents from all liability with Tenant's Work. During performance of Tenant's Work and all fixturization and merchandising activities (and during any subsequent repairs, modifications, alterations, and/or renovations of the Premises), in addition to other insurance required under this Lease, Tenant shall provide, or cause its contractor(s) to provide, insurance as specified in this §2.5 of Exhibit B and such insurance as may from time to time be required by city, county, state, or federal laws, codes, regulations, or authorities, together with such other insurance as is reasonably necessary or appropriate under the circumstances. All insurance policies required under this Exhibit B shall name Landlord, Landlord's agents and beneficiaries, Landlord's on-site representatives, Landlord's architect, and Landlord's general contractor as additional insureds, except for Tenant's Workers' Compensation Insurance, which shall contain an endorsement waiving all rights of subrogation against Landlord, Landlord's property management company and personnel, and Landlord's architect, engineer, contractors, agents, and beneficiaries. All policies shall provide that Landlord be given ____ days' prior written notice of any alteration or termination of coverage.**

2.5.1 ***Worker's Compensation.*** **Tenant shall obtain Workers' Compensation Insurance, as required by state law, and Employers' Liability Insurance with limits of not less than $_____, and any other insurance required by any employee benefit act or other statute applicable when the work is to be performed as will protect the contractor and subcontractors from any and all liability under the aforementioned acts or statutes.**

2.5.2 ***Comprehensive General-Liability Insurance.*** **Tenant shall obtain Commercial General-Liability Insurance (including Contractor's Protective Liability) with a combined single limit (bodily injury and property damage) of not less than $_____ per occurrence. Such insurance shall provide for explosion, collapse, and underground coverage and contractual liability coverage and shall insure the general contractor and/or subcontractors against any and all claims for personal injury, including death resulting therefrom and damage to the property of others and arising from [**his**] [**her**] operations under the contract, whether such operations are performed by the general contractor, subcontractors, or any of their subcontractors, or by anyone directly or indirectly employed by any of them. Such insurance policy shall include (a) a products/completed operations endorsement; (b) endorsements deleting the employee exclusion on personal injury and the liquor liability exclusion; and (c) a cross-liability endorsement or a severability of interest clause. Such insurance shall be primary, and Landlord's Insurance shall be excess insurance only.**

2.5.3 ***Comprehensive Automobile Liability Insurance.*** **Tenant shall obtain Comprehensive Automobile Liability Insurance, including the ownership, maintenance, and operation of any automotive equipment, owned, hired, and non-owned in an amount not less than $_____ combined single limit (bodily injury and property damage) per occurrence. Such insurance shall insure the general contractor and/or subcontractors against any and all claims for bodily injury, including death resulting therefrom and damage to the property of others arising from operations under the contract, whether such operations are performed by the general contractor, subcontractor, or any of their subcontractors, or by anyone directly employed by any of them.**

2.5.4 ***Builder's Risk Insurance — Completed Value Builders Risk Damage Insurance Coverage.*** **Tenant shall provide an "All Physical Loss" Builders Risk insurance policy on the work to be performed for Tenant in the Premises as it relates to the building within which the Premises are located. The policy shall include as insureds Tenant, its contractor and subcontractors, and Landlord, as their respective interests may appear within the Premises and within ____ feet thereof. The amount of insurance to be provided shall be ____-percent replacement cost.**

2.6 ***Prior to Construction.*** **Prior to any operations or construction at the Premises, Tenant must secure Landlord's written approval of the Final Drawings per Article 2 of this Exhibit B. At least ____ working days prior to the commencement of construction, Tenant shall deliver to Landlord the following, which shall be subject to Landlord's approval:**

(a) A list of names, addresses, regular and 24-hour emergency phone numbers, and fax numbers for Tenant's construction representative, the general contractor.

(b) Schedule for Tenant's Work, including starting and completion dates, fixturization periods, merchandising periods, and the projected date for "open for business."

(c) Certificates of Insurance, naming Landlord as an additional insured, both for Tenant (per Lease) and Tenant's contractor(s) (per Exhibit B, §2.5 above).

(d) Photocopies of permit cards for Tenant's Work as issued by governing agencies.

2.7 ***Construction.*** **Tenant's Work shall be performed in a first-class, professional manner in conformity with the approved Final Drawings, except when Landlord has given prior written approval for modifications. Only new, first-quality materials shall be used. The quality of Tenant's Work shall be subject to the approval of Landlord, and Landlord shall make any determination as to whether Tenant's Work conforms to the Final Drawings. Landlord shall be allowed to enter the Premises during construction for inspection, coordination, and emergency purposes. Landlord shall have the right to post and keep posted in the Premises notices of nonresponsibility or other notices that Landlord may deem to be proper for the protection of Landlord's interest in the Premises.**

2.7.1 ***General Contractor.*** **Tenant shall use a licensed general contractor, experienced in commercial construction, possessing good labor relations, and approved by Landlord for the construction of Tenant's Work. Landlord reserves the right to disapprove any contractors to whom Landlord has a reasonable objection.**

2.7.2 ***Disruptive Conduct.*** **Tenant and Tenant's contractor(s) shall plan and execute their work to minimize disruption of the normal business operations of existing tenants and the Shopping Center. This may require special scheduling of disruptive aspects of Tenant's Work at Tenant's sole expense. All of Tenant's Work shall be conducted within the interior of the Premises, to the greatest extent possible, and not in the common area. Tenant shall comply with noise abatement measures required by Landlord, and any nuisance is strictly prohibited.**

2.7.3 ***Safety.*** **All of Tenant's Work must be planned and conducted in an orderly manner, with the highest regard for the safety of the public, workers, and property, and in conformity with all local, Illinois, and federal job safety requirements, including OSHA regulations. All workers shall be properly attired and wear long pants, shirts, and work shoes. At no time will pipes, wires, boards, or other construction materials cross public areas where harm could be caused to the public. If Tenant fails to comply with these requirements, Landlord shall have the right, at Tenant's cost, to cause remedial action as deemed necessary by Landlord to protect the public and the property.**

2.7.4 ***Trash Removal and Cleanup.*** **At all times, Tenant shall keep the Shopping Center clean and free of dirt, dust, stains, trash, etc., related to Tenant's Work. During construction, fixturing, and merchandising, Tenant shall, at Tenant's cost, cause the removal and legal disposal of all trash, debris, packaging, and waste materials from the Premises on a daily basis. Upon Landlord's prior approval, Tenant may place trash disposal bins at locations designated by Landlord. If Tenant fails to provide trash disposal and cleanup per these requirements, Landlord shall have the right to cause the removal of such trash and debris or performance of appropriate cleanup at Tenant's sole cost and expense. Tenant and/or Tenant's contractor(s) shall not use the Shopping Center trash bins or receptacles for construction-related disposal under any circumstances.**

2.7.5 ***Building Shell Alterations.*** **There are to be no alterations or modifications to the Landlord's building shell or any structural element thereof, utilities, fire protection services, or Common Area improvements, without Landlord's prior written consent, which may be withheld in Landlord's sole discretion. If Tenant's Work entails structural changes to the Premises, Tenant shall submit detailed structural plans and calculations for Landlord's review at Tenant's expense, up to $_____. Tenant's Work shall not commence until Landlord has approved all structural modification plans in writing.**

2.7.6 ***Roofing.*** **There shall be no penetrations of the roof or installation of radio or television antennas without the prior written approval of Landlord, which may be withheld in Landlord's sole discretion. All flashing, counterflashing, and roofing repairs shall conform to the requirements of Landlord, and such work shall be paid for by Tenant and performed by a roofing subcontractor approved by Landlord. At Landlord's option, Tenant shall use the same roofing contractor used by Landlord for any roofing work to maintain Landlord's roof guarantee.**

2.7.7 ***Landlord's Right To Perform Work.*** **Landlord shall have the right, but not the obligation, to perform, on behalf of and for the account of Tenant, subject to reimbursement of the cost thereof by Tenant, any and all of Tenant's Work that Landlord determines, in its sole discretion, should be performed immediately and on an emergency basis and/or for the**

best interest of the Shopping Center and public safety, including without limitation work that pertains to structural, mechanical, electrical, sprinkler, and general utility systems and roofing.

2.8 ***Completion.*** **Prior to the store opening for business, Tenant shall deliver to Landlord the following:**

(a) A copy of a permanent Certificate of Occupancy for the Premises, as issued by the governing Building Department.

(b) Copies of Final Unconditional Waivers of Lien Rights for all of Tenant's contractors, subcontractors, and suppliers, in a form acceptable to Landlord, for the full amount of all of Tenant's construction and installations in and to the Premises.

2.9 ***Americans with Disabilities Act of 1990.*** **Notwithstanding anything to the contrary contained in the Lease or this Exhibit B, Tenant shall comply with the Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. §12101, *et seq.,* and any amendments to the ADA, as well as all other applicable Laws regarding access to, employment of, and service to individuals covered by the ADA. Tenant's compliance obligation will include but not be limited to the design, construction, and alteration of the Premises and such other areas (*e.g.,* paths of travel) as Tenant may have to alter to be in compliance with the ADA.**

EXHIBIT C
CONFIRMATION LETTER

[date**]**

Tenant Name
_____
_____
_____

RE: CONFIRMATION LETTER

Tenant

Dear Tenant:

On _____, as Landlord and _____, a _____, as Tenant, entered into a Lease for the above-referenced property. By execution of this letter, the parties acknowledge they have agreed to the following:

1. **Term Commencement Date:**
2. **Term Expiration Date:**
3. **Possession Date:**
4. **Rent Commencement Date:**

EXHIBIT D
MINIMUM RENT SCHEDULE

Date	**Minimum Rent**

EXHIBIT E
RULES AND REGULATIONS

[insert applicable rules and regulations**]**

EXHIBIT F
SIGN CRITERIA

GENERAL PROCEDURES

Within ____ days from Lease signing, Tenant shall cause its sign company to prepare and deliver a complete set of plans and specifications of Tenant's proposed signage to Landlord for its review and approval. Prior to engaging the sign company, Tenant shall supply the sign company with a copy of this Exhibit F and instructions to work within the design parameters noted therein. Upon receipt of plans, Landlord will expeditiously review the same, noting its approval, conditional approval, or required changes on the plans, returning two sets of marked-up plans to the Tenant's sign company. If changes are required, Tenant will resubmit to Landlord for approval.

1. Tenant and its sign company shall have Landlord's prior written approval of all signs before making submittals to the [municipality**] and before commencing the fabrication of the signs.**

2. Tenant's sign company, on behalf of Tenant, shall pay for and obtain all [municipality**] permits and licenses required for installation and maintenance of signage.**

3. Location and spacing of the signs on all buildings shall be at a location that centers on that tenant space, or as approved by Landlord.

4. Letter style and design are encouraged to be in good taste. Logos and graphics will be evaluated on an individual basis.

5. Tenant's choice of letter color shall be subject to final approval by Landlord.

EXHIBIT G
FORM OF GUARANTY

[insert form of guaranty**]**

2 Industrial Warehouse Leases

JOSEPH B. VANFLEET
Howard & Howard Attorneys PLLC
Managing Attorney, Peoria Office
Co-Chair, Lending Institutions Practice Group

The contribution of Ariane M. Janz to the previous edition of this chapter is gratefully acknowledged.

VIII. Assignment and Subletting

A. [2.24] Typical Language
B. [2.25] Different Assignment Consideration from Other Commercial Leases
C. [2.26] Sale of Tenant's Business
D. [2.27] Quasi-Sublease Arrangements

IX. [2.28] Sample Industrial Warehouse Lease

I. [2.1] SCOPE OF TRANSACTIONS DISCUSSED

Industrial building leases, which include leases of buildings for both warehouse and manufacturing purposes, often involve issues that do not customarily arise in other types of commercial leases. The transaction typically provides a longer-term relationship than ordinarily found with commercial leases, a landlord with significantly less contact with the operation of the leased premises, increased wear and tear to the building, possible material impact on neighbors, and significant construction or retrofitting to meet the tenant's intended use of the premises. To the extent possible, landlords seek to transfer to their tenants responsibility for all maintenance and repair and, to the extent feasible, "replacement" of the building and building systems. Landlords typically seek to pass the risk of environmental contamination to the premises arising from any cause during the lease term to their tenants under the theory that the tenant is in complete control of the facility and, hence, its "operator." The tenant's objective is simply to seek an affordable, efficient place for manufacturing, assembly, and/or distribution from a facility that often represents the tenant's primary business location. Therefore, the industrial warehouse lease must be reviewed as a critical component of the tenant's business since it represents not only its primary facility for the next ten to fifteen years but a significant portion of its operating costs. Although the transaction is not a fee acquisition, a tenant needs informed counsel, able to handle a sophisticated, long-term transfer of real property. This chapter deals with transactions involving single-tenant buildings, multi-tenant buildings, and multi-tenant sites. Industrial tenants sometimes share common areas such as loading docks, parking lots, and roadways. A portion of the premises usually includes office space.

II. [2.2] GENERAL ECONOMIC AND RISK CONSIDERATIONS

Industrial leases are usually "triple net," which in the purest sense means that the tenant is responsible for all maintenance, repair, replacement, insurance, real estate taxes, and other operating expenses. Although often stated as a triple net lease, many leases are not pure triple net leases since the landlord may retain responsibility for structural matters, including replacement of the roof, foundation, load-bearing walls, building systems, etc. From the landlord's perspective, a triple net lease is viewed as a financial instrument that provides for a predictable income stream that can be sold or financed. This perspective has become even more important with the trend to sell industrial warehouse facilities to real estate investment trusts, pension funds, tenant in common (TIC) investors, and other private and publicly owned national and international real estate investors.

An industrial facility landlord may not be as concerned as commercial owners typically are with external appearances or day-to-day use inside the premises as long as there will be no financial exposure to the landlord for mechanics liens resulting from improvements to the premises, as the result of ordinary wear and tear, or for violations of applicable laws, including environmental laws. Industrial landlords sometimes transfer the responsibility for the restoration of an industrial facility to their tenants in the event of a casualty or partial condemnation. From the tenant's perspective, each tenant has particular business needs for specialized equipment, such as unique storage racking, roof penetrations for required venting, or refrigeration units that entail capital improvements. Generally, landlords may refuse to concede any matter that might increase the landlord's potential

economic exposure without some corresponding benefit. However, the tenant is often able to negotiate successfully for major physical alterations and additions as long as the tenant is willing (a) to indemnify the landlord from potential claims, (b) to provide adequate insurance coverage, (c) to prevent or insure over potential mechanics liens, and (d) to pay the full cost for the installation of improvements and alterations and commit to remove any improvements or alterations to the extent such improvements and alterations do not enhance the value and utility of the leased premises to future potential owners or occupants.

In some cases, the tenant pays the initial cost of the improvements directly to the contractor performing the work. Alternatively, the landlord may pay the contractor and seek reimbursement from the tenant. Sometimes the payments are made as a single payment to the landlord as the work starts or at lease commencement. For tenants with significant financial strength, the landlord may agree to accept payments as the work progresses. Although not as common as in retail or office leases in which the tenants negotiate a level of landlord contribution toward tenant improvements, the landlord may agree to finance the improvements over the lease term or a portion thereof in exchange for a higher rental rate. Some alterations to industrial buildings required by manufacturers (*e.g.,* modified ventilation systems or significantly increased higher electrical or plumbing capacity) are not as readily adaptable for subsequent users as typical alterations to office or retail space; therefore, such alterations involve greater risk and, if the landlord agrees to finance such alterations, the landlord may require that the alterations be amortized over a shorter period of time than the lease term. Alternatively, the landlord may require a higher rate of return on the cost of such improvements to account for the greater risk — that risk being that the cost of such improvements will not be fully amortized during the lease term.

III. DUE-DILIGENCE CONSIDERATIONS FOR TENANT'S COUNSEL

A. [2.3] Preliminary Analysis; Working with the Broker

Since tenants are typically less knowledgeable than landlords concerning the required approvals and potential pitfalls involved in long-term leases, prior to negotiating the initial lease, counsel should

1. undertake a thorough examination of the tenant's intended use of the site and its business needs (many of which are discussed in §§2.4 – 2.7 below);

2. discuss the necessary approvals and findings with the tenant; and

3. develop a strategy to resolve each issue.

In industrial leases, the roles of the attorney and the tenant's broker typically overlap more than in retail or commercial leases. Prior to negotiating the letter of intent, hopefully the broker performed initial due diligence to determine the tenant's needs and the relative merits of the spaces available in the market that match those needs. More sophisticated industrial brokers also perform much of the legwork needed to investigate factors relevant to the tenant's long-term successful use of the demised premises. However, rather than assume that the broker has performed this role, counsel

should discuss with the broker his or her findings during the course of the investigation. Sophisticated brokers should be willing to assist since they do not feel their role is fulfilled at the time the letter of intent is signed, but only after the lease is signed and the tenant has successfully occupied the facility. Counsel should also invite the broker to comment on the initial draft lease since that may provide an opportunity to learn matters important to the client that may not have been shared earlier. Also, brokers sometimes need to reengage with their counterpart or the tenant or landlord's representative during lease negotiations to resolve business issues that are not addressed or fully resolved in the letter of intent.

B. [2.4] Assessing Tenant's Needs

Tenant's counsel should seek to confirm that all the physical attributes necessary for the tenant's operations are available or will be made available. Counsel needs to inquire about

1. the types of materials and products that the tenant will store, manufacture, treat, and/or use in the premises;

2. the tenant's shipping and receiving requirements;

3. the compatibility of ceiling heights with the tenant's existing machinery or shelving;

4. the need for a crane;

5. the tenant's need for a showroom, a service center, or a training facility;

6. the capacity of the utilities (*e.g.,* do electrical or water utilities meet the tenant's needs or do they need to be increased); and

7. the condition of the heating, ventilation, and air-conditioning (HVAC) systems (*i.e.,* do they meet the tenant's needs or need to be modernized/upgraded).

Counsel should determine whether there is sufficient on-site parking for employees and invitees, whether additional portions of the premises will need to be devoted to offices, and whether the tenant has any plans or potential need for future expansion. The tenant should retain inspectors to perform inspections covering the building's structure, including the roof and its electrical, HVAC, and plumbing systems since industrial tenants will generally be responsible for the cost of maintenance and repair of the premises. In some long-term leases, the tenant often is responsible for replacement of building systems serving only the leased premises or, at a minimum, for an amortized allocation of such capital expenditures. Therefore, the client should inspect the building and building systems in order to minimize maintenance, repair, and replacement costs, at least in the early years of the term.

Initial lease drafts generally provide, except for specifically identified work to be performed by the landlord, that the tenant takes the premises condition in "as is, where is" condition. In such cases, once the lease is signed, the cost of maintenance, repair, and, if required, replacement of items not previously identified is either (1) paid directly by the tenant, if the tenant is primarily

responsible for the maintenance and repair, or (2) as part of its reimbursement to the landlord of its pro rata share of operating expenses for the entire complex. If the tenant discovers items in need of repair or replacement prior to finalizing lease negotiations, most landlords do generally agree to repair and/or replace such items to the extent needed or at least provide a partial or full credit toward rent or the cost of repair or replacement. However, the earlier such potential issues are identified the better for both parties and the more likely the parties will come to a mutually satisfactory and amicable resolution.

C. [2.5] Environmental Due Diligence

The tenant or its counsel should request a copy of the landlord's existing environmental audit. If the site is not a single-tenant building, the audit generally includes the entire property or project, so the landlord may be reluctant to share the audit if there are recognized environmental concerns not previously addressed. All sophisticated landlords obtain such audits prior to acquiring industrial property. Even if not recently purchased, environmental audits are typically obtained in the event of a recent refinance of the property. Tenant's counsel can easily determine whether a property was recently acquired or financed by ordering a tract book search from a local title company. Many county recorders also have their property records available online or through databases. From such sources, counsel can determine if a property recently has been sold or refinanced. Although tenants should not be responsible for preexisting environmental conditions unless the contamination is due to a distinct process or type of chemical or was released in certain areas that are no longer permeable, it is not always easy to identify the responsible party. A prior audit, especially if accompanied by a Phase II environmental assessment report, can generally establish a baseline. If not, at a minimum such a report can identify prior on-site and off-site uses that may assist the parties in determining the timeline for contamination. Since the responsibility for contamination is not always easily verifiable, and even if it may result in future interference with the tenant's quick access to the leased premises, counsel may elect to advise its tenant client to avoid facilities with significant prior contamination.

Even if the landlord provides the tenant with its Phase I and/or Phase II audit, since the report will not be addressed to the tenant, it is unlikely that the tenant will be entitled to rely on the audit. However, the audit provides useful information, and it is important to identify potential environmental contamination for which the tenant might become responsible as the "operator" of the property, as well as to provide an evaluation of baseline conditions to limit the tenant's responsibility. The scope of this audit may vary due to circumstances, including the type of property, existing operations on neighboring property, and the tenant's planned operations. In addition, even if the tenant is permitted to rely on the prior report and if the report was completed within the prior six months, in order to qualify for an innocent "landowner" defense, the scope needs to be modified to comply with the United States Environmental Protection Agency's (USEPA's) "all appropriate inquiries" regulations. See 2005 ASTM International, *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process,* E1527-13. E1527-13 is now the standard for performing Phase I environmental site assessments. After its review of the audit, the tenant may determine either (1) not to lease the subject property or (2) to ensure that any potential risks of leasing the property are appropriately and fairly allocated. However, if the tenant needs a certain facility due to its location or needs to finalize the lease in

order to commence operations, the lease should expressly exclude the obligation to remedy any preexisting contamination, including but not limited to known contamination as identified in any existing reports. It is helpful to identify any preexisting contamination or, alternatively, any reports that reference such contamination in an exhibit to the lease.

D. [2.6] Use, Density, Sign Ordinances, and Other Limitations

Restrictions on permitted uses, the ratio of required parking to the square footage of a building and/or number of employees or some combination thereof, the limits on expanding the footprint of the building on the site, and the requirements for business identification signage are all important factors to be evaluated on behalf of the tenant. Depending on a site's location, the limitations might be set out publicly in a zoning ordinance, a special-use permit or variance, or a separate sign ordinance. There also may be private restrictions such as covenants, conditions, or restrictions affecting the site or the industrial park. The tenant or its counsel should obtain and review applicable ordinances to confirm that there will be no limitations on the tenant's intended use. Even if the tenant's intended use is a permitted use elsewhere in the vicinity or elsewhere under the same zoning district, certain manufacturing or warehouse uses require a zoning variance or special-use permit. Sometimes, a variance or special-use permit may be required due to intensive use or exterior storage or if certain ancillary facilities are needed. If counsel is not fully satisfied after review of the applicable ordinances, either the tenant or its counsel should contact the municipality (or county if in an unincorporated area) to confirm that the intended use will be permitted and, if granted by the municipality, a certificate of occupancy will be issued prior to occupancy. This is important if the tenant is performing work or is obligated to commence rent payments by a date certain or a certain number of days after lease execution because the tenant may have to start paying rent but not be able to occupy the premises on the rent commencement date. Since landlords are rarely willing to make any representations or warranties regarding a tenant's specific use, the tenant may have no remedy under the lease. The tenant does not want to be in a position in which it has signed a long-term lease without the ability to occupy the premises for the tenant's intended use.

If the premises are located in an industrial park, especially a park developed since the 1980s, additional restrictions may be imposed pursuant to recorded declarations of covenants, conditions, and restrictions. The lease often provides that the tenant must comply with not only applicable laws but also recorded lease documents. Even if not expressly referred to in the lease, the lease might generally state that the tenant takes subject to recorded "restrictions" or matters of record. In either case, or even if the lease is silent, tenant's counsel should verify whether there are such restrictions. To the extent such restrictions exist, tenant's counsel must review copies of the final, recorded declarations or covenants.

E. [2.7] Capital Improvements and Fixtures

The tenant may be willing to install improvements to the building that enhance its intrinsic value. Typical installations include loading dock lifts, additional electric capacity and/or panels, and additional HVAC capacity or systems. Unless the lease provides otherwise, at the landlord's option, either (1) these items become fixtures and thus the property of the landlord without compensation to the tenant for the unamortized useful life of these fixtures or (2) the landlord may require removal at the expiration of the lease term. Tenant's counsel should make sure that the

client is comfortable with either alternative. If the tenant is not in agreement, it should raise the issue with landlord's counsel. Even if such items add value to the building but can be removed and the building restored without a detrimental effect on the building structure, the landlord may permit the tenant to remove improvements to the premises as long as doing so has been approved prior to execution of the lease. Alternatively, certain tenant improvements detract from the value of the premises at the end of the term. One common tenant improvement is additional tenant's office space built into a previously open area. Although office areas tend to add greater value than industrial space, most initial lease drafts require the tenant to remove any and all alterations identified by the landlord at lease termination. Tenants, generally, are not overly concerned about this potential expense in a long-term lease. However, certain improvements may be made late in the term, so tenant's counsel should discuss the matter with the client and negotiate accordingly.

In the event the lease requires removal of alterations made by the tenant — whether made prior to the commencement date or during the term — tenant's counsel should seek at a minimum to include language in the lease that requires the landlord to identify, at the time the tenant seeks consent to such alterations, the alterations the landlord will require the tenant to remove at the expiration of the term. Since many alterations (*e.g.,* installation of machinery, HVAC, or roof penetrations) may be expensive to remove and restore, the landlord's request to remove such alterations may change the tenant's economic analysis, especially with respect to improvements the tenant considers making in the last few years of the term. For example, if at the time consent is granted the tenant realizes that the landlord will require removal at the expiration of the term at a significant additional cost, the tenant may forgo such alterations.

F. [2.8] Avoiding Building System and Roof Disputes

The most problematic and expensive disputes between industrial landlords and tenants often involve roof problems. The respective parties' obligations must be clarified in the lease document. It is not enough to provide that the tenant will maintain the roof, building systems, or other portion of the premises in good condition and repair. The lease needs to identify clear responsibility for replacement, especially as it relates to capital items. Failure to anticipate and to understand the distinction between maintenance, repair, and replacement can lead to costly disputes. Even when the lease language is included but ambiguous, the ambiguity can lead to litigation. In *Sandelman v. Buckeye Realty, Inc.,* 216 Ill.App.3d 226, 576 N.E.2d 1038, 160 Ill.Dec. 84 (1st Dist. 1991), the plaintiffs purchased a 40-year-old, 185,000-square-foot industrial building for $120,000. The landlord wanted to terminate the long-term, below-market-rent lease based on the tenant's failure to maintain the roof. The lease as drafted was intended to be a triple net lease and provided that the landlord "shall not be obligated to incur any expense for repairing any improvements." 576 N.E.2d at 1040. In spite of such language and affirmative covenants requiring the tenant to repair, etc., the landlord was required to make substantial improvements to the premises in the form of a new roof.

Since *Sandelman* is a First District Appellate Court decision, it is not binding precedent but can be used as a guide, depending on the fact situation. As can be seen in the cases below, other courts have arrived at different conclusions based on different lease provisions. Landlords may dispute *Sandelman*'s applicability to their obligations. In the event of a dispute over the condition of the roof leading to litigation, it is likely the landlord will seek to present a case for repair and the tenant will seek to present a case for replacement. In the meantime, the tenant's operations are

interrupted due to water penetration after heavy rains or snow melts. Unless the lease clearly provides that the landlord is responsible for roof repair or replacement, the tenant should retain a roofing contractor to review the roofing system (to identify the expected life of various portions of the roof) before signing the lease. Upon obtaining information regarding the roof's condition, the best protection is to expressly allocate all responsibilities in the lease for maintenance, repair, and, if necessary, replacement. This is especially true for work that is necessary for the tenant's use of the premises. For example, an inadequate heating system or a leaking roof can be disastrous to the tenant's use of the premises. If the costs of such improvements are passed through to the tenant and such improvements are long-term capital expenditures (*e.g.,* a roof, HVAC, or other system replacement), tenant's counsel should seek to include language in the lease amortizing the cost of the improvements, whether determined in accordance with generally accepted account principles (GAAP) or the useful life of the improvement.

In *Rexam Beverage Can Co. v. Bolger,* 620 F.3d 718 (7th Cir. 2010), in which the dispute also involved the replacement of a roof, the court arrived at a different result from *Sandelman* based on more explicit language in the lease. The lease provided:

> **Lessor shall have no obligation with respect to the maintenance and repair of the Premises or any buildings or improvements which may be erected or made thereon. Lessee shall be solely responsible for the maintenance of such buildings and Premises and for keeping all of the same in good condition, order and repair, including all structural and extraordinary changes that may be required, reasonable use and ordinary wear and tear excepted.** 620 F.3d at 725.

The court said the language "in good condition, order and repair, *including* all structural and extraordinary changes that may be required" was "plainly discoverable," so that it was the tenant's responsibility to fix the roof. [Emphasis in original.] 620 F.3d at 725 – 726. This obligation was imposed even though the term expired and the tenant would receive no future benefit from the roof replacement. The court indicated that the landlord had the right to expect the premises back in good condition. The court imposed the burden on the tenant and found it liable in the amount of $405,470 for the cost to replace the roof.

In *Chicago Title Land Trust Co. v. Fifth Third Bank,* No. 11 C 1914, 2011 WL 6029565 (N.D.Ill. Dec. 5, 2011), a state action that was removed to federal court, the court held that the tenant was liable for the roof repair despite weaker language in the lease. The lease contained a general covenant to repair that did not mention structural changes. The tenant argued that it was not responsible for repairs involving structural changes, such as repairing a roof. The court disagreed. Even under a limited general covenant to repair, a tenant may be liable for "substantial yet foreseeable" repairs. 2011 WL 6029565 at 3. The tenant had built the building, was responsible for its maintenance, and could extend the 25-year lease up to a duration of 70 years; thus, it was foreseeable for this long-term commercial tenant that the roof would need repairing or replacing.

In *Quincy Mall, Inc. v. Kerasotes Showplace Theatres, LLC,* 388 Ill.App.3d 820, 903 N.E.2d 887, 328 Ill.Dec. 227 (4th Dist. 2009), the appellate court decided in favor of the tenant. The tenant notified the landlord that the roof needed to be replaced, and the landlord failed to replace it. The lease provided:

> **Tenant agrees during the term hereof to keep and maintain in good condition and repair, the demised premises and every part thereof, including without limitation the foundations, exterior walls, roof, exterior and interior portions of all doors, windows, plate glass, etc.** 903 N.E.2d at 889.

The court cited *Sandelman, supra,* in stating that the provision in question was a general repair clause and that in order to shift the burden of replacement from landlord to tenant, the basis for the shift must be a " 'plainly discoverable' provision, which requires clear and unambiguous language." 903 N.E.2d at 891, quoting *Sandelman,* 576 N.E.2d at 1040. The court would not read beyond the express language of the lease and, as a result, affirmed the trial court's decision allowing the tenant to set off the cost of the roof replacement (approximately $80,000) against rent otherwise due.

As *Sandelman, Rexam,* and *Quincy Mall* illustrate, this issue is not yet settled in Illinois.

G. [2.9] Roof Penetrations as Part of Tenant's Construction

To the extent the tenant requires certain alterations in order to use the premises for the tenant's intended purpose (*e.g.,* additional HVAC systems, penetrations, machinery and equipment supports, rooftop use for electrical or HVAC systems, or vents to release emissions), tenant's counsel needs to request to amend the lease to expressly permit such alterations and permit the tenant access to the roof or, if future similar alterations may be needed, the tenant should request consent prior to lease execution. The need for a lease revision is especially true for adding additional roof penetrations. The tenant may be aware of the need for consent during initial construction but may not remember when making alterations several years later. Aside from the obvious reason that landlords want to maintain control of the building structure, another practical reason for obtaining the landlord's consent is that the landlord often has a long-term roof warranty on which both parties will rely in order to avoid major expense for a roof failure. Roof warranties are often voidable at the roofer's option or voided if there is a roof penetration by someone other than the warranting party. Such penetrations are easily identified by the roofer when it is called on to address warranty issues. Therefore, the tenant may have to pay for a major expense if there are roof problems during the warranty period and the warranty is voided by unauthorized work, even if the failure is not due to the tenant's wrongful penetration.

The tenant may be required to use or, if not required, should strongly consider using the landlord's roofing contractor (even if more costly) in order to avoid invalidating the landlord's warranty. Even if not required by the landlord, as a practical matter it makes sense to use the same roofer to avoid disputes involving causation between roofing contractors if problems do arise. All reasonable attempts should be made to avoid such disputes since the roof is a critical and often the most expensive component for the continued utility of the premises for the tenant's intended use.

H. [2.10] Landlord's Title and Existing Mortgages

Due to the nature of its business, industrial tenants often require extensive capital improvements to a building to render it useful for the tenant's particular use. Office building improvements, typically, are more readily adapted for another user. Also, it is often more expensive

for an industrial tenant to move to another facility than it is for a commercial tenant. As a result, industrial leases generally have terms of ten or more years, often with multiple options to extend the term. After several years, the lease is desirable if market rents rise faster than the contract rent. A lease termination can be problematic if a party (*e.g.,* a land trust beneficiary) claims an interest in the property and claims it did not agree to the lease. Therefore, tenant's counsel should request evidence of authority or underlying documents that establish the authority of the landlord and its signatory. This material should include

1. a title report;

2. a certified copy of a land trust agreement if title is held in a land trust; and

3. evidence of authority (*e.g.,* resolutions affirming the signatory's right to sign the lease; a certified copy of the bylaws, if a corporation; or resolutions or the operating agreement if a limited liability company).

Landlords often request that the tenant provide evidence of authority for the person and entity signing the lease, so the request by the tenant for reciprocal evidence of authority from the landlord is generally not resisted too strongly. However, the landlord's evidence of authority is usually evidence of the general authority to negotiate and sign leases, while the tenant's approvals are typically site specific. Title records are often available online, and, if not, a tract book or ownership search is relatively inexpensive. As a result, a search provides a simple and inexpensive due-diligence protection for the tenant.

Those who claim fee ownership are not the only parties who might be able to terminate the lease. The aphorism "first in time, first in right" comes to mind. This simple phrase succinctly sets forth the priority, not only between two lenders with secured interests in real property, but between a lender and a tenant. In Illinois, lenders with a recorded mortgage have priority over subsequent tenancies. In addition, a tenant in possession or with a recorded memorandum of lease has priority over subsequent mortgage liens. The most common and important priority issues arise in situations in which the landlord is in default under its loan and its lender elects to foreclose the mortgage. The mortgagee has the option to accept the existing tenants after foreclosure and receive the lease income. Alternatively, the lender may join any one or more subordinate tenants and terminate the leases pursuant to the judicial foreclosure just as a senior mortgagee has the right to terminate the interests of second mortgagees and other junior creditors. In addition to such termination rights, priority grants to superior lenders the right to insurance proceeds and condemnation awards in the event of a casualty or condemnation.

In many leases, the drafts typically provide that the lease is not only subordinate to preexisting mortgages but also automatically subordinate to future mortgages without further action of the parties. The subordination provisions are generally located toward the end of leases in sections that often refer to other rights of mortgagees and might include attornment language and/or references to the tenant's obligation to deliver estoppel certificates. Article 15 of the sample lease found in §2.28 below contains such subordination language, as well as typical attornment and estoppel requirements.

In order to finalize the lease, the tenant may need to agree that its lease is subordinate not only to the interests of existing lenders but to the interests of future lenders and, in rarer cases, to existing and/or future ground leases. However, in the event the tenant has negotiating leverage or meets certain criteria identified below, the tenant should request and possibly require a non-disturbance agreement from existing mortgagees and condition its subordination to subsequent mortgagees to receipt of a commercially reasonable non-disturbance agreement.

Non-disturbance agreements are critical to industrial tenants who cannot easily relocate. For example, tenants whose use requires governmental approvals such as special-use permits or zoning approvals, tenants with significant machinery and equipment that is cost-prohibitive to move, and tenants leasing significant space cannot or should not be asked to relocate since it will result in significant disruption and expense. Landlords are usually willing to request from their lenders and the lenders, generally, do agree to provide non-disturbance agreements to such tenants. A tenant in a single-tenant building or a very large space should also be able to obtain a non-disturbance agreement. In Illinois, tenants' leases will be subordinate to existing mortgages under the "first in time, first in right" analysis. Even if the landlord is unable or refuses to provide a non-disturbance agreement from its existing mortgagee, tenant's counsel should at least seek a commitment from the landlord to obtain commercially reasonable non-disturbance agreements from future mortgagees if the tenant is asked to subordinate its lease to such future mortgagees. However, the tenant should expect to pay the cost, if any (usually in the form of legal fees), to the landlord and the lender as the result of such request. The cost, typically, is minimal when compared to the potential risk.

A non-disturbance agreement, usually, is part of a broader subordination, non-disturbance, and attornment agreement memorializing the subordination of the lease to the mortgage, an agreement by the tenant to attorn (*i.e.,* to recognize) the lender if it forecloses, and an agreement by the lender not to disturb the tenant's rights under the lease as long as the tenant is not in default.

In addition to the agreement not to disturb, the tenant should request that it not be made a party to foreclosure proceedings in order to save attorneys' fees. Lenders willing to provide a non-disturbance agreement, generally, will agree not to join a tenant to a foreclosure action as long as the tenant is not a necessary party to a foreclosure. In Illinois, under §15-1501(a) of the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* as long as the tenant's possessory interest is not being foreclosed, the tenant is not a necessary party.

In the event the tenant is served in a foreclosure action and the lease is subordinate to the mortgage, the lender may terminate the lease and the tenant's right to possession of the premises, subject to the time periods and provisions of §15-1701 of the Illinois Mortgage Foreclosure Law, 735 ILCS 5/15-1101, *et seq.* In the event the tenant is not made a party to the foreclosure action, the lease and the tenant's right of possession cannot be terminated, even if the lease is subordinate to the mortgage or trust deed, as long as the tenant fulfills its obligations under the lease.

Sometimes, landlords negotiating leases with tenants with numerous industrial properties are asked to commit to provide a specific form of non-disturbance agreement. Landlord's counsel should not agree to this since lenders typically use their own form of agreement. Counsel should propose that if the client is to provide a commitment for a non-disturbance agreement, it should be

limited to a commercially reasonable form with a commitment by the lender to recognize the tenant's right to occupy the premises during the term and any extended term as long as the tenant complies with its obligations under the lease and to not make the tenant a party to a foreclosure proceeding as long as the tenant is not a necessary party. As stated above, a tenant is not a necessary a party under 735 ILCS 5/15-1501(a) as long as the lender does not intend to terminate the lease.

IV. COMMENCEMENT DATE; DELAYS IN POSSESSION

A. [2.11] Fixing the Lease Term

In many situations, the lease term is clearly identified by the lease documents. However, the agreement between the principals may contemplate a commencement date based on an event, the date of which is not yet known, such as the completion of the landlord's construction, or a fixed time period after delivery of possession to the tenant. Since this date is not fixed at lease execution, the expiration date for a term of years is also not final. If the anticipated start date does not depend on too many variables (*e.g.,* significant work, permitting, and governmental approvals), for simplicity's sake the parties might agree to fix the expiration date as a firm date, even if that means the lease may be a month longer or shorter than the intended term, depending on when possession is actually delivered for the tenant's intended use. The reason is that, with a lease of ten or more years, the issue of the exact expiration date may not even come up until after the original owner has sold the property or after the tenant or the landlord's employees are gone and the documents confirming the start date are not with the lease files. In such cases, the lease document that provides for expiration "ten years from the date of possession" will provide little help in resolving the ambiguity. *See De Pauw University v. United Electric Coal Cos.,* 299 Ill.App. 339, 20 N.E.2d 146, 147 (3d Dist. 1939). In all cases, certification of the commencement date by a separate written acknowledgment is recommended. *West Ontario Building Corp. v. Palmer Truck Leasing Co.,* 22 Ill.App.3d 467, 317 N.E.2d 740 (1st Dist. 1974).

Alternatively, the parties may want to set the full benefit of the entire term, whether to fully amortize the cost of all improvements or simply to maximum the lease term. In such cases, landlord's or tenant's counsel should recommend the execution of a "Commencement Date Memorandum" once the term commences. The memorandum should identify the lease commencement date and the termination date, and, upon execution, it should be affixed to the landlord's and tenant's original copies of the lease. Counsel should request the client to deliver a signed copy of the memorandum to him or her immediately after the commencement date is identified. The actual commencement date for industrial leases is often six to twelve months after the lease negotiations are finalized and the signed leases are exchanged by the landlord and the tenant. Frequently, this is the case for leases requiring significant build-out. Years later, the tenant may be asked to provide an estoppel in connection with the sale or refinance of the property, which estoppel includes verification of the termination date. The parties also may need to identify an appropriate date period to exercise an option to renew the lease, and the tenant or its counsel will have no way to identify such dates without access to correspondence that may not be readily available. Therefore, when representing a client in lease negotiations, counsel should remind each party to the transaction (1) to provide counsel with a fully executed copy of the lease and (2) to provide, if possible, a written confirmation of the occupancy date. Although it may not be possible to avoid this problem every time, at least counsel's files will contain the final signed copy of the lease.

B. [2.12] Delays Caused by a Holdover Tenant

In the event the tenant negotiates a lease for premises that are currently occupied, the tenant should seek to obligate the landlord to make all commercially reasonable efforts to obtain possession of the premises promptly upon the expiration of the prior tenant's lease term. Such efforts should include filing of an eviction action.

When there is an existing tenant that might hold over, the new lease should provide that it is the landlord's responsibility to evict the existing tenant as diligently as possible. A holdover by an existing occupant with special needs (*e.g.,* significant equipment in place) might last for an extended period, especially if a court with jurisdiction is reluctant to evict the existing tenant. If the new tenant has to vacate its current facility or needs to get in by a certain date in order to avoid further disruption to its operations, the new tenant's counsel should insist on a drop-dead date after which the new tenant can terminate if possession has not been delivered. The new tenant may also request the benefit of any holdover payments made by the existing tenant to the landlord due to rent in excess of base rent since the new tenant may be the one suffering the loss. Alternatively, if consequential damages are available in the existing lease, counsel for the new tenant may be able to negotiate for reimbursement from the landlord for those additional expenses. The landlord then has the basis to claim further reimbursement from the holdover tenant. The new tenant may have to pay its current landlord holdover rent that ranges from 125 to 200 percent of the prior year's rent. The new tenant also may suffer other damages for delay due to additional storage and moving expenses.

C. [2.13] Delays Caused by Construction

Similarly, when the landlord has agreed to make improvements or to retrofit the building, the tenant is at risk of not being able to get into the premises on schedule. A drop-dead date, as well as agreed damages (*e.g.,* delay in the rent commencement date plus one additional day's free rent for each day of delay in delivery of possession for construction delays), will give the tenant some recourse. Counsel and the client will need to understand that most leases provide for "force majeure" delays without penalty; therefore, unless an absolute drop-dead date is agreed on or if the free rent remedy does not trump the force majeure provision, the tenant may still be without an effective remedy for certain delays. The remedy provisions should be drafted to trump the majeure provisions if the tenant is likely to suffer significant damages due to the delay in possession.

If the tenant is responsible for the build-out of the premises, in order to identify a realistic rent commencement date during lease negotiations, the tenant must retain its own architect or contractor as early in the process as possible. Such parties need to provide reliable estimates of the time needed to (1) prepare the plans and specifications necessary for building permits and contractor bids, (2) obtain building permits from the local municipality, and (3) complete the build-out of the premises after receipt of building permits and landlord approval. Although the time period for the landlord's approval is generally included in the work letter, the tenant should include such time periods in its projected timeline, plus a contingency period in the event revisions of the plans are necessary due to rejection or required modification of such plans requested by either the landlord or the municipality.

D. [2.14] Sample Language — Delay in Delivery of Possession

The tenant can obtain legal protection addressing the above problems by bargaining for language as follows:

Landlord shall deliver the Premises to Tenant on _____, 20__ (the Commencement Date). If the Premises are not delivered on the Commencement Date, Tenant's obligation to start paying rent shall abate by two days for each day after the Commencement Date that the Premises are so delivered, unless the delay was caused by Tenant, in which event there shall be no such abatement. In addition, in the event that the Premises are not delivered to Tenant by _____, 20__, then Tenant, at its sole option, shall have the right to terminate this Lease by written notice to Landlord. The term of this Lease shall expire on _____, 20__, notwithstanding any delay in the commencement of this Lease.

V. REAL ESTATE TAXES

A. [2.15] Determining the Applicable Tax Years

Since real estate taxes become a lien more than one year before such taxes are due, counsel needs to be careful when drafting or negotiating a long-term industrial lease. Although landlords, typically, do not intend to recover an extra year's worth of taxes during the first or last year of the lease term, it is not uncommon for long-term industrial leases (as drafted) to state that the tenant is responsible for taxes "attributable to, which become a lien during the term and are payable during the term." It is usually appropriate for the tenant to pay taxes attributable to the term given the length of the lease term, plus the fact that industrial sites are often larger than commercial premises and the vacancy of an industrial building does often significantly reduce the taxes for one or two years. As stated above, real estate taxes become a lien on January 1 of a given year but are not payable until the following year. Taxes in Illinois are paid in two installments. In Cook County, beginning in tax year 2009 (payable in 2010), the first installment tax bill is now 55 percent of the prior year's tax bill. The increase or decrease is reflected in the second installment. In almost every year in the 101 other Illinois counties, the real estate taxes are paid in two equal installments on the first business days of June and September. As a result, the first taxes truly attributable to a particular tenant's term will be due and payable during the second year of the term. In other types of commercial leases, the landlord sometimes ignores this fact and insists that the tenant pay real estate taxes as they come due. The effect is that the tenant pays the real estate taxes attributable to the last year of the prior tenant's term, but does not pay those taxes attributable to the last year of its own term. Even though real estate taxes tend to rise, this is an acceptable trade-off for the landlord because the landlord does not have to chase a tenant for the last year's taxes after the tenant has moved on and the tenant does not have to pay taxes a year after it vacates the premises. This may be skewed for the larger industrial site with one or more vacant spaces.

During the initial negotiations, counsel should review the lease to verify whether the tenant is to pay taxes "which become a lien, or are assessed during the term, or are attributable to the term of the lease" or will be responsible for those taxes "payable during the term." The language should not include both to avoid paying an extra year of taxes for the lease term. In a short-term lease, this

will stand out, but clients sometimes do not have records available at the end of a ten-year lease. Tenants may no longer have correspondence or evidence of payment, and a new landlord may reject a claim and seek to rely on the language in the lease. This is especially true if the premises have been sold during the lease term.

B. [2.16] Accrual of Taxes

Since industrial warehouse leases are usually long term, many landlords do not follow the pattern established for many commercial leases. This is due not only to the tendency for longer-term industrial leases, but also to the fact that industrial properties are sometimes harder to relet than office or retail space. If the premises have been vacant for an extended time before reoccupancy, the vacancy may result in a tax reduction attributable to the period of vacancy. The landlord may not be inclined to pass that savings along to the tenant. Since the final reconciliation may not be made until the third or fourth quarter of the calendar year following the expiration of the lease term, this is an appropriate reason that landlords will require a tax escrow.

The language governing the survival of the tenant's obligations to make up a shortfall in taxes should be reciprocal so that the tenant has a right to recover, from the landlord, an overpayment in its estimated payments for real estate taxes after the expiration of the term. Although rarely considered, this should include not only excess estimated payments but also tax refunds resulting from tax assessment appeals filed by landlords or tenants before either the Illinois Property Tax Appeal Board or the local circuit court by means of a specific objection or a certificate of error.

C. [2.17] Escrows and Letters of Credit

The lease document almost always requires that the tenant escrow monthly payments to ensure that there are funds available to pay the real estate tax bills as they become due. In almost all cases, these escrow funds do not bear interest. The negotiations regarding the need for tax escrow and whether the landlord is to pay interest on the escrowed funds typically depend on the relative bargaining strengths of the parties. Only tenants with strong balance sheets are likely to succeed in avoiding tax escrows. However, tenant's counsel should consider several alternatives, including either (1) establishing a joint account with the landlord and the tenant each having equal control or (2) establishing a segregated escrow account with interest to accrue to the tenant. The landlord is likely to object since it does not want to set up numerous accounts for different tenants. Although interest rates are low at the time of this writing, a segregated account permits the tenant to receive interest on the deposit if rates should increase. If the landlord resists, counsel might suggest, as an alternative, the delivery of a letter of credit as security for the real estate tax obligation. While a letter of credit requires payment of an annual fee and, usually, supporting collateral, the tenant's bank may be willing to accommodate its customer. Usually, landlords accept a letter of credit in lieu of an escrow as long as the tenant promptly provides the cash needed to pay the taxes. The annual cost of a letter of credit is generally less to the tenant than the potential borrowing costs if the funds deposited into the tax escrow would otherwise reduce the tenant's borrowing costs under its line of credit.

D. [2.18] Tenant Control of Tax Protests

In many retail and office commercial leases, the landlord may not grant the tenant the right to protest real estate tax assessments or to maintain tax appeals. In these situations, the tenant's premises are often part of one or more tax parcels; the leases are often of a short term, sometimes without full tax pass-throughs; and the tenant's improvements and particular use do not significantly affect the total tax bill. The tenant, nonetheless, has some protection because the landlord has an incentive to contest the real estate taxes on its office building or shopping center so that the property remains competitive with nearby properties. None of these factors is as applicable when the lease is a long-term industrial warehouse lease in which the property may be assessed as a separate tax parcel or when the tenant's improvements might be deemed to be real estate and a significant factor in the real estate tax assessment. Due to the long-term nature and the full pass-through of taxes, the landlord has less incentive to contest the taxes. For these reasons, tenant's counsel should consider requesting that its client reserve the right to receive copies of all changes of assessment sent to the landlord, to contest payments, and to receive any refunds attributable to the lease term.

The landlord is likely to control tax protests in short-term leases or in multi-tenant buildings or properties that are not separately assessed. In addition, the landlord may also require the right to seek to control tax appeals in long-term leases. However, as a compromise, the parties could agree that if the landlord does not contest taxes, the tenant has the right to do so. In such cases, the parties must be prepared to file the tax appeal shortly after the notices are sent because, in most counties, the window to challenge tax assessments is often only 20 to 30 days. However, if the landlord is responsible for contesting the real estate taxes on the premises, the lease should provide that the landlord will credit the tenant with refunds generated from real estate tax protests received by the landlord after the bills for the given lease year are paid but that relate to real estate taxes paid by the tenant during the lease term. As stated in §2.16 above, in the event the landlord obtains a refund from the circuit court by means of a specific objection or a certificate of error or as the result of complaints filed with the Property Tax Appeal Board, such refunds are often generated several years after originally paid. Due in part to the delay and in part to the fact that it is usually more difficult to confirm the delayed refunds as opposed to the assessment reduction of the county administration level before the tax bills are issued, such refunds are often not passed through to tenants or are overlooked by tenants.

E. [2.19] Reconciliation at the End of the Term

The lease provisions dealing with the final reconciliation of taxes should be part of the negotiations relating to the matters described in §§2.15 – 2.18 above. If the parties have agreed that the tenant will pay taxes on an accrual basis and the tenant will have the right to protest assessments, tenant's counsel might advise the client that it has achieved the fairest result for the tenant. At the same time, the tenant will have to monitor the assessments throughout the term and will not be able to close its accounting on the lease until at least a year after it has left the premises.

To the extent that the final year is not the same as a calendar year, such year might appropriately involve a proration of not only the real estate taxes but also the cost of counsels' fees. The lease

should reference such allocation of fees as well as the taxes. In Cook County, where property is assessed every third year, or in most other counties, where property is assessed every fourth year, tax counsels' fees are often paid based on a percentage of savings in the first year of the triennial or quadrennial. The proration of such fees over the applicable period should be considered.

VI. TENANT USE ISSUES

A. [2.20] Expect Unusual Issues To Arise

Looking at a roster of uses in a typical industrial park, it is surprising to find the varied uses that coexist in close proximity. In one facility, one might find a manufacturing operation with many employees and noisy, heavy equipment, while in adjacent facilities there may be a frozen foods warehouse with massive rooftop refrigeration equipment, a metallurgical operation with extensive use of chemicals and a sophisticated ventilation system, and a precision forging operation using sensitive machine tools. In such situations, it is a daunting task to prevent damage to the land and make improvements to confirm compliance with all applicable laws. Yet this is the essence of the task facing landlord's counsel every time he or she documents an industrial lease transaction. The initial lease draft often includes a description of the tenant's particular use and requires that the tenant obtain all necessary licenses and permits to conduct its business operation. Landlord's counsel should make appropriate changes whenever there is need for specialized construction; the use or storage of large quantities of chemicals, solvents, and/or degreasers; a manufacturing process that might require noise limitations; or a use involving a large volume of waste disposal, hazardous or otherwise. Landlord's counsel should understand any aspects of the potential tenant's operation that might require special provisions to address responsibility for structural repairs or maintenance. In *Aluminum Coil Anodizing Corp. v. First National Bank & Trust Company of Barrington,* 64 Ill.App.3d 256, 381 N.E.2d 301, 21 Ill.Dec. 223 (2d Dist. 1978), the landlord was unable to require the tenant to restore steel bars (damaged by acid fumes used in the tenant's operation) since the lease recognized that the tenant's use might cause corrosion.

The landlord or its counsel should try to determine all licenses and approvals that might be necessary and require, either prior to occupancy or upon the landlord's request, the production of such licenses and approvals as part of the tenant's lease obligations. Examples include copies of contracts with a licensed waste hauler for disposal of hazardous materials or an Illinois Environmental Protection Agency permit for air emissions. The municipality might require that each tenant obtain certificates of occupancy for its individual premises and use as opposed to the entire building.

B. [2.21] Compliance with Future Laws or Regulations

Due to the long-term nature of most industrial warehouse leases, there is a risk that a change in applicable laws or codes might require modifications to the premises or, in an extreme case, might make the preexisting tenant's use unlawful. For example, if an adjacent industrial parcel is rezoned for residential use and developed as loft apartments, the tenant's manufacturing operation may suddenly be in violation of a noise emission ordinance. Although the tenant's use may be grandfathered under the existing ordinances as a legal nonconforming use, this does not necessarily

prevent operational issues arising with adjacent residential uses. Therefore, counsel for both sides need to consider language that requires the tenant to comply with all applicable laws during the term. Landlord's counsel wants to assure that the tenant is responsible for any required modifications to the improvements and that the lease will not be terminated if the permitted uses become more limited by laws passed after lease execution. From the tenant's perspective, counsel wants to obtain the right to terminate if the modifications exceed a fixed dollar amount or if the tenant is unable to continue to operate as originally contemplated without significant changes to its operations. As can be seen, the goals may be inconsistent and need to be reconciled by the parties.

Even in net leases that require the tenant to contribute toward the cost of compliance with applicable codes, if the cost of compliance with future laws or building codes is not the result of the tenant's particular use, capital expenditures should be amortized over the useful life of the improvements. To the extent the useful life of the improvements exceeds the lease term, the tenant should seek to pay only its amortized but proportionate share. However, if the code change results in the need for modifications due to the tenant's particular use of the premises, the landlord is not likely agree to bear any portion of the cost. Even in leases that are not structured as triple net leases, landlord's counsel might consider allocating the cost of improvements resulting from code changes to the tenant if such improvements are necessitated due to the tenant's particular use of the premises, but to the landlord if due to industrial uses generally. For example, if code changes require the installation of sprinklers in a warehouse if certain types of products or inventory are stored there, the tenant should pay if it stores such products or inventory, but if sprinklers are required for all warehouses or for a much broader range of warehouse buildings, the landlord should pay.

C. [2.22] Parking Considerations

Tenants often fail to address their parking needs unless they have experienced problems at a previous facility. The lease document may be silent regarding parking or may simply include a site plan as an exhibit depicting the portions of the building leased to the tenant and the parking area. The tenant's visit to a multi-tenant facility with significant current vacancy or at a time other than peak use could give the tenant a mistaken impression that there will be plenty of parking spaces for its employees and invitees. Tenant's counsel must make sure that the client has weighed the relevant issues.

Tenant's counsel needs to consider the number of employees and visitors the tenant may have on any given day. In a multi-tenant facility, the use by other tenants is also important. Manufacturing facilities generally have more employees per square foot than warehouse facilities and therefore greater parking needs. In addition, industrial facilities with higher percentages of office space usually have greater parking needs since the employee ratio to building area is generally higher in such facilities and also tends to generate larger numbers of visitors. Compliance with local zoning codes governing parking does not always ensure adequate parking. Although certainly not a foolproof solution — especially for new facilities or those not yet fully leased — prior to signing the lease, a prospective tenant should visit the site several times during business hours to identify the parking used by the then existing tenants. If the parking lot is shared with other tenants, it should be determined whether there are occasions when the other occupants have parking needs that will limit available parking.

Parking problems may also arise in the future. For example, if the tenant plans to build into the parking area someday, will a sufficient number of parking stalls remain to comply with the applicable ratio under the zoning ordinance and the tenant's own needs? If the remaining parking is not compliant with zoning, the tenant will not get a building permit allowing a zoning variance. If the parking area is shared, does the landlord retain, or does another tenant have, the right to expand the building, thus reducing the available spaces for all occupants? If the facility has significant vacancy or if a new tenant with more employees or visitors moves in, will the demand of future occupants exceed available parking? These issues should be considered to provide guidance for any necessary additional protections. Even if requested, the landlord may refuse to limit its flexibility, as long as the expansion is compliant with applicable zoning codes, since the only effective tenant relief would be to give the tenant the right to terminate its lease or forgo additional revenue from expansion — both of which might be unacceptable to the landlord. When fully analyzed, the tenant will then need to decide to accept the risk of future expansion or to seek alternative space. However, the issue will have been addressed in advance, and the client will have the opportunity to make an informed decision.

VII. [2.23] EXPANSION OF THE BUILDING

Prior to executing the letter of intent, most tenants will have determined that the premises suit their needs for the term of the lease. Alternatively, the tenant might request options to expand or a right of first refusal, if other space is available. The building may be at or near the maximum size that applicable zoning will permit on the site. If not, the landlord and tenant occasionally might consider a plan for an eventual expansion of the building on the site or an expansion of the site to include additional land owned by the landlord. In addition, the lease should address the following issues:

a. Who will fund the cost of the expansion?

b. Since the construction will increase the square footage of the building, will the overall rental rate per square foot be adjusted?

c. If the tenant funds the expansion, should the rent under the existing lease be reduced since the landlord will end up with an asset of significantly greater value after lease expiration?

d. Should the term be extended to permit the funding party to fully or partially amortize the cost of construction?

Although an unusual situation, if the expansion is not a significant expense for a particular tenant with available funds, the tenant may agree to pay for the expansion and for the resulting increase in real estate taxes and operating expenses, but not pay additional base rent. Also, the tenant may require an extension of the lease term with some abatement of base rent relating to the original premises. This compromise may not be feasible if the expansion involves increasing the site to include additional land that is leased to other tenants or could potentially be leased to others at a higher return to the landlord. In that situation, the landlord might require additional base rent for the added land area, perhaps at the same or a higher rate allocated to the land area for the existing

premises. The tenant might seek an extension of the lease term for both the existing and new space, with little or no rent for the new improvements. Alternatively, the parties can provide for a reduced rate of increase over the term on the existing premises in order to amortize some or all of the cost of the addition.

Landlords of industrial property may be more likely to finance the expansion if the tenant is an institutional grade tenant or is the subsidiary of such an entity and the parent is willing to provide a satisfactory lease guaranty. The tenant, typically, is required to commit to a term sufficient to amortize all or, if the expansion will be easily adapted for use by future tenants, a significant portion of the cost of the expansion. If the tenant anticipates the possible need for future expansion, in lieu of or possibly in addition to a termination right, the tenant should consider including a commitment by the landlord to expand the premises as part of its initial letter-of-intent negotiations. Generally, only certain sophisticated, well-capitalized landlords can consider such requests. Since the exact size of the expansion and the actual costs are not likely to be known at lease execution, the parties should agree to a formula for calculating the increased rent payments. The necessary parameters include the maximum and minimum size of the improvements; the maximum cost to the landlord; the number of years of the "extended term" in order to amortize all or a significant portion of the cost of the improvements; the rate of return to the landlord, whether calculated as a fixed rate of return or a percentage return to the landlord over the then available interest rates for financing industrial buildings; and whether lease guarantees are necessary. Any such expansions are also subject to governmental regulations relating to issues such as zoning and subdivision setbacks, applicable floor area ratios, density, parking ratios, and stormwater retention or detention.

As an alternative to expansion of the physical plant, the lease for a multi-tenant building might include an option to expand into existing space at a predetermined date, a right of first refusal, or a right of first offer for adjacent space as it becomes available during the term. Landlords with large real estate portfolios, the owners of significant property, or the owner of an industrial park may be willing to consider giving the tenant the right to relocate to a larger facility owned by the landlord, usually in the general vicinity of the original leased premises. Although this may be practical for a warehouse tenant whose inventory moves in and out rather quickly, relocation might not be realistic for a manufacturer whose costs to remove and reinstall equipment may be prohibitive.

VIII. ASSIGNMENT AND SUBLETTING

A. [2.24] Typical Language

The limitations regarding assignment and subletting are often similar in the industrial warehouse lease to those in other commercial leases. Typically, the tenant is not allowed to assign or sublease without the approval of the landlord. Even though the initial lease drafts do not always recite the relevant standard, the standard in Illinois is that the landlord's consent should not be unreasonably withheld. In Illinois, commercial reasonableness standards include the creditworthiness of the proposed assignee or subtenant, the use of the premises, and whether the use will compete with the business of the landlord or other tenants. *See Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 60 Ill.Dec. 703 (1st Dist. 1982); *Vranas & Associates, Inc. v. Family Pride Finer Foods, Inc.,* 147 Ill.App.3d 995, 498 N.E.2d 333,

101 Ill.Dec. 151 (2d Dist. 1986); *Jung v. Zemel,* 189 Ill.App.3d 191, 545 N.E.2d 242, 136 Ill.Dec. 718 (1st Dist. 1989). An example of a landlord's refusal to accept subtenants that fell below Illinois' commercial reasonableness standards is discussed in *Golf Management Co. v. Evening Tides Waterbeds, Inc.,* 213 Ill.App.3d 355, 572 N.E.2d 1000, 1004, 157 Ill.Dec. 536 (1st Dist. 1991) (tenant "tendered ready, willing, and able subtenants and [landlord's] refusal to consent to a sublease was unreasonable"). In *Golf Management,* the landlord appeared to refuse subleases as a matter of policy, insisted only on direct leases, and demanded excessive rent — sometimes almost twice the rent of the original lease — from any interested potential subtenant. Landlords must be careful that their actions do not fall below Illinois' commercial reasonableness standards.

From the industrial landlord's perspective, granting or withholding consent primarily relates to the creditworthiness of the proposed transferee and the proposed assignee's or subtenant's intended use of the premises, not competition. The landlord also is concerned with any new occupant's use as it relates to additional wear and tear on the building, the increased potential release of hazardous materials due to a new occupant's use, and the additional demand, if any, on limited parking. The landlord will be allowed to disapprove the proposed transferee if its net worth is not sufficient to provide the landlord with a reasonable expectation that the proposed assignee has the financial wherewithal to make future rental payments. Depending on the specific lease language, any change in the ownership of the tenant, but more often the transfer of the controlling interest, might also constitute an assignment triggering the need for the landlord's approval.

Counsel must review the language contained in the assignment section to determine if the transfer or sale of all or any significant ownership interests in the tenant is deemed to be an assignment of the lease requiring the landlord's consent. In the event the lease is silent regarding such transfers, the landlord's consent is not required in the event of the transfer or sale of stock if a corporation, membership interests if a limited liability company, or partnership interests if a partnership.

The assignment provisions should be reviewed closely by counsel for a tenant whose business is likely to expand or contract significantly over the lease term or for a tenant whose business may be sold. The assignment provisions are often the most important lease provisions after the business terms relating to the payment of rent, term, use, maintenance, and default. The assignment provisions must be considered in the context of the entire term. The longer the term, the more likely the provisions will become relevant. The provisions apply if the tenant decides to vacate the space due to financial difficulty; the need to expand or reduce its space; the death, disability, or retirement of the majority owner or tenant; its intent to sell or bring new owners into the business; or the need or desire to relocate its facility.

There are two theories regarding the landlord's obligations concerning the approval of a proposed lease assignment — the contract theory and the conveyance theory. Under the conveyance theory, once the landlord has conveyed the leasehold interest to the tenant, the landlord has no obligation to do anything upon the tenant's abandonment. Under this theory, the tenant is liable for rent for the full term, and the landlord has no obligation to mitigate its damages or accept a substitute tenant. Under the contract approach, a landlord may be entitled to full rent for the entire term, but subject to an obligation to mitigate. Illinois follows the contract approach; therefore,

landlords must make reasonable attempts to mitigate their damages, rather than allowing the building to sit empty while the landlord collects rent for the duration of the term. This obligation is imposed pursuant to statute (735 ILCS 5/9-213.1) and applicable caselaw. This area is discussed in more detail in this handbook in Chapters 1 and Chapter 6 of this handbook.

A 2018 Illinois appellate court decision highlights the importance of drafting clear and unambiguous language in the lease pertaining to the right to collect unpaid rents. *See 1002 E. 87th Street LLC v. Midway Broadcasting Corp.,* 2018 IL App (1st) 171691, 107 N.E.3d 868, 424 Ill.Dec. 149 (new commercial landlord lacks standing to sue for unpaid rents). The court held that a new landlord lacks standing to sue for unpaid rents that were incurred before it owned the property as the right to the unpaid rents belongs to the original landlord and is not "extinguished by a conveyance of the land." 2018 IL App (1st) 171691 at ¶24, quoting *Dasenbrock v. Interstate Restaurant Corp.,* 7 Ill.App.3d 295, 287 N.E.2d 151, 156 (5th Dist. 1972). The court stated that there was a lease transfer "after" conveyance of the property. 2018 IL App (1st) 171691 at ¶23. The court also found no evidence that the original landlord intended to assign its right to unpaid rents to the new landlord. Such decisions demonstrate the paramount importance of clear, contractual language in leases, especially concerning unpaid rents during an assignment.

B. [2.25] Different Assignment Consideration from Other Commercial Leases

Although tenant's counsel may be familiar with the limitations on assignment for office or retail leases, counsel needs to know there are slightly different issues for the industrial warehouse client who eventually may run into financial difficulties, seek to downsize or relocate the operations, or want to sell the business during the term. This is due, in part, to the effect of §9-213.1 of the Code of Civil Procedure, 735 ILCS 5/9-213.1, which requires the landlord to mitigate damages after a tenant default. For commercial leases, whether office or retail, when the tenant tenders possession of the premises, if the business climate is not very poor, the landlord can generally relet the premises within a year. Reletting of industrial facilities often presents more difficult challenges, including environmental issues and more limited available replacement tenants.

It must be kept in mind that, in Illinois, the landlord is not permitted to arbitrarily reject the tenant's prospective transferee because the defaulting tenant can argue in court proceedings that the landlord's refusal to accept a reasonably acceptable replacement tenant is a violation of the landlord's duty to mitigate damages, thereby relieving the tenant of further rent obligations. These issues must be considered during negotiations over a proposed assignee or sublessee that is less than ideal for the landlord. However, this argument may not always prevail in the industrial context due to other factors. General office use and, except for certain shopping centers for which the tenant mix is important, retail uses are often rather fungible with respect to the impact on the property. Since the replacement tenant or sublessee offered by the current tenant might have a significantly different operation and/or require significant changes to the premises, including structural changes, greater stress on the building, or the possibility of greater environmental contamination as the result of the tenant's operations, the industrial warehouse landlord is less likely to be found unreasonable in rejecting the proposed assignee or subtenant. *See Losurdo Bros. v. Arkin Distributing Co.,* 125 Ill.App.3d 267, 465 N.E.2d 139, 80 Ill.Dec. 348 (2d Dist. 1984). Reletting an industrial warehouse building can take years if the location is poor or the economy is not experiencing significant

industrial expansion. This has certainly been true at various times. As a result, the landlord has a stronger basis to reject a proposed occupant in the assignment or sublease negotiations. Tenant's counsel should take the time to explain these issues to the client before execution of the lease. One alternative is for tenant's counsel to seek a provision permitting the tenant to buy out the lease if the landlord rejects an assignee. The termination payment will be large, but such a provision is better than nothing. The termination payment will include all unamortized brokers' commissions and tenant improvements funded by the landlord. The tenant also may need to pay six to twelve months base rent. In addition, the termination notice will be due at least six to twelve months prior to the effective termination date. However, many landlords will not even consider the concept, since it creates the possibility of an early termination, which in turn reduces the marketability and value of the property for both possible sale and refinance by the landlord.

The tenant might be able to negotiate a safe harbor for a replacement tenant whose use does not significantly change from the original tenant's use by identifying a certain fixed-net-worth limit for the assignee or guarantor. The tenant should also seek to permit the assignment of the lease, without the landlord's consent, to a publicly traded corporation or to the subsidiary of a publicly traded corporation. Although not all publicly traded companies are truly creditworthy, in most cases such requests are honored simply due to the size of the assets, rather than the net worth of the public company. In addition, the landlord may feel that a publicly traded company enhances the curb appeal of its property.

C. [2.26] Sale of Tenant's Business

The initial lease draft document often provides that the sale of any ownership interest in the tenant, or the change of control of a corporate or limited liability company tenant, will constitute an assignment of the lease. When the tenant's core business operation is located in the premises, this language may provide the landlord an effective veto over the tenant's sale of the business to anyone who is not as creditworthy as the tenant. For a privately held business, if ownership interests are sold, the transaction often results in the seller receiving a substantial portion of the equity from the business. By removing some of the equity, the tenant's net worth might be reduced so that the landlord may be within its rights to disapprove the deal unless new equity is contributed to the business by the new owner. Tenant's counsel should discuss this possible scenario with the client before executing the lease. If there is the chance that such a transfer will occur, tenant's counsel should bargain, prior to lease execution, for the right to transfer the ownership of the tenant to an entity that meets or exceeds a certain net worth or to enhance the landlord's collateral in exchange for the landlord's consent to a sale of the ongoing business. Examples of such enhancements include the rights to increase the security deposit, to provide a letter of credit if feasible, or to have the buyer's principal or principals personally guarantee all or a portion of future rental payments. At the time of the initial lease negotiation, such a scenario may strike the tenant as highly unlikely if it has no plans to sell the business. However, if circumstances change, the client may be grateful that it has a quantifiable economic option or a safe harbor that does allow for the sale of the business.

In addition to the discussion regarding net worth, the limitation should be tied to the transfer of a controlling interest of the entity as opposed to the transfer of any interests since the addition or transfer of minority interests is not likely to alter the identity or the financial strength of the

entity operating the business. Furthermore, in a privately held company, counsel may wish to exclude from the limitation or transfers conveyances of the ownership interests to family members or living trusts, whether for estate planning purposes or to provide for a generational change in the ownership and operation of the company.

The sale of the tenant's business, especially an industrial company with the potential for significant environmental liability, may involve the transfer of assets as opposed to the transfer of ownership interests. In such situations, counsel may want to consider the same safe harbors or permitted transferees discussed in §2.25 above (*i.e.,* those with a net worth equal to or greater than that of the existing tenant, to a publicly traded company, or to a subsidiary of a publicly traded company whose parent is willing to guaranty the lease).

Many current leases provide the landlord the right to recapture the space in the event of a proposed assignment of the lease or the relevant portion with respect to a sublease of part of the premises. In the event of an assignment of the lease or sublease of the premises, the recapture right terminates the lease with all profit accruing to the landlord if the landlord signs a new lease with the proposed assignee or subtenant. Since the underlying theory behind this is that the tenant should not be competing with the landlord in the real estate business, the right of recapture is usually appropriate. In such cases, the trade-off for the lost profit on the transaction is that the tenant's obligations under the lease are terminated in their entirety in the case of an assignment or with respect to the portion sublet in the case of a sublease for less than all of the premises. However, the tenant should seek to exclude this termination right in the event the assignment is due to the sale of the tenant's business since the purchaser likely views the premises as an important business asset if for no other reason than to avoid disrupting the business or the location for the tenant's employees. Landlords, generally, do agree to waive this right in the event of the sale of the business as long as the purchaser meets certain financial standards or otherwise provides credit enhancements such as an increased security deposit, guaranty, or letter of credit. Furthermore, tenant's counsel should seek to eliminate this provision with respect to the temporary subletting of only a portion of the premises or to an affiliate. The tenant may need the space in the future but may be generating some additional income or accommodating the use by an affiliate for a limited period of time.

D. [2.27] Quasi-Sublease Arrangements

Landlord's counsel should be aware that in some leases, the sublease limitations may not require an enterprising tenant to seek consent for certain business arrangements with third parties that are the functional equivalent of subleases. Examples are situations in which the tenant allows a vendor or customer to store products on the premises or to use a portion of the premises for assembly or shipment. As a practical matter, the landlord may not be interested in policing the occupancy as long as the tenant is paying the rent and keeping the premises insured and in good and operating condition without complaints from the municipality, adjoining tenants, or property owners. If the landlord wants greater control, counsel should expand the limitation or assignment and subleasing to also prohibit the use of all or any portion of the premises by anyone other than the tenant and its employees in order to preclude any arrangements, oral or written, by which third parties have access to or use of any portion of the premises for any business purposes other than as an agent of the tenant.

Tenant's counsel should take the time to learn how the tenant operates its business to determine whether the tenant intends to permit others to use the premises. If so, counsel should seek to include the landlord's consent to such activities during lease negotiations.

IX. [2.28] SAMPLE INDUSTRIAL WAREHOUSE LEASE

The following sample lease sets forth provisions typically found in a negotiated industrial warehouse lease that, for the most part, is fairly balanced. The lease is not necessarily ideal for either the landlord or the tenant since it was negotiated by parties for a particular transaction and may not reflect the needs of other clients, whether landlords or tenants.

Remember that a new landlord should negotiate for the conveyance of the right to collect any and all unpaid rents, if applicable. Such a conveyance needs to be written in clear and unambiguous language in the lease.

INDUSTRIAL WAREHOUSE LEASE

This Industrial Warehouse Lease (Lease) is made and entered into as of the ____ day of _____, 20__, by and between _____, a _____ limited liability company authorized to transact business in Illinois (Landlord), and _____, a _____ corporation authorized to transact business in Illinois (Tenant).

Definitions:

"Brokers" means the Tenant's Broker and the Landlord's Broker, collectively.

"Business Days" means all days, excluding the following days: Saturdays, Sunday, and all days observed as legal holidays by the Federal Government, the State Government, and/or any labor unions servicing the Premises, the Common Areas, the Building, and all other existing and future buildings and improvements placed on the Land.

"Landlord's Architect" means [insert name**].**

"Landlord's Broker" means [insert name**].**

"Personal property" means all tangible personable property existing or at any time hereafter located on or at the Premises or used in connection with the Premises, including without limitation all trade fixtures, machinery, appliances, furniture, equipment, and inventory.

[NOTE: The above "personal property" provision is pro-landlord.**]**

"Property manager" means [insert name**].**

"State" means the State of Illinois.

"Tenant's Broker" means [insert name**].**

"Tenant's Contractor" means [insert name**].**

Recitals:

1. Landlord, in consideration of the rents and covenants hereinafter set forth, does hereby lease and let unto Tenant, and Tenant does hereby hire and take from Landlord, that certain space shown and designated on the site plan attached hereto and made a part hereof as Exhibit A-1, located in the _____ Building (Building), the address of which space is _____, Illinois, which Building is located in that certain business park known as _____ (Park).

2. The aforesaid space leased and let unto Tenant is herein called the "Premises." The land (including without limitation all easement areas appurtenant thereto) on which the Building is located is herein called the "Property." The Property, the Building, any and all other buildings and improvements, all personal property of Landlord used in connection with the operation or maintenance thereof that is located therein and thereon, and the appurtenant parking facilities, if any, are herein together called the "Warehouse Complex." Subject to this Recital 2, Landlord and Tenant acknowledge and agree that, for purposes of this Lease, (a) the Building is comprised of approximately _____ square feet, (b) the Premises are comprised of approximately _____ square feet, (c) approximately _____ square feet of the Premises will constitute office space, and (d) approximately _____ square feet of the Premises will constitute warehouse/distribution space.

3. Tenant hereby accepts this Lease and the Premises on the covenants and conditions set forth herein and subject to any encumbrances, covenants, conditions, restrictions, and other matters of record and all applicable zoning, municipal, county, state, and federal laws, ordinances, and regulations from time to time governing and regulating the Premises and the use thereof.

Agreements:

TO HAVE AND TO HOLD THE SAME, without any liability or obligation on the part of Landlord to make any alterations, improvements, or repairs of any kind on or about the Premises, except as expressly provided herein, for a term of ____ years and ____ months, commencing on the ____ day of _____, 20__ (except as such date may be modified pursuant to the provisions of Article 4 hereof, such date is herein called the "Commencement Date"), and ending on the ____ day of _____, 20__, unless sooner terminated or unless extended, in each case in the manner provided herein (Term), to be occupied and used by Tenant for warehouse/distribution and ancillary office purposes, and for no other purpose, subject to the covenants and agreements hereinafter contained.

Article 1 — Base Rent

Section 1.1. *Base Rent.* Subject to Recital 2 hereof, in consideration of the leasing aforesaid, Tenant agrees to pay to Landlord, _____, _____, Illinois, or at such other place as Landlord from time to time may designate in writing, the following base rent (Base Rent):

(a) Subject to this Section 1.1(a), for the first ____ consecutive months of the Term, the annual Base Rent will be equal to $_____, payable monthly, in advance, in equal monthly installments of $_____, provided, however, that during the first through the ____ months of the Term, being a total of ____ months, all Base Rent will abate and will not be due and payable hereunder, but Tenant's Pro Rata Share of Operating Expenses (as such term is defined in Section 2.2(d) hereof), Tenant's Pro Rata Share of Real Estate Taxes (as such term is defined in Section 2.2(d) hereof), and all other Additional Rent (as such term is defined in Section 2.1 hereof) will continue to be due and payable during such ____-month period;

(b) For the next ____ consecutive months of the Term, the annual Base Rent will be equal to $_____, payable monthly, in advance, in equal monthly installments of $_____;

(c) For the next ____ consecutive months of the Term, the annual Base Rent will be equal to $_____, payable monthly, in advance, in equal monthly installments of $_____;

(d) For the next ____ consecutive months of the Term, the annual Base Rent will be equal to $_____, payable monthly, in advance, in equal monthly installments of $_____;

(e) For the last ____ consecutive months of the Term, the annual Base Rent will be equal to $_____, payable monthly, in advance, in equal monthly installments of $_____.

Except as provided in Section 1.1(a) hereof, Tenant's payments of Base Rent (and Additional Rent) will commence on the first day of the Term and will continue on the first day of each and every month thereafter for the next succeeding months during the balance of the Term. If the Term commences on a date other than the first day of a calendar month or ends on a date other than the last day of a calendar month, monthly rent for the first month of the Term or the last month of the Term, as the case may be, as well as the abatement of Base Rent described in Section 1.1(a) hereof, will be prorated based on the ratio that the number of days in the Term within such month bears to the total number of days in such month.

Article 2 — Additional Rent

Section 2.1. ***Additional Rent.*** **In addition to the Base Rent payable by Tenant under the provisions of Article 1 hereof, Tenant will pay to Landlord "Additional Rent" as provided in this Article 2. All sums under this Article 2 and all other sums and charges required to be paid by Tenant (whether to Landlord or to a third party) under this Lease (except Base Rent), however denoted, will be deemed to be Additional Rent. If any such amounts or charges are not paid at the time provided in this Lease, they will nevertheless be collectible as Additional Rent with the next installment of Base Rent falling due.**

Section 2.2. ***Definitions.*** **For the purposes of this Lease, the parties hereto agree on the following definitions:**

(a) "Calendar Year" will mean each of those calendar years commencing with and including the year during which the Term commences, and ending with the calendar year during which the Term (including without limitation any extensions or renewals) terminates.

(b) "Real Estate Taxes" will mean and include all real estate taxes and installments of special assessments, relating to the Warehouse Complex, and all other governmental charges, general and special, ordinary and extraordinary, foreseen as well as unforeseen, of any kind and nature whatsoever, or other tax, however described, which is levied or assessed by the United States of America or the state in which the Warehouse Complex is located or any political subdivision thereof, against Landlord or all or any part of the Warehouse Complex as a result of Landlord's ownership of the Warehouse Complex, and payable during the respective Calendar Year. It will not include any net income tax, estate tax, or inheritance tax.

(c) "Operating Expenses" will mean and include all reasonable and necessary expenses incurred with respect to the maintenance and operation of the Warehouse Complex as determined by Landlord's accountant in accordance with generally accepted accounting principles consistently followed, including without limitation insurance premiums; maintenance and repair costs; steam, electricity, water, sewer, gas, and other utility charges; fuel; lighting; wages payable to employees of Landlord whose duties are connected with the operation and maintenance of the Warehouse Complex (but only for the portion of their time reasonably allocable to work related to the Warehouse Complex); amounts paid to contractors or subcontractors for work or services performed in connection with the operation and maintenance of the Warehouse Complex; all costs of uniforms, supplies, and materials used in connection with the operation and maintenance of the Warehouse Complex; all payroll taxes, unemployment insurance costs, vacation allowances, and the cost of providing disability insurance or benefits, pensions, profit-sharing benefits, hospitalization, retirement or other so-called fringe benefits, and any other expense imposed on Landlord, its contractors or subcontractors, pursuant to law or pursuant to any collective bargaining agreement covering such employees; all services, supplies, repairs, replacements, or other expenses for maintaining and operating the Warehouse Complex; reasonable attorneys' fees and costs in connection with any appeal or contest of real estate or other taxes or levies; and such other expenses as may be incurred in the operation and maintenance of a warehouse

complex and not specifically set forth herein, including reasonable management fees and the costs of a warehouse building at the Warehouse Complex. The term "Operating Expenses" will not include (i) any capital improvement to the Warehouse Complex, other than replacements required for normal maintenance and repair; (ii) repairs, restoration, or other work occasioned by fire, windstorm, or other insured casualty; (iii) expenses incurred in leasing or procuring tenants; (iv) leasing commissions; (v) advertising expenses; (vi) expenses for renovating space for new tenants; (vii) legal expenses incident to enforcement by Landlord of the terms of any lease; (viii) interest or principal payments on any mortgage or other indebtedness of Landlord; (ix) compensation paid to any employee of Landlord above the grade of building superintendent; (x) depreciation allowance or expense; (xi) the cost of repairs or restoration necessitated by any condemnation; (xii) franchise taxes and income taxes of Landlord; (xiii) the cost of any items to the extent Landlord is reimbursed by insurance, by other tenants of the Warehouse Complex (except pursuant to provisions for the payment of a proportionate share of Operating Expenses), by warranty or otherwise; (xiv) the cost of any work or service performed for or made available to any tenant of the Warehouse Complex (other than Tenant) to a materially greater extent or in a materially more favorable manner than that furnished generally, without additional expense, to the tenants and other occupants (including Tenant); (xv) rent under any ground, overriding, and/or underlying leases; (xvi) the cost of any electric current or gas furnished to any areas of the Warehouse Complex occupied by tenants for purposes other than operation of Warehouse Complex equipment or machinery or the lighting of restrooms, shaftways, or Warehouse Complex machinery or fan rooms; (xvii) any cost stated in Operating Expenses representing an amount paid to a Landlord-related corporation or entity for services or products to the extent that such cost is in excess of the fair market value of such services or products; (xviii) advertising and promotional expenses of the Warehouse Complex and any artwork or similar decoration in common areas; (xix) the cost of installing, operating, and maintaining any specialty amenity serving the Warehouse Complex, such as but not limited to an observatory, broadcasting facilities, luncheon club, athletic or recreational club, theater, rehearsal hall, art gallery, or garage; (xx) managing agents' fees or commissions in excess of four percent of annual Rent, and auditing fees, other than auditing fees in connection with the preparation of statements required pursuant to additional rent or lease escalation provisions; (xxi) the cost of any repair made by Landlord to remedy damage caused by, or resulting from, the gross negligence or willful act or omissions of Landlord, its agents, servants, contractors, or employees; (xxii) any insurance premium to the extent that Landlord is entitled to be reimbursed therefor by Tenant pursuant to this Lease or by any other occupant of the Warehouse Complex pursuant to its lease (other than as a tenant's pro rata share of Operating Expenses); (xxiii) legal and other professional fees and expenses incurred in preparing, negotiating, and executing leases, lease amendments, lease terminations, and lease extensions; and (xxiv) closing and related expenses incurred by Landlord in connection with the transfer or disposition of the Land or Warehouse Complex or any ground, underlying, or overriding lease, including without limitation transfer, deed, and gains taxes. Notwithstanding the foregoing, in the event Landlord installs equipment in or makes improvements or alterations to the Warehouse Complex that are for the purpose of reducing energy costs, maintenance costs, or other Operating Expenses, or that are required under any governmental laws, regulations, or ordinances that were not required as of the date of this Lease, Landlord may include in Operating Expenses reasonable charges for

interest on the cost of such improvements or alterations and reasonable charges for depreciation on the same so as to amortize such cost over the reasonable life of such improvements or alterations on a straight-line basis. Operating Expenses will also be deemed to include, without limitation, expenses incurred by Landlord in connection with city sidewalks adjacent to the Property and any other public facility to which Landlord or the Warehouse Complex is from time to time subject in connection with operations of the Warehouse Complex.

(d) "Tenant's Pro Rata Share of Real Estate Taxes" will mean ____ and ____/100ths percent of the Real Estate Taxes for the applicable Calendar Year, and the term "Tenant's Pro Rata Share of Operating Expenses" will mean ____ and ____/100ths percent of the Operating Expenses for the applicable Calendar Year. Such percentages have been agreed on by the parties hereto after due consideration of the rentable area of the Premises compared to the rentable area of the Building (all on the basis of the provisions of Recital 2 hereof); provided, however, that the percentages for Tenant's Pro Rata Share of Real Estate Taxes and Tenant's Pro Rata Share of Operating Expenses will be adjusted to reflect any change in the net rentable area of the Building from time to time.

Section 2.3. ***Adjustment of Operating Expenses.*** **Notwithstanding anything to the contrary set forth above, it is agreed that in the event the Warehouse Complex is not fully occupied during any Calendar Year, a reasonable and equitable adjustment will be made by Landlord in computing those of the Operating Expenses for such year that vary due to changes in the occupancy level of the Warehouse Complex so that those Operating Expenses will be adjusted to the amount that would have been incurred had the Warehouse Complex been fully occupied during such year.**

Section 2.4. ***Estimated Taxes and Expenses for Subsequent Year.*** **As to each Calendar Year after the initial Calendar Year, Landlord will estimate for each such Calendar Year (a) the total amount of Real Estate Taxes, (b) the total amount of Operating Expenses, (c) Tenant's Pro Rata Share of Real Estate Taxes, (d) Tenant's Pro Rata Share of Operating Expenses, and (e) the computation of the annual and monthly rental payable during such Calendar Year as a result of increases or decreases in Tenant's Pro Rata Share of Real Estate Taxes and Tenant's Pro Rata Share of Operating Expenses. Such estimate will be in writing and will be delivered or mailed to Tenant as provided herein.**

Section 2.5. ***Payment of Additional Rent.*** **Tenant will pay, as Additional Rent, the amount of Tenant's Pro Rata Share of Real Estate Taxes for each Calendar Year and Tenant's Pro Rata Share of Operating Expenses for each Calendar Year, so estimated, in equal monthly installments, in advance, on the first day of each month during each applicable Calendar Year. In the event that such estimate is delivered to Tenant after the first day of January of the applicable Calendar Year, such amount, so estimated, will be payable as Additional Rent, in equal monthly installments, in advance, on the first day of each month over the balance of such Calendar Year, with the number of installments being equal to the number of full calendar months remaining in such Calendar Year.**

Section 2.6. *Reestimates of Taxes and Expense.* From time to time during any applicable Calendar Year (but in no event more often than two times in any Calendar Year), Landlord may reestimate the amount of Real Estate Taxes and Operating Expenses and Tenant's Pro Rata Share thereof. In such event, Landlord will notify Tenant, in writing, of such reestimate in the manner above set forth, and fix monthly installments for the then remaining balance of such Calendar Year in an amount sufficient to pay the reestimated amount over the balance of such Calendar Year after giving credit for payments made by Tenant on the previous estimate.

Section 2.7. *Adjustment of Actual Taxes and Expenses.* Upon completion of each Calendar Year, Landlord will cause its accountants to determine the actual amount of Real Estate Taxes and Operating Expenses for such Calendar Year and Tenant's Pro Rata Share thereof and deliver a written certification of the amounts thereof to Tenant not later than 90 days after the end of each Calendar Year. If Tenant has paid less than its Pro Rata Share of Real Estate Taxes or its Pro Rata Share of Operating Expenses for any Calendar Year, Tenant will pay the balance of its Pro Rata Share of the same within 30 days after receipt of such statement. If Tenant has paid more than its Pro Rata Share of Real Estate Taxes or its Pro Rata Share of Operating Expenses for any Calendar Year, Landlord will, at Tenant's option, either (a) refund such excess within 30 days after delivery of such statement or (b) credit such excess against the most current monthly installment or installments due Landlord for its estimate of Tenant's Pro Rata Share of Real Estate Taxes and Tenant's Pro Rata Share of Operating Expenses for the next following Calendar Year. In calculating any sums due and payable under this Article 2, a pro rata adjustment will be made for a fractional Calendar Year occurring during the Term (including without limitation any renewal or extension thereof) based on the number of days of the Term during such Calendar Year, as compared to 365, and all sums payable by Tenant or credits due Tenant as a result of the provisions of this Article 2 will be adjusted accordingly. The obligations of Landlord and Tenant with respect to the annual reconciliation of Real Estate Taxes and Operating Expenses will survive the expiration or termination of this Lease.

Section 2.8. *Separately Metered Utilities.* Electricity and gas service will be separately metered to the Premises at Landlord's expense and charged directly to Tenant. Tenant will pay any and all such charges when due, and prior to the attachment of any lien or other collection action being taken by the utility providing such service. To the extent that water and sewer service are not separately metered to the Premises, Landlord will bill Tenant from time to time for water and sewer service attributable to the Premises, as reasonably determined by Landlord, and Tenant will pay any and all such amounts billed by Landlord within ____ days after Landlord's written request therefor. All such payments will constitute Additional Rent hereunder; provided, however, that the parties acknowledge and agree that payments for electricity and gas service will not be due and payable to Landlord unless Tenant defaults in its payment obligations to the appropriate utilities and, after notice and an opportunity for Tenant to cure as provided herein, Landlord makes such payment itself.

Section 2.9. *Other Additional Rent.* Furthermore, Tenant will pay, also as Additional Rent, all other sums and charges required to be paid by Tenant under this Lease, and any tax or excise on rents, gross receipts tax, or other tax, however described, that is levied or assessed

by the United States of America or the state in which the Warehouse Complex is located or any political subdivision thereof against Landlord in respect to the Base Rent, Additional Rent, or other charges reserved under this Lease or as a result of Landlord's receipt of such rents or other charges accruing under this Lease; provided, however, that Tenant will have no obligation to pay net income, inheritance, or estate taxes of Landlord.

Article 3 — Overdue Amounts; Rent Independent

Section 3.1. ***Interest on Past Due Obligations.*** **Any installment of Base Rent, Additional Rent, or other charges to be paid by Tenant accruing under the provisions of this Lease that will not be paid when due will bear interest at a per annum rate equal to four percentage points in excess of the "prime rate" of interest then charged by [**bank**] (or, if it is not then in existence, its successor, or if neither is then in existence, another reasonably comparable bank), from the date when the same is due until the same will be paid, but if such rate exceeds the maximum interest rate permitted by law, such rate will be reduced to the highest rate allowed by law under the circumstances (Interest Rate).**

Section 3.2. ***Rent Independent.*** **Tenant's covenants to pay the Base Rent and the Additional Rent are independent of any other covenant, condition, provision, or agreement herein contained. Except as otherwise herein expressly provided, nothing herein contained will be deemed to suspend or delay the payment of any amount of money or charge at the time the same becomes due and payable hereunder, or limit any other remedy of Landlord. Base Rent and Additional Rent are sometimes collectively called "Rent." Rent will be payable without deduction, offset, prior notice, or demand, in lawful money of the United States.**

Article 4 — Construction of Leasehold Improvements; Possession of Premises

Section 4.1. ***Leasehold Improvements; Change Orders; Allowances.***

(a) Leasehold Improvements. Prior to the Commencement Date, Landlord will, at its sole cost and expense (except as provided in this Section 4.1(a) or elsewhere in this Lease), fit up the Premises with the "Leasehold Improvements," all as described in the outline specifications, space plan, and related materials attached hereto and made a part hereof as Exhibit A-2 (together "Outline Specifications and Space Plan Materials"). Anything in this Lease to the contrary notwithstanding, the Leasehold Improvements will not include, and Tenant (and not Landlord) will have sole responsibility for furnishing and installing (subject to Section 8.1 hereof) data and telephone cabling and other items described as "Exclusions" on the Outline Specifications and Space Plan Materials. Subject to this Section 4.1(a), (i) Tenant acknowledges that it will be required to approve plans and specifications for use in the construction of the Leasehold Improvements based on the Outline Specifications and Space Plan Materials and will also be required to make certain finish selections; (ii) promptly following the execution and delivery of this Lease by both Landlord and Tenant, Landlord will prepare and submit to Tenant, for its approval, proposed plans and specifications showing in reasonable detail, among other things, the design and appearance of the Leasehold Improvements; and (iii) Tenant, upon receipt of such proposed plans and specifications, will examine the same and within ____ business days thereafter will provide Landlord with any

objections or comments with respect thereto, any of which objections or comments will be wholly consistent with the Outline Specifications and Space Plan Materials and none of which will result in any adverse impact on the balance of the Warehouse Complex. The plans and specifications for the construction of the Leasehold Improvements, as so approved by Tenant, are herein called the "Issued for Construction Plans." In order for the Issued for Construction Plans to be finalized, Tenant must provide, among other things, its final racking plan, as well as color and other finish selections, to Landlord. Anything in this Lease to the contrary notwithstanding, Tenant will provide Landlord with such final racking plan and all required color and other finish selections no later than _____, 20__.

Subject to this Section 4.1(a), Tenant will not withhold its approval of the proposed Issued for Construction Plans except for just and reasonable cause and will not act in an arbitrary or capricious manner with respect to the approval thereof. The Issued for Construction Plans will be approved by Landlord and Tenant by affixing thereon the signature or initials of an authorized officer or employee of each of the respective parties hereto, and a description thereof will be attached to each party's copy of this Lease and made a part hereof as Exhibit A-3. Except as provided in this Section 4.1(a), such Exhibit A-3 will be in lieu of and will replace Exhibit A-2, except as to any nonconstruction matters contained in the Outline Specifications and Space Plan Materials. The signature of an authorized officer or employee (including without limitation any specifically designated representative under this Lease) will be deemed conclusive evidence of the approval indicated by such signature. Landlord agrees to appoint competent personnel to work with Tenant in the preparation of the Issued for Construction Plans, and Tenant agrees to appoint an officer or employee of Tenant to work with Landlord in such regard. When Landlord reasonably requests Tenant to specify details, Tenant will specify the same, subject to the provisions of the Outline Specifications and Space Plan Materials and this Section 4.1(a), so as not to delay the completion thereof.

Whenever Landlord reasonably requires information, consents, approvals, or the like from Tenant in connection with Landlord's obligations under this Article 4 to construct the Leasehold Improvements, Landlord will inform Tenant thereof and will provide Tenant with a reasonable time period within which Tenant is to respond thereto. Tenant will use all reasonable efforts to comply with all such time periods as requested by Landlord. In any event, however, if the time periods established by Landlord are reasonable, but Tenant fails to act within such time periods, or otherwise fails to act reasonably with respect to Landlord's requests, then Tenant will pay to Landlord all increased costs or damages (which are to be documented and verifiable) incurred by Landlord attributable to and resulting from such delays.

As set forth in this Article 4, in order for Landlord to achieve various scheduled delivery dates, Tenant will be required to provide certain definitive information, documentation, or other materials on certain specific dates. In order to facilitate various scheduling activities in connection with the construction of the Leasehold Improvements, certain scheduled delivery and other so-called milestone dates with respect to activities required in connection with the construction of the Leasehold Improvements (together, "Milestone Dates") are set forth on Exhibit A-4 attached hereto and made a part hereof. However, anything in this Section 4.1(a), in Exhibit A-4, or elsewhere in this Lease to the contrary notwithstanding, in the event of any

conflict between the terms, provisions, and conditions of this Lease and the terms, provisions, and conditions of Exhibit A-4, the terms, provisions, and conditions of this Lease will govern and control. For all purposes under this Lease, any failure or delay of Tenant, or those acting for or under Tenant, to satisfy any of the Milestone Dates that are specifically set forth or addressed in this Lease (*e.g.,* the date by which Tenant is to have delivered Issued for Construction Leasehold Improvement Plans) will be an act or neglect of Tenant, regardless of whether such failure or delay preceded the date of the execution of this Lease. Under no circumstances will Landlord's execution of this Lease be considered to be an acquiescence in or waiver of any such preexisting failure or delay.

(b) Change Orders. Except as otherwise expressly provided herein, Tenant may order changes in the work with respect to the Leasehold Improvements that are reasonably acceptable to Landlord, consisting of additions or deletions to, or other revisions in, the Outline Specifications and Space Plan Materials or the Issued for Construction Plans, with appropriate provisions for credits to or payments by Tenant as herein provided. Any such change in work that has been authorized by a written change order (which will be executed as herein provided) is herein called a "Change Order." Anything in this Lease to the contrary notwithstanding, Landlord will not be responsible or liable hereunder for any delay in the construction of the Leasehold Improvements or in the Commencement Date to the extent such delay is caused by a Change Order, and no Change Order will be effected if it is not permitted by any applicable laws, statutes, ordinances, rules, regulations, or codes, as the same are then interpreted and enforced by the appropriate authorities having jurisdiction thereof.

A Change Order is a written order signed by Tenant (or accepted by Tenant via e-mail) and accepted in writing by Landlord, stating in detail the change in the work, and, if appropriate, the change in the cost of the work resulting therefrom.

The cost of a Change Order will be equal to the sum of all actual costs (which will be documented and verifiable) incurred in connection with the subject change. The actual costs of the subject change will be the aggregate of all interest costs arising in connection with any resultant delays and any and all payment obligations under those contracts or modifications to contracts entered into by Landlord or its contractors, subcontractors, or sub-subcontractors, plus all applicable general conditions, plus a fee equal to ten percent of all of the foregoing costs, which fee will be in lieu of overhead and profit, any construction management fees, and any other fees to Landlord. Tenant will pay the entire costs of each Change Order to Landlord within ____ days after Landlord's invoice therefor.

Landlord will have the authority to make minor changes in the work to be performed by it under this Lease not involving any extension of the Commencement Date and not inconsistent with the intent of the Outline Specifications and Space Plan Materials or the Issued for Construction Plans, as the case may be; provided, however, that Landlord will use all reasonable efforts to give Tenant prior notice (which may be oral or written) of each such change and will record all such changes in writing; and provided further, however, that such changes will not adversely affect the quality or the value of the work to be performed by Landlord under this Lease.

Section 4.2. ***Substantial Completion; Force Majeure; Change Orders; Punch List Items; Pre-Commencement Date Access.***

(a) ***Date for Substantial Completion; Force Majeure.*** **Landlord will diligently proceed with the construction of the Leasehold Improvements and will substantially complete (as such term is defined in Section 4.2(b) hereof) the same, except as provided in this Lease, on or about _____, 20__; provided, however, that if delay is caused or contributed to by act or neglect of Tenant, or those acting for or under Tenant (Tenant Delays), or by labor disputes; casualties; acts of God or the public enemy; governmental embargo restrictions; shortages of fuel, labor, or building materials; action or nonaction of public utilities or of local, state, or federal governments affecting the work; or other causes beyond Landlord's reasonable control (together, and including without limitation Tenant Delays, "Excused Delays"), then the time of completion of such construction will be extended for the additional time caused thereby. Except in the case of Tenant Delays, neither the Term nor Tenant's obligations thereupon to begin and thereafter continue to make Rent payments will commence until the Leasehold Improvements have been substantially completed and are ready for occupancy by Tenant, as provided in Section 4.2(b) hereof. Furthermore, Tenant will be solely responsible for all costs and expenses resulting from any delay caused or contributed to by any act or neglect of Tenant, or those acting for or under Tenant.**

(b) ***Substantial Completion.*** **For purposes of this Lease, the Leasehold Improvements will be considered "substantially completed and ready for occupancy" (or "substantially completed," "ready for occupancy," or other similar use of a phrase including the words "substantially completed" or "ready for occupancy" or a form of either or both) at such time as the municipality having jurisdiction thereof issues a permanent or temporary certificate of occupancy permitting Tenant to occupy the Premises for general warehouse purposes, or takes such other action as may be customary to permit the permanent or temporary occupancy or use thereof; provided, however, that the aforesaid issuance of a permanent or temporary certificate of occupancy or such other action as may be customary to permit the permanent or temporary occupancy or use thereof will not be a condition to the achievement of "substantial completion and ready for occupancy," and will not be a condition to payment of Rent or commencement of the Term, if any delay or failure to achieve the aforesaid substantial completion or to secure such certificate or action is caused by any Tenant Delay. In the event that any Tenant Delay causes a delay or failure of the aforesaid issuance of any such certificate or the taking of any other such action, such certificate or action will be considered to have been issued or taken on the date on which it would have been issued or taken in fact, but for such Tenant Delay.**

(c) ***Punch List Items.*** **Not fewer than ____ days prior to the date on which Landlord, in good faith, anticipates that the Leasehold Improvements will be substantially completed, Landlord will notify Tenant of the date of such anticipated date of substantial completion, and of no fewer than ____ alternate dates on which Landlord and Tenant (or their respective representatives) will meet to inspect the same. Within ____ days after such inspection, Landlord and Tenant, acting reasonably and in good faith, will prepare, agree on, and execute a written "punch list" of items yet to be completed with respect to the Leasehold**

Improvements. At such time, Tenant will also execute and deliver to Landlord a written acceptance of the Premises (in a form prepared by Landlord and reasonably acceptable to Tenant), subject to such punch list items. Landlord will complete all such punch list items within _____ days thereafter, subject to Excused Delays.

(d) ***Pre-Commencement Date Access.*** **Subject to this Section 4.2(d), beginning on or about _____, 20__ (or such later date as may be required in the event of one or more Excused Delays), Tenant will be allowed access to the Premises until the Commencement Date to install its racking and trade fixtures in the warehouse portion thereof, provided that such access for all such purposes is permitted by all applicable governmental authorities having jurisdiction. The access to the Premises to be afforded to Tenant pursuant to this Section 4.2(d) is herein called "Pre-Commencement Date Access."**

Anything in this Section 4.2(d) to the contrary notwithstanding, in connection with the Pre-Commencement Date Access, (i) Tenant will not unreasonably interfere with the completion of construction of the Warehouse Complex, the Leasehold Improvements, or any other tenant or other improvements in the Property, or occasion any labor dispute as a result of such installations; and (ii) Tenant does hereby agree to assume all risk of loss or damage to its racking, trade fixtures, and equipment, and to any and all other personal property of Tenant, or its contractors, subcontractors, agents, and employees, and to indemnify, defend, and hold harmless Landlord, and its officers, directors, shareholders, employees, contractors, and agents, from any loss or damage to such racking, trade fixtures, and equipment, and all other personal property, and all liability, loss, or damage arising from any injury to the property of Landlord, or its contractors, subcontractors, or material suppliers, and any death or personal injury to any person or persons to the extent arising out of such installations. Landlord may, at any time, suspend Tenant's rights to the Pre-Commencement Date Access in the event that Landlord determines that such access or any work being performed by or for Tenant is unreasonably interfering with the construction of the Warehouse Complex, the Leasehold Improvements, or any other tenant or other improvements in the Property, is creating security or safety risks, or is otherwise not in conformance with the conditions of this Section 4.2. Beginning on the date on which Tenant commences any activities under its right to Pre-Commencement Date Access, and continuing through the day before the Commencement Date, Tenant will contribute to the payment of the utility charges at the Premises, if such charges are higher than would customarily be the case for contractors performing the construction of the Warehouse Complex or the Leasehold Improvements, or otherwise would have been the case, in the absence of such work by or for Tenant. The parties will cooperate to arrive at an equitable allocation of any such charges. Such allocation will be generally designed to result in Tenant's paying that portion of such utility charges attributable to Tenant's activities at the Premises.

Landlord has informed Tenant of the probability, if Tenant, or any of its contractors, subcontractors, sub-subcontractors, employees, or agents, should use or employ nonunion labor in connection with any work performed pursuant to this Lease (including, without limitation, this Section 4.2 and Section 8.1 hereof), that such use may occasion labor disputes, work stoppages, or other delays or difficulties in Landlord's construction of the Warehouse Complex and the Leasehold Improvements, Landlord's management of the Warehouse

Complex, or the fulfillment of other obligations of Landlord under this Lease and under other leases with respect to the Warehouse Complex. Accordingly, and anything in this Lease to the contrary notwithstanding, (i) neither Tenant, nor any of its contractors, subcontractors, sub-subcontractors, employees, or agents, will use or employ nonunion labor in connection with the performance of activities in the Premises under this Section 4.2(d); (ii) Landlord will not be liable or responsible for any delays in the performance of the construction of the Warehouse Complex or the Leasehold Improvements, or in any other obligations of Landlord hereunder, that may result from any such use or employment of nonunion labor; and (iii) Tenant will indemnify, defend, and hold harmless Landlord, and its officers, directors, shareholders, employees, and agents, from and against any and all losses, costs, claims, and other damages arising out of or in connection with the use or employment of nonunion labor, including without limitation costs relating to delays in Landlord's prosecution of its work at the Warehouse Complex (whether for Tenant or for other tenants of the Warehouse Complex) and reasonable attorneys' fees and costs.

(e) *Prohibition on Conduct of Business Prior to Commencement Date.* Anything in this Section 4.2 to the contrary notwithstanding, Tenant will not accept delivery of any product at the Premises or commence the conduct of any business from the Premises until the Commencement Date.

Section 4.3. *Construction Guaranty.* Landlord warrants the Leasehold Improvements against defective workmanship and materials for a period of ____ year after the date of substantial completion thereof. Landlord's sole obligation under this warranty is to repair or replace, as necessary, any defective item caused by poor workmanship or materials if Tenant notifies Landlord of the defective item within such ____-year period. Landlord has no obligation to repair or replace any item after such ____-year period expires. THIS EXPRESS WARRANTY IS GIVEN AS THE SOLE AND EXCLUSIVE RIGHT AND REMEDY OF TENANT FOR INCOMPLETE OR DEFECTIVE WORKMANSHIP OR MATERIALS OR OTHER DEFECTS IN THE PREMISES IN LIEU OF ANY CONTRACT, TORT, WARRANTY, OR OTHER RIGHTS OR CLAIMS, WHETHER EXPRESS OR IMPLIED, THAT MIGHT OTHERWISE BE AVAILABLE UNDER APPLICABLE LAW. ALL OTHER WARRANTIES ARE EXPRESSLY DISCLAIMED.

The warranty that is provided hereunder is limited in certain respects and is conditioned on the following:

(a) Tenant will use the Leasehold Improvements only in accordance with the design capacities and criteria established therefor. Tenant acknowledges that any misuse thereof may void the warranty hereunder and may void any manufacturers' or other warranties that may be assigned or otherwise made available to Tenant hereunder.

(b) The warranty will not extend to the electrical systems; plumbing systems; heating, ventilating, and air-conditioning systems; fire protection systems; or other mechanical systems servicing only the Premises (the maintenance and operation of such systems servicing the balance of the Building are the subject of separate obligations hereunder), unless such systems are maintained and operated in compliance with the manufacturers' specifications therefor by one or more professionals experienced in the maintenance and servicing of such systems, at least through the applicable warranty period.

(c) Any and all work required to be performed under this Section 4.3 will not in any way include, or require Landlord to perform, any routine or appropriate regular maintenance of the Leasehold Improvements required to be performed by Tenant during the applicable warranty period as part of Tenant's duties and obligations under this Lease.

(d) The warranty hereunder specifically excludes damages to Tenant's products, equipment, or other personal property that may be located within the Premises.

Section 4.4. *Repair and Maintenance.* Subject to Section 4.2(c) hereof and except as expressly provided in this Lease (including, without limitation, the one-year guaranty against defective items occasioned by poor workmanship and/or materials under Section 4.3), Tenant, upon commencement of the Term, will have and hold the Premises as the same will then be, without any liability or obligation on the part of Landlord for making any alterations, improvements, or repairs of any kind in or about the Premises for the Term (including without limitation any extension or renewal thereof), and Tenant agrees to maintain the Premises and all parts thereof in a good and sufficient state of repair as required by the provisions of this Lease.

Section 4.5. *Delayed or Earlier Possession.* If Landlord does not give possession of the Premises on the scheduled date for the commencement of the Term because the construction of the Warehouse Complex or the completion of the Premises has not been sufficiently completed to make the Premises ready for occupancy, or for any other reason, Landlord will not be subject to any claims, damages, or liabilities for the failure to give possession on such date. Under such circumstances, the Rent reserved and the covenants to pay the same will not commence until possession of the Premises is given or the Premises are ready for occupancy, whichever is earlier. Failure to give possession on the date specified therefor herein will in no way affect the validity of this Lease or the obligations of Tenant hereunder, but the expiration date of the Term will be extended by the number of days after _____, 20__, that possession by Tenant is so delayed. If Tenant is given and accepts possession of the Premises on a date earlier than the date above specified for commencement of the Term, then the Rent reserved herein and all covenants, agreements, and obligations herein and the Term will commence on the date that possession of the Premises is given to Tenant. Notwithstanding the foregoing, Tenant's Pre-Commencement Date Access to the Premises in accordance with Section 4.2(d) hereof will not be deemed to be acceptance of possession for purposes of this Section 4.5 unless Tenant commences conduct of business in the Premises in connection with such Pre-Commencement Date Access.

Section 4.6. *Effect of Possession.* If and to the extent applicable hereunder, Tenant's acceptance of possession of the Premises on the Commencement Date will be deemed conclusively to establish that the Premises, and all other improvements of the Warehouse Complex required to be constructed by Landlord for use thereof by Tenant hereunder, have been completed at such time to Tenant's satisfaction and in conformity with the provisions of this Lease in all respects, unless Tenant notifies Landlord in writing within ____ days after the commencement of the Term as to any items not completed. Tenant waives any claim as to matters not listed in such notice. Tenant acknowledges that, except as provided in Section 4.3 hereof, neither Landlord nor any agent of Landlord has made any representation or

warranty with respect to the Premises or the Warehouse Complex, or with respect to the suitability or fitness of either for the conduct of Tenant's business, or for any other purpose. Nothing contained in this Article 4 will affect the commencement of the Term or the obligation of Tenant to pay any Rent due under this Lease.

Section 4.7. *Use.* The Premises will be used for warehouse/distribution and ancillary office purposes, and for carrying on such activities as may be incidental thereto; provided, however, that Tenant may not use or occupy the Premises, or permit the Premises to be used or occupied, contrary to any laws, statutes, ordinances, or governmental rules or regulations applicable thereto, or in any manner that would violate any certificate of occupancy or permit affecting the same, or that would cause structural injury to the Premises or cause the value or usefulness of the Premises, or any part thereof, substantially to diminish (reasonable wear and tear excepted) or that would constitute a private or public nuisance or waste, and Tenant agrees that it will promptly, upon discovery of any such use, take all necessary steps to compel the discontinuance of such use.

Section 4.8. *Compliance with Environmental Laws.* Tenant will not (either with or without negligence) cause or permit the escape, disposal, or release of any biologically or chemically active or other hazardous substances or materials in, on, or around the Premises or the Warehouse Complex, or any part thereof or in the vicinity thereof. Tenant will not allow the storage or use of such substances or materials in violation of applicable Environmental Laws and by commercially reasonable standards prevailing in the industry for the storage and use of such substances or materials, nor allow to be brought into the Warehouse Complex any such materials or substances except to use in the ordinary course of Tenant's business (but still subject to the aforesaid obligations regarding the storage and use thereof), and then only after written notice is given to Landlord of the identity of such substances or materials. Hazardous substances and material will include, without limitation, those described in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), as amended, 42 U.S.C. §9601, *et seq.;* the Resource Conservation and Recovery Act of 1976 (RCRA), as amended, 42 U.S.C. §6901, *et seq.;* any applicable state or local laws and the regulations adopted under these acts. If any lender or governmental agency will ever require testing to ascertain whether there has been any release of hazardous materials, then the reasonable costs thereof will be reimbursed by Tenant to Landlord upon demand as additional charges if such requirement applies to the Premises or relates to activities conducted on the Premises or to Tenant's possession of the Premises. In addition, Tenant will execute affidavits, representations, and the like from time to time at Landlord's request concerning Tenant's best knowledge and belief regarding the presence of hazardous substances or materials on the Premises. In all events, Tenant will indemnify Landlord in the manner elsewhere provided in this Lease from any release of hazardous materials on the Premises occurring while Tenant is in possession, or elsewhere if caused by Tenant or persons acting under Tenant. The aforesaid covenants will survive the expiration or earlier termination of the Term.

Section 4.9. *Landlord's Environmental Warranties.* Landlord hereby represents to Tenant that Landlord is not aware of any hazardous substances or materials (as such term is defined in Section 4.8 hereof) that exist or are located on or in the Premises, except as may be disclosed

in that certain environmental assessment report for the Property, dated _____, 20__, and prepared by _____, a copy of which has heretofore been delivered to Tenant. Further, Landlord represents to Tenant that, to the best of its knowledge, Landlord has not caused the generation, storage, or release of such hazardous substances or materials on the Premises, except in accordance with Applicable Laws. For purposes of this Section 4.9, Landlord's awareness or best knowledge will mean the actual knowledge, without independent investigation, of [designated individuals**], respectively of Landlord.**

Article 5 — Services

Section 5.1. ***Services Provided by Landlord.*** **Subject to the provisions of Article 2 hereof, Landlord will provide the following services hereunder:**

(a) Landlord will maintain in good order, condition, and repair the parking facilities and all driveways leading thereto, and will keep the same free from any unreasonable accumulation of snow. For purposes of this Section 5.1(a), unreasonable accumulation of snow will mean snow in excess of two inches deep. Landlord will keep and maintain the landscaped area and parking facilities in a neat and orderly condition. Landlord reserves the right to designate areas of the appurtenant parking facilities where Tenant, and its agents, employees, and invitees, will park, and may exclude Tenant, its agent, employees, and invitees, from parking in other areas as designated by Landlord; provided, however, that Landlord will not be liable to Tenant for the failure of any tenant, or its invitees, employees, agents, or customers, to abide by Landlord's designations or restrictions.

(b) Landlord will also maintain in reasonably good, clean order, condition, and repair, perform all reasonable maintenance, and make all reasonably required repairs and replacements to the roof, the foundation, and the precast and steel structural components of the Warehouse Complex.

Section 5.2. ***Other Provisions Relating to Services.*** **No interruption in, or temporary stoppage of, any of the aforesaid services caused by repairs, renewals, improvements, alterations, strikes, lockouts, labor controversy, accidents, inability to obtain fuel or supplies, or other causes will be deemed an eviction or disturbance of Tenant's use and possession, or render Landlord liable for damages, by abatement of Rent or otherwise, or relieve Tenant from any obligation herein set forth. In no event will Landlord be required to provide any heat, air-conditioning, electricity, or other service in excess of that permitted by voluntary or involuntary guidelines or laws, ordinances, or regulations of governmental authority.**

Article 6 — Insurance

Section 6.1. ***Landlord's Casualty Insurance Obligations.*** **Landlord will keep the Warehouse Complex insured for the benefit of Landlord in an amount equivalent to the full replacement value thereof (excluding foundation, grading, and excavation costs) against**

(a) loss or damage by fire;

(b) such other risk or risks of a similar or dissimilar nature as are now, or may in the future be, customarily covered with respect to buildings and improvements similar in construction, general location, use, occupancy, and design to the Warehouse Complex, including but without limiting the generality of the foregoing windstorms, hail, explosions, vandalism, malicious mischief, civil commotion, and such other coverage as Landlord may deem appropriate or necessary, providing such additional coverage is obtainable and providing such additional coverage is customarily carried with respect to buildings and improvements similar in construction, general location, use, occupancy, and design to the Warehouse Complex; and

(c) if Landlord so chooses, rent interruption, insuring against loss of all or any portion of the Rent due and payable hereunder, for up to 12 months.

These insurance provisions will in no way limit or modify any of the obligations of Tenant under any provision of this Lease. Landlord agrees that such policy or policies of insurance will permit releases of liability as provided herein and/or waiver of subrogation clauses as to Tenant. Landlord waives, releases, and discharges Tenant, and its agents, employees, and servants, from all claims or demands whatsoever that Landlord may have or acquire arising out of damage to or destruction of the Warehouse Complex or loss of use thereof occasioned by fire or other casualty, whether such claim or demand may arise because of the negligence or fault of Tenant, or its agents, employees, servants, customers, or business invitees, or otherwise, and Landlord agrees to look to the insurance coverage only in the event of such loss. Notwithstanding the foregoing, Tenant will be obligated to pay the rental called for hereunder in the event of damage to or destruction of the Premises or the Warehouse Complex, if such damage or destruction is occasioned by the negligence or fault of Tenant, or its agents or employees. Insurance premiums paid for insurance coverage required under this Article 6 by Landlord will be a portion of the "Operating Expenses" described in Article 2 hereof.

Section 6.2. ***Tenant's Casualty Insurance Obligations.*** **Tenant will be solely responsible for determining the amounts and scope of insurance coverage, if any, Tenant deems necessary in connection with the insuring of its machinery, equipment, furniture, fixtures, and personal property (including also property under the care, custody, or control of Tenant) that may be located in, on, or about the Premises against**

(a) loss or damage by fire; and

(b) such other risk or risks of a similar or dissimilar nature as are now, or may in the future be, customarily covered with respect to a tenant's machinery, equipment, furniture, fixtures, personal property, and business located in a building similar in construction, general location, use, occupancy, and design to the Warehouse Complex, including but without limiting the generality of the foregoing windstorms, hail, explosions, vandalism, theft, malicious mischief, civil commotion, and such other coverage as Tenant may deem appropriate or necessary.

Tenant agrees that, to the extent Tenant maintains any such insurance coverage, such policy or policies of insurance will permit release of liability as provided herein and/or waiver of subrogation clauses as to Landlord. Tenant waives, releases, and discharges Landlord, and its agents, employees, servants, and contractors, from all claims or demands whatsoever that Tenant may have or acquire arising out of damage to or destruction of the machinery, equipment, furniture, fixtures, personal property, or loss of use thereof, occasioned by fire or other casualty, whether such claim or demand may arise because of the negligence or fault of Landlord, or its agents, employees, servants, contractors, or otherwise, and Tenant agrees to look to Tenant's insurance coverage only in the event of such loss.

Section 6.3. ***Landlord's Liability Insurance Obligations.*** **Landlord will, as a portion of the Operating Expenses defined in Article 2, maintain, for its benefit and the benefit of its managing agent, commercial general liability insurance against claims for personal injury, death, or property damage occurring on, in, or about the Warehouse Complex, such insurance to afford protection to Landlord and its managing agent.**

Section 6.4. ***Tenant's Liability Insurance Obligations.*** **Tenant will, at Tenant's sole cost and expense, but for the mutual benefit of Landlord, Landlord's members, Landlord's managing agent, any Mortgagee or other party reasonably requested by Landlord, and Tenant, maintain commercial general liability insurance against claims for personal injury, death, or property damage occurring on, in, or about the Premises, such insurance to afford protection to Landlord, Landlord's members, Landlord's managing agent, any Mortgagee or other party reasonably requested by Landlord, and Tenant to the limit of not less than $_____ in respect to the injury or death to a single person, and to the limit of not less than $_____ in respect to any one accident, and to the limit of not less than $_____ in respect to any property damage. All of Tenant's insurance will be written by companies rated at least A-VII by A.M. Best Company and otherwise reasonably satisfactory to Landlord, and with deductibles reasonably satisfactory to Landlord, and will name Landlord, Landlord's members, Landlord's managing agent, and any Mortgagee or other party reasonably requested by Landlord as additional insureds thereunder. Tenant will deliver a certified copy of each policy, or other evidence of insurance reasonably satisfactory to Landlord, (a) on or before the Commencement Date (and prior to any earlier occupancy by Tenant), (b) not later than ____ days prior to the expiration of any current policy or certificate, and (c) at such other times as Landlord may reasonably request. If Landlord allows Tenant to provide evidence of insurance by certificate, Tenant will deliver [**an ACORD Form 27**] (or equivalent) certificate and will attach or cause to be attached to the certificate copies of the endorsements required under this Article 6 (including without limitation the "additional insured" endorsement). Tenant's insurance must permit waiver of subrogation as provided hereunder. At such time as insurance limits required of tenants in warehouse buildings in the area in which the Property is located are generally increased to greater amounts, Landlord will have the right to require such greater limits as may then be customary. The coverage provided by Tenant's insurance will be deemed primary to any liability coverage secured by Landlord. Such insurance will also afford coverage for all claims based on acts, omissions, injury, or damage, which claims occurred or arose (or the onset of which occurred or arose) in whole or in part during the policy period. If Tenant provides such liability insurance under a blanket policy, the insurance must be made specifically applicable to the Premises and this Lease on a "per location" basis.**

Section 6.5. *Tenant's Indemnification of Landlord.* Tenant agrees to indemnify, protect, defend, and hold Landlord and Landlord's directors, shareholders, members, agents, employees, servants, lenders, and managing agents harmless from and against any and all claims, costs, expenses, liabilities, actions, and damages, including without limitation attorneys' fees and costs on behalf of any person or persons, firm or firms, corporation or corporations, arising from any breach or default on the part of Tenant in the performance of any covenant or agreement on the part of Tenant to be performed pursuant to the terms of this Lease or arising from any act or negligence on the part of Tenant, or its agents, employees, servants, customers, business invitees, or contractors, or arising from any accident, injury, or damage to the extent caused by Tenant, or its agents, employees, servants, customers, business invitees, or contractors, to any person, firm, or corporation, occurring during the Term or any renewal thereof, in or about the Premises or the Warehouse Complex. In case any action or proceeding be brought against Landlord or its directors, shareholders, members, agents, employees, servants, lenders, or managing agents by reason of any such claim, Tenant, upon notice from Landlord, covenants to resist or defend such action or proceeding by counsel reasonably satisfactory to Landlord.

Section 6.6. *Tenant's Waiver.* Tenant agrees, to the extent not expressly prohibited by law, that Landlord, and its agents, employees, servants, and contractors, will not be liable, and Tenant waives all claims, for damage to property and business sustained during the Term by Tenant occurring in or about the Warehouse Complex, resulting directly or indirectly from any existing or future condition, defect, matter, or thing in the Premises, the Warehouse Complex, or any part thereof, or from equipment or appurtenances becoming out of repair or from accident, or from any occurrence or act or omission of Landlord, or its agents, employees, servants, or contractors, or any tenant or occupant of the Warehouse Complex or any other person. This Section 6.6 will apply especially but not exclusively to damage caused by the aforesaid or by the flooding of basements or other subsurface areas, or by refrigerators, sprinkling devices, air-conditioning apparatus, water, snow, frost, steam, excessive heat or cold, falling plaster, broken glass, sewage, gas, odors, or noise, or the bursting or leaking of pipes or plumbing fixtures, and will apply equally, whether any such damage results from the act or omission of other tenants or occupants in the Warehouse Complex or any other persons, and whether such damage is caused by or results from any of the aforesaid, or will be caused by or result from other circumstances of a similar or dissimilar nature.

Section 6.7. *Landlord's Deductible.* Anything in this Lease to the contrary notwithstanding, in the event any damage to the Warehouse Complex results from any act or omission of Tenant, or its agents, employees, servants, customers, or business invitees, and all or any portion of Landlord's loss is "deductible," Tenant will pay to Landlord the amount of such deductible loss.

Section 6.8. *Tenant's Property.* All property in the Warehouse Complex or on the Premises belonging to Tenant, or its agents, employees, or invitees, or otherwise located at the Premises, will be at the risk of Tenant only. Landlord will not be liable for damage thereto or theft, misappropriation, or loss thereof, and Tenant agrees to defend and hold Landlord, and its agents, employees, and servants, harmless and indemnify them against claims and liability for injuries to such property.

Section 6.9. *Increase in Insurance.* Tenant will not do or permit anything to be done in or about the Premises nor bring or keep anything therein that will in any way affect any fire or other insurance on the Warehouse Complex or any of its contents (other than an increase in the rate of insurance), or cause a cancellation of any insurance policy covering the Warehouse Complex or any of its contents. In addition, Tenant will not do or permit anything to be done in or about the Premises nor bring or keep anything therein that will in any way increase the existing rate of insurance on the Warehouse Complex or any of its contents unless Tenant promptly, on demand, reimburses Landlord for the full amount of any additional premium charged for such policy in connection therewith. Any such additional premium will be deemed Additional Rent hereunder.

Section 6.10. *Tenant's Failure To Insure.* In the event, after ____ days' written notice, Tenant fails to provide Landlord with evidence of insurance required under this Article 6, Landlord may, but will not be obligated to, without further demand on Tenant, and without waiving or releasing Tenant from any obligation contained in this Lease, effect such insurance. Tenant agrees to repay, upon demand, all such sums incurred by Landlord in effecting such insurance. All such sums will become a part of the Additional Rent payable hereunder, but no such payment by Landlord will relieve Tenant from any default under this Lease.

Section 6.11. *Waiver of Subrogation.* In addition to the foregoing provisions of this Article 6, and anything in such provisions to the contrary notwithstanding, (a) all policies of fire, extended coverage, or similar casualty insurance, or commercial general liability insurance, that either party obtains for the Warehouse Complex or the Premises, will include a clause or endorsement denying the insurer any rights of subrogation against the other party to the extent rights have been waived by the insured before the occurrence of injury or loss; and (b) Landlord and Tenant hereby waive any rights of recovery, claim, action, or cause of action against the other for injury or loss (including without limitation injury or loss caused by the negligence or willful misconduct of the other party) by reason of any cause required to be insured against hereunder, which waiver the parties agree will be effective for purposes of the endorsement referred to in this Section 6.11.

Article 7 — Certain Rights Reserved by Landlord

Section 7.1. *Rights Reserved by Landlord.* Landlord reserves the following rights, exercisable without notice and without liability to Tenant, 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:

(a) *Control Signage.* Subject to the terms of Section 16.30 hereof, to control, install, affix, and maintain any and all signs on the Property, or on the exterior of the Warehouse Complex, and in any common corridors, entrances, and other common areas thereof, except those signs within the Premises not visible from outside the Premises.

(b) *Restrict Services.* To reasonably designate, limit, restrict, and control any service in or to the Warehouse Complex, including without limitation the designation of sources from which Tenant may obtain sign painting and lettering. Any restriction, designation, limitation, or control imposed by reason of this subparagraph will be imposed uniformly on Tenant and other tenants occupying space in the Warehouse Complex.

(c) *Retain Keys.* To retain at all times, and to use in appropriate instances, keys to all doors within and into the Premises (except for keys to dock doors that will not be retained by Landlord until termination or expiration of this Lease). Except with respect to dock doors as provided above, no locks will be changed without the prior written consent of Landlord, and keys to any and all new locks will be immediately delivered to Landlord. This provision will not apply to Tenant's safes or other areas maintained by Tenant for the safety and security of moneys, securities, negotiable instruments, or similar items.

(d) *Make Repairs.* To make repairs, alterations, additions, or improvements, whether structural or otherwise, in and about the Warehouse Complex, or any part thereof, and for such purposes to enter on the Premises, and during the continuation of any of such work, to temporarily close doors, entryways, public spaces, and corridors in the Warehouse Complex and to interrupt or temporarily suspend services and facilities.

(e) *Regulate Heavy Equipment.* To approve the floor loading and floor anchoring characteristics of racks and other heavy equipment and articles in and about the Premises and the Warehouse Complex and to require all such items to be moved into and out of the Warehouse Complex and the Premises only at such times and in such manner as Landlord will direct in writing.

Section 7.2. *Emergency Entry.* Landlord and its agents may enter the Premises at any time in case of emergency and will have the right to use any and all means that Landlord may deem proper to open such doors during an emergency in order to obtain entry to the Premises. Any entry to the Premises obtained by Landlord in the event of an emergency will not, under any circumstances, be construed or deemed to be a forcible or unlawful entry into, or detainer of, the Premises, or to be an eviction of Tenant from the Premises or any portion thereof.

Section 7.3. *Exhibition of Premises.* Tenant will permit Landlord and its agents, upon reasonable advance notice, to enter and pass through the Premises or any part thereof at reasonable times during normal business hours to (a) post notices of nonresponsibility; (b) exhibit the Premises to holders of encumbrances on the interest of Landlord under the Lease and to prospective purchasers, mortgagees, or tenants of the Warehouse Complex; and (c) during the period of ____ months prior to the expiration of the Term, exhibit the Premises to prospective tenants thereof. If during the last month of the Term Tenant will have removed substantially all of Tenant's property and personnel from the Premises, then Landlord may enter the Premises and repair, alter, and redecorate the same, without abatement of Rent and without liability to Tenant, and such acts will have no effect on this Lease.

Section 7.4. *Right of Landlord to Perform.* All covenants and agreements to be performed by Tenant under any of the terms of this Lease will be performed by Tenant at Tenant's sole cost and expense and without any abatement of Rent. If Tenant will fail to pay any sum of money (other than Rent due Landlord) required to be paid by it hereunder or will fail to perform any other act on its part to be performed hereunder, including without limitation the failure to commence and complete repairs promptly and adequately and the failure to remove any liens or otherwise to perform any act or fulfill any obligation required of Tenant under this Lease, Landlord may, after ____ days' written notice (or such shorter notice period as Landlord may reasonably determine in the event of an emergency), but will not be obligated to do so, and without waiving or releasing Tenant from any obligations of Tenant, make any such payment or perform any such act on Tenant's part to be made or performed as in this Lease provided. All sums so paid by Landlord and all necessary incidental costs, together with an administrative charge in the amount of ____ percent of any costs incurred by Landlord, and interest thereon at the Interest Rate accruing from the date paid or incurred by Landlord until reimbursed to Landlord by Tenant, will be payable to Landlord by Tenant as Rent on demand, and Tenant covenants to pay all such sums. Landlord will have (in addition to any other right or remedy of Landlord) the same rights and remedies in the event of Tenant's nonpayment of such sums as in the case of default by Tenant in the payment of Rent to Landlord.

Article 8 — Alterations and Improvements

Section 8.1. *Procedures for Tenant's Improvements.* Tenant will not make any improvements, alterations, additions, or installations in or to the Premises (herein called the "Work") without Landlord's prior written consent, which consent will not be unreasonably withheld or delayed (other than in connection with "Major Work" (defined below) for which Landlord's consent may be granted or withheld in Landlord's sole and absolute discretion). As used herein, the term "Major Work" will mean Work involving modifications to or affecting the structural; mechanical; electrical, plumbing; fire/life safety; or heating, ventilating, and air-conditioning systems of the Building; or modifications to any portion of the Property outside the interior of the Premises. Along with any request for Landlord's consent and before commencement of the Work or delivery of any materials to be used in the Work to the Premises or into the Warehouse Complex, Tenant will furnish Landlord with plans and specifications, names and addresses of contractors, copies of contracts, necessary permits, and licenses, an indemnification in such form and amount as may be reasonably satisfactory to Landlord, and, with respect to third-party contractors performing work, a performance bond executed by a commercial surety reasonably satisfactory to Landlord, and in an amount equal to the Work and the payment of all liens for labor and material arising therefrom. Tenant agrees to defend and hold Landlord forever harmless from any and all claims and liabilities of any kind and description that may arise out of or be connected in any way with such improvements, alterations, additions, or installations. All Work will be done only by contractors or mechanics reasonably approved by Landlord and at such time and in such manner as Landlord may from time to time reasonably designate. All work done by Tenant, or its agents, employees, or contractors, will be done in such a manner as to avoid labor disputes. Landlord has informed Tenant of the probability, if Tenant, or any of its contractors, subcontractors, sub-subcontractors, employees, or agents, should use or employ

nonunion labor in connection with any Work, that such use may occasion labor disputes, work stoppages, or other delays or difficulties in Landlord's construction of the Warehouse Complex and the Leasehold Improvements, Landlord's management of the Warehouse Complex, or the fulfillment of other obligations of Landlord under this Lease and under other leases with respect to the Warehouse Complex. Accordingly, and anything in this Lease to the contrary notwithstanding, (a) neither Tenant nor any of its contractors, subcontractors, sub-subcontractors, employees, or agents will use or employ nonunion labor in connection with the performance of Work; (b) Landlord will not be liable or responsible for any delays in the performance of the construction of the Warehouse Complex or the Leasehold Improvements, or in any other obligations of Landlord hereunder, that may result from any such use or employment of nonunion labor in connection with the performance of Work; and (c) Tenant will indemnify, defend, and hold harmless Landlord, and its officers, directors, shareholders, employees, and agents, from and against any and all losses, costs, claims, and other damages arising out of or in connection with the use or employment of nonunion labor in connection with the performance of the Work, including without limitation costs relating to delays in Landlord's prosecution of its work at the Warehouse Complex (whether for Tenant or for other tenants of the Warehouse Complex) and reasonable attorneys' fees and costs. Tenant will pay the cost of all such improvements, alterations, additions, or installations (including a reasonable charge for Landlord's services and for Landlord's inspection and engineering time), and also the cost of painting, restoring, or repairing the Premises and the Warehouse Complex occasioned by such improvements, alterations, additions, or installations. Upon completion of the Work, Tenant will furnish Landlord with contractors' affidavits or unconditional lien releases and full and final waivers of liens, and receipted bills covering all labor and materials expended and used. The Work will comply with all insurance requirements and all laws, ordinances, rules, and regulations of all governmental authorities, and will be constructed in a good and workmanlike manner. Tenant will permit Landlord to inspect construction operations in connection with the Work. Tenant will not be allowed to make any alterations, modifications, improvements, additions, or installations if such action results or would result in a labor dispute or otherwise would materially interfere with Landlord's operation of the Warehouse Complex. Landlord, by written notice to Tenant given at or prior to the termination of this Lease, may require Tenant to remove any improvements, additions, or installation installed by Tenant in the Premises, at Tenant's sole cost and expense, and repair or restore any damage caused by the installation and removal of such improvements, additions, or installations; provided, however, the only improvements, additions, or installations that Tenant will remove will be those specified in such notice.

Notwithstanding anything in this Section 8.1 of the Lease to the contrary, Landlord's consent will not be required to any Work that costs less than $_____ and is not Major Work.

Section 8.2. ***Mechanics Liens.*** **Tenant will keep the Premises and the Warehouse Complex free from any liens arising out of any work performed, material furnished, or obligations incurred by Tenant. In the event Tenant elects to contest any mechanics liens, Tenant will indemnify, protect, defend, and hold Landlord harmless from any liens and encumbrances arising out of any work performed, material furnished, or obligations incurred by or at the direction of Tenant. In the event that Tenant does not, within ____ days following the**

imposition of any such lien, either cause such lien to be insured over in a manner reasonably acceptable to Landlord and to any Mortgagee or released of record by payment or by posting a proper bond, Landlord will have, in addition to all other remedies provided herein and by law, the right, but not the obligation, to cause the same to be released by such means as it will deem proper, including payment of and/or defense against the claim giving rise to such lien. All such sums paid by Landlord and all expenses incurred by it in connection therewith, including attorneys' fees and costs, will be payable as Additional Rent to Landlord by Tenant on demand, with interest at the Interest Rate accruing from the date paid or incurred by Landlord until reimbursed to Landlord by Tenant.

Section 8.3. ***Alterations a Part of the Premises.*** **Any additions to, or alterations of, the Premises, except as specified in Tenant's notice to Landlord or that constitute Tenant's trade fixtures or storage racks, will become at once a part of the Premises and belong to Landlord without compensation to Tenant.**

Article 9 — Repairs

Section 9.1. ***Tenant's Repair Obligations.*** **Subject to Article 11 hereof, Tenant will, during the Term, at Tenant's expense, keep the Premises in as good order, condition, and repair as they were at the time Tenant took possession of the same, reasonable wear and tear and insured damage from fire and other casualties excepted. Tenant will keep the Premises in a neat and sanitary condition and will not commit any nuisance or waste on the Premises or in, on, or about the Warehouse Complex, throw foreign substances in the plumbing facilities, or waste any of the utilities furnished by the Landlord. All uninsured damage or injury to the Premises, or to the Warehouse Complex, caused by Tenant's moving furniture, fixtures, racks, equipment, or other devices in or out of the Premises or Warehouse Complex or by installation or removal of furniture, fixtures, racks, equipment, devices, or other property of Tenant, or its agents, contractors, servants, or employees, due to carelessness, omission, neglect, improper conduct, or other cause of Tenant, or its servants, employees, agents, visitors, or licensees, will be repaired, restored, and replaced promptly by Tenant at its sole cost and expense to the reasonable satisfaction of Landlord. All repairs, restorations, and replacements will be in quality and class equal to the original work and will comply with all requirements of the Lease.**

Section 9.2. ***Landlord's Inspection.*** **Landlord, or its employees or agents, will have the right to enter the Premises at any reasonable time or times for the purpose of inspection, cleaning, repairs, altering, or improving the same. However, nothing contained herein will be construed as imposing any obligation on Landlord to make any repairs, alterations, or improvements that are the obligation of Tenant.**

Section 9.3. ***Joint Inspection upon Vacation.*** **Tenant will give written notice to Landlord at least ____ days prior to vacating the Premises, for the express purpose of arranging a meeting with Landlord for a joint inspection of the Premises. In the event of Tenant's failure to give such notice and arrange such joint inspection, Landlord's inspection at or after Tenant's vacation of the Premises will be conclusively deemed correct for purposes of determining Tenant's responsibility for repairs and restoration hereunder.**

Article 10 — Assignment and Subletting

Section 10.1. ***General Prohibition; Recapture; Exceptions.***

(a) ***General Prohibition.*** **Subject to this Section 10.1, Tenant will not, without the prior written consent of Landlord, which consent will not be unreasonably withheld or delayed, (i) transfer, pledge, mortgage, or assign this Lease or any interest hereunder; (ii) permit any assignment of this Lease by voluntary act, operation of law, or otherwise; (iii) sublet the Premises or any part thereof; or (iv) permit the use of the Premises by any parties other than Tenant, its agents, and its employees. Tenant will seek such written consent of Landlord by a written request therefor, setting forth the information described in Section 10.1(b) hereof and such other information as Landlord may deem necessary.**

(b) ***Recapture.*** **Tenant's aforesaid written notice will (i) advise Landlord of its intention from, on, and after a stated date (which will not be fewer than ____ days after date of Tenant's notice), to assign this Lease or to sublet any part or all of the Premises for the balance or any part of the Term; and (ii) state the terms on which Tenant intends to make such assignment or sublease. In such event, Landlord will have the right, to be exercised at Landlord's sole option by giving written notice to Tenant within ____ days after receipt of Tenant's notice, to recapture the space described in Tenant's notice. Any such recapture notice will, if given, cancel and terminate this Lease with respect to the space therein described as of the date stated in Tenant's notice. If Tenant's notice will cover all of the Premises, and Landlord will have exercised its foregoing recapture right, the Term will expire and end on the date stated in Tenant's notice as fully and completely as if that date had been herein definitely fixed for the expiration of the Term. If, however, this Lease will be canceled with respect to less than the entire Premises, the Base Rent and Additional Rent will be equitably adjusted by Landlord with due consideration of the size, location, type, and quality of the portion of the Premises so remaining after the "recapture," and such Rent will be reduced accordingly from and after the termination date for such portion. This Lease as so amended will continue thereafter in full force and effect. The Rent adjustments provided for herein will be evidenced by an amendment to this Lease executed by Landlord and Tenant. If this Lease will be terminated in the manner aforesaid, either as to the entire Premises or only a portion thereof, to such extent the Term will end upon the appropriate effective date of the proposed sublease or assignment as if that date had been originally fixed in this Lease for such expiration. In the event of a termination affecting less than the entire Premises, Tenant will comply with Article 13 hereof with respect to such portion of the Premises affected thereby.**

(c) ***Exceptions.*** **Anything in this Section 10.1 or elsewhere in this Lease to the contrary notwithstanding, but subject to Sections 10.6 and 10.8 hereof, Tenant will be permitted to assign or sublease the Premises, or any portion thereof, upon written notice to Landlord not less than ____ days prior to such assignment or subletting but without the necessity of Landlord's prior written consent, to (i) any entity directly resulting from a merger or consolidation of Tenant, (ii) any entity succeeding to all of the business and assets of Tenant, or (iii) any subsidiary or affiliate of Tenant.**

Section 10.2. ***Payment of Commissions in Event of Termination.*** **In the event of any termination pursuant to this Article 10, Tenant will, at its sole cost and expense, discharge in full (a) any outstanding commission obligation on the part of Landlord with respect to that part of this Lease so terminated, and (b) any commission that may be due and owing as a result of any proposed assignment or subletting, regardless of whether the subject portion of the Premises is recaptured pursuant thereto and rented by Landlord to the proposed tenant or any other tenant.**

Section 10.3. ***Right To Recapture Not Exercised.*** **If Landlord, upon receiving Tenant's notice with respect to any such space, will not exercise its right to recapture as aforesaid, Landlord will not unreasonably withhold its consent to Tenant's assignment of the Lease or subletting such space to the party identified in Tenant's notice (except as provided in Section 10.1(c) hereof); provided, however, that in the event Landlord consents to any such assignment or subletting, and as a condition thereto, Tenant will pay to Landlord 50 percent of any profit derived by Tenant from such assignment or subletting, net of all reasonable expenses in connection with such assignment or subletting (including without limitation free rent, leasehold improvements, attorneys' fees, brokerage commissions, and the like). For purposes of the foregoing, profit will be deemed to include without limitation the amount of all rent payable by such assignee or sublessee in excess of the Base Rent, and rent adjustments payable by Tenant under this Lease. If a part of the consideration for such assignment or subletting will be payable other than in cash, the payment to Landlord will be in cash for its share of any noncash consideration based on the fair market value thereof.**

Section 10.4. ***Tenant's Profit Statement.*** **Tenant will and hereby agrees that it will furnish to Landlord upon request from Landlord a complete statement, certified by an independent certified public accountant, setting forth in detail the computation of all profit derived and to be derived from such assignment or subletting, such computation to be made in accordance with generally accepted accounting principles. Tenant agrees that Landlord or its authorized representatives will be given access at all reasonable times to the books, records, and papers of Tenant relating to any such assignment or subletting, and Landlord will have the right to make copies thereof. The percentage of Tenant's profit due Landlord hereunder will be paid to Landlord within ____ days of receipt by Tenant of all payments made from time to time by such assignee or sublessee to Tenant.**

Section 10.5. ***Tenant's Changes Deemed an Assignment.*** **For purposes of the foregoing, any change in the partners of Tenant, if Tenant is a partnership, or, if Tenant is a corporation, any transfer of any or all of the shares of stock of Tenant by sale, assignment, operation of law, or otherwise resulting in a change in the present control of such partnership or corporation by the person or persons owning a majority of such partnership interests or shares as of the date of this Lease, will be deemed to be an assignment within the meaning of this Article 10.**

Section 10.6. ***Continuing Tenant Liability.*** **Any subletting or assignment hereunder will not release or discharge Tenant of or from any liability, whether past, present, or future, under this Lease, and Tenant will continue fully liable thereunder. The subtenant or subtenants or assignee will agree in a form satisfactory to Landlord to comply with and be**

bound by all of the terms, covenants, conditions, provisions, and agreements of this Lease to the extent of the space sublet or assigned, and Tenant will deliver to Landlord promptly after execution an executed copy of each such sublease or assignment and an agreement of compliance by each such subtenant or assignee. Consent by Landlord to any assignment of this Lease or to any subletting of the Premises will not be a waiver of Landlord's rights under this Article 10 as to any subsequent assignment or subletting.

Section 10.7. ***Void Transfers.*** **Any sale, assignment, mortgage, transfer, or subletting of this Lease that is not in compliance with the provisions of this Article 10 will be of no effect and void. Landlord's right to assign its interest in this Lease will remain unqualified. Landlord may make a reasonable charge to Tenant for any reasonable attorneys' fees or expenses incident to a review of any documentation related to any proposed assignment or subletting by Tenant.**

Section 10.8. ***Prohibited Transferees.*** **Anything in this Lease to the contrary notwithstanding, Tenant will not assign its rights under this Lease or sublet all or any part of the Premises to any person or entity that is (or, immediately prior to such subletting or assignment, was) a tenant or occupant of the Warehouse Complex or any office building in the Park.**

Section 10.9. ***Criteria for Withholding Consent.*** **The consent of Landlord to a transfer, assignment, sublease, or other transaction described in Section 10.1 hereof will not be unreasonably withheld, provided that should Landlord withhold its consent for any of the following reasons, which list is not exclusive, such withholding will be deemed to be reasonable:**

(a) Financial strength of the proposed transferee is not at least equal to that of Tenant at the time of execution of this Lease or of lessees occupying comparable premises in the Warehouse Complex or in other buildings owned or operated by Landlord located in the same metropolitan area as the Warehouse Complex;

(b) A proposed transferee whose business conducted in the Premises would cause a diminution in the reputation of the Warehouse Complex or the other businesses located therein;

(c) A proposed transferee whose impact on the common areas or the other occupants of the Warehouse Complex would be disadvantageous, or whose occupancy can reasonably be expected to exceed the parking capacity for the Building;

(d) A proposed transferee whose occupancy will require any variation in the terms and conditions of this Lease; or

(e) A proposed transferee that is a governmental entity or unit, or any agency, department, or authority thereof.

Tenant agrees that its personal business skills and philosophy were an important inducement to Landlord for entering into this Lease and that Landlord may reasonably object to the transfer of the Premises to another whose proposed use, while permitted by this Lease, would involve a materially different quality, manner, or type of business skills than that of Tenant.

Article 11 — Damage by Fire or Other Casualty

Section 11.1. ***Tenantable Within ____ Days.*** **If fire or other casualty will render the whole or any material portion of the Premises untenantable, and the Premises can reasonably be expected to be made tenantable within ____ days from the date of such event, then Landlord will repair and restore the Premises and the Warehouse Complex to as near their condition prior to the fire or other casualty as is reasonably possible within such ____-day period (subject to delays for causes beyond Landlord's reasonable control), and will notify Tenant that it will be doing so, such notice to be mailed within ____ days from the date of such damage or destruction. This Lease will remain in full force and effect, but the Rent for the period during which the Premises are untenantable will be abated pro rata (based on the portion of the Premises that is untenantable). If Landlord is required to repair the Warehouse Complex and/or the Premises as aforesaid, such work will be undertaken and prosecuted with all due diligence and speed.**

Section 11.2. ***Not Tenantable Within ____ Days.*** **If fire or other casualty will render the whole or any material part of the Premises untenantable, and the Premises cannot reasonably be expected to be made tenantable within ____ days from the date of such event, then either party, by notice in writing to the other mailed within ____ days from the date of such damage or destruction, may terminate this Lease effective upon a date within ____ days from the date of such notice.**

Section 11.3. ***Warehouse Complex Substantially Damaged.*** **In the event that more than ____ percent of the value of the Warehouse Complex is damaged or destroyed by fire or other casualty, and irrespective of whether damage or destruction can be made tenantable within ____ days thereafter, then at Landlord's option, by written notice to Tenant, mailed within ____ days from the date of such damage or destruction, Landlord may terminate this Lease effective upon a date within ____ days from the date of such notice to Tenant.**

Section 11.4. ***Deductible Payments.*** **If the Premises or the Warehouse Complex is damaged, and such damage is of the type insured against under the fire and special form property damage insurance maintained by Landlord hereunder, the cost of repairing such damage up to the amount of the deductible under such insurance policy will be included as a part of the Operating Expenses. If the damage is not covered by such insurance policy and Landlord elects to repair the damage, then Tenant will pay Landlord a pro rata share of the "deductible amount" (if any) under Landlord's insurance policy, based on Tenant's Pro Rata Share of Operating Expenses, and, if the damage was due to an act or omission of Tenant, Tenant will pay Landlord the entire amount of such deductible (if any) not to exceed $25,000.**

Section 11.5. ***Landlord's Repair Obligations.*** **If (a) fire or other casualty will render the whole or any material part of the Premises untenantable, the Premises cannot reasonably be expected to be made tenantable within ____ days from the date of such event, and neither party hereto terminates this Lease pursuant to its rights herein; (b) more than ____ percent of the value of the Warehouse Complex is damaged or destroyed by fire or other casualty, and Landlord does not terminate this Lease pursuant to its option granted herein; or (c) ____ percent or less of the value of the Warehouse Complex is damaged or destroyed by fire or other casualty, and neither the whole nor any material portion of the Premises is rendered untenantable, then Landlord will repair and restore the Premises and the Warehouse Complex to as near their condition prior to the fire or other casualty as is reasonably possible, using all due diligence and speed (subject to delays for causes beyond Landlord's reasonable control). The Rent for the period during which the Premises are untenantable will be abated pro rata (based on the portion of the Premises that is untenantable). In no event will Landlord be obligated to repair or restore any special equipment or improvements installed by Tenant at Tenant's expense.**

Section 11.6. ***Rent Apportionment.*** **In the event of a termination of this Lease pursuant to this Article 11, Rent will be apportioned on a per diem basis and paid to the date of the fire or other casualty.**

Article 12 — Eminent Domain

Section 12.1. ***Tenant's Termination.*** **If the whole of or any substantial part of the Premises is taken by any public authority under the power of eminent domain, or taken in any manner for any public or quasi-public use, so as to render (in Tenant's reasonable judgment) the remaining portion of the Premises unsuitable for the purposes intended hereunder, then the Term will cease as of the day possession will be taken by such public authority, and Landlord will make a pro rata refund of any prepaid Rent. All damages awarded for such taking under the power of eminent domain or any like proceedings will belong to and be the property of Landlord, Tenant hereby assigning to Landlord its interest, if any, in such award. In the event that ____ percent or more of the building area of the Premises or ____ percent or more of the value of the Warehouse Complex is taken by public authority under the power of eminent domain, then, at Landlord's option, by written notice to Tenant, mailed within ____ days from the date possession will be taken by such public authority, Landlord may terminate this Lease effective upon a date within ____ days from the date of such notice to Tenant. Furthermore, if all or any material part of the Premises is taken by public authority under the power of eminent domain, or taken in any manner for any public or quasi-public use, so as to render the remaining portion of the Premises unsuitable in Tenant's reasonable opinion, for the purposes intended hereunder, upon delivery of possession to the condemning authority pursuant to the proceedings, Tenant may, at its option, terminate this Lease as to the remainder (and entirety) of the Premises by written notice to Landlord, such notice to be given to Landlord within ____ days after Tenant receives notice of the taking. Tenant will not have the right to terminate this Lease pursuant to the preceding sentence unless (a) the business of Tenant conducted in the portion of the Premises taken cannot in Tenant's reasonable judgment be carried on with substantially the same utility and efficiency in the remainder of the Premises (or any substitute space securable by Tenant pursuant to clause**

(b) hereof); and (b) Tenant cannot secure substantially similar (in Tenant's reasonable judgment) alternate space on the same terms and conditions as set forth in this Lease from Landlord in the Warehouse Complex. Any notice of termination will specify the date not more than ____ days after the giving of such notice as the date for such termination.

Section 12.2. ***Tenant's Participation.*** **Anything in this Article 12 to the contrary notwithstanding, Tenant will have the right to prove in any condemnation proceedings and to receive any separate award that may be made for damages to or condemnation of Tenant's movable trade fixtures and equipment, for moving expenses, and for its interest in this Lease or for loss of leasehold; provided, however, that no such separate award, or any action taken by Tenant in connection therewith, will diminish or prevent Landlord from obtaining any award in any such proceedings. Anything in this Article 12 to the contrary notwithstanding, in the event of a partial condemnation of the Warehouse Complex or the Premises, and if this Lease is not terminated, Landlord will, at its sole cost and expense, restore the Premises and Warehouse Complex to a complete architectural unit. The Base Rent provided for herein during the period from and after the date of delivery of possession pursuant to such proceedings to the termination of this Lease, will be reduced to a sum equal to the product of the Base Rent provided for herein multiplied by a fraction, the numerator of which is the fair market rent of the Premises after such taking and after the same has been restored to a complete architectural unit, and the denominator of which is the fair market rent of the Premises prior to such taking.**

Article 13 — Surrender of Premises

Section 13.1. ***Surrender of Possession.*** **On the last day of the Term, or on the sooner termination thereof, Tenant will peaceably surrender the Premises in good condition and repair consistent with Tenant's duty to make repairs as herein provided. On or before the last day of the Term, or the date of sooner termination hereof, Tenant will, at its sole cost and expense, remove all of its property and trade fixtures and equipment from the Premises, and all property not removed will be deemed abandoned. Tenant hereby appoints Landlord its agent to remove all abandoned property of Tenant from the Premises upon termination of this Lease and to cause its transportation and storage for Tenant's benefit, all at the sole cost and risk of Tenant. Landlord will not be liable for damage, theft, misappropriation, or loss thereof, and Landlord will not be liable in any manner in respect thereto. Tenant will pay all costs and expenses of such removal, transportation, and storage. Tenant will leave the Premises in good order, condition, and repair, reasonable wear and tear and insured damage from fire and other casualty excepted. Tenant will reimburse Landlord upon demand for any expenses incurred by Landlord with respect to removal, transportation, or storage of abandoned property and with respect to restoring such Premises to good order, condition, and repair. All alterations, additions, and fixtures, other than Tenant's trade fixtures and equipment that have been made or installed by either Landlord or Tenant on the Premises, will remain the property of Landlord and will be surrendered with the Premises as a part thereof. If the Premises are not surrendered at the end of the term or sooner termination thereof, Tenant will indemnify Landlord against loss or liability resulting from delay by Tenant in so surrendering the Premises, including, without limitation, claims made by any**

succeeding tenants founded on such delay and any attorneys' fees resulting therefrom. Tenant will promptly surrender all keys for the Premises to Landlord at the place then fixed for the payment of rent and will inform Landlord of combinations on any vaults, locks, and safes left on the Premises.

Section 13.2. ***Tenant Retaining Possession.*** **In the event Tenant remains in possession of the Premises after expiration of this Lease, and without the execution of a new lease, but with Landlord's written consent, Tenant will be deemed to be occupying the Premises as a tenant from month to month, subject to all the provisions, conditions, and obligations of this Lease insofar as the same can be applicable to a month-to-month tenancy; provided, however, that the Base Rent will be escalated to Landlord's then current base rent for the Premises according to Landlord's then current rental rate schedule for prospective tenants. In the event Tenant remains in possession of the Premises after expiration of this Lease, without the execution of a new lease and without Landlord's written consent, Tenant will be deemed to be occupying the Premises without claim of right, and Tenant will pay Landlord for all costs arising out of loss or liability resulting from delay by Tenant in so surrendering the Premises as above provided and will pay as a charge for each day of occupancy an amount equal to ____ percent of the Base Rent and ____ percent of the Additional Rent (on a daily basis) then currently being charged by Landlord on new leases in the Warehouse Complex for space similar to the Premises.**

Article 14 — Default of Tenant

Section 14.1. ***Events of Default.*** **The occurrence of any one or more of the following events (Event of Default) will constitute a default and breach of this Lease by Tenant:**

(a) ***Monetary Default.*** **If Tenant fails to pay any Base Rent or Additional Rent payable under this Lease or fails to pay any obligation required to be paid by Tenant when and as the same will become due and payable, and such default continues for a period of ____ days after written notice thereof given by Landlord to Tenant.**

(b) ***Nonmonetary Default.*** **If Tenant fails to perform any of Tenant's nonmonetary obligations under this Lease for a period of ____ days after written notice from Landlord; provided that if more time is required to complete such performance, Tenant will not be in default if Tenant commences such performance within the ____-day period and thereafter diligently pursues its completion. The notice required by this subsection is intended to satisfy any and all notice requirements imposed by law on Landlord and is not in addition to any such requirements.**

(c) ***Violation of Assignment or Sublet Requirements.*** **If Tenant, by operation of law or otherwise, violates the provisions of Article 10 hereof relating to assignment, sublease, mortgage, or other transfer of Tenant's interest in this Lease or in the Premises or in the income arising therefrom.**

(d) *False or Misleading Representations.* If Landlord discovers that any financial statement, warranty, representation, or other information given to Landlord by Tenant, any assignee of Tenant, any subtenant of Tenant, any successor in interest of Tenant, or any guarantor of Tenant's obligation hereunder, and any of them, in connection with this Lease, was materially false or misleading when made or furnished.

(e) *Environmental Default.* If Tenant, by operation of law or otherwise, violates the provisions of Section 4.8 hereof relating to compliance with environmental laws for a period of ____ days after written notice from Landlord, or such shorter time period as is reasonable in the event of an emergency; provided that if more time is required to complete such performance, Tenant will not be in default if Tenant commences such performance within the ____-day (or shorter, if applicable) period and thereafter diligently pursues its completion. The notice required by this subsection is intended to satisfy any and all notice requirements imposed by law on Landlord and is not in addition to any such requirements.

(f) *Bankruptcy; Insolvency.* If (i) Tenant makes a general assignment or general arrangement for the benefit of creditors; (ii) a petition for adjudication of bankruptcy or for reorganization or rearrangement is filed by Tenant and is not dismissed within ____ days or is filed against Tenant and is not dismissed within ____ days; (iii) a trustee or receiver is appointed to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in the Lease and possession is not restored to Tenant within ____ days; or (iv) substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease is subjected to attachment, execution, or other judicial seizure that is not discharged within ____ days. If a court of competent jurisdiction determines that any of the acts described in this subsection does not constitute an Event of Default and a trustee is appointed to take possession (or if Tenant remains a debtor-in-possession) and such trustee or Tenant transfers Tenant's interest hereunder, then Landlord will receive, as Additional Rent, the difference between the Rent (or any other consideration) paid in connection with such assignment or sublease and the Rent payable by Tenant hereunder. As used in this subsection, the term "Tenant" will also mean any guarantor of Tenant's obligations under this Lease. If any such Event of Default will occur, Landlord, at any time during the continuance of any such Event of Default, may give written notice to Tenant, stating that this Lease will expire and terminate on the date specified in such notice. Upon the date specified in such notice, this Lease, and all rights of Tenant under this Lease, including all rights of renewal whether exercised or not, will expire and terminate, or in the alternative, or in addition to the foregoing remedy, Landlord may assert and have the benefit of any other remedy allowed herein, at law, or in equity.

Section 14.2. *Landlord's Remedies.* Upon the occurrence of an Event of Default by Tenant, and at any time thereafter, with or without notice or demand and without limiting Landlord in the exercise of any right or remedy that Landlord may have, Landlord will be entitled to the rights and remedies set forth below.

(a) *Termination of Possession.* Upon the occurrence of an Event of Default by Tenant, Landlord will have the right to terminate Tenant's right to possession of the Premises by any lawful means, in which case this Lease will terminate and Tenant will immediately surrender

possession of the Premises to Landlord. In such event, Landlord will have the immediate right to reenter and remove all persons and property, and such property may be removed and stored in a public warehouse or elsewhere at the cost of and for the account of Tenant, all without service of notice or resort to legal process and without being deemed guilty of trespass, or becoming liable for any loss or damage that may be occasioned thereby. In the event that Landlord will elect so to terminate this Lease, then Landlord will be entitled to recover from Tenant all damages incurred by Landlord by reason of Tenant's default, including

(i) the equivalent of the amount of the Base Rent and Additional Rent that would be payable under this Lease by Tenant if this Lease were still in effect; less

(ii) the net proceeds of any reletting effected pursuant to the provisions of this Section 14.2 after deducting all of Landlord's reasonable expenses in connection with such reletting, including without limitation all repossession costs, brokerage commissions, legal expenses, reasonable attorneys' fees and costs, alteration costs, and expenses of preparation of the Premises, or any portion thereof, for such reletting.

Tenant will pay such current damages in the amount determined in accordance with the terms of this Section 14.2 as set forth in a written statement thereof from Landlord to Tenant (Deficiency). Such payments will be made to Landlord in monthly installments on the days on which the Rent would have been payable under this Lease if this Lease were still in effect, and Landlord will be entitled to recover from Tenant each monthly installment of the Deficiency as the same will arise.

(b) ***Damages.*** **At any time after an Event of Default and termination of this Lease, whether or not Landlord will have collected any monthly Deficiency as set forth in this Section 14.2, Landlord will be entitled to recover from Tenant, and Tenant will pay to Landlord, on demand, as and for final damages for Tenant's default, an amount equal to the difference between the then present worth of the aggregate of the Base Rent and Additional Rent and any other charges to be paid by Tenant hereunder for the unexpired portion of the Term (assuming this Lease had not been so terminated), and the then present worth of the then aggregate fair and reasonable fair market rent of the Premises for the same period. In the computation of present worth, a discount at the rate of ____ percent per annum will be employed. If the Premises, or any portion thereof, will be relet by Landlord for the unexpired Term, or any part thereof, before presentation of proof of such damages to any court, commission, or tribunal, the amount of Rent reserved upon such reletting will, prima facie, be the fair and reasonable fair market rent for the part or the whole of the Premises so relet during the term of the reletting. Nothing herein contained or contained in this Section 14.2 will limit or prejudice the right of Landlord to prove and obtain, as damages by reason of such expiration or termination, an amount equal to the maximum allowed by any statute or rule of law in effect at the time when, and governing the proceedings in which, such damages are to be proved, regardless of whether such amount be greater, equal to, or less than the amount of the difference referred to above.**

(c) *Reentry and Removal.* Upon the occurrence of an Event of Default by Tenant, Landlord will also have the right, with or without terminating this Lease, to reenter the Premises to remove all persons and property from the Premises. Such property may be removed and stored in a public warehouse or elsewhere at the cost of and for the account of Tenant. If Landlord elects to reenter the Premises, Landlord will not be liable for damages by reason of such reentry.

(d) *No Termination; Recovery of Rent.* If Landlord does not elect to terminate this Lease as provided in this Section 14.2, then Landlord may, from time to time, recover all Rent as it becomes due under this Lease. At any time thereafter, Landlord may elect to terminate this Lease and to recover damages to which Landlord is entitled.

(e) *Reletting the Premises.* In the event that Landlord should elect to terminate this Lease and to relet the Premises, it may execute any new lease in its own name. Tenant hereunder will have no right or authority whatsoever to collect any Rent from such Tenant. The proceeds of any such reletting will be applied as follows:

(i) first, to the payment of any indebtedness other than Rent due hereunder from Tenant to Landlord, including without limitation storage charges or brokerage commissions owing from Tenant to Landlord as the result of such reletting;

(ii) second, to the payment of the costs and expenses of reletting the Premises, including alterations and repairs that Landlord, in its sole and absolute discretion, deems reasonably necessary and advisable and reasonable attorneys' fees incurred by Landlord in connection with the retaking of the Premises and such reletting;

(iii) third, to the payment of Rent and other charges due and unpaid hereunder; and

(iv) fourth, to the payment of future Rent and other damages payable by Tenant under this Lease.

The parties hereto will, and they hereby do, waive trial by jury in any action, proceeding, or counterclaim brought by either of the parties hereto against the other on any matters whatsoever arising out of, or in any way connected with, this Lease, the relationship of Landlord and Tenant, Tenant's use or occupancy of the Premises and/or Warehouse Complex, and/or claim or injury or damage. In the event Landlord commences any proceeding to enforce this Lease or the Landlord-Tenant relationship between the parties or for nonpayment of Rent (of any nature whatsoever) or additional moneys due Landlord from Tenant under this Lease, Tenant will not interpose any counterclaim of whatever nature or description in any such proceedings. In the event Tenant must, because of applicable court rules, interpose any counterclaim or other claim against Landlord in such proceedings, Landlord and Tenant covenant and agree that, in addition to any other lawful remedy of Landlord, upon motion of Landlord, such counterclaim or other claim asserted by Landlord will be severed out of the proceeding instituted by Landlord (and, if necessary, transferred to a court of different jurisdiction), and the proceedings instituted by Landlord may proceed to final judgment separately and apart from and without consolidation with or reference to the status of each counterclaim or any other claim asserted by Tenant.

Section 14.3. ***Written Notice of Termination Required.*** **Landlord will not be deemed to have terminated this Lease and Tenant's right to possession of the leasehold or the liability of Tenant to pay Rent thereafter to accrue or its liability for damages under any of the provisions hereof, unless Landlord will have notified Tenant in writing that it has so elected to terminate this Lease. Tenant covenants that the service by Landlord of any notice pursuant to the applicable unlawful detainer statutes of the state in which the Warehouse Complex is located and Tenant's surrender of possession pursuant to such notice will not (unless Landlord elects to the contrary at the time of, or at any time subsequent to the service of, such notice, and such election be evidenced by a written notice to Tenant) be deemed to be a termination of this Lease or of Tenant's right to possession thereof.**

Section 14.4. ***Remedies Cumulative; No Waiver.*** **All rights, options, and remedies of Landlord contained in this Lease will be construed and held to be cumulative, and no one of them will be exclusive of the other. Landlord will have the right to pursue any one or all of such remedies or any other remedy or relief that may be provided by law whether or not stated in this Lease. No waiver by Landlord of a breach of any of the terms, covenants, or conditions of this Lease by Tenant will be construed as or held to be a waiver of any succeeding or preceding breach of the same or any other term, covenant, or condition therein contained. No waiver of any default of Tenant hereunder will be implied from any omission by Landlord to take any action on account of such default if such default persists or is repeated, and no express waiver will affect default other than as specified in such waiver. The consent or approval by Landlord to or of any act by Tenant requiring Landlord's consent or approval will not be deemed to waive or render unnecessary Landlord's consent to or approval of any subsequent similar acts by Tenant.**

Section 14.5. ***Legal Costs.*** **Tenant will reimburse Landlord, upon demand, for any costs or expenses incurred by Landlord in connection with any breach or default of Tenant under this Lease, regardless of whether suit is commenced or judgment entered. Such costs will include, without limitation, legal fees and costs incurred for the negotiation of a settlement, enforcement of rights, or otherwise. Furthermore, if any action for breach of or to enforce the provisions of this Lease is commenced, the court in such action will award to the party in whose favor a judgment is entered a reasonable sum as attorneys' fees and costs. Such attorneys' fees and costs will be paid by the losing party in such action. Tenant will also indemnify Landlord against and hold Landlord harmless from all costs, expenses, demands, and liability incurred by Landlord if Landlord becomes or is made a party to any claim or action (a) instituted by Tenant, or by any third party against Tenant; (b) for foreclosure of any lien for labor or material furnished to or for Tenant or such other person; (c) otherwise arising out of or resulting from any act or transaction of Tenant or such other person; or (d) necessary to protect Landlord's interest under this Lease in a bankruptcy proceeding, or other proceeding under Title 11 of the United States Code, as amended. Tenant will defend Landlord against any such claim or action at Tenant's expense with counsel reasonably acceptable to Landlord, or at Landlord's election, Tenant will reimburse Landlord for any legal fees or costs incurred by Landlord in any such claim or action.**

Section 14.6. ***Waiver of Damages for Reentry.*** **To the extent that Landlord complies with all applicable law, Tenant hereby waives all claims for damages that may be caused by**

Landlord's reentering and taking possession of the Premises or removing and storing the property of Tenant as permitted under this Lease, and will save Landlord harmless from all losses, costs, or damages occasioned Landlord thereby. No such reentry will be considered or construed to be a forcible entry by Landlord.

Article 15 — Subordination/Estoppel

Section 15.1. ***Lease Subordinate.*** **This Lease will be subject and subordinate to any mortgage, deed of trust, or ground lease now or hereafter placed on the Premises, the Warehouse Complex, the Property, or any portion thereof by Landlord, or its successors or assigns, and to amendments, replacements, renewals, and extensions thereof. Tenant agrees at any time hereafter, upon demand, to execute and deliver any instruments, releases, or other documents that may be reasonably required for the purpose of subjecting and subordinating this Lease, as above provided, to the lien of any such mortgage, deed of trust, or ground lease. It is agreed, nevertheless, that as long as Tenant is not in default in the payment of Base Rent or Additional Rent, or the payment of other charges to be paid by Tenant under this Lease, or the performance of all covenants, agreements, and conditions to be performed by Tenant under this Lease, then there will be no interference with Tenant's right to quiet enjoyment under this Lease, or with the right of Tenant to continue to occupy the Premises and to conduct its business thereon, in accordance with the terms of this Lease, as against any lessor, lessee, mortgagee, or trustee, or their respective successors or assigns. At Tenant's request, Landlord will request that any Mortgagee enter into with Tenant a commercially reasonable form of subordination, non-disturbance, and attornment agreement that is consistent with the terms of this Section 15.1.**

Section 15.2. ***Attornment.*** **The above subordination provisions will be effective without the necessity of the execution and delivery of any further instruments on the part of Tenant to effect such subordination. Notwithstanding anything hereinabove contained in this Article 15, in the event the holder of any mortgage, deed of trust, or ground lease will at any time elect to have this Lease constitute a prior and superior lien to its mortgage, deed of trust, or ground lease, then, and in such event, upon any such holder or landlord notifying Tenant to that effect in writing, this Lease will be deemed prior and superior in lien to such mortgage, deed of trust, or ground lease, whether this Lease is dated prior or subsequent to the date of such mortgage, deed of trust, or ground lease, and Tenant will execute such attornment agreement as may be reasonably requested by such holder.**

Section 15.3. ***Tenant's Notice of Default.*** **Tenant agrees, provided the mortgagee, ground lessor, trust deed holder, or other secured party under any mortgage, ground lease, deed of trust, or other security instrument (Mortgagee) will have notified Tenant in writing (by way of a notice of assignment of lease or otherwise) of its address, Tenant will give such Mortgagee, simultaneously with delivery of notice to Landlord, by registered or certified mail, a copy of any such notice of default served on Landlord. Tenant further agrees that such Mortgagee will have the right to cure any alleged default during the same period that Landlord has to cure such default.**

Section 15.4. ***Estoppel Certificates.*** **Tenant agrees from time to time upon not less than ____ days' prior written request by Landlord to deliver to Landlord a statement in writing certifying (a) that this Lease is unmodified and in full force and effect (or if there have been modifications that the Lease as modified is in full force and effect and stating the modifications); (b) the dates to which the Rent and other charges have been paid; (c) that Landlord is not in default in any provision of this Lease or, if in default, the nature thereof specified in detail; (d) the amount of monthly rental currently payable by Tenant; (e) the amount of any prepaid rent; and (f) such other matters as may be reasonably requested by Landlord or any mortgagee or prospective purchaser of the Warehouse Complex.**

If Tenant does not deliver such statement to Landlord within such ____-day period, Landlord and any prospective purchaser or encumbrancer of the Premises or the Warehouse Complex may conclusively presume and rely on the following facts: (a) that the terms and provisions of this Lease have not been changed except as otherwise represented by Landlord; (b) that this Lease has not been canceled or terminated and is in full force and effect, except as otherwise represented by Landlord; (c) that the current amounts of the Base Rent are as represented by Landlord; (d) that there have been no subleases or assignments of the Lease; (e) that not more than one month's Base Rent or other charges have been paid in advance; and (f) that Landlord is not in default under the Lease. In such event, Tenant will be estopped from denying the truth of such facts.

Article 16 — Miscellaneous

Section 16.1. ***Time Is of the Essence.*** **Time is of the essence with respect to the performance of every provision of this Lease in which time of performance is a factor.**

Section 16.2. ***Memorandum of Lease.*** **No memorandum of this Lease may be recorded by Tenant without the prior written consent of Landlord.**

Section 16.3. ***Joint and Several Liability.*** **All parties signing this Lease as Tenant will be jointly and severally liable for all obligations of Tenant.**

Section 16.4. ***Fees of Landlord's Broker.*** **Upon the execution and delivery of this Lease, the Landlord shall pay a real estate commission to its Broker, as specified in a separate written agreement between the Landlord and its Broker. The Landlord's Broker shall pay an appropriate portion of its commission to Tenant's Broker, if such is specified in the agreement between the Tenant's Broker and the Landlord's Broker.**

Section 16.5. ***No Other Brokers.*** **Tenant represents that Tenant has dealt directly with and only with _____ and _____ (collectively "Broker"), as brokers, in connection with this Lease, and that insofar as Tenant knows, no other broker negotiated or participated in negotiations of this Lease or submitted or showed the Premises or is entitled to any commission in connection therewith. Landlord agrees to indemnify, defend, and hold harmless Tenant, and Tenant's successors and assigns, with respect to any claim by Broker, any person or entity claiming to have been engaged by either or both of Broker or anyone claiming by, through, or under Landlord, so as to become entitled to any such fee or**

commission. Tenant agrees to indemnify, defend, and hold harmless Landlord, and Landlord's successors and assigns, with respect to any claim by any person or entity, other than Broker, claiming to have been engaged by Tenant, or by anyone (again, other than Broker) claiming by, through, or under Tenant, so as to become entitled to any such fee or commission.

Section 16.6. ***Notices.*** **All notices, demands, and requests will be in writing and will be effectively served by forwarding such notice, demand, or request by certified or registered mail, postage prepaid, or by commercial overnight courier service addressed as follows:**

(a) If addressed to Tenant prior to the Commencement Date:

_____
_____
_____
Attn: _____

with a copy to:

_____
_____
_____
Attn: _____, Esq.

(b) If addressed to Landlord:

_____
_____
_____
Attn: _____

or at such other address as Landlord and Tenant may hereafter designate by written notice. The effective date of all notices will be the time of mailing such notice or the date of delivery to a commercial overnight courier service. All notices and demands delivered by a party's attorney on a Party's behalf shall be deemed to have been delivered by that Party.

Section 16.7. ***Landlord's Agent.*** **All rights and remedies of Landlord under this Lease or that may be provided by law may be executed by Landlord in its own name individually, or in the name of its agent, and all legal proceedings for the enforcement of any such rights or remedies, including those set forth in Article 14 hereof, may be commenced and prosecuted to final judgment and execution by Landlord in its own name or in the name of its agent.**

Section 16.8. ***Quiet Possession.*** **Landlord covenants and agrees that Tenant, upon paying the Base Rent, Additional Rent, and other charges herein provided for and observing and keeping the covenants, agreements, and conditions of this Lease on its part to be kept and performed, will lawfully and quietly hold, occupy, and enjoy the Premises during the Term.**

Section 16.9. *Successors and Assigns.* The covenants and agreements herein contained will bind and inure to the benefit of the Landlord, its successors and assigns, and Tenant and its permitted successors and assigns.

Section 16.10. *Severability.* If any term or provision of this Lease will to any extent be held invalid or unenforceable, the remaining terms and provisions of this Lease will not be affected thereby, but each term and provision of this Lease will be valid and enforced to the fullest extent permitted by law. This Lease will be construed and enforced in accordance with the laws of the state in which the Premises are located.

Section 16.11. *No Abandonment or Waste.* Tenant covenants not to do or suffer any waste or damage or disfigurement or injury to the Premises or Warehouse Complex.

Section 16.12. *Transfers by Landlord.* The term "Landlord" as used in this Lease as far as covenants or obligations on the part of Landlord are concerned will be limited to mean and include only the owner or owners of the Warehouse Complex at the time in question, and in the event of any transfer or transfers or conveyances, the then grantor will be automatically freed and released from all personal liability accruing from and after the date of such transfer or conveyance as respects the performance of any covenant or obligation on the part of Landlord contained in this Lease to be performed, it being intended hereby that the covenants and obligations contained in this Lease on the part of Landlord will be binding on the Landlord, and its successors and assigns, only during and in respect to their respective successive periods of ownership.

In the event of a sale or conveyance by Landlord of the Warehouse Complex or any part of the Warehouse Complex, the same will operate to release Landlord from any future liability upon any of the covenants or conditions herein contained, and in such event Tenant agrees to look solely to the responsibility of the successor in interest of Landlord in and to this Lease. This Lease will not be affected by any such sale or conveyance, and Tenant agrees to attorn to the purchaser or grantee, which will be personally obligated on this Lease only as long as it is the owner of Landlord's interest in and to this Lease.

Section 16.13. *Delivery of Documents and Information.* Tenant will, without charge to Landlord, at any time and from time to time within ____ days after written request by Landlord, deliver to Landlord (a) a current version of the form of letter attached hereto as Exhibit C regarding the then current financial status of Tenant and the Guarantor (defined in Section 16.31 below), which letter will be signed by Tenant's then current auditor; and (b) a written statement from the Guarantor that (i) the Guaranty (defined in Section 16.31 below) is unmodified and is in full force and effect (or if there have been modifications, that the Guaranty as modified is in full force and effect and stating the modifications), (ii) that the Guarantor has no claims against Landlord or defenses under the Guaranty, and (iii) such other factual matters as may be reasonably requested by Landlord or any mortgagee or prospective purchaser of the Warehouse Complex.

Section 16.14. *Jury Trial Waiver.* TENANT AND LANDLORD VOLUNTARILY, KNOWINGLY, AND INTENTIONALLY WAIVE TRIAL BY JURY IN ANY

PROCEEDING OR ACTION BROUGHT BY EITHER TENANT OR LANDLORD IN ANY MATTER ARISING FROM THE LEASE, THE PARTIES' RELATIONSHIP, TENANT'S USE OR OCCUPANCY OF THE PREMISES, OR ANY CLAIM OF DAMAGE OR INJURY.

Section 16.15. ***Prevailing Party.*** **If either Party brings a proceeding or action involving the Premises to declare the rights hereunder or enforce the Terms hereof, and such initiating party is determined to be the Prevailing Party in any action, proceeding, or appeal thereon, then such initiating party shall be entitled to receive reasonable attorneys' fees.**

Section 16.16. ***Headings.*** **The marginal or topical headings of the several articles and sections are for convenience only and do not define, limit, or construe the contents of such articles and sections.**

Section 16.17. ***Written Agreement.*** **All preliminary negotiations are merged into and incorporated in this Lease.**

Section 16.18. ***Modifications or Amendments.*** **This Lease can be modified or amended only by an agreement in writing signed by the parties hereto. No receipt of money by Landlord from Tenant or any other person after termination of this Lease or after the service of any notice or after the commencement of any suit or after final judgment for possession of the Premises will reinstate, continue, or extend the Term or affect any such notice, demand, or suit, or imply consent for any action for which Landlord's consent is required, unless specifically agreed to in writing by Landlord. Any amounts received by Landlord may be allocated to any specific amounts due from Tenant to Landlord as Landlord determines.**

Section 16.19. ***Landlord Control.*** **Landlord will have the right to close any portion of the building area or land area to the extent as may, in Landlord's reasonable opinion, be necessary to prevent a dedication thereof or the accrual of any rights to any person or the public therein. Landlord will at all times have full control, management, and direction of the Warehouse Complex, subject to the rights of Tenant in the Premises, and Landlord reserves the right at any time and from time to time to reduce, increase, enclose, or otherwise change the size, number, and location of buildings, layout, and nature of the Warehouse Complex; to construct additional buildings and additions to any building; to create additional rentable areas through use and/or enclosure of common areas, or otherwise; to place signs on the Warehouse Complex; and to change the name, address, number, or designation by which the Warehouse Complex is commonly known. Landlord will use commercially reasonable efforts in exercising its rights under this Section 16.19 to not materially interfere with Tenant's normal use of or access to the Premises in connection therewith.**

Section 16.20. ***Utility Easement.*** **Tenant will permit Landlord (or its designees) to erect, use, maintain, replace, and repair pipes, cables, conduits, plumbing, vents, and telephone, electric, and other wires or other items, in, to, and through the Premises, as and to the extent that Landlord may now or hereafter deem necessary or appropriate for the proper operation and maintenance of the Warehouse Complex.**

Section 16.21. ***Not Binding Until Properly Executed.*** **Employees or agents of Landlord have no authority to make or agree to make a lease or other agreement or undertaking in connection herewith. The submission of this document for examination does not constitute an offer to lease, or a reservation of, or option for, the Premises. This document becomes effective and binding only upon the execution and delivery hereof by the proper officers of Landlord and by Tenant. Tenant confirms that Landlord and its agents have made no representations or promises with respect to the Premises or the making of or entry into this Lease except as in this Lease expressly set forth, and agrees that no claim or liability will be asserted by Tenant against Landlord for, and Landlord will not be liable by reason of, breach of any representations or promises not expressly stated in this Lease. This Lease, except for the Warehouse Complex Rules and Regulations, in respect to which this Section 16.21 will prevail, can be modified or altered only by agreement in writing between Landlord and Tenant, and no act or omission of any employee or agent of Landlord will alter, change, or modify any of the provisions hereof.**

Section 16.22. ***Warehouse Rules and Regulations.*** **Tenant will perform, observe, and comply with the Warehouse Rules and Regulations of the Warehouse Complex, a copy of which is attached hereto and made a part hereof as Exhibit B, with respect to the safety, care, and cleanliness of the Premises and the Warehouse Complex, and the preservation of good order thereon (Rules and Regulations). Upon written notice thereof to Tenant, Tenant will perform, observe, and comply with any changes, amendments, or additions thereto, as from time to time will be established and deemed advisable by Landlord for tenants of the Warehouse Complex. Landlord will not be liable to Tenant for any failure of any other tenant or tenants of the Warehouse Complex to comply with the Rules and Regulations. Landlord will enforce the Rules and Regulations in a uniform and nondiscriminatory manner regarding the tenants in the Warehouse Complex.**

Section 16.23. ***Compliance with Laws and Recorded Covenants.*** **Tenant will not use the Premises in any way, or permit anything to be done in or about the Premises, that will conflict with any law, statute, ordinance, or governmental rule or regulation now in force or that may hereafter be enacted or promulgated. Tenant will, at its sole cost and expense, promptly comply with all laws, statutes, ordinances, and governmental rules and regulations now in force or that may hereafter be in force, and with the requirements of any fire insurance underwriters or other similar body now or hereafter constituted relating to or affecting the condition, use, or occupancy of the Premises. Tenant will use the Premises and comply with any recorded covenants, conditions, and restrictions affecting the Premises and the Warehouse Complex as of the commencement of the Lease or that are recorded during the Term.**

Section 16.24. ***Tenant Obligations Survive Termination.*** **All obligations of Tenant hereunder not fully performed as of the expiration or earlier termination of the Term will survive the expiration or earlier termination of the term hereof, including without limitation all payment obligations with respect to Operating Expenses and Real Estate Taxes and all obligations concerning the condition of the Premises.**

Section 16.25. ***Time Period for Tenant Claims.*** **Any claim that Tenant may have against Landlord for default in performance of any of the obligations herein contained to be kept and performed by Landlord will be deemed waived unless such claim is asserted by written notice thereof to Landlord within ____ days of commencement of the alleged default or of accrual of the cause of action and unless suit be brought thereon within ____ months subsequent to the accrual of such cause of action.**

Section 16.26. ***Tenant's Waiver.*** **Tenant agrees to look solely to Landlord's interest in the Warehouse Complex, and to any insurance, condemnation, or sales proceeds relating thereto, for the recovery of any judgment from Landlord, it being agreed that neither Landlord nor, if Landlord is a partnership, any of its partners, whether general or limited, nor, if Landlord is a corporation, any of its directors, officers, or shareholders, will ever be personally liable for any such judgment.**

Section 16.27. ***Tenant Authorization.*** **Tenant will furnish to Landlord, promptly upon demand, a corporate resolution, proof of due authorization of partners, or other appropriate documentation reasonably requested by Landlord evidencing the due authorization of Tenant to enter into this Lease.**

Section 16.28. ***No Partnership or Joint Venture.*** **This Lease will not be deemed or construed to create or establish any relationship or partnership or joint venture or similar relationship or arrangement between Landlord and Tenant hereunder.**

Section 16.29. ***Tenant's Obligation To Pay Miscellaneous Taxes.*** **Tenant will pay, prior to delinquency, all taxes assessed or levied on its occupancy of the Premises, or on the trade fixtures, furnishings, equipment, and all other personal property of Tenant located in the Premises, and when possible, Tenant will cause such trade fixtures, furnishings, equipment, and other personal property to be assessed and billed separately from the property of Landlord. In the event any or all of Tenant's trade fixtures, furnishings, equipment, or other personal property, or Tenant's occupancy of the Premises, will be assessed and taxed with the property of Landlord, Tenant will pay to Landlord its share of such taxes within ____ days after delivery to Tenant by Landlord of a statement in writing setting forth the amount of such taxes applicable to Tenant's personal property.**

Section 16.30. ***Prohibited Signs.*** **Tenant will not place, or permit to be placed or maintained, on any exterior door, wall, or window of the Premises any sign, awning or canopy, or advertising matter or other thing of any kind, and will not place or maintain any decoration, lettering, or advertising matter on the glass of any window or door, or that can be seen through the glass, of the Premises except as specifically approved in writing by Landlord. Tenant further agrees to maintain such sign, awning, canopy, decoration, lettering, advertising matter, or thing as may be approved in good condition and repair at all times. Tenant agrees at Tenant's sole cost that any Tenant sign will be maintained in strict conformance with Landlord's sign criteria, if any, as to design, material, color, location, size, letter style, and method of installation.**

Tenant will be permitted one identification sign on the [north] elevation of the Building in close proximity to the primary business entrance to the Premises and one identification sign on the common monument sign for the Property, all of which signage will be subject to Landlord's prior written consent as to design, material, color, location, size, letter style, and method of installation (which consent will not be unreasonably withheld) and otherwise comply with the requirements of this Lease and will comply with all laws, statutes, codes, ordinances, rules, and regulations (including without limitation those of the City of _____, the State of Illinois, and the Park Association). Landlord will provide a power feed to Tenant's identification sign on the elevation of the Building described above.

Section 16.31. *Guaranty.* The timely performance of all Tenant's duties and obligations under this Lease is secured, in part, by a Guaranty from _____, a _____ corporation (Guarantor), which Guaranty is in the form attached hereto as Exhibit D (Guaranty).

Section 16.32. *Governing Law.* This Lease is governed by, and must be interpreted under, the internal laws of the State of Illinois.

Section 16.33. *Parking.* Subject to this Section 16.33, Landlord will make available on the Property a parking area or areas, as generally designated on Exhibit A-1, attached hereto, for the exclusive use of Tenant, and its employees and invitees, which parking areas will consist of not less than _____ automobile parking spaces. Such parking areas and the use thereof will be subject to applicable, laws, statutes, codes, ordinances, rules, and regulations (including those of the City of _____, the State of Illinois, and the Park Association), and such reasonable rules and regulations as Landlord may from time to time institute. Landlord reserves the right to designate areas of the appurtenant parking facilities where tenants in the Warehouse Complex, and their respective agents, contractors, employees, invitees, or licensees, will park, and may exclude Tenant, and its agents, contractors, employees, invitees, or licensees, from parking in other areas as designated by Landlord. Notwithstanding anything in this Section 16.33 to the contrary, Landlord will not be liable to Tenant for the failure of any tenant or other person or entity, or their respective agents, contractors, employees, invitees, or licensees, to abide by Landlord's designations or restrictions regarding parking.

Section 16.34. *Exhibits.* The following are made a part hereof, with the same force and effect as if specifically set forth herein:

Site Plan — Exhibit A-1

Outline Specifications and Space Plan Materials — Exhibit A-2

Description of Issued for Construction Plans — Exhibit A-3

Milestone Dates — Exhibit A-4

Warehouse Rules and Regulations — Exhibit B

Letter as to Financial Status of Tenant and Guarantor — Exhibit C

Form of Guaranty — Exhibit D

In witness whereof, the parties have executed this Lease as of the day and year first above written.

Landlord:

_____, a _____

By: _____
Its: _____

Tenant:

_____, a _____

By:_____
Its:_____

Exhibit A-1 — Site Plan

[to be attached in accordance with lease**]**

Exhibit A-2 — Outline Specifications and Space Plan Materials

[to be attached in accordance with lease**]**

Exhibit A-3 — Description of Issued for Construction Plans

[to be attached in accordance with lease**]**

Exhibit A-4 — Milestone Dates

Activity	Milestone Date	Responsible Party
Execution of Lease		**Landlord and Tenant**
Commencement of Permit Plans		**Landlord**
Submission of Final Racking Plan by Tenant to Landlord		**Tenant**
Completion of Permit Plans		**Landlord**
Submission for Building Permit		**Landlord**
Approval of Issued for Construction Plans		**Tenant**
Obtaining of Building Permit		**Landlord**
Construction Commencement		**Landlord**
Commencement of Pre-Commencement Date Access		**Landlord and Tenant**
Commencement Date		**Not Applicable**

Exhibit B — Warehouse Rules and Regulations

1. Any sign, lettering, picture, notice, or advertisement installed on or in any part of the Premises and visible from the exterior of the Building, or visible from the exterior Premises, will be installed at Tenant's sole cost and expense, and in such manner, character, and style as Landlord may approve in writing. Anything herein to the contrary notwithstanding, approval as to signs will be subject to Landlord's approval, which may be withheld in Landlord's sole and absolute discretion. In the event of a violation of the foregoing by Tenant, Landlord may remove the same without any liability and may charge the expense incurred by such removal to Tenant.

2. No awning or other projection will be attached to the outside walls of the Building. No curtains, blinds, shades, or screens visible from the exterior of the Building, or visible from the exterior of the Premises, will be attached to or hung in, or used in connection with, any window or door of the Premises without the prior written consent of Landlord. Such curtains, blinds, shades, screens, or other fixtures must be of a quality, type, design, and color, and attached in the manner, approved by Landlord.

3. Tenant, and its servants, employees, customers, invitees, and guests, will not obstruct sidewalks, entrances or passages, corridors, vestibules, halls, or stairways, in and about the Warehouse Complex, that are used in common with other tenants and their servants, employees, customers, guests, and invitees and that are not a part of the Premises of Tenant. Tenant will not place objects against glass partitions or doors or windows that would be unsightly from the Building corridors or from the exterior of the Building and will promptly remove any such objects upon notice from Landlord.

4. Tenant will not waste electricity, water, or air-conditioning furnished by Landlord, if any, and will cooperate fully with Landlord to ensure the most effective operation of the Building's heating and air-conditioning systems.

5. Tenant assumes full responsibility for protecting its space from theft, robbery, and pilferage, which includes keeping doors locked and other means of entry to the Premises closed and secured after normal business hours.

6. Subject to Section 4.8 of the Lease, in no event will Tenant bring into the Warehouse Complex inflammables, such as gasoline, kerosene, naphtha, and benzene, or explosives or any other article of intrinsically dangerous nature. If, by reason of the failure of Tenant to comply with the provisions of this paragraph, any insurance premium for all or any part of the Warehouse Complex will at any time be increased, Tenant will make immediate payment of the whole of the increased insurance premium, without waiver of any of Landlord's other rights at law or in equity for Tenant's breach of this Lease.

7. Tenant will comply with all applicable federal, state, and municipal laws, ordinances, regulations, and building rules and will not directly or indirectly make any use of the Premises that may be prohibited by any of the foregoing or that may be dangerous to persons or property or may increase the cost of insurance or require additional insurance coverage.

8. Landlord will have the right to prohibit any advertising by Tenant that in Landlord's reasonable opinion tends to impair the reputation of the Warehouse Complex or its desirability as a warehouse complex for warehouse use, and upon written notice from Landlord, Tenant will refrain from or discontinue such advertising.

9. The Premises will not be used for cooking (as opposed to heating of food), lodging, or sleeping, or for any immoral or illegal purpose.

10. Tenant and Tenant's servants, employees, agents, visitors, and licensees will observe faithfully and comply strictly with the foregoing rules and regulations and such other and further appropriate rules and regulations as Landlord or Landlord's agent may from time to time adopt. Reasonable notice of any additional rules and regulations will be given in such manner as Landlord may reasonably elect.

11. Unless expressly permitted by Landlord, no additional locks or similar devices will be attached to any door or window, and no keys other than those provided by Landlord will be made for any door. If more than two keys for one lock are desired by Tenant, Landlord may provide the same upon payment by Tenant. Upon termination of this Lease or of Tenant's possession, Tenant will surrender all keys of the Premises and will explain to Landlord all combination locks on safes, cabinets, and vaults.

12. Tenant will not (a) make excessive noises, (b) cause disturbances or vibrations, (c) use or operate any electrical or mechanical devices that emit excessive sound or other waves or disturbances, (d) create obnoxious odors, or (e) conduct any business or activity, any of which of the foregoing either may be offensive to or contaminate any products of the other tenants

and occupants of the Warehouse Complex, or may interfere with the operation of any device, equipment, radio, television broadcasting, or reception from within the Building or elsewhere. Furthermore, Tenant will not place or install any projections, antennae, aerials, or similar devices inside or outside the Premises or on the Building.

13. Any carpeting cemented down by Tenant will be installed with a releasable adhesive. In the event of a violation of the foregoing by Tenant, Landlord may charge the expense incurred for removal to Tenant.

14. The water and wash closets, drinking fountains, and other plumbing fixtures will not be used for any purpose other than those for which they were constructed, and no sweepings, rubbish, rags, coffee grounds, or other substances will be thrown therein. All damages resulting from any misuse of the fixtures will be borne by Tenant who, or those servants, employees, agents, visitors, or licensees, will have caused the same. No person will waste water by interfering or tampering with the faucets or otherwise.

15. No electrical circuits for any purpose will be brought into the leased premises without Landlord's written permission specifying the manner in which same may be done. Tenant will not overload any utilities serving the Premises.

16. No bicycle or other vehicle (other than customary forklifts, mechanized floor sweepers, and other such vehicles customarily used in a warehouse/distribution facility), and no dog or other animal will be allowed in the Building (except for service animals, as required to comply with legal requirements).

17. Tenant will not throw anything out the door or windows, or down any passageways or elevator shafts.

18. All loading, unloading, receiving, or delivery of goods and supplies, and disposal of garbage or refuse, will be made only through entryways and freight elevators provided for such purposes and indicated by Landlord. Tenant will be responsible for any damage to the Warehouse Complex or property of its employees or others and injuries sustained by any person whomsoever resulting from the use or moving of such articles in or out of the Premises, and will make all repairs and improvements required by Landlord or governmental authorities in connection with the use or moving of such articles.

19. All safes, racks, equipment, or other heavy articles will be carried in or out of the Premises only at such time and in such manner as will be prescribed in writing by Landlord, and Landlord will in all cases have the right to specify the proper position of any such safes, racks, equipment, or other heavy articles, which will be used by Tenant only in a manner that will not interfere with or cause damage to the Premises or the Building in which they are located, or to the other tenants or occupants of the Warehouse Complex. Tenant will be responsible for any damage to the Warehouse Complex or the property of its employees or others and injuries sustained by any person whomsoever resulting from the use or moving of such articles in or out of the Premises, and will make all repairs and improvements required by Landlord or governmental authorities in connection with the use or moving of such articles.

20. Canvassing, soliciting, and peddling in or about the Warehouse Complex are prohibited, and each Tenant will cooperate to prevent the same.

21. In case of invasion, mob, riot, public excitement, or other commotion, Landlord reserves the right to prevent access to the Warehouse Complex during the continuance thereof by closing the doors or otherwise, for the safety of the tenants or the protection of the Warehouse Complex and the property therein. Landlord will in no case be liable for damages for any error or other action taken with regard to the admission to or exclusion from the Warehouse Complex of any person or entity.

22. Wherever in these Warehouse Rules and Regulations the word "Tenant" occurs, it is understood and agreed that it will mean Tenant's associates, agents, clerks, servants, and visitors. Wherever the word "Landlord" occurs, it is understood and agreed that it will mean Landlord's assigns, agents, clerks, servants, and visitors.

23. Landlord will have the right to enter upon the Premises at all reasonable hours upon reasonable advance notice (except in emergencies) for the purpose of inspecting the same.

24. Landlord will have the right to enter the Premises at hours convenient to the Tenant for the purpose of exhibiting the same to prospective tenants within the ____-day period prior to the expiration of this Lease and may place signs advertising the leased premises for rent on the windows and doors of such Premises at any time within such ____-day period.

25. Tenant, and its servants, employees, customers, invitees, and guests, will, when using the common parking facilities, if any, in and around the Warehouse Complex, observe and obey all signs regarding fire lanes and no-parking zones, and when parking, always park between the designated lines. Landlord reserves the right to tow away, at the expense of the owner, any vehicle that is improperly parked or parked in a no-parking zone. All vehicles will be parked at the sole risk of the owner, and Landlord assumes no responsibility for any damage to or loss of vehicles. No vehicles will be parked overnight.

26. All entrance doors to the Premises will be locked when the Premises are not in use. All corridor doors will also be closed during times when the air-conditioning equipment in the Building is operating so as not to dissipate the effectiveness of the system or place an overload thereon.

27. Landlord reserves the right at any time and from time to time to rescind, alter, or waive, in whole or in part, any of these rules and regulations when it is deemed necessary, desirable, or proper, in landlord's judgment, for its best interest or for the best interest of the tenants of the warehouse complex; provided, however, that any such rescission, alteration, or waiver will be reasonably applied to all tenants in an equitable and nondiscriminatory manner.

28. If and to the extent that these Rules and Regulations conflict with the terms and provisions of the balance of this Lease, then the terms and provisions of the balance of this Lease will govern and control.

Exhibit C — Letter as to Financial Status of Tenant and Guarantor

[to be attached in accordance with lease**]**

Exhibit D — Form of Guaranty

[to be attached in accordance with lease**]**

3 Office Leases

LAWRENCE C. EPPLEY
MICHAEL J. ROTH JR.
Sheppard, Mullin, Richter & Hampton LLP
THOMAS C. HOMBURGER
K&L Gates LLP (Retired)
Chicago

I. [3.1] SCOPE OF CHAPTER

This chapter is designed to serve the general practitioner faced with the task of representing either a landlord or a tenant in the preparation and negotiation of a lease of office space in a multi-tenant office building in Illinois. The chapter contains sample landlord-oriented and tenant-oriented lease provisions and a discussion of the law and the practical considerations related to these provisions.

II. [3.2] IN GENERAL

There is no magic to a multi-tenant office lease. It is a lease tailored to a specific kind of premises, but nevertheless a lease involving the same basic considerations as most other forms of leases. Accordingly, much of the discussion in this chapter, while oriented toward the problems of an office lease, is applicable equally to other kinds of leases. In fact, many of the cited cases deal with leases other than office leases and enunciate principles of law relevant to all leases.

Many of the following sections contain samples of landlord-oriented and tenant-oriented versions of provisions typically found in an office lease for a multi-tenant building, followed by a discussion of the law and of the practical considerations involved in each of these provisions. Examples of special landlords' provisions, special tenants' provisions, and special provisions for agents or other representatives of landlords can be found in §§3.125 – 3.131 below.

For illustrative purposes, the sample provisions were made clearly favorable alternatively to the landlord and to the tenant. Of course, no one lease can be (or even should be) wholly favorable to one party or the other. An attorney representing a landlord or a tenant must be prepared to vary from the strong positions taken by the sample provisions in order to reach a final, workable agreement. In addition, because each office building has different features and each tenant has different needs, an attorney must investigate and identify these differences and modify sample provisions accordingly. Since this handbook contains extended discussions of certain specific lease provisions, examples of those provisions found in this chapter are not followed by a discussion of the applicable law.

The sample provisions presume an introductory clause in which the names of the landlord and the tenant are set forth and the demised premises and the building in which the premises are located are defined. The drafter should be sure to delineate clearly all the areas of the building included within the premises. Areas usually considered part of the common areas of the building (*e.g.,* elevator lobbies, hallways, and restrooms) that the parties intend to include in the premises should be specifically included in the definition of the premises. As a general rule, a floor plan outlining the premises should be attached to the lease to help avoid subsequent disputes as to what constitutes the premises. However, outlining the premises on a floor plan can also cause problems, particularly in the case of a full-floor tenant since the whole floor will be outlined. In such a case, the landlord should make it clear in the text of the lease that certain common elements of the building, such as janitors' and electrical closets and stairwells, are excluded from the full-floor tenant's possession despite the expansive outlining. *See Cory v. Minton,* 49 Ill.App.3d 312, 364 N.E.2d 311, 7 Ill.Dec. 150 (1st Dist. 1977), for an example of the problems that an ambiguous description of the premises can cause.

Throughout the chapter, the terms "landlord" and "tenant" are used instead of "lessor" and "lessee." Use of the terms "landlord" and "tenant" helps avoid the use of one term when the other is intended, an error that can more easily be made when "lessor" and "lessee" are used. Other commonly used terms, such as "building," "premises," and "term" are not specifically defined, although the drafter should consider adding a definitional section to the beginning of the lease to establish the definitions of these and other commonly or specifically used terms. The definitional section can specifically set forth the definitions of the terms or cross-reference the lease provisions in which the terms are defined.

An attorney drafting an office lease may wish to review Andrew R. Berman, FRIEDMAN ON LEASES (6th ed. 2019), a leading book on the topic, for more detailed treatment of particular provisions. The following articles provide a useful reference of issues to be considered in the preparation and negotiation of an office lease: Philip G. Meyers, *A Lease Worksheet for Analyzing the Typical Office Lease,* 16 Prac.Law. No. 8, 69 (Dec. 1970); Curtis J. Berger, *Hard Leases Make Bad Law,* 74 Colum.L.Rev. 791 (1974) (excellent article that discusses problems of form lease); and Peter S. Britell and Howard R. Shapiro, *New York City Office Leases: "Money Issues" for the Major Tenant,* 53 N.Y.St.B.J. 472 (1981) (well-written survey of major economic issues in landlord's form lease).

III. LETTER OF INTENT

A. [3.3] In General

Prior to the negotiation of an office lease, the landlord and the tenant or their respective agents typically agree on the business terms of the proposed lease and memorialize these terms in a letter of intent. Despite its common use, a letter of intent is often a trap for the unwary — binding when one of the parties believes it not binding or not binding when one of the parties hopes to be able to rely on it as a binding contract. In other instances, a letter of intent, while not constituting a binding agreement to consummate the agreement described therein, can nevertheless restrict the breadth of a party's ability to negotiate a fair lease agreement. Considering the widespread use of letters of intent in connection with commercial and office leases, it is important to understand how these documents can affect the rights and obligations of the parties, particularly if the deal falls through.

Under Illinois law, the intent of the parties when entering into a letter of intent can have varying effects on the obligations of the landlord and the tenant to negotiate a lease. Illinois courts have identified three possible results of a letter of intent, which can be

1. a binding contract that the parties can enforce with respect to the transaction outlined in the letter of intent (*e.g.,* an obligation to purchase and sell real estate);

2. not a contract to consummate the transaction outlined in the letter of intent but rather a contract creating an obligation of the parties to negotiate in good faith in a manner consistent with the terms outlined in the letter of intent; or

3. a simple term sheet outlining the discussions of the parties but creating no obligation either to consummate the transaction outlined in the letter of intent/term sheet or even to negotiate in good faith.

Which category a letter of intent falls under is a question of the intent of the parties. *Quake Construction, Inc. v. American Airlines, Inc.,* 141 Ill.2d 281, 565 N.E.2d 990, 152 Ill.Dec. 308 (1990). The Illinois Supreme Court has stated that intent must be determined solely from the language used when no ambiguity in its terms exists (*Schek v. Chicago Transit Authority,* 42 Ill.2d 362, 247 N.E.2d 886 (1969); *see also Feldman v. Allegheny International, Inc.,* 850 F.2d 1217 (7th Cir. 1987) (applying New York and Wisconsin law)) and that parties may decide for themselves whether the results of preliminary negotiations bind them, but they must do so through their words (*Chicago Investment Corp. v. Dolins,* 107 Ill.2d 120, 481 N.E.2d 712, 89 Ill.Dec. 869 (1985)).

B. Parties Intend To Create Nothing More than a Nonbinding Term Sheet

1. [3.4] Version Suitable for Both Landlord and Tenant

This document is only a list of proposed points that may or may not become part of an eventual contract. It is not based on any agreement between the parties. It is not intended to impose any obligations whatsoever on either party, including without limitation an obligation to bargain in good faith or in any way other than at arms' length. The parties do not intend to be bound by any agreement until both agree to and sign a formal written contract, and neither party may reasonably rely on any promises inconsistent with this paragraph. This paragraph supersedes all other conflicting language. William G. Schopf et al., *When a Letter of Intent Goes Wrong: Will You Win if It's in the Hands of a Jury?,* 5 Bus.L. Today, No. 3, 31, 34 (Jan.-Feb. 1996).

2. [3.5] Comment

If the parties to a letter of intent desire to create nothing more than an unenforceable, nonbinding term sheet, several steps should be taken to help prevent the letter of intent from becoming a binding contract. First, the title of the letter of intent should not include the words "agreement" or "contract." Instead, it could be titled "tentative proposal," "status letter," "term sheet," or "list of proposed points." Second, the letter of intent should contain clear language indicating that it is not binding and that it creates no binding obligations, including no duty to negotiate in good faith. The document should begin with an opening paragraph repudiating the idea that it is binding in any way.

The paragraph recommended in §3.4 above has three important features: (a) it expresses a clear intent that the document is not a contract; (b) it prevents a plaintiff from attempting to read ambiguity into the document by referring to any other part of it; and (c) it provides strong evidence against any oral contract or promissory estoppel claim. William G. Schopf et al., *When a Letter of Intent Goes Wrong: Will You Win if It's in the Hands of a Jury?,* 5 Bus.L. Today, No. 3, 31 (Jan.-Feb. 1996).

The letter of intent should also use the words "proposed," "subject to," and "preliminary" often, mention the fact that the negotiations might fail, refer to a binding agreement to be drafted in the future, and state that any agreement between the parties is contingent on certain conditions precedent. Also, a landlord or proposed tenant seeking to ensure that a letter of intent is nonbinding should not sign the agreement whenever practicable.

C. Parties Intend To Create Duty To Continue Negotiations in Good Faith

1. [3.6] Version Suitable for Both Landlord and Tenant — Sample Language

This document contains an enumeration of certain business understandings that the parties have reached that may become part of a lease if the parties eventually enter into such a definitive lease agreement. Standing on its own, however, this document is not intended to impose any obligations whatsoever on either party, except for the sole exception of an obligation to bargain in good faith based on the business understandings enumerated herein. The parties do not intend to be bound by any other agreement until both agree to and sign a formal written contract, and neither party may reasonably rely on any promises inconsistent with this paragraph. Until such a definitive lease agreement is finalized, approved by the respective authorized representatives of the parties (which approval shall be in the sole subjective discretion of the respective authorized representatives of the parties), and properly executed, neither party shall have any obligation to the other (whether under this letter of intent or otherwise), with the sole exception of a legal duty as aforesaid to continue negotiations in good faith toward the goal of reaching such a definitive lease agreement. This paragraph supersedes all other conflicting language in this document.

2. [3.7] Comment

If the landlord and the proposed tenant intend, rather than simply memorializing the current state of negotiations, to create between themselves a duty to continue negotiations in good faith (but nothing more), certain measures are recommended. The letter of intent should be drafted carefully in order to walk the fine line between imposing no obligations whatsoever and creating a binding contract. In order to prevent a court from finding a binding, enforceable contract beyond an agreement to negotiate in good faith, the parties should take substantially the same steps and precautions described in §3.5 above. However, the letter of intent must be drafted in such a way as to create a limited duty and obligation between the parties.

In such a case, the parties' intent should be clear on the face of the document. Thus, the title to the letter of intent might be "Agreement To Negotiate in Good Faith." In the body of the letter of intent, the use of the word "agreement" is of concern since it might raise red flags to those who are afraid of committing themselves to a binding contract. To protect such a party and alleviate these concerns, the text of the letter agreement should contain language that unequivocally repudiates the idea of a binding contract while at the same time imposing limited obligations.

D. [3.8] Parties Intend To Create a Binding Contract

While very unlikely in the negotiation of a lease, the parties might conceivably rely on the letter of intent to constitute a binding contract, with the definitive lease to be only an elaboration of the

enforceable agreements reached in the letter of intent. This might be a consequence if the parties are operating under time pressure, with the expectation that the "t"s would be crossed and the "i"s dotted at a later time by the parties' attorneys. (This technique seems fraught with danger if there is a disagreement on the details of the final lease since, in such a case, the parties will be forced to consummate the transaction utilizing the less-than-complete provisions of the letter of intent.) If, notwithstanding the foregoing, the parties' intent is a binding contract, the letter of intent must contain at a minimum a clear statement of the terms required by basic contract law to achieve this goal.

E. [3.9] Summary

While a letter of intent may play an important role in facilitating lease negotiations, the parties to such a document must come to an understanding, a preliminary "meeting of the minds," about their reasons for entering into the agreement. The business executives and attorneys involved must judge whether it is time to cement the deal and how fast they want that cement to dry. They must decide whether they wish to impose on themselves an obligation to negotiate in good faith, to execute a binding contract, or to create no obligations whatsoever. The answers to these questions should be clearly stated in the document and will be a function of the stage of negotiations and, in some instances, the parties' individual levels of risk aversion. If skillfully drafted, letters of intent are valuable negotiating tools. Ambiguous letters of intent, however, are a recipe for future litigation.

IV. TERM

A. [3.10] Landlord's Version — Sample Language

The Term of this Lease shall commence on _____, 20__, and shall terminate on _____, 20__, unless terminated earlier or extended further as provided below.

B. [3.11] Tenant's Version — Sample Language

Landlord has agreed to substantially complete any portion of Landlord's Base Building Work that is to be completed before tender of the Premises to Tenant and to tender possession of the Premises to Tenant by _____, 20__ (Delivery Date), in order to enable Tenant to commence construction of the improvements to the Premises desired by Tenant (Tenant's Work). If Landlord so tenders possession of the Premises by the Delivery Date, the Commencement Date shall occur, and Rent shall commence, at the expiration of the _____-day period (Tenant Construction Period) beginning on the Delivery Date. If Landlord shall be unable for any reason to give possession of any portion of the Premises by the Delivery Date or to substantially complete the portions of Landlord's Base Building Work that are to be completed prior to tender of possession of the Premises to Tenant, Landlord shall not be subject to any liability on account of such failure, and such failure shall not affect the validity of this Lease or the obligations of Tenant hereunder, except that the Delivery Date shall be deferred and thus the expiration of the Tenant Construction Period. If the Commencement

Date is deferred, the Expiration Date shall be correspondingly adjusted so that the Term ends on the expiration of the [state term in years**] Lease Year following the deferred Commencement Date. Rent shall commence on the expiration of the Tenant Construction Period even if Tenant has not substantially completed such improvements by that date.**

Promptly following the actual Commencement Date, Landlord and Tenant shall execute a supplement to this Lease setting forth the actual Commencement Date and Expiration Date of this Lease.

All of the covenants and conditions of this Lease shall apply to and shall control all possession and occupancy of all or any part of the Premises by Tenant prior to the Commencement Date, whether for the purpose of preparation of the Premises for Tenant's occupancy or for operation of Tenant's business, except that Tenant shall not be required to pay either Base Rent or Additional Rent on account of occupancy of the Premises prior to the Commencement Date for the purpose of constructing and installing Tenant's Work and otherwise preparing the Premises for the conduct of Tenant's business therein.

Tenant shall have the option (Termination Option) to terminate this Lease effective as of the _____ anniversary of the Commencement Date (Early Termination Date) if Tenant is not in default under any of its obligations under this Lease at the time it exercises such option. To exercise the Termination Option, Tenant must

1. **give to Landlord written notice of such election at least _____ months prior to the applicable Termination Date; and**

2. **pay to Landlord at the time of such exercise a termination fee (Termination Fee) in an amount equal to the sum of (a) $_____, which equals the unamortized costs (calculated as if Landlord's costs were a mortgage loan with a term equal to the Term of this Lease at an interest rate of _____ percent per annum) incurred by Landlord in connection with this Lease for any allowances, credits, or other tenant incentives and any brokers' commissions or fees, plus (b) an amount equal to the amount of all Rent due and payable under the terms of this Lease for the _____-month period immediately preceding the Termination Date.**

Exercise of the Termination Option shall be irrevocable but shall not excuse Tenant from paying Rent accruing through the Early Termination Date. If Tenant fails to timely exercise its Termination Option, Tenant shall be deemed to have waived all of its rights to terminate this Lease as of the Early Termination Date.

C. [3.12] Comment

Any lease for a term of more than one year must be in writing to be enforceable. 740 ILCS 80/2; *Chicago Attachment Co. v. Davis Sewing Mach. Co.,* 142 Ill. 171, 31 N.E. 438 (1892).

The length of the lease term is a business decision. Nevertheless, an attorney representing a landlord should make sure that in setting the term of the lease the client has properly considered

the relationship between the subject lease and any option or expansion rights given to other tenants in the building. The attorney should also confirm that the lease term meets the leasing parameters established by the landlord's lender or equity partner.

If the premises must be built out or remodeled prior to occupancy, the lease should address the need for a deferral of the commencement date in the event of construction delays. See §§3.27 – 3.29 below. The critical issue is whether the landlord or the tenant is responsible for carrying out the work. Larger office tenants are demanding the right to retain contractors directly to control the quality and cost of the improvements to their new space, which leads to clauses such as the tenant's version in which the landlord, while giving the tenant control of the project, also imposes the economic responsibility for the duration of the work on the tenant. In these situations, the landlord performs all necessary "base building" work (usually any work in common areas or to building systems shared by all tenants) and then turns over the premises to the tenant for remodeling. The tenant gets the scheduling, design, and price benefits inherent in having direct control over the contractor but also shoulders the financial risk of construction delays since virtually all landlords will require a fixed rent start date at the end of the agreed-on rent-free construction period. See §3.28 below for an alternative when the landlord is controlling the remodeling.

A lease may provide for a right of one or both of the parties to terminate the lease term prior to its stated expiration date without affecting the validity of the lease. *Cox v. Grant,* 57 Ill.App.3d 922, 373 N.E.2d 820, 15 Ill.Dec. 474 (5th Dist. 1978); *Preston A. Higgins & Co. v. Stevenson,* 28 Ill.App.3d 150, 328 N.E.2d 79 (1st Dist. 1975). Most leases that give the tenant an early termination right have a fixed date for the termination, as shown in the tenant's version. This approach is more common than giving the tenant a continuing termination right. The calculation of a termination fee by reference to the landlord's unamortized costs is also typical since it allows the landlord to recoup its original leasing costs despite the shortened term. To achieve this result, the basic dollar amount to be inserted in the tenant's version should equal the landlord's unamortized costs of improving the premises for the tenant, whether directly or by provision of an improvement allowance, leasing commissions for leasing the space to the tenant, attorneys' fees in preparing the lease to be canceled, any rent abatement or period of "free rent," and other out-of-pocket expenses of the landlord. If a stated dollar amount is not agreed to in the lease, it is necessary to be specific about the method of calculating unamortized costs. Are the costs to be amortized with interest? Using what type of amortization schedule? Over what period of time? As in the tenant's version, often the landlord will require an additional element in the termination fee equal to rent for some period of time to defray some of the projected downtime in reletting the space.

Alternatively, the tenant's right to terminate might be made subject to a specifically designated condition precedent that would make the continuation of the leasehold undesirable to the tenant. For example, if the tenant is an individual or an entity in which an individual is the key figure, termination could be conditioned on the death, incompetency, or incapacitating illness of that individual.

A landlord might also desire a right to terminate the lease after a certain time period in order to make space available to meet the expansion needs of a major tenant or to maintain flexibility in remodeling or demolishing the building. See, for example, paragraph 5 of the provision in §3.125 below. Recognizing that an office lease is less of an interest in real estate and more of a service

agreement, more and more landlords retain control over occupancy in their buildings by reserving the right to relocate tenants to other space in the building (see paragraph 4 of the provision in §3.125 below) and reserve the right to terminate the lease as to space that a tenant proposes to sublease. See §3.86 below.

When a tenant is entering into multiple leases in order to rent separate premises intended to be used as a single space, it should ensure that (absent some special factual considerations to the contrary) whatever events terminate one lease terminate all leases. Without such a provision, the tenant may be forced to continue leasing certain space that, standing alone, has virtually no economic value. *See Smith v. Roberts,* 54 Ill.App.3d 910, 370 N.E.2d 271, 12 Ill.Dec. 648 (4th Dist. 1977), in which, after the lease covering a tenant's primary retail space was terminated by reason of fire, the tenant successfully invoked the doctrine of commercial frustration to terminate its separate lease of certain incidental adjoining space. The tenant cannot always be assured of such a sympathetic court.

V. BASE RENT

A. [3.13] Landlord's Version — Sample Language

Tenant shall pay to [name of landlord or landlord's agent or representative**], in coin or currency that, at the time or times of payment, is legal tender for public and private debts in the United States of America, at [**address at which rent is to be paid**] or at such other location as directed from time to time by Landlord's notice, minimum Rent during the Term (Base Rent) at the annual rate of $_____ per year per square foot of rentable area of the Premises for an initial Base Rent of $_____ per year, payable in monthly installments of $_____, each installment being payable in advance promptly on the first day of every calendar month of the Term, without any abatement, setoff, or deduction or further demand whatsoever, except that Tenant, at the time of execution of this Lease, shall pay the installment due for the first full month of the Term and for any initial fractional month of the Term. If the Term commences other than on the first day of the month or ends other than on the last day of the month, the Base Rent for that month shall be prorated. Base Rent shall be increased effective on the _____ anniversary of the Commencement Date of this Lease by an amount equal to _____ percent of the most recent Base Rent. This Base Rent is payable in addition to any Additional Rent that Tenant may be required to pay under other provisions of this Lease. Unpaid Rent (or as much of that Rent as may remain unpaid from time to time) shall bear interest at _____ percent per annum from the date due until paid. Landlord's right to receive this interest shall not, in any way, limit any of Landlord's other remedies under this Lease or at law or in equity. Tenant shall also pay a late charge of _____ percent of any Rental payment made more than _____ days after the due date to compensate Landlord for administrative and collection costs that Tenant agrees Landlord will incur by failure of Tenant to pay its Rent in a timely manner.**

B. [3.14] Tenant's Version — Sample Language

Tenant shall pay to [name of landlord or landlord's agent or representative**], in coin or currency that, at the time or times of payment, is legal tender for public and private debts in**

the United States of America, at [address at which rent is to be paid**], or at such other location as directed from time to time by Landlord's written notice, minimum Rent during the Term (Base Rent) at the annual rate of $_____ per year per square foot of rentable area of the Premises for an initial Base Rent of $_____ per year, payable in monthly installments of $_____, each installment being payable in advance promptly on the first business day of every calendar month of the Term. If the Term begins on a day other than the first day of the month or ends on a day other than the last day of the month, Base Rent for that period shall be prorated at a per diem rate based on a 365-day year.**

C. [3.15] Comment

A fixed base rent provision is common in office leases. This amount will cover the landlord's primary ongoing expenses, such as debt service and the cost of operating and maintaining the building, and will include the landlord's profit. At times, the fixed base rent will also include a depreciation factor for the eventual replacement of capital improvements. The stated base rent is often supplemented by several kinds of additional rent provisions to protect the landlord's profit. The landlord can protect itself against rising expenses by the provisions described in §§3.16 – 3.20 below, but this simply guarantees that the landlord's profit will remain at a fixed dollar amount annually throughout the term of the lease. Because the value of the dollar may decrease significantly over a long term due to inflation, the landlord can further protect its return by escalating the base rent through periodic readjustments calculated by comparison with the changes in an appropriate index of the dollar's value (*e.g.,* the Consumer Price Index) or by an agreed percentage increase. While additional rent based on a percentage of the tenant's sales is rarely appropriate for or found in a true office lease, this type of rent is applicable to those portions of an office building leased for retail operations.

Determination of base rent by reference to a particular price per square foot of rentable area is standard in office leases. This method of calculating rent permits some flexibility if the size of the premises is not exactly determined when the lease is executed or if the size changes during the term, but it does require careful analysis of the meaning of the term "rentable area." Rentable area should include not only the space actually occupied by the tenant (which is the tenant's usable area) but also a proportionate share of the common areas located on the same floor as the premises. The size of the common areas on a floor varies from building to building and will be affected by the landlord's configuration of corridors and lobbies on the floor. For a tenant comparing base rents at different locations, it is important to identify the percentage difference between rentable area and usable area, commonly called the "loss factor." From the tenant's point of view, "rentable area" should always be specifically defined so that the landlord's calculations can be confirmed. This is especially important because many landlords use different definitions of "rentable area" to accommodate unusual features in their buildings.

Base rent may also be expressed as a gross amount for the full term of the lease. This approach can be useful if the landlord wants to attempt the most aggressive remedy upon default — acceleration and immediate payment of the rent for the full term. See Michael J. Shelly, *The Validity of Lease Acceleration Clauses Under a Contractual Approach to the Landlord-Tenant Relationship,* 10 Cap.U.L.Rev. 159 (1980). This remedy may not be available in Illinois because of a landlord's duty to mitigate. 735 ILCS 5/9-213.1.

Landlords often offer concessions to market the space in their buildings. These concessions might include a total or partial rent abatement in the early years of the lease term, reduced rent prorated throughout the term of the lease, a cash payment by the landlord to induce the tenant to enter into the lease, a purchase by the landlord of an annuity that will serve to reduce the tenant's rental outlays during the lease term, assumption by the landlord of the tenant's obligations under an existing lease of the tenant's then-current premises, and countless other variations. A tenant entity in which equity ownership interests might change during the term of the lease (*e.g.,* a professional partnership) should evaluate the lease concessions in order to avoid penalizing later owners of the tenant entity. For example, a concession involving a total rent abatement in the early years of the lease term with higher rent in the later years of the lease term would benefit the current owners but penalize later owners. The drafter should make sure that any concession is clearly and completely stated in the lease, *e.g.,* whether additional rent is abated along with base rent. Anyone using or exhibiting a lease in connection with a sale or loan that does not recite all rent concessions actually granted is guilty of a Class A misdemeanor. See the Rent Concession Act, 765 ILCS 730/0.01, *et seq.*

A tenant would rather omit any requirement that it pay interest or late charges on overdue base rent. If the tenant must agree to pay interest on overdue base rent, the tenant should attempt to limit the imposition of interest until the expiration of a grace or cure period, until after the tenant's receipt of notice of the delinquency, or both. A limitation of this sort will avoid the imposition of an interest charge when a rent payment is delayed through no fault of the tenant (*e.g.,* by the loss or delay of the rent payment in the mail). In addition, the tenant should try to avoid the imposition of both interest on overdue rent and a late charge in order to avoid a double penalty for a late rent payment.

See §3.100 below for a discussion of interest charged on overdue payments.

VI. ADDITIONAL RENT — TAXES AND OPERATING EXPENSES

A. [3.16] Landlord's Version — Sample Language

It is understood that the Base Rent does not include the cost of Taxes on the Building or on the Land underlying the Building or the cost of operating and maintaining the Building. Therefore, in order that the rental payable under this Lease shall reflect any such cost, Tenant agrees to pay Additional Rent computed as set forth below.

1. Tenant agrees to pay as Additional Rent, for each calendar year during the Term, including any extensions or renewals thereof, Tenant's proportionate share (determined below) of (a) Taxes (defined in Paragraph 4 below) assessed or incurred, regardless of when such Taxes are payable; and (b) Operating Expenses (defined in Paragraph 3 below) paid or incurred by Landlord on account of the ownership, management, operation, or maintenance of the Building during each of the calendar years of the Term. Tenant's proportionate share shall be the percentage determined by dividing the Net Rentable Area of the Premises — being _____ square feet — into the Net Rentable Area of the Building — being _____ square feet; such percentage being _____ percent. Net Rentable Area has been calculated by Landlord on a uniform basis for the Building, and Tenant accepts the Net Rentable Areas

stated in the preceding sentence. If at any time during the Term of this Lease the Net Rentable Area of either the Premises or the Building changes for any reason, Tenant's proportionate share for the year in which such change takes place shall be computed on the basis of the daily average of the Net Rentable Areas of the Premises and the Building for that year.

2. a. Tenant shall pay to Landlord, on the first day of each month during the Lease Term, an estimated payment on account of Additional Rent for the current year in the amount Landlord shall specify from time to time by written notice.

b. As soon as practicable after January 1 in each year during the Term of this Lease and in the year next following the year in which this Lease terminates, Landlord shall deliver to Tenant a statement setting forth the Additional Rent due for the immediately preceding calendar year. Within _____ days after the delivery of this statement, Tenant shall pay any Additional Rent to Landlord less the amount of all estimated payments on account of Additional Rent paid by Tenant during the preceding calendar year. In the event the estimated payments made by Tenant in the immediately preceding calendar year exceed the Additional Rent actually due for the preceding calendar year, Landlord shall, at its option, either pay to Tenant any excess amount within _____ days after delivery of Landlord's statement or credit that amount against Tenant's future Rent payments.

3. As used in this Lease, the term "Operating Expenses" means (a) all costs of ownership, management, operation, and maintenance of the Building, as determined by standard accounting principles, and shall include the following by way of illustration and not limitation: heat, water, electricity, and other utility charges; insurance premiums; license, permit, and inspection fees; and the cost of all labor, contracted or otherwise, materials, and other services paid or incurred by Landlord in the operation and maintenance of the Building during the Lease Term; and Operating Expenses shall also include the costs of Building security as more particularly described in the Building's security plan [see §§3.136 – 3.139 below**]; and (b) the cost as reasonably amortized by Landlord with interest at the per annum rate of _____ percent on the unamortized amount of any capital improvement to the Building made after the Base Year that (i) reduces some of the costs set forth in paragraph a above; (ii) is required by Landlord's insurance carrier; or (iii) is required to be installed by governmental authorities, including capital improvements that are for health or safety measures.**

Operating Expenses shall not include (a) any principal payments or interest expense on any loans secured by mortgages placed on the Building and underlying Land, or ground rent; (b) the cost of any work or service performed in any instance for any tenant (including Tenant) at the cost of that tenant; or (c) any cost for which Landlord has received direct reimbursement other than by payment of Base Rent or of Tax and Operating Expense payments under clauses similar to this paragraph. In determining the amount of Operating Expenses for the purposes of this paragraph, if less than 100 percent of the Net Rentable Area of the Building shall have been occupied by tenants and fully used by them during the year, Operating Expenses shall be deemed for the purposes of this paragraph to be increased to the amount of Operating Expenses that would normally be expected to be incurred had occupancy been 100 percent and had full use been made during the entire period. In addition,

if Landlord is not furnishing any particular work or service (the cost of which, if performed by Landlord, would constitute an Operating Expense) to a tenant of the Building who had undertaken to perform work or service in lieu of the performance thereof by Landlord, Operating Expenses shall be deemed to be increased by an amount equal to the additional Operating Expenses that would reasonably have been incurred during that period by Landlord if it had at its own expense furnished the work or service to the tenant.

4. As used in this Lease, the term "Taxes" means all federal, state, and local governmental taxes, assessments, and charges (including transit or transit district taxes or assessments), general real estate taxes, assessments (whether they be general or special), sewer rents, rates, and charges, taxes based on leases or the receipt of rent, ad valorem taxes, and any other federal, state, or local governmental charges, general, special, ordinary, or extraordinary, of every kind or nature levied or assessed on or with respect to, or that become payable because of or in connection with the ownership, leasing, management, control, or operation of the Land or Building or both or the personal property, fixtures, machinery, equipment, systems, and apparatus located therein or used in connection therewith.

Should the State of Illinois, or any political subdivision of that state or any other governmental authority having jurisdiction over the Land or the Building, (a) impose a tax, assessment, charge, or fee or increase a then-existing tax, assessment, charge, or fee, that Landlord shall be required to pay, either by way of substitution for real estate taxes and ad valorem personal property taxes or in addition to real estate taxes and ad valorem personal property taxes; or (b) impose an income or franchise tax or a tax on rents in substitution for or as a supplement to a tax levied against the Land or the Building or the personal property used in connection therewith, all such taxes, assessments, fees, or charges (Alternate Taxes) shall be deemed to constitute "Taxes" under this Lease. "Taxes" shall also include all installments of real estate taxes and special assessments that are required to be paid during any year of the Lease Term and all fees and costs, including attorneys' fees and expenses, incurred by Landlord in seeking to obtain a reduction of or a limitation on the increase in any taxes, regardless of whether any reduction or limitation is obtained. Except as provided in this Lease with regard to Alternate Taxes, "Taxes" shall not include any inheritance, estate, succession, transfer, gift, franchise, net income, or capital stock tax imposed on or assessed against Landlord. In determining the amount of "Taxes" for the purposes of this paragraph, if less than 100 percent of the Net Rentable Area of the Building shall have been occupied by tenants during the year, "Taxes" shall be deemed for the purposes of this paragraph to be increased to the amount of taxes that would normally be expected to be incurred had occupancy been 100 percent.

B. [3.17] Tenant's Version — Sample Language

It is understood that the Base Rent does not include the cost of Taxes on the Building or on the Land underlying the Building or the cost of operation and maintenance of the Building. Therefore, in order that the rental payable under this Lease shall reflect any such cost, Tenant agrees to pay Additional Rent computed as set forth below.

1. Tenant agrees to pay as Additional Rent for each calendar year during the Term, including any extensions or renewals, Tenant's proportionate share (determined below) of

(a) the real estate taxes assessed against the Building and the Land underlying the Building that is taxed together therewith as one parcel and actually paid by Landlord in that year; and (b) Operating Expenses (defined in Paragraph 3 below) actually paid by Landlord on account of the operation or maintenance of the Building during each calendar year, or portion thereof, falling within the Term, the amount being called the "Additional Rent." Tenant's proportionate share shall be the percentage determined by dividing the Net Rentable Area (defined in Paragraph 4 below) of the Premises into the total Net Rentable Area of the Building; that percentage being _____ percent. If at any time during the Term of this Lease the Net Rentable Area of either the Premises or the Building changes for any reason, Tenant's proportionate share for the year in which that change takes place shall be computed on the basis of the daily average of the Net Rentable Areas of the Premises and the Building for that year.

2. a. Additional Rent for each calendar year for which Additional Rent is payable shall be payable by Tenant to Landlord in equal monthly installments over the balance of the next calendar year commencing on the first day of the month next succeeding the month after which Landlord renders a statement to Tenant. Tenant may, at its election, pay the Taxes component of Additional Rent in a lump sum upon Landlord's payment of the various tax bills corresponding to those Taxes.

b. (i) Landlord agrees that any statement of Additional Rent shall contain the calculations by which Landlord ascertained the amount of Additional Rent due from Tenant and shall be delivered to Tenant no later than March 1st of the year following the calendar year for which it applies. After receipt by Tenant of Landlord's statement of Additional Rent due, if Tenant has cause to believe that Landlord's statement of Additional Rent due is incorrect, Tenant shall notify Landlord in writing within _____ days after receipt of that statement. Tenant may, through its employees, representatives, and accountants, inspect, audit, and copy Landlord's books and records, as they apply to the Additional Rent due, to verify Landlord's statement of the amount of Additional Rent due. Landlord shall cooperate with Tenant in any verification effort and shall provide Tenant with such paid receipts and vouchers as Tenant may reasonably request evidencing payments made. Tenant's obligations to pay Additional Rent shall be deferred for the lesser of the period necessary to make such verification or _____ days from the date of receipt by Tenant of Landlord's statement of Additional Rent due.

(ii) If, through Tenant's review of Landlord's books and records, Tenant shall determine that Landlord's statement of Additional Rent due from Tenant is incorrect, Tenant shall notify Landlord within _____ days after receipt of Landlord's notice of Additional Rent due and Tenant's obligation to pay the Additional Rent shall continue to be deferred until this dispute is resolved. If the parties are unable to resolve these differences as to the amount of Additional Rent due, Landlord and Tenant shall agree on a certified public accountant who shall review Landlord's books and records as to the amount in dispute and who shall settle the dispute. The certified public accountant's decision shall be binding on both parties, and Tenant shall promptly pay the Additional Rent found due as provided above. Landlord and Tenant shall share equally the costs and fees of the certified public accountant.

(iii) If Tenant fails to notify Landlord of Tenant's objections to Landlord's statement of Additional Rent due within the time periods provided in this Lease, Tenant shall be deemed to have waived the right to object.

c. The Additional Rent payable for the last calendar year or last fractional calendar year of the Term shall be payable in a lump sum within _____ days following receipt by Tenant of Landlord's statement of Additional Rent due, subject, however, to Tenant's right to object to such statement as provided above.

3. As used in this Lease, the term "Operating Expenses" means the following direct costs of operation and maintenance of the Building, as determined by generally accepted accounting principles, consistently applied: heat, water, electricity, and other utility charges; insurance premiums; and the cost of all labor, contracted or otherwise, materials, and other services paid or incurred by Landlord in the operation and maintenance of the Building during the Lease Term as determined by the certified public accountant employed by Landlord for the applicable calendar year. "Operating expenses" shall not include (a) ground rents, principal payments, or any interest expense on any loans secured by mortgages placed on the Building and underlying Land (or a leasehold interest therein); (b) franchise or income taxes imposed on Landlord; (c) the cost of any work or service performed in any instance for any tenant (including Tenant) at the cost of that tenant; (d) leasing and brokerage expenses and commissions and other costs or concessions related to leasing space in the Building; (e) capital improvements; (f) salaries of Landlord's or its manager's executive personnel; (g) all other expenses for which Landlord is entitled to receive reimbursement; (h) the cost of legal, accounting, and other professional services incurred by Landlord for reasons not in connection with the day-to-day operation of the Building; (i) the cost of offices of Landlord that are not part of the offices of the Building; (j) costs of relocating tenants; (k) costs associated with the cure or correction of latent defects; (*l*) costs associated with the correction or abatement of environmental hazards (i) on the Land, or (ii) in the Building or in the Premises; (m) wages for concessionaires employed by Landlord; and (n) fees for management of the Building in excess of market rates for building management.

4. As used in this Lease, the term "Net Rentable Area" means Net Rentable Area computed in accordance with the Recommended Standard Method of Floor Measurement for Office Buildings sponsored by the Building Owners and Managers Association International.

C. [3.18] Comment

An additional rent provision benefits the landlord by neutralizing the impact on the landlord of rising operating costs and real estate taxes. Having the tenant absorb increases in operating costs and real estate taxes helps stabilize the landlord's fixed return from the premises that would otherwise be eroded year by year during the lease term by increased operating costs and real estate taxes (although inflation may also serve to reduce the value of this fixed return). See §3.15 above.

The considerations in §§3.19 and 3.20 below were taken into account in preparing the sample provisions in §§3.16 and 3.17 above and should be of assistance in preparing or reviewing additional rent provisions for an office lease.

1. [3.19] Landlord's Considerations

a. Due to the accounting problems and costs in administering this type of provision, the landlord should attempt to impose a uniform additional rent provision on all tenants in a building. Changes in additional rent provisions, such as the method of billing or the definitions of "taxes" and "operating expenses," will cause the landlord administrative problems and additional expenses and should be avoided unless the additional exclusions are consistent with the landlord's existing practices.

b. The sample provision assumes a "net lease" under which the tenant pays its proportional share of operating expenses and taxes. If a landlord desires a rent structure with tax and operating expense stops, the sample provision needs to be modified to include the concept that the tenant will pay increases in taxes and operating expenses over an established base. The term "base amount" rather than "base year" has been used by landlords to simplify the legal and accounting problems inherent in "base year" provisions and to maintain income at the original budget projection. A tenant must be careful to verify that the base amount is not substantially below the actual taxes and operating expenses, because otherwise the tenant might be required to pay additional rent immediately upon the commencement of its lease. Also, differences in base amounts or stops make it more difficult for tenants to compare rents at various buildings.

c. In connection with the definition of "operating costs," the following should be considered:

1. The direct costs considered in calculating operating expenses should be as complete as possible in order to stabilize the landlord's return. Any specific costs referred to should not be exclusive, only an illustration.

2. The landlord's version includes as an operating expense the amortized cost of capital improvements, plus interest thereon, that result in the reduction of operating expenses, thus precluding the tenant from receiving a windfall if the landlord makes a capital improvement that results in a reduction of the operating expenses. The tenant will often seek to limit the amount of this amortization to the actual savings in the amount of the operating expense realized as a result of such capital improvement. Including the cost of capital improvements required by insurance carriers or governmental authorities in operating expenses passes on to the tenant the risk of changes in building standards required by those parties.

3. The landlord's version requires the tenant to pay additional rent based on operating expenses and taxes calculated assuming 100-percent occupancy, even if this is not the fact. Consequently, the tenant pays the costs it would have paid had the building been full. The so-called "gross-up" provision is necessary from the landlord's point of view in order to pass on to the tenants all operating costs and taxes for the building. Inclusion of this provision may result in an actual reduction or elimination of the landlord's operating cost and tax liability for vacant space in the building. Tenants should attempt to limit the applicability of the gross-up provision to those operating expenses and taxes that vary with the building's occupancy level, *i.e.,* the provision should not apply to fixed operating costs. Tenants should also attempt to lower the target occupancy level to the 90 – 95 percent range.

4. Taxes are also "grossed up" in the landlord's version. Landlords argue that this is an appropriate result since tax "breaks" based on vacancy are intended to recognize the lack of cash flow from the vacant space and to help the landlord through the initial leasing period for new buildings. A tenant that agrees to this type of "gross-up" provision should recognize that the tenant is really paying excess rent since, if the landlord is paying no real estate taxes on vacant space, the amount of tax reimbursement will inevitably be in excess of the amount of real estate taxes that would be allocated to the tenant's premises if the building were fully occupied.

5. The landlord's version also requires the tenant to pay additional rent calculated as though the landlord were performing the basic services for all tenants, even if this is not the case. This requirement avoids a windfall to the tenant, which would otherwise profit by the fact that another tenant was able to negotiate the right to perform certain services otherwise provided by the landlord.

6. The landlord wants to collect additional rent in advance of the date on which it must pay the underlying bills so that it will not have to fund these costs and wait for reimbursement, particularly in the case of real estate taxes, which are typically payable in two large installments during the year. Landlords may profit from this advance collection because deposits are collected during the year in which taxes are assessed even though those taxes are not payable until the following year. Major tenants prefer to impose some limit on the amount of the estimated installments or to pay their additional rent after the date the landlord has actually incurred the cost. Such a deferral is shown in the tenant's version.

d. For leases with tax and expense stops, landlords often separate taxes from operating expenses to create a base amount for each. This separation permits reconciliation of estimated installments of taxes as soon as the actual bills are received.

2. [3.20] Tenant's Considerations

a. Economically, the best interests of the tenant are often served by paying a fixed rent or gross rent and having the landlord absorb all operating costs and real estate taxes, unless the fixed rent payable is set artificially high or is inflated throughout the lease term by an unreasonable percentage or index to account for inflation. In the latter case, the tenant may be better off accepting a lower net rent or net rent with stops and an additional rent provision, gambling that inflation will not drive operating costs and real estate taxes up at too rapid a rate. The tenant may also negotiate a cap on the additional rent, usually calculated as a maximum annual percentage increase in taxes and operating expenses that can be passed on to the tenant.

b. The additional rent paid by the tenant is deductible as an ordinary and necessary business expense for federal income tax purposes, just as the tenant's payment of fixed rent is deductible. 26 U.S.C. §162.

c. The tenant's version contains a somewhat elaborate procedure for protesting the amount of additional rent requested and for verifying the landlord's figures. The tenant's right to defer

payment of additional rent during the period of contest should be clearly set out. Otherwise, the landlord is entitled to regain possession by summary proceedings for failure to pay additional rent, even if that failure is under color of a justifiable dispute concerning the additional rent due.

The tenant's ability to obtain this right will depend, of course, on the bargaining power of the tenant. If the tenant occupies only a small portion of the building, the landlord will be quite reluctant to open its books and records to the tenant for an audit.

d. The tenant's version provides for the payment of additional rent for the final year of the lease term at the time that additional rent is ascertained (sometime during the calendar year following the end of the lease term). This allows the tenant to pay additional rent on the basis of actual figures instead of estimated figures. The tenant, however, must reserve in its budget an estimated amount of this additional rent since it will be payable after the tenant has vacated the premises. A landlord may well object to this type of delay for any but the most creditworthy tenant since the tenant's refusal to pay additional rent after the end of the lease term will leave the landlord with nothing but a contractual claim for the payment — the typical landlord's remedies no longer being available.

e. The tenant should attempt to limit the definition of the components of "operating expenses" to specific items agreed on in advance, which will help avoid subsequent disputes as to whether any certain items should be included in the calculation of operating expenses. In addition, note the categories of expenses excluded from the calculation of operating expenses in the sample provision. Tenants should carefully review a landlord's statement of additional rent to make sure it conforms to the agreed inclusions and exclusions.

f. For leases with tax and operating expense stops, if the tenant is taking possession of the premises prior to the complete occupancy of the building, the base years for real estate taxes and operating expenses should be set at a time when the amounts spent for these items will reflect real estate taxes on a fully assessed building and operating expenses on a normally operating building. For example, the base year for real estate taxes could be the year in which the building is assessed as fully improved and fully occupied. The base year for operating expenses could be the year in which the building reaches a 90-percent occupancy level (under the assumption that at this point operating expenses will be more or less the same as for a fully occupied building). If the base year for taxes is set too early, the tenant will pay increases in taxes resulting from the change in the status of the building from a parcel taxed as unimproved property to a parcel taxed as a completed building. Similarly, if the base year for operating expenses is set too early, the tenant will pay increases in operating expenses arising from additional services being provided to tenants who occupy space vacant in the base year. Compare this provision to the gross-up provision of the landlord's version.

VII. SECURITY DEPOSIT

A. [3.21] Landlord's Version — Sample Language

1. Tenant agrees to pay Landlord a security deposit equal to $_____ upon the

execution of this Lease. The security deposit shall be held by Landlord as security for the faithful performance by Tenant of all of the terms, covenants, and conditions of this Lease to be kept and performed by Tenant, without any obligation on Landlord's part to pay any interest thereon. If, at any time during the Term of this Lease, any of the Rent due Landlord shall be overdue and unpaid, then Landlord may, at its option, appropriate and apply any portion of the security deposit to the payment of any overdue Rent or other sum. In addition, in the event of the failure of Tenant at any time during the Term of this Lease to keep, observe, and perform any of the terms, covenants, and conditions of this Lease to be kept, observed, and performed by Tenant, then Landlord, at its option, may appropriate and apply the entire security deposit, or as much of that deposit as may be necessary, to compensate Landlord for loss or damage sustained or suffered by Landlord due to Tenant's breach. The use, application, or retention of the security deposit, or any portion of that deposit, by Landlord shall not prevent Landlord from exercising any other right or remedy provided by this Lease, or at law or in equity (it being intended that Landlord shall not first be required to proceed against the security deposit), and shall not operate as a limitation on any recovery to which Landlord may otherwise be entitled.

2. Should the entire security deposit, or any portion of that deposit, be appropriated and applied by Landlord for the payment of overdue Rent or other sums due and payable to Landlord by Tenant or to compensate Landlord for loss or damage sustained by Landlord due to Tenant's breach, Tenant shall, upon Landlord's demand, immediately remit to Landlord a sufficient amount in cash to restore the security deposit to the original sum deposited. Tenant's failure to restore the security deposit within _____ days after receipt of Landlord's demand shall constitute a breach of this Lease.

3. Tenant acknowledges that Landlord has the right to transfer its interest in the Land and the Building and in this Lease, and Tenant agrees that in the event of any such transfer, Landlord shall have the right to transfer the security deposit to the transferee. Upon the transfer of the security deposit, Landlord shall thereby be released from all liability or obligation to Tenant for the return of the security deposit, and Tenant agrees to look solely to the transferee for the return of the security deposit.

4. Landlord agrees that if, upon the date of termination of this Lease or Tenant's right to possession under this Lease, Tenant is not in default under any of the terms, covenants, and conditions in this Lease, Landlord shall, within _____ days after the date Tenant surrenders possession of the Premises to Landlord, return to Tenant the security deposit or the portion of that deposit that remains in Landlord's hands on that date. In no event shall the security deposit be deemed to constitute, nor be used by Tenant to pay, the final [month's**] [**_____ months'**] Rent. In the absence of written evidence satisfactory to Landlord of permitted assignments of the right to receive the security deposit, or of the remaining balance of the deposit, Landlord may return it to the original Tenant, regardless of one or more assignments of Tenant's interest in this Lease or the security deposit. In such event, upon the return of the security deposit, or the remaining balance thereof, to the original Tenant, Landlord shall be completely relieved of liability with respect to the security deposit.**

B. [3.22] Tenant's Version — Sample Language

1. Tenant shall deposit a security deposit (Security Deposit) with Landlord as security for the prompt, full, and faithful performance by Tenant of each and every provision of the Lease and of all obligations of Tenant hereunder in the Security Deposit Amount (as defined below). The Security Deposit shall be in the form of a Letter of Credit (as defined below). The Security Deposit shall be delivered not later than the date of execution of this Lease in the Security Deposit Amount. The term "Letter of Credit" as used herein shall mean an irrevocable, unconditional standby letter of credit with an initial expiration date no earlier than the date that the Security Deposit Amount is scheduled to be reduced to zero or having an automatic renewal provision as described in Paragraph 2 below, issued by a bank reasonably acceptable to Landlord (Issuing Bank), which Letter of Credit shall be payable to Landlord upon demand made pursuant to presentation of an unconditional sight draft with a certificate by Landlord that Landlord is entitled to draw thereunder pursuant to the terms of this Lease. The term "Security Deposit Amount" as used herein means _____ Thousand Dollars ($_____). Notwithstanding the foregoing, on each of the _____ through _____ anniversaries of the Commencement Date, the Security Deposit Amount shall be decreased by _____ Thousand Dollars ($_____), and on the _____ anniversary of the Commencement Date, the Security Deposit Amount shall be reduced to zero, provided, however, that no such reduction under this sentence shall become effective if an Event of Default by Tenant has occurred and is continuing on the scheduled reduction date. If any such reduction in the Security Deposit Amount does not become effective due to the existence of such an Event of Default, and if a cure of such Event of Default is subsequently accepted by Landlord, the scheduled reduction that was deferred shall become effective on the date such cure is accepted. From and after the date the Security Deposit Amount is reduced to zero, Tenant shall have no further obligation to provide a Security Deposit to Landlord.

2. Unless the stated expiration date of the Letter of Credit is not on or after the expiration date of this Lease, the Letter of Credit shall be automatically renewed unless the Issuing Bank shall deliver to Landlord a notice of nonrenewal no later than _____ days prior to the expiration of the Letter of Credit. In the event that the Issuing Bank has not timely renewed the Letter of Credit, Landlord shall be entitled to draw the full amount of the Letter of Credit and hold the same as a cash security deposit, subject to the same terms and conditions of this Section.

3. If an Event of Default by Tenant then exists under the Lease, Landlord may use, apply, or retain such portion of the Security Deposit that is necessary for the payment of (a) any Rent or other sums of money that Tenant has not paid when due after any applicable cure period; (b) any sum previously expended by Landlord on behalf of Tenant in accordance with the provisions of the Lease; or (c) any sum that Landlord may then have expended by reason of any Event of Default under the Lease by Tenant, including without limitation any damage or deficiency in or from the reletting of the Premises as provided in the Lease.

4. If Tenant shall fully and faithfully comply with all of the provisions of the Lease, the Security Deposit, or balance thereof, if not previously reduced to zero as provided in

Paragraph 1 above, shall be returned to Tenant within _____ days after the expiration or termination of the Term, or upon any later date after which Tenant has vacated the Premises. In the event of any assignment of Tenant's interest in the Lease to which Landlord has consented, Landlord shall return the Security Deposit to the original Tenant or such assignee, as provided for in Landlord's consent to such assignment.

5. Tenant acknowledges that Landlord has the right to transfer its interest in the Building and in the Lease as set forth herein, and Tenant agrees that if such a transfer occurs, Landlord shall have the right to transfer or assign the Security Deposit to the transferee. Notwithstanding such transfer or assignment and delivery of the Security Deposit to the transferee, unless Tenant has received written notice of such transferee's assumption of responsibility for the return of the Security Deposit to Tenant, Landlord shall continue to be liable for the return of the Security Deposit to Tenant.

C. [3.23] Comment

1. Whether to require a security deposit is a business decision. If a landlord holds a security deposit, it has the assurance that funds will be readily available to at least partially compensate it in the event of the tenant's default. This is valuable with regard to those obligations of the tenant that accrue only at the end of the lease term (*e.g.,* restoring the premises to their original condition).

2. From a tenant's point of view, allowing the landlord to hold a security deposit reduces the tenant's bargaining position in the event of a dispute concerning the tenant's obligations. If the landlord appropriates the security deposit, claiming a default by the tenant, the tenant's only recourse will be a suit against the landlord for return of the security deposit. Because the amount of the security deposit is usually small relative to the total lease obligation, such a suit may be economically impractical.

3. A landlord should bear several practical considerations in mind when preparing a security deposit provision:

a. The tenant should be obligated to restore a security deposit if the deposit is used to cure a default. The tenant's failure to do so should be a default under the lease. The sample provision is drafted accordingly.

b. The lease should expressly provide that the security deposit is not to be used for the final month's or months' rent. The tenant's use of the security deposit for this purpose will defeat the benefit to the landlord of providing a fund to ensure performance by the tenant of its obligations at the end of the lease term. If the security deposit is equal to only one month's rent, the rights granted to the landlord by such a provision are limited because the landlord's only remedy, if the tenant fails to pay its final month's rent, would be an action to deprive the tenant of possession of the premises plus a suit for any damages that the landlord may have incurred by reason of the tenant's failure to perform its obligations. One way to avoid this problem is to require a security deposit equal to more than one month's rent so that the tenant, by using the security deposit for rent for those final months, risks losing possession several months before the end of the lease term.

c. The landlord has a personal obligation to return the security deposit to the tenant — an obligation that is not released by the conveyance of the landlord's interest in the building or the lease. *McDonald's Corp. v. Blotnik,* 28 Ill.App.3d 732, 328 N.E.2d 897 (3d Dist. 1975). Therefore, to avoid this personal obligation, the landlord should expressly provide that it is released from this obligation upon a transfer of the tenant's security deposit to the landlord's successor.

4. The tenant should bear certain practical considerations in mind in preparing a security deposit provision:

a. The landlord should not be entitled to appropriate any part of the security deposit until the tenant has defaulted and all applicable notice and grace periods have expired, thus avoiding a dispute as to whether the tenant is entitled to remedy any defaults pursuant to other terms of the lease before its security deposit is appropriated.

b. Illinois law requires interest on security deposits to be paid only to tenants of residential units in certain multifamily residential buildings (765 ILCS 715/1), so the lease must spell out the rights of a tenant to receive interest on its security deposit. The lease should provide that the tenant receive interest on the security deposit, to the extent it is not appropriated by the landlord from time to time during the lease term. Other ways to avoid giving the landlord free use of the tenant's money during the lease term include depositing negotiable government securities or other securities satisfactory to the landlord, with the income from the securities going to the tenant, or depositing a suitable letter of credit with the landlord, thereby freeing some of the tenant's cash resources. There is a need for care in drafting and administering lease clauses for these alternate security deposits. For example, letters of credit are typically issued for one to five years and rarely will cover the full lease term. Therefore, the landlord should be expressly permitted to draw on the letter of credit if it is not renewed by a certain date (usually 30 days) in advance of the letter of credit's expiration date. Of course, if the landlord fails to monitor compliance with this clause, the landlord will lose its security when the letter of credit expires.

c. In the event of a transfer of the landlord's interest in the building, the tenant may not be able to recover its security deposit from the transferee without the last clause in the tenant's version. Illinois law imposes liability on the transferee for return of such a security deposit in residential situations. 765 ILCS 710/1.1.

5. The tenant's version illustrates two elements often found in long-term office leases. A landlord is required to incur a substantial up-front cost in providing a "tenant allowance" for the improvement of the leased premises to meet the particular tenant's needs and a leasing commission for the tenant's broker. To improve its chances of recovering that large initial investment, a landlord will require a security deposit that approximates that initial out-of-pocket investment, which is much larger than just one or two months of rent. Because of the size of the deposit, the tenant most often is permitted to deliver a letter of credit from its bank rather than cash, so that the tenant does not lose the right to use that cash in its business for other purposes. In addition, once the tenant has paid rent for a few years and the landlord has begun to recoup this initial investment, the landlord

will permit the size of the deposit to be reduced, often on a straight-line amortization over a number of years. The sample provision illustrates the use of a letter of credit and the structuring of these annual reductions.

Acceptance of a letter of credit rather than cash as security is sometimes viewed by landlords as a benefit. In a tenant bankruptcy, a cash security deposit cannot be freely withheld by the landlord and applied to its damages but instead is treated as property of the estate and is subject to the cap on a bankrupt tenant's liability for lease damages under §502(b)(6) of the Bankruptcy Code, 11 U.S.C. §101, *et seq.,* while amounts recovered under a letter of credit have under some circumstances escaped that cap. *See In re PPI Enterprises (U.S.), Inc.,* 324 F.3d 197 (3d Cir. 2003) (treating letter of credit in that case same as cash security deposit); *In re Stonebridge Technologies, Inc.,* 430 F.3d 260 (5th Cir. 2005) (since landlord had not filed claim in bankruptcy action, amount recovered under letter of credit was not subject to cap).

See comment 11 in §3.77 below for a discussion of issues that may be encountered (a) if a landlord accepts a standby letter of credit from a financially troubled tenant to secure the performance by the tenant of its past lease obligations and (b) if a landlord elects to accept a direct payment of a lease obligation from a financially troubled tenant instead of drawing on a standby letter of credit given by the tenant to secure the performance of that obligation.

6. In recent economic times, tenants have become increasingly concerned about the ability of a landlord to perform its obligations under the lease, such as the obligations to improve the premises. Tenants try to obtain security from the landlord to ensure the landlord's performance. This type of security can include having the landlord deposit in an escrow with a third-party escrowee sufficient funds to ensure completion of the landlord's obligations, requiring the landlord to deliver a standby letter of credit to secure the landlord's performance, providing a guaranty of the landlord's performance from a creditworthy third party, obtaining an assurance from the landlord's lender that it will make sufficient funds available to allow the landlord to perform its obligations, and obtaining a rental offset right so that the tenant can perform the landlord's obligations if the landlord fails to do so. Landlords generally vigorously resist such attempts — often with great success.

VIII. CONDITION OF THE PREMISES UPON TENANT'S TAKING POSSESSION

A. [3.24] Landlord's Version — Sample Language

Tenant's taking possession of the Premises or any portion of the Premises shall be conclusive evidence against Tenant that the Premises or portion thereof, as the case may be, were in good order and satisfactory condition when Tenant took possession and that all work to be done on the Premises pursuant to the terms of this Lease, if any, has been completed in accordance with the terms of this Lease and to Tenant's satisfaction. No promise of Landlord to alter, remodel, remove, improve, redecorate, or clean the Premises or the Building and no representation respecting the condition of the Premises or the Building have been made by Landlord, or Landlord's agent or the managing agent of the Building, to Tenant, unless the promise or representation is expressly stated herein or made a part hereof.

B. [3.25] Tenant's Version — Sample Language

Except as provided in the following sentence, Tenant's occupancy of the Premises for a period of _____ days after commencement of the Lease Term shall constitute an acknowledgment by Tenant that the Premises were, on the date possession was taken, in good order and satisfactory condition and that any work that Landlord undertook to perform for Tenant as contained in this Lease has been completed in accordance with the agreement between Landlord and Tenant. The above notwithstanding, Tenant shall not be deemed to have accepted the Premises as provided in the previous sentence

1. **if, within _____ days after the commencement of the Lease Term, Tenant serves written notice on Landlord specifying in particular where the Premises (other than the electrical, heating, plumbing, air-conditioning ducts, systems, or equipment on the Premises) are not in good order and satisfactory condition or where, if applicable, such work was not completed in accordance with the agreement between Landlord and Tenant; and**

2. **if, within _____ days after the commencement of the Lease Term, Tenant serves written notice on Landlord specifying any defect or omission in the installation or operation of the electrical, heating, plumbing, air-conditioning ducts, systems, or equipment that prevents them from reasonably accomplishing the purpose or object for which they are intended or any other latent defects in the Premises.**

Failure of Tenant to specify any defects or omissions within the applicable time periods shall be deemed to be a waiver by Tenant of any defects or omissions. Landlord agrees that Landlord will, at its own expense, promptly correct any defects or omissions of which it is given timely notice. If Landlord fails to correct any defects or omissions promptly after receipt of notice from Tenant, Tenant shall have the right (but not the obligation) to perform the necessary work and to install the necessary materials to correct any defects or omissions and to deduct the cost therefor, plus interest at the rate of _____ percent per annum, from Base Rent and Additional Rent due.

C. [3.26] Comment

1. The general rule in Illinois is that the tenant takes possession of the premises in "as is" condition unless the lease provides otherwise. There is no implied covenant on the part of either the landlord or the tenant to repair the premises. *Yuan Kane Ing v. Levy,* 26 Ill.App.3d 889, 326 N.E.2d 51 (1st Dist. 1975); *Hollywood Bldg. Corp. v. Greenview Amusement Co.,* 315 Ill.App. 658, 43 N.E.2d 566 (1st Dist. 1940); David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 327 – 328.

2. The landlord's version restates the rule of law that the tenant is taking possession of the premises in "as is" condition, with no promises to improve the premises other than as stated in the lease. In light of the cases in which Illinois courts have looked to oral promises by the landlord to the tenant in order to construe ambiguous lease provisions (*see, e.g., Schmohl v. Fiddick,* 34 Ill.App. 190 (2d Dist. 1889)), it is important, from a landlord's point of view, that the absence of any obligation by the landlord to improve the premises be clearly set forth.

3. The tenant's version gives the tenant a period of time after taking possession to object to the condition of the premises and the quality of the landlord's work before the tenant is deemed to have accepted the premises as satisfactory and the landlord's work as having been performed in accordance with an agreement between the landlord and the tenant. In this way, the tenant has an opportunity to occupy the premises for a period of time before making that determination. The tenant has a shorter period of time to ascertain if all parts of the premises other than the electrical, heating, and air-conditioning systems are in proper order and a longer period of time to determine if the latter systems are functioning properly. A longer period is allowed for the mechanical systems because any deficiencies in these systems should be apparent to the tenant after completing one year of operation.

4. A compromise provision could provide for mutual inspection on or immediately prior to the date the tenant takes possession and agreement of a punch list of items to be corrected or repaired by the landlord after the tenant takes possession in order to place the premises in the condition required under the lease. Under that kind of provision, the premises are deemed to be in satisfactory condition at the time possession was delivered to the tenant, subject only to the punch list items and perhaps latent defects.

IX. DELIVERY OF POSSESSION; IMPROVEMENTS TO BE MADE BY LANDLORD TO THE PREMISES PRIOR TO THE BEGINNING OF THE TERM

A. [3.27] Landlord's Version — Sample Language

1. a. Landlord shall, at its own cost and expense, make the alterations and improvements set forth in Exhibit _____, attached to and made a part of this Lease, to prepare the Premises for Tenant's occupancy.

b. Landlord shall not be subject to any liability if Landlord shall be unable to give Tenant possession of the Premises on the Commencement Date of the Term of this Lease because the Building has not been sufficiently completed to make the Premises ready for occupancy, because a certificate of occupancy has not been obtained for either the Building or the Premises, because of the holding over or retention of possession of any tenant or occupant, or because the work set forth in Exhibit _____ has not been completed for any reason. Under such circumstances (and provided that Tenant has in no way caused or contributed to such circumstances), the Rent payable shall not commence until possession of the Premises is given to Tenant or the Premises are available for occupancy by Tenant. However, the failure to give possession on the Commencement Date of the Term of this Lease shall in no way (i) affect the validity of this Lease or the obligations of Tenant under this Lease, or (ii) be construed to extend the Term of this Lease.

2. With Landlord's prior written consent, which Landlord may withhold at its sole discretion, and subject to reasonable regulations that Landlord may impose, Tenant and its employees and contractors may enter the Premises prior to the commencement of the Term of this Lease during normal working hours for the purpose of performing work other than

the work herein agreed to be performed by Landlord. All work shall be performed at Tenant's sole risk, responsibility, and cost. Tenant shall, prior to the commencement of any work and before any equipment or materials needed for the performance of that work are brought onto any part of the Building, furnish to Landlord any instruments Landlord may request in order to protect the Premises, the Building, and Landlord's interest in the Building, including but not limited to certificates of insurance, waivers of lien for all materials and labor used in performing that work, and copies of contracts, plans, and necessary permits, all of which shall be subject to the written approval of Landlord. All work and materials shall be of first-class quality and shall be performed in a manner and at such times as to cause no delay in work being performed by Landlord in the Premises or elsewhere in the Building. The work and materials shall comply in all respects with the requirements of all rules, regulations, and codes of all governmental bodies and departments having jurisdiction over the Premises and with the terms and conditions of all insurance coverage applicable to the Premises and the Building. Tenant shall not contract for any work or service that might involve the employment of labor incompatible with the employees or contractors of Landlord. Tenant shall reimburse Landlord and Landlord's contractors for all costs or expenses that any of them may incur in connection with Tenant's work, including but not limited to the cost of services provided to Tenant or any contractor of Tenant at the Premises, the cost of supervision to ensure compliance of Tenant's work with the plans and specifications for the Building, and any additional architectural or engineering costs resulting from Tenant's work. Tenant agrees to indemnify, defend, and hold Landlord and Landlord's contractors, and the employees, officers, partners, agents, and subcontractors of any of them, harmless of, from, and against all loss, cost, or expense they or any of them might suffer arising out of or in any way connected with the performance of such work by Tenant and its employees, agents, and contractors.

B. [3.28] Tenant's Version — Sample Language

1. Landlord agrees to construct and remodel the Premises prior to Tenant's taking possession in accordance with the plans and specifications described in Exhibit _____ attached to and made a part of this Lease. Tenant shall have the right to require changes in the plans and specifications or in the work to be performed by Landlord, provided, however, that those changes do not cause material delay in the completion of construction and that either (a) the changes will not materially increase the cost of construction, or (b) Tenant shall have undertaken to reimburse Landlord for any increase in the cost resulting therefrom.

2. All work to be completed by Landlord is to be performed in a good and professional manner with new materials and first-class labor. During the progress of the construction and remodeling of the Premises, Tenant and its agents, contractors, and representatives may enter the Premises for inspections, measurements, and any other similar purpose without thereby being deemed to have taken possession of the Premises. If, at any time prior to taking possession, Tenant discovers a deviation from the plans and specifications and Landlord fails to correct that deviation promptly after receipt of notice thereof from Tenant, Tenant is hereby granted permission to perform the necessary work and to install the necessary materials to correct that deviation, so the Premises, as completed, will conform to the plans and specifications, and to deduct the cost of all work, plus interest at _____ percent per annum, from Base Rent and Additional Rent due under this Lease.

3. Tenant and its agents, contractors, or representatives shall have the right to begin the installation of its fixtures and other property in the Premises before the final completion of Landlord's work on the Premises without being deemed to have taken possession of the Premises by so doing, provided Tenant's work does not unreasonably interfere with Landlord's work.

4. When Landlord shall have fully completed the Premises as provided in this Lease, Landlord shall submit to Tenant a certificate of Landlord's architect certifying that all work has been fully completed in accordance with the plans and specifications. If required by any law, ordinance, or governmental regulation, a final certificate of occupancy or its equivalent covering the Premises and issued by the governmental authority having jurisdiction, or a certified copy of such certificate, shall be furnished by Landlord to Tenant prior to the delivery of possession of the Premises to Tenant.

5. Notwithstanding any other provisions of this Lease, the Term of this Lease and the obligation of Tenant to pay Rent shall not commence until the first day of the calendar month immediately following the month in which the architect's certificate and certificate of occupancy provided for above are delivered to Tenant and Landlord has delivered possession of the Premises to Tenant. The Term of this Lease shall then run _____ years from the Commencement Date as provided above. If the Premises are not so completed and possession is not delivered on or before _____, 20__, Tenant may, upon written notice to Landlord at any time before completion and delivery of possession, terminate this Lease, whereupon this Lease shall be and become null and void. Such right of termination shall not in any way limit Tenant's other rights and remedies in the event Landlord fails to deliver possession on the date promised.

C. [3.29] Comment

1. The sample provisions deal with two subjects — the delivery of possession of the premises to the tenant, and the performance of certain specified work prior to the beginning of the lease term.

2. In light of Illinois law that the landlord has no duty to repair the premises after delivery of possession (see §3.26 above), it is important for the tenant that the lease clearly spell out the nature of the work, the time period within which it is to be performed, and the standard of quality that the work must meet. These matters are often addressed in a "work letter" that becomes an exhibit to the lease. The work letter should provide a detailed description of the improvements and materials the landlord agrees to install in the premises prior to commencement of the lease term (in new buildings these materials may be called "building standard" items or perhaps "core and shell" items). Initial or outline plans and specifications for producing and agreeing on the final plans and specifications for all of the landlord's improvements can also be included in the work letter if the final plans and specifications for leasehold improvements have not been prepared at the time the lease is executed.

The landlord would prefer that the tenant's obligations under the lease be unaffected by the inability of the landlord to complete the work by the stated commencement date. Absent any provisions in the lease, if a landlord fails to complete promised repairs or work prior to the

beginning of a lease term, the tenant can refuse to take possession of the premises until the work is completed. *Reno v. Mendenhall,* 58 Ill.App. 87 (4th Dist. 1894). Once the tenant has taken possession of the premises, however, absent any provision in the lease, it cannot keep possession of the premises and refuse to pay rent for the breach of the covenant to make promised repairs. The tenant must either sue the landlord for damages or recoup its damages through a defense raised in any action by the landlord for rent. *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 5 Ill.Dec. 282 (2d Dist. 1977); *Reno, supra.*

3. The tenant's version provides that the tenant may terminate the lease if the landlord fails to complete its work and deliver possession of the premises by a certain date. The tenant can exercise its right to terminate if the landlord delivers the premises without completing the work and the premises are not ready for occupancy. *See Young v. Kaplan,* 7 Ill.App.3d 1064, 288 N.E.2d 698 (1st Dist. 1972). However, the tenant should be cautious in exercising the termination right if the work remaining to be completed is relatively minor and would not prevent the tenant from occupying the premises for their intended use. If the work remaining to be completed by the landlord is not substantial and would not prevent the tenant from occupying the premises for their intended use, the tenant should not accept occupancy of the premises unless the lease gives the tenant the right to complete the work and deduct the costs of completion from the rent payments.

4. Another problem inherent in the preparation of the premises for possession is the performance of work by the tenant in addition to work being done by the landlord. The tenant's work ordinarily must be completed prior to the time the tenant can begin using the premises. While it is important to the tenant that it be able to obtain access to the premises prior to the beginning of the lease term to perform this work, it is equally important to the landlord that the tenant's work not interfere with the completion of the landlord's work. The sample provisions address these problems.

5. The tenant's version provides that the lease term does not begin until the landlord finishes the work promised in the lease and delivers possession of the premises to the tenant. Under Illinois law, a landlord is obligated to deliver to the tenant only the right to possession of the premises. A landlord is not obligated to expel any party wrongfully in possession of the premises, including a former tenant who wrongfully holds over. Absent a provision in the lease, it is the tenant's obligation to evict a party wrongfully in possession. *Gazzolo v. Chambers,* 73 Ill. 75 (1874); David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 327. Accordingly, the tenant should be sure that the lease expressly provides that the lease term does not begin until the landlord is able to deliver possession of the premises to the tenant and that if possession is not delivered by an outside date, the tenant may terminate the lease. In setting this outside date, the tenant should determine how much time it will require to find alternative premises if the premises are not completed and its present occupancy rights terminate. An alternative approach for the tenant, if it is in a position to remain in possession of its current premises for a period after the expiration of its current lease term, is to provide that the landlord must compensate the tenant (presumably through reduced rent) for any increased costs and other damages that the tenant incurs by reason of having to stay in possession of its old premises beyond the date the new lease was to commence.

6. Both parties should carefully consider whether a delay in delivery of possession of the premises should extend the term of the lease. A tenant may desire the longest term possible; a landlord may have made other commitments based on a firm date for termination (*e.g.,* an option of another tenant to lease the premises may be timed to coincide with the originally contemplated termination date of the previous lease).

7. The landlord's version with respect to the work to be performed by the tenant prior to possession contemplates a situation in which the landlord is still completing construction of the building or must make substantial modifications to the premises before the lease term will begin. If the building is completed or if the landlord has not promised to perform any substantial work on the premises, this portion of the landlord's version can be substantially shortened.

X. OCCUPANCY PRIOR TO BEGINNING OF THE LEASE TERM

A. [3.30] Landlord's Version — Sample Language

If Tenant occupies the Premises prior to the beginning of the Lease Term (which Tenant may do only with Landlord's prior written consent), all the provisions of this Lease shall be in full force and effect as of the date of that occupancy. Rent for any period prior to the beginning of the Lease Term shall be fixed by agreement between Landlord and Tenant or, in the absence of any agreement, at the Rent set forth in this Lease for the beginning of the Lease Term. Early possession shall not be deemed to accelerate the stated Termination Date of this Lease.

B. [3.31] Tenant's Version — Sample Language

If Tenant occupies the Premises prior to the beginning of the Lease Term, all provisions of this Lease shall be in full force and effect as of the date of occupancy, except that no Base Rent shall be payable for any period prior to the beginning of the Term of this Lease, but Additional Rent with respect to Taxes and Operating Expenses shall be payable as set forth in this Lease for such period prior to the beginning of the Lease Term. The above notwithstanding, if, at Tenant's request, Landlord makes the Premises available to Tenant prior to the date of commencement of the Lease Term for the purpose of decorating, furnishing, and equipping the Premises, the use of the Premises for this work shall not create a landlord-tenant relationship between the parties and shall not constitute occupancy until the Lease Term begins or Tenant begins using the Premises in accordance with the use provided for in this Lease rather than for the purpose of decorating, furnishing, and equipping the Premises. Early possession shall not be deemed to accelerate the stated Termination Date of this Lease.

C. [3.32] Comment

1. Inclusion of a provision governing occupancy of the premises by the tenant prior to the beginning of the stated lease term may obviate the necessity for a supplemental agreement (which

the parties may well neglect to execute) if in fact the tenant takes possession earlier than the stated commencement date. Under the sample provisions, the terms of the lease govern the relationship of the parties as of the date the tenant takes possession of the premises.

2. Note that in the tenant's version, a sentence was added making it clear that the tenant's taking of possession of the premises for the purpose of completing leasehold improvements will not constitute early acceptance of the premises as a tenant.

3. While landlords usually welcome the chance to collect rent earlier, it is wise that the landlord reserve the decision whether to permit early occupancy, as provided in the landlord's version. Early occupancy by a tenant may adversely affect the landlord's completion of other work in the building or the landlord's tax position. The tenant's version shows a typical compromise on early occupancy. The tenant begins to pay its share of occupancy costs, but base rent is deferred until the agreed start date.

XI. SERVICES TO BE FURNISHED BY LANDLORD

A. [3.33] In General

Sections 3.34 – 3.56 below provide sample provisions enumerating the types of services that landlords customarily furnish to tenants in office buildings. Each provision is, when appropriate, followed by specific commentary describing issues to consider when drafting such a provision and the applicable law on the subject.

Leases must be customized to fit specific situations and premises involved in particular transactions. These services provisions will typically be the most particularized provisions in office leases, reflecting the quality of the building and the day-to-day expectations of the tenant.

B. Janitorial Services

1. [3.34] Landlord's Version — Sample Language

Landlord shall provide customary janitorial services in and about the Premises, Saturdays, Sundays, and holidays excepted. Tenant shall not provide any janitorial service without Landlord's prior written consent. If Landlord so consents, janitorial service

1. **shall be performed during hours designated by Landlord;**

2. **shall be subject to Landlord's supervision (but shall be performed at Tenant's sole cost, risk, and expense, Landlord assuming no responsibility therefor); and**

3. **shall be performed through a janitorial contractor or employees who are, and shall continuously be, in each and every instance satisfactory to Landlord.**

In addition, if Tenant elects to provide janitorial services and Landlord consents, Tenant shall maintain liability insurance, in amounts, with coverages, and with a carrier satisfactory to Landlord, naming Landlord as an additional insured and insuring against any claim for injury or damage occurring on or about the Premises or in the Building. In no instance shall Tenant be entitled to any reduction in Rent or any other payment due under this Lease by reason of any janitorial services provided by Tenant.

2. [3.35] Tenant's Version — Sample Language

Landlord shall provide daily janitorial service in and about the Premises, Saturdays, Sundays, and holidays excepted, so that the Premises are maintained in a clean and wholesome condition, suitable for use as a first-class office with the specific cleaning services and frequencies set forth on Exhibit _____ attached to and made a part of this Lease. The above notwithstanding, Tenant may, by written notice to Landlord, elect to perform some or all of the janitorial services in the Premises that Landlord is otherwise obligated to provide and, in such case, the Rent payable under this Lease shall be reduced by an amount derived by multiplying the total cost to Landlord of providing the particular janitorial service to the Building by a fraction, the numerator of which is the Net Rentable Area of the Premises and the denominator of which is the total Net Rentable Area of the Building.

3. [3.36] Comment

a. In the landlord's version, the tenant is specifically required to carry liability insurance if the tenant performs some or all of its own janitorial work. This important requirement is often omitted from standard office leases. However, absent such a provision, should an injury occur on the premises during the performance of the janitorial work, the landlord will most likely be joined with the tenant in any suit brought by the injured party.

b. The tenant's version contains a specific formula by which rent will be reduced if the tenant undertakes to perform certain of the janitorial services otherwise supplied by the landlord. Absent such a provision, the tenant will have no basis to negotiate a reduction if the tenant undertakes to perform some of the janitorial services after the beginning of the lease term.

c. To avoid future disputes, the parties may agree to attach to the lease a detailed list of the exact nature and timing of the janitorial services to be provided — called "cleaning" or "janitorial specifications."

C. Heating, Ventilating, and Air-Conditioning

1. [3.37] Landlord's Version — Sample Language

Landlord shall provide heating, ventilating, and air-conditioning daily from [_____ a.m. to _____ p.m. and Saturdays from _____ a.m. to _____ p.m., Sundays and holidays excepted**], whenever heat and air-conditioning shall, in Landlord's judgment, be required for the comfortable occupation and use of the Premises. When machines or equipment are used in**

the Premises that generate heat or in any way affect the temperature otherwise maintained by the air-conditioning system, Landlord reserves the right to install supplementary air-conditioning units in the Premises, the cost of installation, operation, and maintenance of which shall be paid by Tenant to Landlord as Additional Rent due within _____ days after being invoiced therefor.

2. [3.38] Tenant's Version — Sample Language

Landlord shall provide heating, ventilating, and air-conditioning daily from [_____ a.m. to _____ p.m. and Saturdays from _____ a.m. to _____ p.m., Sundays and holidays excepted**], in quantities as may be required to meet Tenant's temperature and humidity requirements described in Exhibit _____ attached to and made a part of this Lease. Upon Tenant's request, Landlord shall make heating, ventilating, and air-conditioning available to Tenant at all other times. Tenant shall reimburse Landlord for all costs actually incurred in providing such extra service (without profit to Landlord) on the next Rent payment date falling not less than _____] days after receipt by Tenant of an itemized list of charges for extra service. Building ventilation shall use no less than MERV-13 air filtration.**

3. [3.39] Comment

a. The heating and cooling of a tenant's space are among the most likely areas of dispute in a lease. While the landlord prefers a general statement that conditions will be "comfortable," a larger tenant will require some objective standards on temperature and humidity. Since there are many factors that can prevent compliance with temperature standards, including unusually severe weather conditions or special tenant installations, as described in the landlord's version, a compromise is often reached by stating the design criteria of the landlord's heating, ventilating, and air-conditioning (HVAC) system and the exterior temperature and humidity conditions on which those criteria are based. These are often incorporated in HVAC specifications attached to the lease. Because many tenants have employees working early and late on a regular basis, the tenant should draft provisions to ensure that after-hour HVAC services will be available and to prevent overcharging by the landlord for these after-hours services. There is a substantial variation from building to building in the cost of after-hours services, resulting primarily from actual physical differences among HVAC systems.

b. During the COVID-19 pandemic, tenants and landlords often focused on specific ventilation requirements in leases, as air circulation, filtration, and fresh air ventilation may be important factors in halting or impeding the spread of the COVID -19 virus in indoor office settings. Landlords focused on increased air circulation, better filtration equipment, and fresh air ventilation in an attempt to differentiate their buildings from competing buildings and to convince tenants and their employees that office spaces were safe. Similarly, tenants focused on the same standards in their leases so as to attempt to protect their employees from airborne virus transmission and potentially entice the same back to the office. Landlords and tenants should seek advice from their engineering consultants on specific HVAC standards to add to a lease to ensure that the lease reflects the most current guidance on such issues.

D. Water

1. [3.40] Landlord's Version — Sample Language

1. Landlord shall provide water from [name of utility supplying water**] mains for drinking, lavatory, and toilet purposes, drawn through fixtures installed by Landlord or by Tenant with Landlord's prior written consent. Tenant shall pay Landlord, as Additional Rent, at rates fixed by Landlord, for water used for air-conditioning, refrigerating, cooling, or any purpose other than drinking, lavatory, and toilet purposes.**

2. Tenant shall not waste or permit the waste of water. In the event Tenant fails to make prompt payment to Landlord for water furnished by Landlord as provided above, Landlord may, upon _____ days' prior notice, discontinue furnishing such service.

2. [3.41] Tenant's Version — Sample Language

Landlord shall provide hot and cold water suitable for all customary office purposes and shall make available to Tenant, at Landlord's cost, chilled water from the Building's main supply for any supplementary air-conditioning or other equipment installed by Tenant.

3. [3.42] Comment

The tenant's version of this provision does not contain any requirement by the tenant to pay the landlord for water furnished. If, however, the tenant is required to reimburse the landlord for water used, the tenant should attempt to limit its obligations to the landlord's costs in obtaining such water. The tenant should also be entitled to reasonable proof of the landlord's calculations of the amount due from the tenant for water. Provision of chilled water by the landlord, even if not free of charge, can also be of substantial benefit to a tenant with substantial computer operations or other special uses.

E. Elevator Service

1. [3.43] Landlord's Version — Sample Language

1. Landlord shall provide passenger elevator service in common with other tenants daily from [_____ a.m. to _____ p.m. and Saturdays from _____ a.m. to _____ p.m., Sundays and holidays excepted**], and freight elevator service in common with other tenants and subject to Landlord's scheduling daily from [**_____ a.m. to _____ p.m., Saturdays, Sundays, and holidays excepted**]. Providing elevator service at other times shall be optional with Landlord, shall be paid for by Tenant, and, if provided, shall never be deemed a continuing obligation of Landlord.**

2. Landlord may change manually operated and controlled elevators to operatorless, automatic elevators, operated and controlled by passengers, without liability of Landlord to Tenant and without impairing any obligation of Tenant under this Lease.

2. [3.44] Tenant's Version — Sample Language

Landlord shall provide at least _____ passenger elevators and at least _____ freight elevators in common with other tenants with sufficient frequency to provide adequate means of ingress and egress to and from the Premises commensurate with a first-class office building. At least one passenger elevator shall be available to provide access to the Premises 24 hours a day, every day of the year.

3. [3.45] Comment

Limitations on the availability of elevator service are generally relevant only with respect to buildings with manually operated elevators. The landlord's version requires the landlord to provide elevator service at certain specified times, while elevator service at other times is optional with the landlord. This provision is harsh on a tenant who might require access to its office during nonbusiness hours. An alternative (and more reasonable) provision would be for the landlord to agree to provide elevator service during nonbusiness hours, using such elevators as the landlord deems reasonably necessary, with the tenant paying any additional cost incurred by the landlord. In a building equipped with automatic elevators, the problem of elevator service during nonbusiness hours is virtually eliminated, although most tenants will still want to be assured of all-hours access to their space. Often tenants will find that freight elevator service for their move-in may be difficult to schedule and may be an additional cost. Provision for move-in elevator service should be negotiated in special situations and perhaps should include the passenger elevators as well as the freight elevators.

F. Electricity

1. Landlord's Version

a. [3.46] Alternative if Landlord Does Not Provide Electricity — Sample Language

1. Landlord shall provide electricity at the distribution panel on each floor of the Building sufficient for an average electrical load on each floor of _____ watts per square foot and Building standard distribution circuits and receptacles in the Premises. Tenant shall deal directly with the electrical utility company servicing the Building concerning Tenant's own electrical needs and shall pay all costs incident to this service, including without limitation the cost of meters, connection charges, and deposits, and any costs incurred by Landlord due to Tenant's electrical needs being greater than the electrical service provided to the Premises as Building standard. Tenant shall pay for all other electricity consumed in the Premises, including any electricity used during janitorial service, alterations, or repairs in the Premises. Tenant shall pay all bills for electricity promptly and shall indemnify, defend, and hold Landlord harmless of, from, and against all cost or expense that Landlord may incur resulting from Tenant's failure to pay any bills or to perform any of its obligations with respect to the purchase of electricity.

2. Tenant agrees that Landlord shall in no event be liable or responsible to Tenant for any loss, damage, or expense that Tenant may sustain or incur if the quality or character of electrical service either is changed or is no longer suitable for Tenant's requirements. Tenant further agrees that at all times its use of electric current shall never exceed the capacity of existing feeders to the Building or the risers or wiring or installation of the Building.

b. [3.47] Alternative if Landlord Provides Electricity — Sample Language

1. Landlord shall provide electricity if and as long as Landlord generates or distributes electric current for light and power in the Building. As long as Landlord provides electricity in the Building, Tenant shall obtain all current used in the Premises from Landlord and shall pay Landlord's charges therefor within _____ days after being invoiced therefor unless otherwise specified in Landlord's invoice. Tenant's failure to pay as stated above shall entitle Landlord to discontinue furnishing electricity to Tenant. Tenant's use of electric current shall never exceed the capacity of existing feeders to the Building or the risers or wiring or installations of the Building.

2. Upon not less than _____ days' notice, Landlord may cease to furnish electricity to Tenant without responsibility to Tenant except to connect, within the _____-day period, the electric wiring system of the Premises with another source of supply of electricity and to install separate electric meters for the Premises. Electrical service may be changed, upon _____ days' notice, from direct current to alternating current without liability of Landlord to Tenant.

3. All electricity used during janitorial service, alterations, and repairs in the Premises shall be paid for by Tenant.

2. Tenant's Version

a. [3.48] Alternative if Landlord Does Not Provide Electricity — Sample Language

Landlord shall provide electricity at the distribution panel on each floor, distribution circuits to and in the Premises, and receptacles in the Premises sufficient to provide Tenant with adequate electrical service to the Premises so that the Premises can be used as a first-class office and for the purposes for which they are intended. Landlord shall also install, at Landlord's expense, electric meters satisfactory to the utility supplying electricity to the Premises to measure electricity supplied to the Premises. Tenant shall pay for all electricity supplied to the Premises. Tenant shall have the right, at its expense, to install additional risers and wiring in the Building if necessary to serve Tenant's electrical needs.

b. [3.49] Alternative if Landlord Provides Electricity — Sample Language

1. Landlord shall provide electric current for light and power in the Building, subject to Landlord's right to cease the generation and/or distribution of electric current as provided below.

2. Landlord may cease to furnish electricity to Tenant at any time during the Lease Term on the following conditions: (a) Landlord gives Tenant not less than _____ days' prior written notice of discontinuance; (b) prior to discontinuance, Landlord connects the electric wiring system of the Premises with another source of supply of electricity providing electricity of at least the wattage supplied by the previously existing system; and (c) Landlord installs, at Landlord's expense, electric meters satisfactory to the utility supplying electricity to the Premises to measure electricity supplied to the Premises. In addition, the monthly installments of Rent payable under this Lease shall be reduced, from and after the date on which Tenant begins paying directly for the electricity supplied to the Premises, by an amount equal to the average monthly electric bill for the Building over the three preceding months multiplied by a fraction, the numerator of which is the Net Rentable Area of the Premises and the denominator of which is the Net Rentable Area of the Building.

3. [3.50] Comment

a. The landlord's and tenant's versions of the electricity provision have been divided into two alternative types of provisions — one in which electricity is provided by the landlord, and one in which the tenant deals directly with the utility company. Because in many instances the provision of electricity will depend on the physical layout of the building, the particular needs of the tenant, and the tariffs and procedures under which the local utility company operates, the lawyer drafting such a provision for a standard office lease is well-advised to consult with an architectural or engineering expert concerning electricity requirements.

b. There is a third alternative in dealing with electricity. The landlord may provide electricity for "normal" office uses as a part of the basic services included in the base rent. Any excess use by a particular tenant will be determined by a survey of electrical equipment and usage, performed by a consultant to the landlord, and will be billed to that tenant. This technique is more fallible than direct metering and is usually opposed by major tenants. For a concise summary of the problems, see Peter S. Britell and Howard R. Shapiro, *New York City Office Leases: "Money Issues" for the Major Tenant,* 53 N.Y.St.B.J. 472 (1981).

c. In the landlord's version in §3.47 above, the landlord provides electricity and requires the tenant to pay all costs of electricity used during janitorial service, alterations, and repairs. Unless the tenant is required to reimburse the landlord for the cost of all electricity consumed on the premises, practical difficulty might be encountered in attempting to measure the amount of electricity used for these purposes.

d. In the tenant's version in §3.49 above, the landlord provides electricity and does not require the tenant to pay the cost of electricity used during janitorial service, alterations, and repairs. If the tenant is required to pay for electricity provided by the landlord, the tenant should seek a formula by which the payment equals the amount paid by the landlord for the electricity. In addition, the tenant should be entitled to reasonable evidence of the amount of electricity used and the cost of that electricity before paying any invoice from the landlord. See paragraph 2(b) in §3.17 above for a suggested provision giving the tenant the right to object to a statement by the landlord of amounts due from the tenant.

G. Additional Services

1. [3.51] Landlord's Version — Sample Language

Landlord shall not be obligated to provide any services other than those expressly set forth above. The foregoing notwithstanding, if Landlord provides any additional work or services requested by Tenant or provides any unusual amount of any of the work or services described above (including service furnished outside any stipulated hours), Tenant shall pay Landlord, as Additional Rent under this Lease, an amount equal to the sum of Landlord's costs therefor, plus _____ percent of those costs to reimburse Landlord for Landlord's overhead costs incurred thereby.

2. [3.52] Tenant's Version — Sample Language

Landlord shall provide any other services as may be required so that the Premises can be used as first-class office space and for the purposes for which they are intended. Tenant shall have the right to share in the use of any future facilities or services offered in the Building without any additional charge.

3. [3.53] Comment

a. Any charges for extra services are properly borne by the tenant receiving those services. Otherwise, the landlord will pass on all or a portion of the cost of those services to the other tenants of the building as an increase in operating expenses. See §§3.16 – 3.20 above.

b. From the tenant's point of view, the lease should expressly spell out all of the services that the landlord is to provide and should contain a provision allowing the tenant the right to request additional services consistent with the enjoyment of the premises as a first-class office facility. The general rule in Illinois, absent anything to the contrary in the lease, is that a landlord is not obligated to provide any services to the tenant with respect to the demised premises unless set forth in the lease. *Lippman v. Harrell,* 39 Ill.App.3d 308, 349 N.E.2d 511 (4th Dist. 1976); *Hollywood Bldg. Corp. v. Greenview Amusement Co.,* 315 Ill.App. 658, 43 N.E.2d 566 (1st Dist. 1940); *Campbell v. Banks,* 257 Ill.App. 354 (3d Dist. 1930). This rule has been limited by the courts in multi-tenant buildings in which, absent any contrary lease provision, the landlord must provide basic services to the common areas not leased to any specific tenant. *Mangan v. F.C. Pilgrim & Co.,* 32 Ill.App.3d 563, 336 N.E.2d 374 (1st Dist. 1975); *Durkin v. Lewitz,* 3 Ill.App.2d 481, 123 N.E.2d 151 (1st Dist. 1954); *Campbell, supra.* Tenants often seek to specify and define other landlord services in the building. These services might include tenant identification signs in the elevator lobbies, space on the building directory, replacement of light bulbs and ballasts, and security services in the building.

H. Failure of Covenanted Services

1. [3.54] Landlord's Version — Sample Language

Landlord does not warrant that any of the services mentioned above will be free from interruptions caused by war, insurrection, civil commotion, riots, acts of God, enemy or

government action, repairs, renewals, improvements, alterations, strikes, lockouts, picketing, whether legal or illegal, accidents, inability of Landlord to obtain fuel or supplies, or any other cause or causes beyond Landlord's reasonable control. Any such interruption of service shall never be deemed an eviction (actual or constructive) or a disturbance of Tenant's use and possession of the Premises or any part of the Premises and shall never render Landlord liable to Tenant for damages or relieve Tenant from performance of Tenant's obligations under this Lease.

2. [3.55] Tenant's Version — Sample Language

Landlord acknowledges and agrees that the services above mentioned are vital to Tenant's continued peaceful occupation of the Premises. Landlord shall, to the extent reasonably possible, continue to provide all such services. If Landlord fails or is unable to provide those services, Tenant may, in addition to all other remedies available to Tenant under this Lease, offset any damages incurred by Tenant by reason of Landlord's failure to provide those services from Base Rent and Additional Rent due under this Lease and, if such interruption of services makes impossible Tenant's continued peaceful occupation of the Premises for the purposes for which they are intended, Tenant may terminate this Lease upon _____ days' prior written notice to Landlord unless those services are restored within the _____-day period.

3. [3.56] Comment

a. Generally, absent a contrary provision in a lease, a tenant may recover damages, either in a suit against the landlord or in a defense to an action for rent, if the landlord fails to provide the services it covenanted to provide. In *C.F. Birtman Co. v. Thompson,* 136 Ill.App. 621 (1st Dist. 1907), in which the landlord failed to provide heat as covenanted in the lease, the court stated that a tenant could recover, in a recoupment asserted in an action for rent, the damages suffered by reason of the landlord's failure to provide the promised services. While the court said the normal measure of damages is the difference between the stated rent and the fair rental value of the premises without the promised services, in *Birtman,* the court held that the sum the tenant paid its employees for the time they could not work because of the lack of heat was a precise measure of damages. *See also John Munic Meat Co. v. H. Gartenberg & Co.,* 51 Ill.App.3d 413, 366 N.E.2d 617, 9 Ill.Dec. 360 (1st Dist. 1977), and *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 5 Ill.Dec. 282 (2d Dist. 1977), in which both courts stated that a tenant can recover damages (including the tenant's lost profits) that are the direct result of the landlord's failure to provide covenanted services and that were within the contemplation of the parties when the lease was entered into. In *Zion Industries,* the court ultimately refused to allow the tenant lost profits since the lease exculpated the landlord from liability therefor. Accordingly, a landlord should limit as specifically as possible its liability for damages arising from failure to provide promised services.

b. It is also important, from the landlord's point of view, to limit a tenant's right to claim a constructive eviction arising from a failure of the landlord to provide promised services. The landlord's version recites a number of circumstances in which the landlord's obligation to provide services will be excused. While the enforceability of a provision completely waiving a tenant's

right to claim constructive eviction is open to question, the sample provision in §3.54 above seems acceptable under Illinois law. The court in *John Munic Meat, supra,* summarized the law of constructive eviction as follows:

> **Constructive eviction has been defined as "something of a grave and permanent character done by the landlord with the intention of depriving the tenant of the enjoyment of the premises" . . . and, as a general rule, there can be no constructive eviction unless the tenant surrenders possession or abandons the premises. . . . Where premises leased are rendered useless to the tenant or the tenant is deprived, in whole or in part, of the possession and enjoyment thereof as the result of the wrongful act of the landlord, there is a constructive eviction . . . and it may result from the landlord's failure or refusal to perform the covenants and conditions of the lease. . . . It is not essential that there be an express intention of the landlord to compel a tenant to leave the demised premises or to deprive him of their beneficial enjoyment, since persons are presumed to intend the natural and probable consequence of their acts and, accordingly, acts or omissions of the landlord making it necessary for the tenant to move from the demised premises [**constitute**] a constructive eviction. [**Citations omitted.**]** 366 N.E.2d at 620, quoting *Gillette v. Anderson,* 4 Ill.App.3d 838, 282 N.E.2d 149, 151 – 152 (2d Dist. 1972).

In light of the emphasis on the nature and consequences of the landlord's acts, the parties should be able to agree that a termination of service under certain reasonable circumstances will not constitute a "wrongful act of the landlord" or a constructive eviction.

American National Bank & Trust Company of Chicago v. Sound City, U.S.A., Inc., 67 Ill.App.3d 599, 385 N.E.2d 144, 145, 24 Ill.Dec. 377 (2d Dist. 1979), indicates that the pivotal issue in a constructive eviction is not whether the premises have been rendered "useless" but whether "the leased premises [have] become unfit for the purpose" for which they are leased. The court in *Sound City* also held that the tenant's delay in abandoning the premises was reasonable in light of the landlord's promises to correct the defects (which were minor but crucial to the physical appearance of the premises and thus to their suitability for the tenant's use). 385 N.E.2d at 146. This case, by extending the doctrine of constructive eviction under commercial leases, seems to respond to the same problems that gave rise to the implied warranty doctrine applicable to residential leases. See §3.62 below.

c. In construing the obligations of the parties to a lease with respect to their duties under the lease, Illinois courts will generally construe a provision against the party that drafted it. Thus, in *Coney v. Rockford Life Insurance Co.,* 67 Ill.App.2d 395, 214 N.E.2d 1 (3d Dist. 1966), in which the lease clearly provided that the landlord would install air-conditioning equipment but was ambiguous on whether the landlord or the tenant would pay for the electricity used in operating the system, the court found against the tenant because the tenant made substantial modifications in the form lease presented by the landlord. In *Schmohl v. Fiddick,* 34 Ill.App. 190 (2d Dist. 1889), in which the landlord, who drafted the lease, had inserted meaningless language in the lease provision governing the duty to maintain an elevator installed by the landlord while simultaneously orally assuring the tenant that the landlord would maintain the elevator, the court held that the landlord was estopped from denying his own construction of the ambiguous provision and had to maintain the elevator.

d. Some Illinois cases suggest that a tenant may withhold from rent due the damages that the tenant suffers by reason of the landlord's failure to provide promised services. *See, e.g., Book Production Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881 (2d Dist. 1961). When the landlord agrees to pay for water, gas, or electrical service and nonpayment jeopardizes that service, there is statutory authorization for a tenant to pay for those services and deduct those payments from its rent. 765 ILCS 735/1. Tenants should be aware, however, that any decision to withhold rent as compensation for damages arising from a landlord's failure to provide promised services could result in the loss of possession. While a tenant may, in an action for rent by a landlord, set off any damages the tenant incurs from the failure of the landlord to provide promised services or bring an action against the landlord to recover those damages, Illinois law holds that absent an express right of setoff in the lease, the landlord's failure to provide promised services under a commercial lease cannot be raised as a defense in an action by the landlord to regain possession for failure to pay rent. See §3.62 below for citations to Illinois cases. The obligation to pay rent is a separate and independent covenant from the obligation of the landlord to provide the services. Thus, as the court stated in *Truman v. Rodesch,* 168 Ill.App. 304, 306 (2d Dist. 1912):

> **The covenant to pay rent was not upon condition that plaintiff comfortably heat said premises, but was a separate and independent covenant; and when [**tenant**] failed to perform it, the landlord had the right, after notice and demand, to declare the lease forfeited, and to sue for possession. . . .**
>
> **If this was an action for recovery of the rent, a different question would be presented. . . .**
>
> **. . . [**T**]he tenant cannot prove his damages suffered because of the failure or neglect of the landlord to perform an independent covenant on his part, in an action solely for possession.**

While this continues to be the law in Illinois, there is a growing trend in other jurisdictions to diminish the independence of the rent covenant from the landlord's basic services covenant. In an excellent article, two Illinois lawyers have suggested that these covenants be made dependent in short-term commercial leases. Gerald G. Greenfield and Michael Z. Margolies, *An Implied Warranty of Fitness in Nonresidential Leases,* 45 Alb.L.Rev. 855 (1981). For an example of this in Massachusetts, *see Wesson v. Leone Enterprises, Inc.,* 437 Mass. 708, 774 N.E.2d 611 (2002).

e. In order to eliminate all ambiguities as to the tenant's rights in the event the landlord fails to provide promised services, tenants often seek the right to abate the obligation to pay rent or offset rent obligations by the damages suffered (as provided in the tenant's version) if services are discontinued for a stated period of time or to terminate the lease if the interruption continues for a longer stated period of time. These rights (especially the termination right) are often limited to the interruption of services that prevent the tenant from using the premises for their intended purposes. In setting the time periods, the tenant must consider how long it can economically function without the designated services. The ability of the tenant to abate rent or terminate the lease will be of great concern to the landlord's lender, who relies on the continued rent as the landlord's means of servicing the debt and as a factor in maintaining the value of the premises if the lender must foreclose.

One compromise position might be that the landlord can prevent the tenant from abating rent or terminating if the landlord can provide alternative premises until the services can be restored. Another compromise might be to limit the tenant's rights of abatement and termination to situations in which the interruption of services is the result of the landlord's willful or negligent acts. This compromise, however, shifts the risk to the tenant of doing without services in situations not resulting from the landlord's willful or negligent acts while still being obligated to pay rent. To the extent that the tenant is required to bear any risk of the inability to use the premises because of a discontinuation of covenanted services, the tenant should explore the possibility of business interruption insurance that will compensate it for losses incurred during the period when the premises are unavailable. An interruption of a tenant's ability to use its premises for several days could have disastrous economic consequences on the tenant's business.

XII. RIGHTS RESERVED TO LANDLORD

A. [3.57] Landlord's Version — Sample Language

Landlord shall have the following rights, each of which Landlord may exercise without liability to Tenant for damage or injury to property, person, or business due to the exercise of those rights, and the exercise of those rights shall not be deemed to constitute an eviction or disturbance of Tenant's use or possession of the Premises and shall not give rise to any claim for setoff, deduction, or abatement of Rent or any other claim:

1. To change the name of the Building or the Building's street address.

2. To install, affix, and maintain any and all signs on the exterior and on the interior of the Building.

3. To relocate, enlarge, reduce, or change lobbies, exits, or entrances in or to the Building and to decorate and to make repairs, alterations, additions, and improvements, structural or otherwise, in or to the Building or alley, including for the purpose of connection with or entrance into or use of the Building in conjunction with any adjoining or adjacent building or buildings now existing or to be constructed, and for those purposes to erect scaffolding and other structures required by the character of the work to be performed and during those operations to enter on the Premises and take into and on or through any part of the Building, including the Premises, all materials that may be required to make those repairs, alterations, improvements, or additions, and in that connection Landlord may temporarily close public entryways, other public spaces, stairways, or corridors and interrupt or temporarily suspend any services or facilities agreed to be furnished by Landlord, all without such action constituting an eviction of Tenant in whole or in part and without abatement of Rent by reason of loss or interruption of the business of Tenant or otherwise and without in any manner rendering Landlord liable for damages or relieving Tenant from performance of Tenant's obligations under this Lease, and if Tenant desires to have any such work done during other than ordinary business hours, Tenant shall pay all overtime and additional expenses resulting therefrom.

4. To retain at all times, and to use in appropriate instances, keys to all doors within and into the Premises. Tenant agrees to purchase only from Landlord additional duplicate keys as required, to change no locks, and to affix no locks on doors without the prior written consent of Landlord. No duplicate keys shall be made; all extra keys will be furnished by Landlord at Tenant's expense. If the keys provided to Tenant shall be lost or any locks damaged, Tenant shall be liable for the cost of replacement or repair. Notwithstanding the provision for Landlord's access to the Premises, Tenant relieves and releases Landlord of all responsibility and liability arising out of theft, robbery, or pilferage. Upon the expiration of the Term or of Tenant's right to possession, Tenant shall return all keys to Landlord and shall disclose to Landlord the combination of any safes, cabinets, or vaults left in the Premises.

5. To approve the weight, size, and location of safes, vaults, books, files, and other heavy equipment and articles in and about the Premises and the Building so as not to exceed the design live load per square foot designated by the structural engineer for the Building, and to require all such items and furniture and similar items to be moved into or out of the Building and the Premises only at times and in a manner as Landlord shall direct in writing. Tenant shall not install or operate machinery or any mechanical devices of a nature not directly related to Tenant's ordinary use of the Premises without the prior written consent of Landlord. Movement of Tenant's property into or out of the Building or the Premises and within the Building is entirely at the risk and responsibility of Tenant, and Landlord reserves the right to require permits before allowing any property to be moved into or out of the Building or Premises.

6. To establish controls for the purpose of regulating all property and packages, personal or otherwise, to be moved into or out of the Building and the Premises and to establish controls for all persons using the Building.

7. To grant to anyone the exclusive right to conduct any particular business or undertaking in the Building.

8. To regulate delivery of supplies and services in order to ensure the cleanliness and security of the Premises and the Building and to avoid congestion of the loading docks, receiving areas, and freight elevators.

9. To show the Premises to prospective tenants at reasonable hours during the last _____ months of the Term or to prospective mortgagees, ground lessors, or purchasers of the Land or the Building or both at any time and, if vacated or abandoned, to show the Premises to prospective tenants at any time and to prepare the Premises for reoccupancy.

10. To erect, use, and maintain concealed pipes, ducts, wiring, and conduits and appurtenances thereto in and through the Premises in walls, below the floor, and above the suspended ceiling.

11. To enter the Premises at any reasonable time upon prior notice (except that no notice shall be required in the event of an emergency) to inspect the Premises.

B. [3.58] Tenant's Version — Sample Language

Subject to Landlord's obligation to operate the Building in a first-class manner as set forth in section _____ of this Lease, Landlord shall have the following rights, exercisable, however, only in a manner that will not disturb Tenant's use and occupancy of the Premises:

1. To change the name of the Building (but not to the name of a competitor of Tenant) or the Building's street address upon _____ months' prior written notice to Tenant.

2. Subject to Tenant's signage rights set forth in section _____ of this Lease, to install, affix, and maintain any and all signs on the exterior and on the interior of the Building, provided that no such sign shall obstruct Tenant's views from the Premises.

3. At any time after Tenant abandons the Premises, to decorate, remodel, repair, alter, or otherwise prepare the Premises for reoccupancy.

4. To constantly have pass keys to the Premises, provided that Landlord shall be liable to Tenant for any damages suffered by Tenant resulting from any misuse of those pass keys.

5. To grant to anyone the exclusive right to conduct any particular business or undertaking in the Building, provided the exclusive right shall not operate to exclude Tenant from the use permitted in this Lease.

6. To exhibit the Premises to others during the last _____ days of the Term of this Lease, provided that the Premises are exhibited in a way that will not interfere with Tenant's business conducted on the Premises.

7. To require all persons entering or leaving the Building during the hours that Landlord may from time to time reasonably determine to identify themselves to a security guard by registration or otherwise and to establish their right to leave or enter, and to exclude or expel any peddler, solicitor, or beggar at any time from the Building.

8. To take any and all measures, including inspections, repairs, alterations, additions, and improvements to the Premises or to the Building as may be necessary or desirable, in Landlord's reasonable judgment, for the safety, protection, or preservation of the Premises or the Building, provided that those measures are taken in a way that will not interfere with Tenant's business being conducted on the Premises and that those measures do not decrease the usable area of the Premises.

C. [3.59] Comment

1. This clause is used by landlords to negate any implied rights on the part of a tenant that might interfere with the landlord's use and control of its building. The specific rights reserved to the landlord must be tailored to the needs of the particular project. The sample provisions in §3.57 above are intended merely as illustrations of the types of rights that landlords often reserve for themselves.

2. These reservations can be very important when a landlord desires to change the common areas or the building utility systems. *See Blue Cross Ass'n v. 666 North Lake Shore Drive Associates,* 100 Ill.App.3d 647, 427 N.E.2d 270, 56 Ill.Dec. 190 (1st Dist. 1981) (need to penetrate tenant's space with new utility lines for conversion of other space in building to residential use); *Advertising Checking Bureau, Inc. v. Canal-Randolph Associates,* 101 Ill.App.3d 140, 427 N.E.2d 1039, 56 Ill.Dec. 634 (1st Dist. 1981) (reconfiguration of corridor connecting tenant's space to elevator lobby).

XIII. REPAIRS; RETURN OF PREMISES

A. [3.60] Landlord's Version — Sample Language

1. Tenant shall, at Tenant's expense, keep the Premises in good order, condition, and repair and shall promptly and adequately repair all damage to the Premises and replace or repair all glass, fixtures, equipment, and appurtenances therein damaged or broken with materials equal in quality and class to the original materials damaged or broken.

2. At the termination of this Lease by lapse of time or otherwise:

a. Tenant shall return the Premises in as good condition as when Tenant took possession (ordinary wear and tear and loss by fire, unless resulting from Tenant's negligent acts or omissions, excepted).

b. Tenant shall, at Landlord's request, remove any floor covering laid by Tenant and (i) remove all nails, tacks, paper, glue, bases, and other vestiges of the floor covering and restore the floor surface to the condition existing before such floor covering was installed; or (ii) pay to Landlord, upon demand, the cost of restoring the floor surface to such condition.

c. Tenant shall surrender all keys to the Premises and shall make known to Landlord the combinations for all locks on safes, cabinets, and vaults.

d. All installations, additions, hardware, non-trade fixtures, and improvements, temporary or permanent, in or on the Premises, except movable furniture and equipment belonging to Tenant, whether placed there by Tenant or Landlord, shall be Landlord's property and shall remain on the Premises, all without compensation, allowance, or credit to Tenant, provided, however, that if prior to such termination or within _____ days thereafter Landlord so directs by notice, Tenant shall promptly, at Tenant's cost, remove the installations, additions, hardware, non-trade fixtures, and improvements placed in or on the Premises by Tenant and designated in the notice and shall repair any damage caused by that removal, failing which Landlord may remove such items and Tenant shall, upon demand, pay to Landlord the cost of that removal and of any necessary restoration of the Premises plus any interest at the rate of _____ percent per annum. Tenant's security deposit shall secure Tenant's obligation to remove the items that Landlord directs Tenant to remove pursuant to this Lease and shall not be returned to Tenant until those items are removed in accordance with this provision.

3. All fixtures, installations, and personal property belonging to Tenant not removed from the Premises upon termination of this Lease and not removed as provided in this Lease shall be conclusively presumed to have been abandoned by Tenant, and title to those items shall pass to Landlord under this Lease as by a bill of sale.

B. [3.61] Tenant's Version — Sample Language

1. a. Except for ordinary wear and tear, loss by fire, or other casualty, Landlord's repair and maintenance obligations, and as otherwise provided in this Lease, Tenant shall at its expense keep in good order, condition, and repair the interior of the Premises and shall promptly and adequately repair all damage to the interior of the Premises and replace or repair all glass, doors, fixtures, equipment, and appurtenances therein damaged or broken. Tenant shall deliver up the Premises at the termination of the Lease in the same condition as when received by Tenant, reasonable use, wear and tear, loss by fire or other casualty or act of God, and the repair and maintenance obligations of Landlord under this Lease excepted; provided, however, that Tenant shall not be obligated to remove any improvements placed or installed on or in the Premises by Tenant.

b. All trade fixtures of Tenant and all improvements that are removable without irreparable damage to the Premises that have been placed or installed on or in the Premises by Tenant and that Tenant elects to remove shall remain the property of Tenant and may be removed by Tenant at any time within _____ days after the last day of the Term of this Lease. Title to any such improvements not removed by Tenant within such _____-day period and to all improvements made at Tenant's expense that are not removable without irreparable damage to the Premises shall remain in Tenant's possession until the expiration of the Lease, and upon that expiration title to those improvements shall immediately vest in Landlord as by a bill of sale, and Tenant shall have no further obligation in connection therewith.

2. Landlord shall, at its expense, maintain the Building in good repair and condition (other than the obligations assumed by Tenant in this Lease), including but not limited to maintaining, repairing, and replacing the roof, foundation, air-conditioning, heating, plumbing, electrical, and sewerage systems and the structural components and soundness of the exterior and interior walls of the Building, maintaining and repairing all parking lots and landscaping, keeping parking spaces, driveways, and sidewalks reasonably free from snow and ice, and keeping the Premises free from any infestation of insects, rodents, bugs, or other animals.

3. To induce Tenant to execute this Lease, Landlord represents and warrants to Tenant that at the beginning of the Term of this Lease the plumbing, electrical wiring, water, and sewerage systems, fire protection and sprinkler systems, heating system, air-conditioning equipment, and elevators of the Building are in good operating condition and comply with applicable governmental codes and ordinances.

C. [3.62] Comment

1. The rights and duties of landlords and tenants to repair the premises and the building have been widely litigated in Illinois. The general rule with respect to repairs, as in the case of the landlord's services generally (see §3.53 above) and absent any contrary lease provision, is that

> **[**t**]he relation of landlord and tenant creates no obligation or duty on the landlord to make repairs, unless he assumed such duty by express agreement with the tenant. . . . A covenant to repair by the tenant, except to prevent waste by his acts of negligence, is not implied by law and an express covenant to repair will not be enlarged by construction. [**Citation omitted.**]** *Hollywood Bldg. Corp. v. Greenview Amusement Co.,* 315 Ill.App. 658, 43 N.E.2d 566, 567 (1st Dist. 1940).

Accord Yuan Kane Ing v. Levy, 26 Ill.App.3d 889, 326 N.E.2d 51 (1st Dist. 1975). If the landlord voluntarily repairs or improves the premises, *i.e.,* not pursuant to a request by the tenant to do so, the tenant is not liable to pay for those repairs. *Wicker v. Lewis,* 40 Ill. 251 (1866). Similarly, a right reserved in the landlord to enter the premises to make any necessary repairs, without any accompanying requirement that the tenant pay for those repairs, will not obligate the tenant to pay for repairs made by the landlord. *Rose v. Stoddard,* 181 Ill.App. 405 (1st Dist. 1913). However, a promise made by the landlord after the execution of the lease to make certain repairs is unenforceable. *Yuan Kane Ing, supra,* 326 N.E.2d at 54. See generally David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 334 – 335; Bennett I. Berman, *The Duty of Repair and Restoration of Leased Premises in Illinois,* 53 Chi.B.Rec. 373, 376 – 377 (1972).

2. Illinois courts have read certain exceptions into the general common-law rule stated in comment 1 above:

a. A landlord must repair and maintain the common areas of the building under the landlord's control, unless the lease provides otherwise. As stated in *Durkin v. Lewitz,* 3 Ill.App.2d 481, 123 N.E.2d 151, 154 (1st Dist. 1954):

> **The common law regarded a lease . . . as a grant of an estate for years, with respect to which the lessee had the exclusive right and exclusive responsibility. The lessor was under no obligation to repair or to maintain passageways or other premises used in common by all tenants. . . . The common law conception, strictly applied, could hardly prove workable in these days of 40-story office buildings. [**Citations omitted.**]**

See also Mangan v. F.C. Pilgrim & Co., 32 Ill.App.3d 563, 336 N.E.2d 374 (1st Dist. 1975); *Campbell v. Banks,* 257 Ill.App. 354 (3d Dist. 1930).

b. Even if the tenant agreed in the lease to keep the premises in repair and to return the premises in good order and condition at the end of the lease term, absent any contrary lease provision, the landlord must make extraordinary or substantial repairs that are necessary for the continued use of the premises for which they are intended. In *Kaufman v. Shoe Corporation of America,* 24 Ill.App.2d 431, 164 N.E.2d 617 (3d Dist. 1960), in which the tenant agreed to repair and maintain the premises, the court held that this did not require the tenant to replace the source

of heat when the outside supplier of heat discontinued the service during the lease term. The landlord was required to install a replacement heating system. The court stated:

> **A general covenant of the tenant to repair, or to keep the premises in repair, merely binds him to make the ordinary repairs reasonably required to keep the premises in proper condition; it does not require him to make repairs involving structural changes. In order to shift on the tenant a burden which would naturally fall on the landlord, the warrant for the change should be plainly discoverable in the lease. . . .**
>
> **Where a tenant covenants merely to repair and the alterations or additions to the premises are of a structural or substantial nature and are made necessary by extraordinary or unforeseen future events not within the contemplation of the parties at the time the lease was executed, the landlord is ordinarily held liable for such alterations or additions. [**Citation omitted.**]** 164 N.E.2d at 620.

See also Baxter v. Illinois Police Federation, 63 Ill.App.3d 819, 380 N.E.2d 832, 20 Ill.Dec. 623 (1st Dist. 1978); *Bogan v. Postlewait,* 130 Ill.App.2d 729, 265 N.E.2d 195 (4th Dist. 1970); *Berman, supra.*

3. The landlord's breach of its covenant to make repairs gives rise to various rights and remedies of the tenant. As the court stated in *Book Production Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881, 885 (2d Dist. 1961):

> **A landlord and tenant may by express covenant or agreement regulate their respective duties of repair. On breach of the landlord's covenant to repair, the tenant may abandon the premises if they become untenantable by reason thereof, or may remain and recoup his damages in an action for rent or by payment of less rent, or in a proper case he may make repairs and deduct the cost from the rent or sue the landlord for their cost, or may sue the landlord for damages and the damages in that instance are usually the difference between the rental value of the premises in repair and out of repair.**

However, the court would not allow the tenant to recover the actual money damages sustained by the tenant by reason of the landlord's breach — the damage to the tenant's personal property — due to the existence in the lease of a waiver of the tenant's claims for damages to its personal property caused by the building being out of repair. A similar result was reached in *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 5 Ill.Dec. 282 (2d Dist. 1977). See §§3.89 – 3.91 below for further discussion of such a waiver.

A tenant's agreement to repair is enforceable. For example, in *Hollywood Bldg. Corp., supra,* in which the tenant agreed to maintain the premises in compliance with police regulations and to maintain a theater marquee that formed part of the premises, the tenant was required to alter the marquee to comply with police regulations after the street was widened. When the tenant covenants generally to keep the premises in good repair and fails to do so, the landlord need not wait until the end of the lease term to recover for the cost of repairs that should have been made at the tenant's expense. *Gubbins v. Glabman,* 215 Ill.App. 43 (1st Dist. 1919).

4. As discussed in §3.56 above, the exercise by a tenant of its right to withhold rent to compensate it for damages arising from the landlord's failure to provide promised services may result in the tenant's loss of possession of the premises. In an action by a landlord for possession by reason of a tenant's failure to pay rent, a tenant cannot raise as a defense the failure of the landlord to make promised repairs. *Truman v. Rodesch,* 168 Ill.App. 304 (2d Dist. 1912). While Illinois courts have modified this rule in certain circumstances, allowing tenants of residential units in multifamily buildings to raise, in an action for possession, the defense of a breach of an implied warranty of habitability (*Jack Spring, Inc. v. Little,* 50 Ill.2d 351, 280 N.E.2d 208 (1972)), so far this modification has been rejected in cases involving commercial leases. *Elizondo v. Perez,* 42 Ill.App.3d 313, 356 N.E.2d 112, 1 Ill.Dec. 112 (1st Dist. 1976); *Yuan Kane Ing, supra.* Many of the concerns raised in *Jack Spring* with respect to imposing repair obligations on residential tenants — such as the complexity of the building, the need for access to common areas, and the difficulty of financing repairs with just a leasehold interest — are equally applicable in multi-tenant office buildings. Nevertheless, the court in *Yuan Kane Ing* rejected any implied warranty in commercial leases, stressing the difference in the bargaining positions of residential and commercial tenants as the basis for limiting *Jack Spring* to residential situations. 326 N.E.2d at 54. This distinction is questionable, considering the often minimal bargaining position of a tenant leasing a small space in a large multi-tenant office building. Nevertheless, even tenants leasing a small space cannot rely on any implied warranty of habitability with regard to the premises or the building. Consequently, a commercial landlord can recover possession of the premises if a tenant withholds its damages or repair costs from rent due, leaving the tenant with only an action for damages or repair costs against the landlord.

5. Because office leases quite commonly require the landlord to maintain the structural portions of the building and the tenant to maintain the interior portions of the premises, disputes will often turn on whether the repair involved structural or nonstructural portions of the premises. Generally, these situations depend on the specific facts. *See, e.g., Hardy v. Montgomery Ward & Co.,* 131 Ill.App.2d 1038, 267 N.E.2d 748 (5th Dist. 1971), in which the court, after considering at length the dictionary definition of "plaster," decided that plaster was a nonstructural item and, accordingly, the tenant was obligated to repair faulty plaster situated in the premises. *Accord Baxter, supra. See also National Tea Co. v. Gaylord Discount Department Stores, Inc.,* 100 Ill.App.3d 806, 427 N.E.2d 345, 56 Ill.Dec. 265 (1st Dist. 1981) (light fixtures were not part of building's structure). Tenants must take care to limit their maintenance obligations with respect to the exterior glass of the building since in a modern office building large panels of glass, which may be very costly to replace, often take on the characteristics of a structural element of the building.

6. The portion of the sample provisions relating to the condition of the premises upon their return to the landlord has become the focus of a number of Illinois cases. In *One Hundred South Wacker Drive, Inc. v. Szabo Food Service, Inc.,* 60 Ill.2d 312, 326 N.E.2d 400 (1975), a landlord sought damages from a tenant that had negligently caused a fire that destroyed the leased premises and part of the building containing them. The court, after scrutinizing the entire lease, held that the lease contained an implied release of the tenant's liability for such negligence and a concomitant obligation on the landlord to carry sufficient insurance on the premises and the building to protect its interest therein. This decision relied in part on a clause similar to that contained in the tenant's version calling for the tenant to return the premises in their original condition, "loss or damage by fire or other casualty . . . excepted." [Emphasis omitted.] 326 N.E.2d at 401. *See also Barr v. Cutler,*

64 Ill.App.3d 518, 381 N.E.2d 413, 21 Ill.Dec. 304 (4th Dist. 1978). Later cases involving clauses similar to that contained in the landlord's version that specifically exclude fire caused by the tenant's acts or negligence have reached differing results as to whether such a provision is sufficient to impose liability on the tenant for the fire and to preclude any implied obligation of the landlord to carry full insurance. *See Hardware Mutual Casualty Co. v. Bob White Oldsmobile-Cadillac, Inc.,* 46 Ill.App.3d 722, 361 N.E.2d 325, 5 Ill.Dec. 186 (4th Dist. 1977) (tenant not liable); *Englehardt v. Triple X Chemical Laboratories, Inc.,* 53 Ill.App.3d 926, 369 N.E.2d 67, 11 Ill.Dec. 613 (1st Dist. 1977) (tenant may be liable). A more recent Illinois Supreme Court decision on this issue, *Dix Mutual Insurance Co. v. LaFramboise,* 149 Ill.2d 314, 597 N.E.2d 622, 173 Ill.Dec. 648 (1992), demonstrates both the general trend toward protecting the tenant against liability by liberal interpretation of the lease language and the concerns about this trend in the form of a strong dissent and special concurrence. If the landlord is not willing to exculpate the tenant from liability, the lease should include, in addition to the language found in the landlord's version, another provision expressly stating that the tenant will be liable for all damages resulting from its negligence. See §3.89 below for a sample provision on this point.

7. Whether at the end of the lease term the tenant has the right at its discretion or the obligation to remove the improvements it has placed or installed on or in the premises presents the parties with resolving which party will assume the costs and risks arising from dealing with the tenant's leasehold improvements at the end of the term. If the tenant has discretion as to whether to remove the leasehold improvements, the landlord may be left with improvements that might not be salvageable for use by future tenants and accordingly must be removed by the landlord at its expense in order to make the premises leasable. If the tenant is obligated to remove the improvements (which probably have no salvage value), the tenant will incur a substantial cost at the end of the term if the improvements it has installed during the lease term are substantial. If the lease is silent as to the removal of tenant improvements, the tenant may remove such improvements before the expiration of the lease term. *Lewis v. Real Estate Corp.,* 6 Ill.App.2d 240, 127 N.E.2d 272 (1st Dist. 1955). Improvements that remain after the expiration of the lease term become the property of the landlord, which is not liable to the tenant for the value of the improvements in the absence of an agreement to the contrary. *Id.*

Not surprisingly, the landlord's and tenant's versions address the conflicting interests of the landlord and the tenant with respect to obligations concerning the tenant's leasehold improvements at the end of the lease term from opposite directions. The landlord's version provides that the landlord has the option to require the tenant to remove, at the tenant's cost, any of the improvements designated for removal by the landlord. Any of the tenant's improvements that the landlord does not require the tenant to remove become the landlord's property and are to remain on the premises at the end of the lease term. If the landlord fails to timely request that the tenant remove leasehold improvements, the tenant will have no obligation to do so, nor can the tenant be charged the costs incurred by the landlord in removing any tenant improvements. The tenant's version, on the other hand, leaves removal of the leasehold improvements to the tenant's discretion. It provides that the improvements are the property of the tenant and can be removed by the tenant within a specified number of days after the end of the lease term (typically 30), though the tenant is under no obligation to remove the improvements. If the tenant elects not to remove the improvements within the designated period or simply fails to do so, the improvements become the property of the landlord (with the accompanying cost burden of removing the improvements in order to make the

premises tenantable), regardless of whether the landlord desires the improvements to remain in place.

An additional concern arises when the landlord and the tenant are parties to successive leases of the same premises (as opposed to a mere extension of the first lease). *See First National Bank of Des Plaines v. Shape Magnetronics, Inc.,* 135 Ill.App.3d 288, 481 N.E.2d 953, 90 Ill.Dec. 153 (1st Dist. 1985) (when lease clearly indicates that it is separate agreement, it will not be construed as extension of prior lease between parties). If either the landlord's or the tenant's version has been used in both the first and second lease, the landlord cannot request that the tenant remove improvements made during the first lease term at the conclusion of the second lease term. Under the landlord's version, if the landlord fails to request the removal of the improvements at the end of the first term, the improvements become the property of the landlord and remain so throughout the term of the second lease. Similarly, under the tenant's version, if the tenant does not choose to remove the leasehold improvements at the end of the term of the first lease, the improvements become the landlord's property. In either case, the tenant cannot be required to remove the landlord's property from the premises at the end of the second lease term. Similarly, if the tenant wishes for some reason to retain ownership of improvements placed in the premises during the first term, it will not be entitled to do so under this scenario. In order to resolve this problem, the lease that governs the successive lease term must specifically deal with this problem in a provision addressing ownership of the tenant's leasehold improvements and the rights and obligation of the parties with respect to these improvements at the end of the term of the second lease. These results are consistent with the requirement in the landlord's version that the premises be returned "in as good condition as when Tenant took possession" and the requirement in the tenant's version that the premises be returned "in the same condition as when received by Tenant." Though there are no Illinois cases on point, in *Summerville v. Belk-Rhodes Co.,* 160 Ga.App. 162, 286 S.E.2d 497 (1981), when a second lease required the leased premises to be returned to the landlord at the expiration of the term in the same condition as first received, the court held that the tenant must surrender the premises in the condition in which they existed at the beginning of the second lease term.

XIV. ALTERATIONS BY TENANT

A. [3.63] Landlord's Version — Sample Language

1. Tenant shall not make any alterations in or additions to the Premises without Landlord's advance written consent in each and every instance having been first obtained. Landlord's refusal to give consent shall be conclusive. If Landlord consents to any alterations or additions, before commencement of the work or delivery of any materials onto the Premises or into the Building, Tenant shall furnish Landlord with plans and specifications and permits necessary for those alterations or additions, all in form and substance satisfactory to Landlord. Landlord may impose further conditions with respect to any alterations or additions as Landlord deems appropriate, including without limitation requiring Tenant to furnish Landlord with security for the payment of all costs to be incurred in connection with that work. Tenant shall pay, within _____ days after being billed, Landlord's fees and costs for outside consultants retained by Landlord to review the plans

and specifications for those alterations or additions and to inspect those alterations or additions made in connection therewith. All additions and alterations shall be installed in a good, professional manner and only new, high-grade materials shall be used. All alterations and additions to the Premises, whether temporary or permanent in character and whether made or paid for by Landlord or Tenant, shall without compensation to Tenant become Landlord's property upon installation on the Premises and shall, unless Landlord requests their removal, be relinquished to Landlord in good condition, ordinary wear excepted, at the termination of this Lease by lapse of time or otherwise.

2. Tenant agrees to indemnify, defend, and hold Landlord harmless of, from, and against any and all liabilities, costs, and expenses of every kind and description (including but not limited to attorneys' fees and expenses) that may arise out of or be connected in any way with any alterations or additions. Tenant shall furnish Landlord with certificates of insurance from all contractors performing labor or furnishing materials in connection with any additions or alterations, insuring Landlord against any and all liabilities that may arise out of or be connected in any way with those additions or alterations.

3. The work necessary to make any alterations or additions to the Premises shall be done at Tenant's expense by employees of, or contractors hired by, Landlord except to the extent Landlord gives its prior written consent to Tenant's hiring of contractors. Tenant shall promptly pay to Landlord or to Tenant's contractors, as the case may be, when due, the cost of all work and also the cost of any restoration of the Premises made necessary by such work (including all decorating required by reason of that work). Tenant shall also pay to Landlord a percentage of the cost of all work equal to _____ percent to reimburse Landlord for all overhead, general conditions, fees, and other costs and expenses arising from Landlord's involvement with that work. In the event that Landlord has consented to Tenant's hiring of contractors, upon completing any alterations or additions, Tenant shall furnish Landlord with contractors' and subcontractors' affidavits and full and final waivers of lien and receipted bills, covering all labor and materials expended and used, all in form and substance satisfactory to Landlord.

4. All alterations and additions shall comply with all insurance requirements applicable to the Building and with all ordinances, statutes, and regulations of all governmental bodies, departments, or agencies having jurisdiction over the Building. Tenant shall permit Landlord to supervise construction operations in connection with alterations or additions, at Landlord's request, provided that Landlord shall have no duty to so supervise.

B. [3.64] Tenant's Version — Sample Language

Tenant may, at its own expense, make any nonstructural improvements to the Premises as it deems necessary for its use. Tenant shall not make any structural improvements, alterations, or additions to the Premises or the Building without Landlord's prior written consent, which consent shall not be unreasonably withheld or delayed.

C. [3.65] Comment

1. Any work performed on the premises at the tenant's request gives the party performing labor or supplying material a right to a mechanics or material supplier's lien against only the leasehold estate unless the landlord has given actual or constructive permission for the work to be performed. As stated in *Williams v. Vanderbilt,* 145 Ill. 238, 34 N.E. 476 (1893):

> **[**The contractor's**] contract for doing the work and furnishing the material in altering and repairing the building was with the lessee or lessees of the premises; therefore, whatever lien he had under the contract extended to the leasehold interest only. . . . The party with whom the contract is made by the person furnishing the labor or materials is only regarded as owner, within the meaning of the law, to the extent of the interest which he owns. It is that interest which is subjected to the lien. . . . A tenant for life or years cannot, by contract, create a lien upon the fee. He may, by contract, create a lien to the extent of his right and interest in the premises, but no further. . . . As appellant's lien extended to the leasehold estate only, it did not take effect upon [**the landlord's**] legal title. [**Citations omitted.**]**

See also Judson v. Stephens, 75 Ill. 255 (1874). The mechanics lien claimant, having a claim only on the leasehold estate, succeeds to the leasehold estate subject to all of the landlord's rights against the tenant, including the landlord's right to summary reentry. *Williams, supra.*

2. If the landlord "authorized or knowingly permitted [the tenant] to contract, to improve" the premises, however, the mechanics lien claim lies against both the leasehold estate and the underlying fee interest. 770 ILCS 60/1. As stated by the court in *Miller v. Reed,* 13 Ill.App.3d 1074, 302 N.E.2d 131, 133 (5th Dist. 1973):

> **The owner is assumed to have "knowingly permitted" the improvements where he knew and failed to protest or accepted the benefits of the improvements.**

Knowledge of improvements can be imputed to the landlord (a) if the landlord's managing agent knew of improvements made by the tenant, even if the lease requires the landlord's prior written consent to those improvements and the agent has no authority to give its consent (*Johns-Manville Corporation of Delaware v. La Tour D'Argent Corp.,* 277 Ill.App. 503 (1st Dist. 1934)) and (b) if the lease requires the tenant to make certain improvements to the premises, even if the tenant fails to follow the safeguards set out in the lease to protect the landlord from a mechanics lien claim (*Armco Steel Corp. v. LaSalle National Bank,* 31 Ill.App.3d 695, 335 N.E.2d 93 (2d Dist. 1975)). In multi-tenant office buildings with a minimally observant owner or manager controlling access to the building and freight elevators, it will be almost impossible for the landlord not to know that tenant improvements are being made. In commenting on when a landlord will be found to have knowingly permitted improvements by a tenant, the court in *Armco Steel* stated:

> **We believe the words of the statute "knowingly permit" are to be taken in the general sense of being aware of and consenting to such improvements, that is, the initiation of such improvements. They are not intended as a continuing shield for the landlord in case the lessee does not perform a particular covenant.** 335 N.E.2d at 96 – 97.

Clearly, a landlord must carefully monitor construction work done on a tenant's premises. For this reason, the landlord's version provides that the landlord may supervise or actually perform the construction and thereby ensure that all work is properly paid for and completed.

3. Both versions state that the alterations and additions shall be made at the tenant's expense. Absent some agreement to the contrary, the landlord will not be liable to the tenant for the value of improvements voluntarily made by the tenant even though the improvements may become the property of the landlord upon installation. *Johnston v. Suckow,* 55 Ill.App.3d 277, 370 N.E.2d 650, 12 Ill.Dec. 846 (5th Dist. 1977). The landlord must be wary, however, that specific language in the lease or the landlord's ratification of the acts of the tenant might result in a finding of an agency relationship between the landlord as principal and the tenant as agent, making the landlord liable to third parties to pay for improvements ordered by the tenant. *See id.*

4. The landlord has many legitimate concerns regarding the alteration of the premises. Certain alterations may make the premises less desirable to future tenants; may adversely affect the performance of heating, cooling, or other mechanical systems of the building; or may be detrimental to the structure of the building. Note that even the tenant's version provides that the tenant may not make certain repairs or alterations without the consent of the landlord. See §3.112 below for a discussion of the right of the landlord to grant or withhold consent.

XV. USE OF PREMISES BY TENANT

A. [3.66] Landlord's Version — Sample Language

1. Tenant shall occupy and use the Premises continuously during the Term of this Lease for the following specified purpose and no other: _____.

2. Tenant agrees to observe the following covenants and to comply with all rules and regulations that Landlord may from time to time make for the Building:

a. Tenant shall not conduct itself or permit its contractors, agents, employees, or invitees to conduct themselves in the Premises or in the Building in a manner inconsistent with the character of the Building as an office building of the highest class or inconsistent with the comfort or convenience of other tenants.

b. Tenant shall not exhibit, sell, or offer for sale on the Premises or in the Building any article or thing, except those articles and things essentially connected with the stated use of the Premises, without the prior written consent of Landlord.

c. Tenant shall not make or permit to be made any use of the Premises that, directly or indirectly, is forbidden by public law, ordinance, or governmental regulation, that may be dangerous to life, limb, or property, or that may invalidate or increase the cost of any policy of insurance carried on the Building or covering its operation.

d. Tenant shall not sell or offer to sell or permit to be sold or offered for sale in the Premises any alcoholic or other intoxicating beverage.

e. Tenant shall not display, inscribe, paint, print, maintain, or affix on any place in or about the Building any sign, notice, legend, direction, figure, or advertisement, except on the doors of the Premises and on the directory board of the Building, and then only such name or names and in such color, size, style, place, material, and manner as Landlord shall approve in writing.

f. Tenant shall not use the name of the Building for any purpose other than that of business address of Tenant and shall not use any picture or likeness of the Building in any circulars, notices, advertisements, or correspondence without Landlord's prior written consent.

g. Tenant shall not obstruct or use for storage or for any purpose other than ingress and egress the sidewalks, entrances, passages, courts, corridors, vestibules, halls, elevators, and stairways of the Building.

h. No bicycle or other vehicle and no dog or other animal or bird shall be brought or permitted to be in the Building or any part of the Building, other than as an aid to handicapped persons.

i. Tenant shall not permit any noise or odor that is objectionable to other occupants of the Building to emanate from the Premises, shall not create or maintain a nuisance therein, shall not disturb, solicit, or canvass any occupant of the Building, and shall not do any act tending to injure the reputation of the Building as a first-class office building.

j. Tenant shall not install any piano, phonograph, or other musical instrument in the Building, or any antennae, aerial wires, or other equipment inside or outside the Building, without, in each and every instance, the prior written consent of Landlord. The use thereof, if permitted, shall be subject to control by Landlord to the end that others shall not be disturbed or annoyed.

k. Tenant shall not place or permit to be placed any article of any kind on the window ledges or on the exterior walls and shall not throw or permit to be thrown or dropped any article from any window of the Building.

l. Tenant shall not undertake to regulate any thermostat and shall not waste water by tying, wedging, or otherwise fastening open any faucet.

m. Tenant shall not attach or permit to be attached any additional locks or similar devices to any door or window, nor shall Tenant make or permit to be made any keys for any door to the Premises or Building other than those provided by Landlord. If more than two keys for one lock are desired by Tenant, Landlord may provide them upon payment by Tenant.

n. Tenant shall be responsible for locking the doors and closing the transoms and windows in and to the Premises.

o. **If Tenant desires telegraphic, telephonic, microwave, burglar alarm, or signal service, Landlord will, upon request, direct where and how connections and all wiring for those services shall be introduced and run. Tenant shall make no boring, cutting, or installation of wires or cables without Landlord's consent and direction.**

p. If Tenant desires, and Landlord permits, blinds, shades, awnings, or other forms of inside or outside window covering or window ventilators or similar devices, they shall be furnished, installed, and maintained at Tenant's expense and shall be of such shape, color, material, and make as are approved in writing by Landlord and shall be consistent with the first-class standard of the building.

q. Tenant shall not install, without Landlord's prior written consent, or operate any steam or internal combustion engine, boiler, machinery, refrigerating or heating device, or air-conditioning apparatus in or about the Premises, carry on any mechanical business therein, use the Premises for housing accommodations or lodging or sleeping purposes, or do any cooking therein, use any illumination other than electric light, or use or permit to be brought into the Building any flammable oils or fluids such as gasoline, kerosene, naphtha, and benzene, or any explosives or other articles deemed hazardous to life, limb, or property.

r. Tenant shall not, without Landlord's prior written consent, place or allow anything to be against or near the glass, partitions, or doors of the Premises that may diminish the light in, or be unsightly from, halls or corridors of the Building.

s. Tenant shall not install in the Premises any equipment that uses a substantial amount of electricity. Tenant shall ascertain from Landlord the maximum amount of electrical current that can safely be used in the Premises, taking into account the capacity of the electric wiring in the Building and the Premises and the needs of other tenants in the Building and shall not use more than safe capacity. Landlord's consent to the installation of electric equipment shall not relieve Tenant from the obligation not to use more electricity than safe capacity.

t. Tenant shall not lay linoleum or other similar floor covering so that such floor covering shall come in direct contact with the floor of the Premises. Tenant shall not use cement or other similar material in affixing floor covering. If linoleum or other similar floor covering is used, an interliner of builder's deadening felt shall first be affixed to the floor by paste or other material soluble in water.

3. a. In addition to all other liability that Tenant may incur for breach of any covenant contained in Paragraph 2 of this section, Tenant shall pay to Landlord an amount equal to any increase in insurance premium or premiums caused by any breach.

b. The violation of any covenant contained in Paragraph 2 of this section may be restrained by injunction or other order issued by a court of equity.

4. Landlord shall not be liable in any way for any damage caused by the nonobservance by any other tenant of the Building of any similar covenant contained in Paragraph 2 of this section or of any rules and regulations made by Landlord.

B. [3.67] Tenant's Version — Sample Language

The Premises shall be used and occupied as an office relating to Tenant's business or for any other lawful use in connection with Tenant's business or the business of any assignee or sublessee permitted under this Lease or consented to by Landlord. Landlord represents and warrants that use of the Premises as an office related to Tenant's business does not violate applicable zoning ordinances or other applicable use restrictions.

C. [3.68] Comment

1. From a landlord's point of view, some express restriction on the use of the premises is necessary in an office lease. Absent a restriction in the lease, a tenant may use the demised premises for any lawful purpose as long as the use does not impair the rental value of the premises or the value of the landlord's reversion. *Northern Trust Co. v. Thompson,* 336 Ill. 137, 168 N.E. 116 (1929). The landlord should also specify that the use of the premises be continuous since, in the absence of such a specification, the lease constitutes merely an undertaking to pay rent, with an interruption of continuous use not constituting a default. *Goldberg v. Pearl,* 306 Ill. 436, 138 N.E. 141 (1923).

2. It is also desirable from a landlord's point of view to provide that the specified use of the premises is the only permitted use. Several Illinois courts have held that a certain specified permitted use, by implication, precludes a use by the tenant inconsistent with the permitted use. For instance, in *Sullivan v. Monahan,* 123 Ill.App. 467, 468 – 469 (3d Dist. 1905), the court quoted with favor a statement from 18 AMERICAN AND ENGLISH ENCYCLOPEDIA OF LAW, p. 635 (2d ed. 1896), as follows:

> **The lessor may, by provisions in the lease, prohibit the lessee's use of the premises for particular purposes or provide that they shall be used for a particular purpose only. To constitute a restriction upon their use, the lease need not contain an express covenant by the lessee imposing restrictions; a lease for a particular use, or to be used for a particular purpose implies a restriction against other uses.**

See also Jalageas v. Winton, 119 Ill.App. 139 (4th Dist. 1905), to the same effect. On the other hand, David Levinson concluded in *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 330, that

> [t]**he mere statement in the lease that the premises may be used for a purpose mentioned does not prohibit the use for any other purpose. It has been held that such a clause is permissive and descriptive only; but where the statement is made in the lease that the premises may be used for given purposes only and for no other purposes, equity will enforce the agreement according to the generally accepted meaning of the words.**

In order to avoid a contention that a specified use permitted by a lease is merely intended as an illustration of one permitted use without imposing a restriction on the common-law right of the

tenant to use the premises for any purpose, a landlord should expressly provide that the use is limited to the stated use. Similarly, if a tenant wishes to have the right to use the premises for any other lawful purpose, the tenant should expressly so state in the lease. This liberal use definition is especially important when a tenant desires to assign the lease or sublet the premises. Both the landlord's and the tenant's versions are drafted to take the foregoing concerns into consideration.

3. If the use of the premises by a tenant violates a use restriction contained in the lease, a court will enjoin the prohibited use. *Jalageas, supra.* Note that the landlord's version expressly confers on the landlord the right to obtain injunctive or other equitable relief to enforce the use restriction. A violation of the use restriction that constitutes a default under the lease may enable the landlord to regain possession of the premises and terminate the lease. *Sullivan, supra.*

4. The landlord's version contains restrictions on the tenant's use of the property of the type typically found in office leases. The restrictions that apply to any particular office building will have to be tailored to fit the appropriate circumstances. Many of these kinds of restrictions are found in the landlord's rules and regulations for the building.

In drafting restrictions, the landlord should bear in mind cases such as *400 North Rush, Inc. v. D.J. Bielzoff Products Co.,* 347 Ill.App. 123, 106 N.E.2d 208 (1st Dist. 1952), in which the court held that a lease included use of the exterior walls so that, absent a covenant to the contrary in the lease, a tenant had the right to erect advertising signs on exterior walls. The tenant, on the other hand, should be aware of cases such as *D.A. Schulte, Inc. v. Eiger,* 206 Ill.App. 59 (1st Dist. 1917), in which the court held that the landlord's parol permission to a tenant to erect an exterior sign was revocable by the landlord at will since the lease contained a covenant prohibiting the tenant from erecting such a sign.

5. The landlord should pay special attention to other leases in the building that grant other tenants rights to use their premises for certain purposes, with an accompanying restriction prohibiting other tenants in the building from engaging in a similar use (*e.g.,* the lease of a ground floor portion of the building as a drugstore with a prohibition against any other tenant selling drugs). In such a case, all other leases must prohibit the exclusively reserved use. Such prohibitions must be carefully and precisely drafted since use-restriction clauses will, within reason, be construed against the landlord. *Belvidere South Towne Center, Inc. v. One Stop Pacemaker, Inc.,* 54 Ill.App.3d 958, 370 N.E.2d 249, 12 Ill.Dec. 626 (2d Dist. 1977). *See also Hanson Natural Resources Co. v. Automated Communications, Inc.,* 926 P.2d 176, 178 (Colo.App. 1996), following *Belvidere* and stating that any specific use restriction on a tenant must receive a narrow interpretation in order to allow the tenant the greatest freedom of use. The Illinois Supreme Court has held that a landlord's breach of a tenant's exclusive-use covenant will permit a tenant to terminate its lease. *Johnstowne Centre Partnership v. Chin,* 99 Ill.2d 284, 458 N.E.2d 480, 76 Ill.Dec. 80 (1983). In addition, the landlord may well wish to prohibit the sale or dispensing of alcoholic beverages in the premises to avoid any potential liability under the Dramshop Act, 235 ILCS 5/6-21. See ILLINOIS DRAMSHOP ACT PRACTICE (IICLE®, 2020).

6. If the tenant is unable to negotiate a warranty from the landlord that the tenant's use complies with applicable zoning, the tenant should independently verify that its intended use does not violate applicable use restrictions.

XVI. UNTENANTABILITY; LANDLORD'S INSURANCE

A. [3.69] Landlord's Version — Sample Language

1. a. In the event (i) the Premises are rendered wholly untenantable by fire or other casualty and Landlord decides not to restore or repair them, or (ii) the Building is so damaged by fire or other casualty that Landlord decides to demolish, rebuild, or rehabilitate it, then in any of such events Landlord may terminate this Lease by written notice to Tenant within _____ days after the date of such fire or other casualty. Rent shall be apportioned on a per diem basis and paid to the date of such fire or other casualty.

b. In the event the Premises are rendered wholly untenantable by fire or other casualty and Landlord decides to rebuild and restore them, this Lease shall not terminate, and Landlord shall repair and restore the Premises at Landlord's expense and with due diligence, subject, however, to (i) reasonable delays for insurance adjustments, and (ii) delays caused by forces beyond Landlord's control. Rent shall abate on a per diem basis during the period of reconstruction and repair.

2. In the event the Premises are partially damaged by fire or other casualty but are not rendered wholly untenantable, Landlord shall, except during the last year of the Term of this Lease, proceed with all due diligence to repair and restore the Premises, subject, however, to (a) reasonable delays for insurance adjustments, and (b) delays caused by forces beyond Landlord's control. Rent shall abate in proportion to the non-usability of the Premises during the period while repairs are in progress. If the Premises are made partially untenantable as stated above during the last year of the Term, Landlord may terminate this Lease as of the date of the fire or other casualty by giving written notice to Tenant within _____ days after the date of fire or other casualty, in which event Rent shall be apportioned on a per diem basis and paid to the date of fire or other casualty.

3. Notwithstanding any provision of this Lease to the contrary, (a) in no event will Landlord be obligated to repair or restore any improvements or alterations made to the Premises by Tenant during the Term of the Lease, the repair and restoration of all such improvements and alterations (and maintaining insurance thereon) to be solely Tenant's Responsibility; and (b) in the event the Premises or the Building are damaged by fire or other casualty resulting from Tenant's act or neglect, Landlord shall have no obligation to rebuild or restore the Building or the Premises or any part thereof, and Tenant shall not be released from any of its obligations under this Lease (including without limitation its duty to repair the Premises and its liability to Landlord for damages caused by fire or other casualty). Tenant by this Lease acknowledges that Landlord is under no obligation to insure Landlord's interest in the Premises or the Building.

B. [3.70] Tenant's Version — Sample Language

1. In the event the Building or the Premises are destroyed or damaged by fire, explosion, the elements, or any other casualty, Landlord shall promptly restore or rebuild the Building and the Premises to their condition prior to such destruction or damage, all in conformity to

the then-current laws and ordinances applicable to the Building and the Premises and fit for use and occupancy by Tenant for the purposes intended.

2. If the Premises are rendered totally untenantable as stated above, Tenant shall not be obligated to pay any Rent for a period from the date the Premises are rendered untenantable until the Premises are again fit and ready for Tenant's use and occupancy. Rent shall abate on a per diem basis. If the Premises are rendered partially untenantable, Rent shall be equitably abated for a period from the date the Premises are rendered untenantable until the Premises are fit and ready for Tenant's use and occupancy. In determining an equitable abatement of Rent in case of such partial untenantability, consideration shall be given to the proportion that the area damaged bears to the entire area of the Premises and to the importance to Tenant, in the conducting of Tenant's business, of the area destroyed or damaged. In the event that Landlord fails to complete rebuilding or repairs within _____ days from the date of the damage, Tenant may, at its option, terminate this Lease upon written notice to Landlord, at which time all rights and obligations under this Lease shall cease.

3. a. Landlord shall maintain in effect throughout the Term of this Lease policies of insurance covering the Building and the improvements on the Premises owned by Landlord, in an amount equal to their full replacement value, providing protection against any peril included under a standard form of insurance policy used in Illinois for fire and extended coverage, together with insurance against vandalism, malicious mischief, and war damage and earthquake insurance (if available at commercially reasonable rates). All proceeds from those insurance policies shall be held in trust by Landlord or Landlord's mortgagee for the restoration of the Building and the Premises pursuant to the terms of this Lease.

b. All insurance required under this Lease shall be placed with reputable and solvent insurance companies authorized to do business in Illinois and shall be furnished through policies of insurance of the type that are usual and customary for landlords of similar premises and owners of buildings similar to the Building.

c. Prior to the beginning of the Term, Landlord shall deliver to Tenant a certificate of the insurance required to be carried by Landlord under this Lease. The certificate shall state the name of the insurer and the insureds, the amount of insurance carried, the coverages provided, the expiration date of the policy, and the date to which premiums have been paid. The certificate shall also contain an endorsement requiring the insurer to give Tenant at least _____ days' prior written notice before changing or canceling the policy. Landlord shall deliver a replacement certificate to Tenant not less than _____ days prior to the expiration date of the then-current certificate.

C. [3.71] Comment

1. In the landlord's version, the landlord is required to restore the premises only if the premises are partially damaged by fire or other casualty and the destruction does not occur during the last year of the lease term. No time limit is set for this restoration other than that implicit in the standard of due diligence. The drafter may wish to modify this format to make it more equitable to

the tenant by obligating the landlord to repair within a fixed period, subject to extensions for causes beyond the landlord's control, and to give the tenant the right to terminate if repairs are not completed within the fixed period.

2. The landlord's version also gives the landlord the option not to restore if the casualty occurs during the last year of the lease term. The rationale is that the premises will be leased to the tenant for only one more year and, accordingly, it may not be economical for the landlord to restore the premises to its pre-casualty condition with only one year of the lease term remaining. Care should be taken if the tenant has an option to extend the term of the lease. The trigger date for termination should not be earlier than the tenant's outside date to exercise its extension option.

3. The tenant's version requires the landlord to carry fire and extended coverage insurance on the building and the improvements in the premises owned by the landlord. This requirement assures the tenant that a source of funds is available to the landlord to reconstruct the premises in accordance with the requirements of the lease. The landlord's version restricts the landlord's restoration obligation with respect to tenant improvements made during the lease term since the landlord may not cover these additions under its insurance policy. In any lease in which the tenant is making or planning to make substantial improvements at its expense, insurance and restoration of these items should be addressed expressly.

4. The landlord's version, by expressly disavowing any obligation to carry insurance, ensures that if the tenant negligently causes damage to the premises or the building, the landlord is not limited to a claim against its insurance carrier but may also proceed against the tenant. In this way, the landlord preserves its recourse against the tenant if the building's insurance lapses or is insufficient to fully reimburse the landlord for the damages or if the landlord elects not to file a claim against its insurer for any other reason (*e.g.,* to avoid an increase in premiums). See §3.62 above. The landlord's version further provides that the tenant will not be released from its obligations under the lease by virtue of any damage caused by the tenant's act or neglect. Absent such a provision, the lease, pursuant to its terms, may terminate or rent may abate even though the damage was the result of the tenant's negligence. *See Interlake, Inc. v. Harris Trust & Savings Bank,* 57 Ill.App.3d 524, 373 N.E.2d 413, 15 Ill.Dec. 67 (1st Dist. 1978). This is a highly problematic clause for any tenant since very few tenants carry sufficient property damage insurance to cover the cost of repairing a large office building.

5. If the landlord's insurance is provided through blanket coverage for more than one building, the tenant should require the landlord to have specific amounts of insurance set aside for the building in which the premises are located. In this way, a casualty affecting another of the landlord's buildings covered under the same blanket policy will not siphon off available coverage.

XVII. CONDEMNATION

A. [3.72] Landlord's Version — Sample Language

1. If the Building or any portion of the Building that includes a substantial part of the Premises or that is necessary to the economical operation of the Building shall be taken or

condemned by any competent authority for any public or quasi-public use or purpose, the Term of this Lease and the term and estate hereby granted shall end on, and not before, the date when the possession of the part so taken shall be required for such use or purpose and current Rent shall be apportioned as of the date of termination, provided, however, that Landlord may elect to make comparable space available to Tenant under the same Rent and terms as provided in this Lease, and Tenant shall accept such space, and this Lease shall then apply to that space. Tenant shall have no right to any apportionment of or share in any condemnation award or judgment for damages made for the taking of any part of the Premises or the Building.

2. If any condemnation proceeding shall be instituted in which it is sought to take or damage any part of the Building or the Land under it that does not include a substantial part of the Premises or that does not prevent the economical operation of the Building, or if the grade of any street or alley adjacent to the Building is changed by any competent authority and such partial taking or change of grade makes it necessary or desirable to remodel the Building, Landlord shall have the right to cancel this Lease upon written notice given not less than _____ days prior to the date of cancellation designated in the notice. No money or other consideration shall be payable by Landlord to Tenant for the right of cancellation, and Tenant shall have no right to share in the condemnation award or in any judgment for damages caused by the partial condemnation or the change of grade.

B. [3.73] Tenant's Version — Sample Language

1. If all or a substantial part of the Premises shall be taken for any public or quasi-public use under any governmental law, ordinance, or regulation or by right of eminent domain or shall be sold to the condemning authority under threat of condemnation or if a substantial part of the Building is so taken or sold so that the Premises cannot, after restoration, be economically used for the purpose intended, this Lease shall terminate, and the Rent shall abate during the unexpired portion of this Lease, effective as of the date of taking of the Premises by the condemning authority.

2. If less than a substantial part of the Premises shall be taken for any public or quasi-public use under any governmental law, ordinance, or regulation or by right of eminent domain or shall be sold to the condemning authority under threat of condemnation or if less than a substantial part of the Building is taken or sold so that the Premises can be economically used for the purpose intended once the balance of the Building is restored, this Lease shall not terminate, but Landlord shall, at its sole expense, restore and reconstruct the Building and the Premises to make them tenantable and economically suitable for the intended use of the Premises. Rent payable for the unexpired portion of the Lease Term shall be adjusted equitably.

3. Landlord and Tenant shall each be entitled to receive such separate awards and portions of lump-sum awards as may be allocated to their respective interests in any condemnation proceedings. The termination of this Lease shall not affect the rights of the respective parties to those awards.

C. [3.74] Comment

1. See Chapter 12 of this handbook for a complete discussion of condemnation questions as they apply to leases.

2. Condemnation provisions are often neglected by the drafters of, and the parties to, office leases, perhaps due to the rarity of an office building condemnation and the myriad possible forms such a condemnation may take. While the landlord is entitled to reserve sufficient flexibility in its leases to deal with the change in the configuration of its property as a result of condemnation, tenants should be careful not to allow the landlord to terminate the lease in the event of a minor street widening or other action having a minimal effect on the building.

XVIII. RIGHTS AND REMEDIES

A. [3.75] Landlord's Version — Sample Language

1. All rights and remedies of Landlord enumerated in this Lease shall be cumulative, and none shall exclude any other right allowed by law.

2. If any voluntary or involuntary petition or similar pleading under any section or sections of any bankruptcy or insolvency act shall be filed by or against Tenant, or any voluntary or involuntary proceeding in any court or tribunal shall be instituted to declare Tenant insolvent or unable to pay Tenant's debts, or Tenant makes an assignment for the benefit of its creditors, or a trustee or receiver is appointed for Tenant or for the major part of Tenant's property, and, in the case of an involuntary petition or proceeding, the petition or proceeding is not dismissed within _____ days from the date it is filed, Landlord may elect, but is not required, with or without notice of that election and with or without entry or other action by Landlord, to immediately terminate this Lease. Notwithstanding any other provision of this Lease, upon termination Landlord shall immediately be entitled to recover damages in an amount equal to Landlord's Damages (as that term is defined in Paragraph 13(b) below).

3. If Tenant defaults in the payment of Rent and that default continues for _____or more days after the Rent is due and payable, or if Tenant defaults in the prompt and full performance of any other provision of this Lease and Tenant does not cure the default within _____ days after written demand by Landlord that the default be cured (unless the default involves a hazardous condition, which shall be cured forthwith upon Landlord's demand), or if the leasehold interest of Tenant is levied on under execution or is attached by process of law, or if Tenant vacates or abandons the Premises, or if the term of any lease, other than this Lease, made by Tenant for any premises in the Building is terminated or terminable after the making of this Lease because of any default by Tenant under any other lease, then and in any such event Landlord may, if Landlord so elects but not otherwise, with or without notice of that election and with or without any demand whatsoever, either immediately terminate this Lease and Tenant's right to possession of the Premises or, without terminating this Lease, immediately terminate Tenant's right to possession of the Premises. An election by Landlord

to terminate Tenant's right to possession of the Premises without terminating the lease shall not preclude a subsequent election by Landlord to terminate the lease.

4. Upon termination of this Lease, whether by lapse of time or otherwise, or upon any termination of Tenant's right to possession without termination of this Lease, Tenant shall surrender possession and vacate the Premises immediately and deliver possession to Landlord. Tenant by this Lease grants to Landlord full and free license to enter into and on the Premises in that event, with or without process of law, and to repossess Landlord of the Premises as of Landlord's former estate and to expel or remove Tenant and any others who may be occupying or within the Premises and to remove any and all property, using force if necessary, without being deemed in any manner guilty of trespass, eviction, or conversion of property and without relinquishing Landlord's right to Rent or any other right given to Landlord under this Lease or by operation of law. Tenant expressly waives the service of any demand for the payment of Rent or for possession and the service of any notice of Landlord's election to terminate this Lease or to reenter the Premises, including any and every form of demand and notice prescribed by any statute or other law, and agrees that the simple breach of any covenant or provision of this Lease by Tenant shall, of itself, without the service of any notice or demand whatsoever, constitute a forcible eviction by Tenant of the Premises within the meaning of the statutes of the State of Illinois.

5. a. If Landlord elects to terminate the lease, Tenant shall pay forthwith to Landlord, not as a penalty but as consideration for the loss of Landlord's bargain, a sum equal to Landlord's Damages (defined in Paragraph 13(b) below) in payment of the damages Landlord incurred by reason of Tenant's default. If Landlord elects to terminate Tenant's right to possession only, without terminating the Lease pursuant to a right granted to Landlord under this Lease, Landlord may, at Landlord's option, enter into the Premises, remove Tenant's signs and other evidences of tenancy, and take and hold possession of those items as Paragraph 3 above of this section provides, without that entry and possession terminating the Lease or releasing Tenant, in whole or in part, from Tenant's obligation to pay the Rent for the full Term.

b. Upon and after entry into possession without termination of the Lease, Landlord, if and to the extent required by law, may relet the Premises or any part of the Premises for the account of Tenant to any person, firm, or corporation other than Tenant for that Rent, for such time and on such terms as Landlord in Landlord's sole discretion shall determine. Landlord shall not be required to accept any tenant offered by Tenant or to observe any instructions given by Tenant about such reletting. In any case, Landlord may make repairs, alterations, and additions in or to the Premises and redecorate the Premises to the extent deemed by Landlord necessary or desirable. Tenant shall, upon demand, pay the cost, together with Landlord's expenses, of the reletting. If the consideration collected by Landlord upon any reletting of the Premises for Tenant's account is not sufficient to pay monthly the full amount of the Base Rent and Additional Rent reserved in this Lease, together with, over the term of such new lease, any Unamortized Leasehold Improvement Costs (as defined in Paragraph 13(a) below), the costs of repairs, alterations, additions, redecorating, and Landlord's other costs and expenses of regaining possession and reletting the Premises, Tenant shall pay to Landlord the amount of each monthly deficiency upon demand.

6. Tenant by this Lease constitutes and irrevocably appoints any attorney of any court to be the true and lawful attorney of Tenant and in the name, place, and stead of Tenant to appear for and on behalf of Tenant in any court of record at any time in any suit or suits brought against Tenant for the enforcement of any right by Landlord, to waive the issuance and service of process and trial by jury, and, from time to time, to confess judgment or judgments in favor of Landlord and against Tenant for any Rent and interest due under this Lease by Tenant to Landlord and for costs of suit and for a reasonable attorney's fee in favor of Landlord to be fixed by the court, and to release all errors that may occur or intervene in those proceedings, including the issuance of execution upon any judgment, and to stipulate that no appeal shall be prosecuted from such judgment or judgments, or that no proceedings in chancery or otherwise shall be filed or prosecuted to interfere in any way with the operation of such judgment or judgments or of any execution issued thereon or with any supplemental proceedings taken by Landlord to collect the amount of any judgment or judgments and to consent that execution on any judgment or decree in favor of Landlord and against Tenant may issue immediately.

7. Any and all property that may be removed from the Premises by Landlord pursuant to the authority of the Lease or of law to which Tenant is or may be entitled may be handled, removed, or stored in a commercial warehouse or otherwise by Landlord at Tenant's risk, cost, and expense, and Landlord shall in no event be responsible for the value, preservation, or safekeeping of that property. Tenant shall pay to Landlord, upon demand, any and all expenses incurred in any removal and all storage charges against that property as long as it shall be in Landlord's possession or under Landlord's control. Any property of Tenant not removed from the Premises or retaken from storage by Tenant within _____ days after the end of the Term shall be conclusively presumed to have been abandoned by Tenant.

8. If Tenant violates any of the terms and provisions of this Lease or defaults in any of its obligations, other than the payment of Rent or other sums payable, such violation may be restrained or such obligation may be enforced by injunction or other equitable action.

9. Tenant by this Lease grants to Landlord a first lien on the interest of Tenant under this Lease to secure the payment of money due under this Lease, which lien may be foreclosed in equity.

10. No waiver by Landlord of any default of Tenant shall be implied to affect, and no express waiver shall affect, any default other than the default specified in such waiver and that only for the time and to the extent stated.

11. No receipt of money by Landlord from Tenant after the termination of this Lease, the service of any notice, the commencement of any suit, or final judgment for possession shall reinstate, continue, or extend the Term of this Lease or affect any notice, demand, suit, or judgment.

12. If Tenant at any time fails to make any payment or perform any other act on its part to be made or performed under this Lease, Landlord may, but shall not be obligated to, after reasonable notice or demand and without waiving or releasing Tenant from any obligation

under this Lease, make such payment or perform such other act to the extent Landlord may deem desirable and in that connection pay expenses and employ counsel. All sums paid by Landlord and all costs, charges, and expenses incurred by Landlord in enforcing Tenant's obligations under this Lease or incurred by Landlord in any litigation, negotiation, or transaction in which Tenant causes Landlord, without Landlord's fault, to be involved or concerned (including but not limited to attorneys' fees and costs) shall be payable upon demand, together with interest at the rate of _____ percent per annum from the date such sum was paid or such charge, cost, or expense was incurred, and Landlord shall have the same rights and remedies for the nonpayment thereof as in the case of default in the payment of Rent under this Lease.

13. As used in this Lease, the following terms shall have the following meanings:

a. "Unamortized Leasehold Improvement Costs" shall mean either the amount of any allowance or credit given by Landlord to Tenant for the initial improvement of the Premises or the cost to Landlord of purchasing, fabricating, and installing all improvements that were installed on the Premises by Landlord pursuant to this Lease prior to the beginning of the Lease Term, including interest calculated by amortizing that amount over the portion of the Term during which Base Rent is payable with interest at the rate specified in this Lease for delinquent Rent payments and multiplying such total by a fraction, the numerator of which is the number of months of the Lease Term not yet elapsed on the date the Lease Term is terminated or Tenant's right to possession is terminated, as the case may be, and the denominator of which is the total number of months of the portion of the Term during which Base Rent is payable. For example, if the total cost to Landlord of installing such improvements was $10,000, the Lease Term was 26 months, Base Rent was abated for the first 2 months of the Term, the interest rate was 10 percent, and the lease was terminated by reason of Tenant's default at the end of 14 months, the Unamortized Leasehold Improvement Costs would be determined as follows:

($461.45 = monthly amortization) × 24 months
= $11,074.80 × 12/24 = $5,537.40

b. "Landlord's Damages" shall mean the sum of (i) the present value of the Base Rent and Additional Rent specified in this Lease for the residue of the stated Term following termination of the lease or of Tenant's right to possession less the present value of the fair market rental value of the Premises, after deduction of all necessary expenses of reletting, for such residue of the Lease Term (that amount not to be less than zero in any event, it being the intention of the parties that Landlord shall have no obligation to pay to Tenant, or to offset against other sums Tenant owes to Landlord, the excess, if any, of the present value of fair market rental value over the present value of the Base Rent and Additional Rent); (ii) any Unamortized Leasehold Improvement Costs; and (iii) any other sums or damages then due to Landlord under this Lease. In calculating the amount of Landlord's Damages, present value shall be computed on the basis of a discount rate equal to the then-current yield on United States Treasury obligations having a maturity approximately equal to the residue of the Lease Term, as determined by Landlord.

B. [3.76] Tenant's Version — Sample Language

1. If Landlord fails to perform any of the terms, covenants, agreements, or conditions on its part to be performed under this Lease and that failure continues uncorrected for _____ days after notice of failure from Tenant, unless otherwise specified in this Lease and subject to the provisions of Paragraph 4 below of this section, this Lease may be terminated by Tenant at any time thereafter during the continuance of that default by written notice to Landlord, and Tenant shall be relieved of any and all liability under this Lease.

2. If at any time or times Tenant defaults in the payment of the Rent reserved or of any part thereof upon the date the amount becomes due and payable and any default shall continue for a period of _____ days after written notice to Tenant, or Tenant fails to pay any other money that may become or fall due or become payable, or defaults in the due and full observance or performance of any other covenant, provision, or condition under this Lease required to be kept, performed, or observed by Tenant, and if any default continues for a period of _____ days after written notice to Tenant thereof unless otherwise specified in this Lease and subject to the provisions of Paragraph 4 below of this section, Landlord may at any time during the continuance of such default, by written notice to Tenant, declare the Term of this Lease terminated.

3. If, during the Term of this Lease or any extension or renewal, (a) Tenant makes an assignment for the benefit of creditors, (b) a writ of execution or attachment is levied against or on the property of Tenant, (c) any action is taken for the voluntary dissolution of Tenant, (d) a voluntary or involuntary petition is filed by or against Tenant having for its purpose adjudication of Tenant as a bankrupt, or (e) a receiver is appointed for the property of Tenant by reason of the insolvency or alleged insolvency of Tenant, the occurrence of any such contingency shall be deemed a breach of this Lease, and this Lease may, at the election of Landlord, upon the happening of any such contingency, be terminated and declared of no further force and effect, provided, however, that in the event of a contingency of the character mentioned in (b), (d), or (e) above, Tenant shall have a period of _____ days after the date of the occurrence of such contingency in which to dispose of or eliminate the condition, or procure a dismissal or a stay of any proceeding constituting the contingency, before that contingency shall be deemed a breach of this Lease, and no breach shall exist if that condition is eliminated or disposed of or said proceedings are dismissed or stayed within the _____-day period.

4. If any default by either party cannot reasonably be remedied within the period of time prescribed in the notice of default and if such party has commenced to remedy the default and diligently pursues such remedy thereafter, then the defaulting party shall have additional time as is reasonably necessary to remedy the default before the Lease can be terminated or other remedies enforced.

5. Each party (Defaulting Party) covenants and agrees that if the other party (Terminating Party) exercises the right to terminate this Lease as provided in this Lease, the Defaulting Party will reimburse the Terminating Party within _____ days from the effective

date of termination for all out-of-pocket expenses incurred by the Terminating Party in terminating this Lease. Nothing contained in this Lease shall be deemed to relieve the Defaulting Party of any other liability arising from any default that has given rise to such right of termination.

6. In case either party to this Lease (Defaulting Party) defaults in the performance of any covenant, condition, or agreement by such party to be performed under this Lease, the other party (Other Party) may (but shall not be required to) execute the performance, and any money advanced or expenses incurred in so doing, plus interest at the rate of _____ percent per annum, shall be and become due and owing from the Defaulting Party to the Other Party upon demand. If the Defaulting Party is Tenant, the amount due shall constitute Additional Rent under this Lease. If the Defaulting Party is Landlord, Tenant may deduct the amount of all such indebtedness from the Rent next coming due.

C. [3.77] Comment

1. See Chapter 8 of this handbook for a complete discussion of the landlord's rights and remedies in the event of the tenant's default.

2. Certain classic disputes arise between the landlord and the tenant in the negotiation of a lease default provision.

a. One such dispute is whether the tenant should be entitled to notice in the event of a default in the payment of money. The landlord's position is that rent is due on a day certain and that the tenant, being aware of whether rent has been paid, does not require a notice of nonpayment. The tenant's rebuttal is that a payment could be made but lost in the mail, or a payment could be missed through clerical error, so that notice is necessary to prevent an unintentional default.

b. A second dispute involves the time period in which the landlord can stay or vacate an involuntary bankruptcy or insolvency proceeding brought against the tenant. The landlord often seeks as short a period as possible, while the tenant seeks a longer period, recognizing the crowded condition of the dockets of most courts. However, even if a bankruptcy proceeding is not dismissed in a timely manner, the federal Bankruptcy Code renders the issue moot by declaring that provisions calling for termination upon bankruptcy are unenforceable. Upon the filing of a bankruptcy proceeding against a tenant, the automatic stay bars the landlord from enforcing state law or contractual remedies against the tenant. Rather, the rights and obligations of the landlord and the bankrupt tenant are governed by §365 of the Bankruptcy Code, 11 U.S.C. §365. See comment 11 below.

c. A third classic dispute is whether, if a nonmonetary default cannot be reasonably cured within the stated cure period, the defaulting party should be subject to the other party's rights and remedies if the defaulting party has commenced curing the default within the stated cure period and continues diligently to do so thereafter. Also, if the non-defaulting party is willing to give this extended cure right, a dispute sometimes arises as to whether the extended cure period should have an outside limit.

d. A final point of dispute is whether the landlord should be allowed to confess judgment against a tenant by reason of the tenant's default. While an improperly confessed judgment can be vacated by the filing of an affidavit stating that the tenant has a valid defense to the landlord's claim of default (Supreme Court Rule 276), the ability of the landlord to confess judgment gives a tactical advantage to the landlord in case of the tenant's default since the landlord can avoid an adversary proceeding if the tenant is in default and has no valid defense. This makes it easier for the landlord to enforce its rights.

3. Note that in the landlord's version of the sample provision use has been made of certain terms that are defined in paragraph 13 of that provision. Using defined terms allows the paragraphs in which the defined terms are used to be shortened and made clearer. In addition, by placing the definitions in an individual subparagraph instead of defining the terms at the point at which they are first used, a party reviewing the lease need not search the lease to find the first place in which each defined term is used and defined.

4. Note also that in paragraph 13(a) of the landlord's version of the sample provision, an example is used illustrating the mathematical formula set forth therein. Use of examples may help avoid questions of interpretation of a formula when a dispute arises. In addition, preparation of such an example forces the parties to work through the formula and, one hopes, to discover inadequacies of the formula before the instrument is executed.

5. The tenant's version of the sample provision contains dual rights, giving the tenant the right to terminate the lease in the event of the landlord's default just as the landlord has the right to terminate the lease in the event of the tenant's default. This provision is unusual in leases because of the landlord's need to demonstrate a steady flow of rents to satisfy its lender.

6. The landlord's version of the sample provision gives the landlord the option to declare a default under the lease if the tenant defaults in the performance of any of its obligations under any other lease of additional space in the building. This type of provision is found in leases commonly in use in the Chicago metropolitan area. By having the right to declare a cross-default, the landlord can exert pressure on the tenant to help ensure performance by the tenant of any of its obligations under the other lease, since a default under the other lease will also trigger a default under this lease. In addition, if the landlord judges that a default by the tenant under one of the tenant's other leases in the building presages a default by the tenant under this lease, the landlord can terminate both leases and relet all space leased to the defaulting tenant without waiting for a future default by the tenant under this lease.

From the tenant's viewpoint, this cross-default provision is unacceptable. If the landlord and the tenant have entered into two separate lease agreements with respect to separate space in the building, each agreement should stand on its own. A default in the performance of one contractual relationship should not give the landlord the right to terminate another contractual relationship as long as the tenant is not in default in the performance of its obligations under the second agreement.

7. Although paragraph 1 of the landlord's version, stating that the landlord's rights shall be cumulative, may seem at first glance to state the obvious, such a provision can be crucial if the landlord undertakes several remedial actions concurrently. *See, e.g., Lehndorff USA (Central), Ltd. v. Cousins Club, Inc.,* 40 Ill.App.3d 875, 353 N.E.2d 171 (1st Dist. 1976).

8. While the landlord's version contains a waiver of statutory notice provisions, it is prudent to comply with all applicable statutes and ordinances when exercising remedies under the lease. Attorneys should be aware of local ordinances that may provide greater protection for tenants than state statutes. *See, e.g., Landry v. Smith,* 66 Ill.App.3d 616, 384 N.E.2d 430, 23 Ill.Dec. 636 (1st Dist. 1978).

9. While Illinois law was not entirely clear on the subject (*see Wanderer v. Plainfield Carton Corp.,* 40 Ill.App.3d 552, 351 N.E.2d 630 (3d Dist. 1976); *Reget v. Dempsey-Tegeler & Co.,* 96 Ill.App.2d 278, 238 N.E.2d 418 (5th Dist. 1968); *Wohl v. Yelen,* 22 Ill.App.2d 455, 161 N.E.2d 339 (1st Dist. 1959)), prior to January 1, 1984, in the event a tenant abandoned the premises during the lease term and absent a specific provision in the lease, the landlord had no general duty to mitigate its damages by actively seeking a subtenant, but only a limited duty to accept a suitable subtenant if and when offered by the former tenant for the landlord's approval. *Reget, supra,* 238 N.E.2d at 419. The burden was on the tenant to produce the subtenant and show that the subtenant was suitable. *Chicago Title & Trust Co. v. Hedges Manufacturing Co.,* 91 Ill.App.3d 173, 414 N.E.2d 232, 46 Ill.Dec. 510 (2d Dist. 1980). This situation was reversed by 735 ILCS 5/9-213.1, which requires landlords to take "reasonable measures" to mitigate their damages in this situation. Landlords seem to have an obligation now to take affirmative steps to find a replacement tenant. Effectively, this puts a heavy burden of proof on landlords who seek to recover from former tenants. Some courts have construed 735 ILCS 5/9-213.1 as imposing a heavy burden of proof on landlords who seek to recover from former tenants by requiring the landlord to plead and prove mitigation as a prerequisite to recovery. *Snyder v. Ambrose,* 266 Ill.App.3d 163, 639 N.E.2d 639, 203 Ill.Dec. 319 (2d Dist. 1994). Other courts found *Snyder* to be a departure from the general rule and held that while the landlord is in the best position to prove mitigation, a failure by the landlord to do so will not bar the landlord's recovery of damages but will only reduce those damages to the extent that mitigation by the landlord would have reduced the landlord's loss. *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 508, 230 Ill.Dec. 1013 (1st Dist. 1998). At least one Illinois federal court has followed the *St. George* approach. *Manufacturers Life Insurance Company (U.S.A.) v. Mascon Information Technologies Ltd.,* 270 F.Supp.2d 1009 (N.D.Ill. 2003). If a landlord leaves space vacant while looking for the best deal, it may not be able to recover from its former tenant. *See MBC, Inc. v. Space Center Minnesota, Inc.,* 177 Ill.App.3d 226, 532 N.E.2d 255, 126 Ill.Dec. 570 (1st Dist. 1988). The statute in effect encourages landlords to cut off their mitigation obligations by negotiating a termination fee (based on the estimated time to relet and the differences between the tenant's rent and then-current market rents) in exchange for a release of the tenant's ongoing liability under the lease.

If the landlord does relet the premises, the tenant is not entitled to recover any rental collected by the landlord from the new tenant in excess of the rental the original tenant was to pay, absent some agreement to that effect. *Wanderer, supra,* 351 N.E.2d at 635. However, a landlord who collects rent at a higher rate for the balance of the original tenant's term must offset the excess over the original tenant's rental rate, after deducting the landlord's costs of reletting, against any other obligations of the original tenant that the landlord might seek to recover, such as past due rent accrued prior to the date of reletting. 351 N.E.2d at 636 – 637.

10. With the advent of larger initial periods of free rent and tenant improvement allowances, many landlords seek assurances that some or all of these up-front costs can be recovered upon a

default. The definition of "Landlord's Damages" in paragraph 13(b) is one way to address this concern. However, some tenants will argue that repayment of these up-front costs was included in determining base rent and is adequately covered by the landlord's right to recover both the present value of any projected rent shortfall for the remainder of the term and the costs of reletting. If the tenant's liability under the lease is limited, the landlord might consider carving out from this limitation damages sufficient to compensate the landlord for up-front costs expended by the landlord to place the tenant in possession (*e.g.,* leasehold improvement costs, brokerage fees, etc.).

11. Under §362(a) of the Bankruptcy Code, 11 U.S.C. §362(a), a debtor's filing of a petition in bankruptcy automatically stays any action to enforce a judgment obtained against the debtor before the filing of the petition. This automatic stay provision precludes a lessor from recovering possession of the leased premises or from obtaining satisfaction of a monetary award granted in an eviction against a defaulting lessee. If a lease terminates at the expiration of its natural term, the automatic stay does not prohibit the lessor from recovering possession of the leased premises. Otherwise, unless the bankruptcy court grants the lessor relief under Bankruptcy Code §362(d), the automatic stay suspends the lessor's right to enforce nonbankruptcy remedies against the lessee until the conclusion of the bankruptcy proceedings or the natural expiration of the lease. If the bankruptcy proceedings end first and the debtor is an individual, the individual tenant will probably receive a discharge under Bankruptcy Code §727, giving the tenant a fresh start and preventing the landlord from enforcing nonbankruptcy remedies against the tenant. Note, however, that if the debtor is a business entity (more commonly found in a commercial property context), discharge does not occur when a business entity is liquidated under Chapter 7 or Chapter 11 of the Bankruptcy Code.

The lessor's principal remedy against a lessee in a bankruptcy proceeding is to compel a prompt assumption or rejection of the lease pursuant to §365(d) of the Bankruptcy Code, which allows the trustee "an opportunity to determine which of the bankrupt's contracts are beneficial to the estate and on that basis make an election whether to assume or to reject them." *In re SteelShip Corp.,* 576 F.2d 128, 132 (8th Cir. 1978). Courts apply a "business-judgment" test to determine "whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 756 F.2d 1043, 1047 (4th Cir. 1985) (probably overruled by subsequent addition of §365(n) to Bankruptcy Code with respect to specific intellectual property issues addressed but still frequently cited for its description of business-judgment rule; *see In re Leroux,* 31 Bankr.Ct.Dec. (LRP) 34 (Bankr. D.Mass. 1997), citing *In re A.J. Lane & Co.,* 107 B.R. 435 (Bankr. D.Mass. 1989)). *See also Software Customizer, Inc. v. Bullet Jet Charter, Inc. (In re Bullet Jet Charter, Inc.),* 177 B.R. 593 (Bankr. N.D.Ill. 1995). Like the business-judgment rule of corporate governance, the business-judgment test in bankruptcy operates as a presumption that the decision of a trustee (here to accept or reject a lease) was made in good faith. The Bankruptcy Code prohibits the trustee from assuming a lease, however, if the lease "has been terminated under applicable nonbankruptcy law prior to the order for relief." 11 U.S.C. §365(c)(3). This provision is consistent with the well-established rule that the "rights of parties to real estate leases are governed by state law unless there are contrary provisions in the Bankruptcy Code." *Waldschmidt v. Appleton Investment Co. (In re Zienel Furniture, Inc.),* 13 B.R. 264, 265 (Bankr. E.D.Wis. 1981).

Under §365(d)(3) of the Bankruptcy Code, the trustee has a 60-day election period to assume or reject the lease. During this period, the trustee must timely perform all obligations of the debtor that fall due subsequent to the filing of the bankruptcy petition. If the trustee determines that a lease is of benefit to the estate, the trustee has 60 days from the date of the filing of the petition to assume the lease. However, this deadline is very commonly extended until the bankrupt's plan of reorganization has been well developed. If the trustee fails to timely assume the lease (and does not apply for and obtain an extension of the 60-day period), Bankruptcy Code §365(d)(4) deems the lease rejected and requires surrender of the property to the lessor.

If the trustee elects to assume the lease, it must cure all existing defaults under the lease (or provide adequate assurance that it will), compensate the lessor for actual pecuniary losses arising out of the defaults (or provide adequate assurance that it will), and provide adequate assurance of future performance under the lease. 11 U.S.C. §365(b)(1). The requirement to cure defaults (or provide adequate assurances) does not apply to defaults relating to the bankruptcy of the debtor, the commencement of the bankruptcy proceedings, or the appointment of a bankruptcy trustee. 11 U.S.C. §365(b)(2). Similarly, the lease may not be terminated or modified at any time after the filing of the petition solely because of provisions in the lease conditioned on the bankruptcy of the debtor, the commencement of the bankruptcy proceedings, or the appointment of a bankruptcy trustee. 11 U.S.C. §365(e).

If the lease is assumed, it must be assumed without modification. Once assumed, the lease may be retained by the bankrupt lessee or assigned to a new lessee, despite any provision in the lease that "prohibits, restricts, or conditions" assignment of the lease if the assignee provides adequate assurance of future performance. 11 U.S.C. §§365(f)(1), 365(f)(2). An assignment relieves the bankrupt lessee from defaults occurring subsequent to the assignment, and proceeds from assignment of the lease become property of the bankrupt estate, available to pay creditors. If the trustee elects to assume and retain the lease, however, all rents and charges that accrue after filing the petition become an administrative charge against the bankrupt estate, entitled to priority against all other unsecured claims. 11 U.S.C. §507(a)(1). Thus, although the Bankruptcy Code provides numerous protections for a bankrupt lessee, the assumption of a lease can create a significant burden on the bankrupt estate.

If the trustee rejects the lease, the lessee must surrender the leased premises, and all of the lessee's obligations for future performance are terminated. However, all rent and charges that accrue between filing the petition in bankruptcy and rejection of the lease are administrative expenses with priority over unsecured claims. *Id.* Finally, rejection constitutes a default under the lease, which entitles the lessor to claim damages as a general unsecured creditor, limited to the greater of one year's rent or 15 percent of the rent for the shorter of the remaining term of the lease or three years. 11 U.S.C. §502(b)(6). In addition, security deposits held by the lessor to secure the lessee's performance may be set off against prepetition rents not paid by the lessee. 11 U.S.C. §553.

A landlord should proceed cautiously before taking comfort in the issuance of a letter of credit in order to secure a financially troubled tenant's performance of its earlier obligations under a lease. In such situations involving the securing of antecedent debt, when the issuance of a letter of credit from a third party is secured by assets of the debtor, and if the letter of credit is issued to the landlord within the preference period prior to a bankruptcy petition under §547(b) of the Bankruptcy Code,

payments received by the landlord as beneficiary under the letter of credit may be subject to avoidance by the tenant's trustee in bankruptcy when the other preference elements are satisfied. *See Leasing Service Corp. v. Wendel (In re Air Conditioning, Inc. of Stuart),* 72 B.R. 657 (S.D.Fla. 1987), *aff'd in part, rev'd in part,* 845 F.2d 293 (11th Cir.), *cert. denied,* 109 S.Ct. 557 (1988); *In re Compton Corp.,* 831 F.2d 586 (5th Cir. 1987). *But see Levit v. Ingersoll Rand Financial Corp.,* 874 F.2d 1186, 1196 (7th Cir. 1989) (criticizing *Leasing Service* and *Compton* in dicta). Further, when a tenant's obligations are secured by a standby letter of credit issued for the benefit of the landlord, the landlord should proceed with great caution before accepting direct payment from a financially troubled tenant; such direct payment may be subject to avoidance when payment is made within the preference period and the other preference elements are satisfied. *See In re Powerine Oil Co.,* 59 F.3d 969 (9th Cir. 1995). Rather, the landlord should seek a payment through a draw against the standby letter of credit. At a minimum, if a direct payment from the tenant is accepted, the landlord should insist on an extension of the standby letter of credit's expiration date following the debtor's direct payment in order to afford the creditor time to be notified of and act on the debtor's bankruptcy and the finding that the direct payment by the tenant is a preference.

XIX. HOLDING OVER

A. [3.78] Landlord's Version — Sample Language

If Tenant retains possession of the Premises or any part of the Premises after the termination of this Lease by lapse of time or otherwise, Tenant shall pay Landlord, in order to compensate Landlord for Tenant's wrongful withholding of possession for the time Tenant remains in possession, for each month that Tenant remains in possession, an amount equal to _____ percent of the Base Rent and Additional Rent in effect immediately prior to such termination, plus all damages, whether direct or consequential, sustained by Landlord by reason of Tenant's wrongful retention of possession unless Landlord makes the election provided for in the following sentence. If Tenant retains possession of the Premises or any part of the Premises after termination of this Lease, Landlord may elect, in a written notice to Tenant and not otherwise, that retention of possession constitutes a renewal of this Lease for one year at the same terms that were in effect on the last month of the Lease Term, in which event this Lease shall be deemed renewed. The provisions of this paragraph shall not constitute a waiver of Landlord's rights of reentry or of any other right or remedy provided in this Lease or at law.

B. [3.79] Tenant's Version — Sample Language

If Tenant shall hold over in possession of the Premises after the expiration of the original Term of this Lease or any extension, such holding over shall not be deemed to extend the Term of or renew this Lease. The tenancy shall thereafter continue in accordance with the terms and conditions of this Lease until terminated by either party by _____ days' notice designating the date of termination.

C. [3.80] Comment

1. Illinois law is clear as to the landlord's rights, absent any provision in the lease to the contrary, if the tenant withholds possession of all or any part of the leased premises after the end of the lease term. As stated by the court in *Peck v. Christman,* 94 Ill.App. 435, 437 (1st Dist. 1900):

> **The landlord has the right, when a tenant withholds possession after the end of his term, to treat him as one wrongfully in possession or as a tenant holding for a new term. But after having once elected to hold him to the one liability, he is not permitted to shift his position and elect to hold him to the other. And slight acts will be construed as constituting such an election.**

"The question as to whether a landlord has so elected is determined by the landlord's intent, as shown by the facts and circumstances." *Farley v. Blackwood,* 56 Ill.App.3d 1040, 372 N.E.2d 921, 925, 14 Ill.Dec. 642 (1st Dist. 1978). If the landlord elects to treat the holdover tenant as a tenant rather than a trespasser, the tenancy created will be a year-to-year tenancy on the same terms set forth in the expired lease unless the expired lease was for a term of less than a year, in which event the term of the new tenancy will be the same as the previous term. David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 324 – 325. Often a landlord will charge a higher monthly rent after the termination date, usually at the renewal rate that the landlord quoted to the tenant. If the tenant pays this rate, a month-to-month tenancy at that rate may be created. *Bismarck Hotel Co. v. Sutherland,* 92 Ill.App.3d 167, 415 N.E.2d 517, 47 Ill.Dec. 512 (1st Dist. 1980).

2. If a landlord seeks to regain possession of the premises after the expiration of the stated term, it need not give any prescribed notice to the tenant, which is merely a tenant at sufferance. 735 ILCS 5/9-213; *Bradley v. Gallagher,* 14 Ill.App.3d 652, 303 N.E.2d 251 (1st Dist. 1973). A tenant willfully holding over after the termination of its lease by lapse of time and after written demand for the premises by the landlord is liable to the landlord for an amount computed "at the rate of double the yearly value of the lands, tenements or hereditaments so detained." 735 ILCS 5/9-202. This amount is usually found to be double the stated rent. *See Burrows v. Schulman,* 19 Ill.App.2d 459, 154 N.E.2d 327 (1st Dist. 1958).

If a tenant notifies the landlord of its intention to vacate the premises on a certain date allowed by the lease but fails to surrender possession on the appointed day, the tenant is liable to the landlord for double the rent that would have been due under the lease. 735 ILCS 5/9-203.

3. The landlord's version of the sample provision attempts to restate the law and make clear that the landlord will not have elected to treat the tenant as a tenant for a new term unless it makes the election in writing.

4. The tenant's version of the sample provision attempts to deprive the landlord of the right to treat the tenant as a trespasser but rather provides that the tenant remaining in tenancy will create a lease for a specified number of days (*e.g.,* 60 days), terminable upon notice by either party. This gives the tenant an automatic grace period if there is a delay in obtaining its new premises. As a compromise position, tenants try to defer the accrual of any damages for a short period of, *e.g.,* 30

days and phase in holdover rent on an increasing scale (*e.g.,* 125 percent in month one of the holdover period, 150 percent in month two, etc.) in case the tenant is required to hold over for a short time for reasons beyond its control. Another typical danger in the landlord's version is the accrual of a full month of holdover rent for a holdover of just a few days. Tenants often successfully negotiate for a day-by-day accrual instead.

5. The landlord's version makes the tenant liable for holdover rent plus all other damages the landlord might suffer by reason of the tenant's holding over. This right of the landlord to damages could be substantial if the landlord incurs liability to a new tenant or loses a new tenant because of the landlord's obligation to deliver the premises to the new tenant. Tenants often try to limit a landlord's remedy to holdover rent.

XX. LANDLORD'S TITLE

A. [3.81] Version Suitable for Both Landlord and Tenant — Sample Language

Landlord's title is and always shall be paramount to the title of Tenant. Nothing herein contained shall empower Tenant to do any act that can, shall, or may encumber Landlord's title.

B. [3.82] Comment

1. This provision is reasonable from both the landlord's and the tenant's points of view. The tenant's rights are limited to the tenant's leasehold estate. Nothing the tenant does should be permitted to affect the landlord's reversionary interest in the premises or the landlord's interest in the balance of the building.

2. See §3.65 above for a discussion of mechanics lien rights against the landlord's reversionary interest arising from work performed on the premises at the direction of a tenant.

XXI. TENANT'S QUIET ENJOYMENT

A. [3.83] Landlord's Version — Sample Language

As long as Tenant shall observe and perform its covenants and agreements under this Lease, Tenant shall, at all times during the Lease Term, peacefully and quietly have and enjoy possession of the Premises without any encumbrance or hindrance by, from, or through Landlord, subject to the provisions of this Lease relating to the subordination of this Lease.

B. [3.84] Tenant's Version — Sample Language

Landlord represents and warrants that it has full right and power to execute and perform this Lease and to grant the estate demised under this Lease and that it has a fee simple estate in the Building and the Land on which it is located, subject only to those matters shown in

Exhibit _____ attached to this Lease. Landlord covenants that Tenant, upon paying the Rent provided and performing the covenants and agreements on its part to be performed, shall peaceably and quietly have, hold, and enjoy the Premises and all rights, easements, appurtenances, and privileges belonging or appertaining thereto during the full Term of this Lease and any renewals or extensions.

C. [3.85] Comment

1. Every lease in Illinois carries with it an implied covenant of quiet enjoyment, whether expressly stated or not. As noted by the court in *Sixty-Third & Halsted Realty Co. v. Chicago City Bank & Trust Co.,* 299 Ill.App. 297, 20 N.E.2d 162, 167 (1st Dist. 1939):

> **"The words 'demise' and 'demised' in a lease import a covenant on the part of the lessor of good right and title to make the lease, and also imply a covenant for quiet enjoyment." . . .**
>
> **. . . So the [**tenant**] is entitled to a covenant of quiet enjoyment, which is implied in every lease.** Quoting *Harms v. McCormick,* 132 Ill. 104, 22 N.E. 511, 512 (1889).

See also David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 326.

2. A breach of the covenant of quiet enjoyment, like any other breach of a landlord's covenant, entitles the tenant to recover the damages incurred and to exercise the other remedies that accrue to a tenant as a result of a landlord's breach. *Sixty-Third & Halsted, supra.* For example, if a landlord fails to pay taxes on the underlying fee, a tenant may undertake to pay taxes and deduct the amount from the rent due the landlord. As stated in *Sixty-Third & Halsted:*

> **A covenant is sometimes introduced into the lease, by which the tenant undertakes to pay the taxes; but, in the absence of such a covenant, the tenant may pay them, and deduct the amount of them out of the rent; for the landlord is bound to protect his tenant from all paramount claims. When therefore, a tenant has been compelled, in order to protect himself in the enjoyment of the land in respect of which his rent is payable, to make payments which ought, as between himself and his landlord, to have been made by the latter, he is considered as having been authorized by the landlord so to apply his rent, whether due or to become due.**
>
> **. . . And if the sum paid by the tenant exceeds the rent due, the landlord will be bound to repay such excess, as being money paid by the tenant to his use.** 20 N.E.2d at 167 – 168, quoting John N. Taylor, AMERICAN LAW OF LANDLORD AND TENANT §395 (9th ed. 1904).

Note generally, however, the dangers of withholding rent — the inability of a tenant to raise the landlord's breach as a defense in an action by the landlord for possession because of nonpayment of rent — as more fully discussed in §§3.56 and 3.62 above.

3. a. In the event of a breach by the landlord of the landlord's covenant of quiet enjoyment or any other covenant of the landlord that makes the premises untenantable by reason of such breach, the tenant may claim a constructive eviction and vacate the premises within a reasonable time after the breach occurs, after which the tenant's liability for rent ceases. See §3.56 above.

b. A tenant must walk a fine line in dealing with a constructive eviction case. Before a breach by a landlord constitutes a constructive eviction, the tenant must give the landlord a reasonable amount of time within which to cure the default. At the same time, the tenant must quit possession of the premises promptly after the period of time for the landlord to cure passes or the tenant waives the right to claim constructive eviction. For example, in *Risser v. O'Connell,* 172 Ill.App. 64 (1st Dist. 1912), the landlord was found not to have constructively evicted the tenant because the tenant failed to give the landlord reasonable time in which to cure an inadequate supply of water. *Risser* was later distinguished in a case finding that a tenant that had been vocal in its complaints had not waived its right to claim constructive eviction even though it remained in possession for three months while the landlord unsuccessfully tried to cure the problems. *American National Bank & Trust Company of Chicago v. Sound City, U.S.A., Inc.,* 67 Ill.App.3d 599, 385 N.E.2d 144, 24 Ill.Dec. 377 (2d Dist. 1979). For an example of a waiver of a claim for constructive eviction because of an unreasonable delay in notifying a landlord of problems that led to the claim for constructive eviction, *see JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 178 Ill.Dec. 444 (3d Dist. 1992), in which the tenant remained on the premises for over five years and signed an extension of the lease despite the allegedly untenantable conditions.

In the event of an abandonment of the premises by the tenant because of a constructive eviction, the tenant can nevertheless sue the landlord for damages resulting from the breach of the landlord's covenant. David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 326.

XXII. ASSIGNMENT AND SUBLETTING

A. [3.86] Landlord's Version — Sample Language

Tenant shall not, without the prior written consent of Landlord, (1) assign, convey, or mortgage this Lease or any interest under this Lease; (2) suffer to occur or permit to exist any assignment of this Lease or any lien on Tenant's interest, voluntarily, involuntarily, or by operation of law; (3) sublet the Premises or any part of the Premises; or (4) permit the use of the Premises by any parties other than Tenant and its employees. Landlord's consent to any assignment, subletting, or transfer shall not constitute a waiver of Landlord's right to withhold its consent to any future assignment, subletting, or transfer. Landlord's consent shall not be withheld in the case of assignment or subletting to an entity controlling, controlled by, or under common control with Tenant (any such entity or successor being sometimes hereafter referred to as an "Affiliate" of Tenant).

Tenant shall give Landlord written notice of any proposed sublease or assignment, which notice shall contain the name of the proposed sublessee or assignee and the proposed principal terms. Upon receipt of notice, Landlord shall have the option to terminate the Lease in its

entirety or, if Tenant proposes to sublease less than all of the Premises, to terminate the Lease with respect to the portion to be so subleased, in which latter event the Base Rent and Additional Rent shall be adjusted on a pro rata basis to reflect the reduced Rentable Area that remains under this Lease. If Landlord wishes to exercise its option to terminate, Landlord shall, within _____ days after Landlord's receipt of notice from Tenant, send to Tenant a notice stating and specifying the date on which such termination is effective; that date shall be the later of the anticipated occupancy date by the proposed assignee or subtenant or _____ days after the date on which Landlord sends notice. Landlord may, at its option, lease the space so recaptured by Landlord to Tenant's proposed subtenant or assignee.

If Landlord does not elect to cancel, Landlord may, in its sole judgment, withhold its consent to any proposed assignment or subletting for reasonable business concerns and purposes. Tenant acknowledges and agrees that Landlord has a vital interest in the nature, variety, and location of tenants in the Building as a whole and that Landlord's right to withhold its consent to any proposed assignment or subletting for reasonable business concerns and purposes is a material consideration for the rental rate and terms contained in this Lease. Tenant also agrees that Landlord has an interest in the rental rates for available space in the Building and that Landlord may withhold its consent if the rent to be charged to the proposed subtenant is substantially less than then-current rates for available space in the Building (even if such then-current rent is greater than the Rent being paid by Tenant).

Notwithstanding anything to the contrary contained in this Section, if Landlord does not elect to terminate this Lease as stated above but approves a proposed assignment or subletting by Tenant, (1) original Tenant shall not be released from any covenant or obligation under this Lease, and (2) if that assignment or subletting is made by Tenant for a monthly rate in excess of the pro rata amount of Rent then currently paid by Tenant for the assigned Premises or the subleased portion of the Premises, or for any other consideration, Landlord shall be paid as Additional Rent 75 percent of the net amount of that excess Rent or other consideration after Tenant has recovered its reasonable costs incurred in connection with that sublease or assignment (Excess Rental). All Excess Rental shall be paid to Landlord by Tenant within 15 days after Tenant's receipt thereof. Landlord may direct any subtenant or assignee to make any monthly payments in full directly to Landlord, and Landlord will remit to Tenant within 15 days after receipt by Landlord that portion of the payments remaining after deduction of the Excess Rental. Tenant and its assignee or sublessee shall certify to Landlord in writing the amount received by Tenant from its assignee or sublessee along with each payment. If the sublease or assignment is made a part of a larger transaction between Tenant and the subtenant or assignee, Landlord shall have the right, in the exercise of its reasonable business judgment, to make an allocation of a portion of the total consideration of the value of the assignment or sublease of this Lease for the purpose of determining Tenant's profit.

B. [3.87] Tenant's Version — Sample Language

Tenant may assign or sublet all or any part of the Premises for any lawful purpose, provided, however, that Tenant shall remain liable on all of its covenants under this Lease

unless, in Landlord's reasonable judgment, the assignee of Tenant's rights and obligations under this Lease is at least as financially responsible as Tenant (in which case Tenant shall then be relieved of all liability under this Lease from and after the date of that assignment).

C. [3.88] Comment

1. See Chapter 6 of this handbook for a complete discussion of provisions of leases concerning assignment and subletting. During periods of rising rents, landlords often find themselves unable to collect current market rates for new leases when space becomes available in a building due to competition from tenants in the building that have older, lower rents and the right under their leases to sublease and keep the profits. This has led landlords to require the types of protection illustrated by the landlord's version. The primary right is an opportunity to terminate the lease as to any space the tenant proposes to sublet. This "recapture" right permits a landlord, if rental rates have risen, to lease directly to the proposed subtenant at a profit and to eliminate the old, lower rental rate on that space. If the landlord has doubts about the financial responsibility of the proposed subtenant, it can permit the sublease and take a percentage of the profits. While many landlords try to take 100 percent of the gross profit, such a provision eliminates any incentive for the existing tenant to sublease for a profit. By permitting the tenant to first recover its costs of subletting and then retain a portion of the profits, the landlord encourages the tenant to charge full market rental for the space involved. Explicit provisions for recapture and profit-sharing sidestep many of the legal challenges faced by landlords seeking to address these financial objectives by withholding consent, such as the claim that an absolute right to withhold consent constitutes an undue restraint on alienation. Clauses such as these illustrate that the modern office lease is more an occupancy and service agreement than an interest in real estate.

2. See §3.112 below for a discussion of the standards governing the granting or withholding of the landlord's consent to an assignment or sublease.

3. While the taxation of leasehold interests is outside the scope of this chapter, attorneys for tenants should keep in mind the possibility that an assignment or sublease under a long-term lease could trigger payment of a transfer tax to the state, county, and local governments. The Real Estate Transfer Tax Law, 35 ILCS 200/31-1, *et seq.,* imposes a tax on transfers of "the lessee interest in a ground lease (including any interest of the lessee in the related improvements) that provides for a term of 30 or more years when all options to renew or extend are included, whether or not any portion of the term has expired." 35 ILCS 200/31-5. Note that it is not just the remaining unexpired term that is measured; it is assumed that all unexercised options to extend the term of the lease will be exercised. The reference to "ground leases" would appear to limit the tax to classic long-term leases of land under a building. However, this language could include single-tenant office building leases when the parking lots and surrounding common areas are leased to that single tenant. In a possible expansion beyond "ground leases," the Illinois Department of Revenue has promulgated rules suggesting that taxable transferred interests could include "any other type of interest with the right to use or occupy real property." 86 Ill.Admin. Code §120.20(a)(2)(D). This could be read as including any office leasing transactions that have a term, including options, of over 30 years.

XXIII. WAIVER OF CLAIMS AND OF SUBROGATION

A. [3.89] Landlord's Version — Sample Language

1. To the extent permitted by law, Tenant waives and releases Landlord and Landlord's contractors, agents, and employees from all claims for damage to person or property sustained by Tenant or any occupant of the Building or Premises relating to (a) the Building or Premises or any part of either or any equipment or appurtenance becoming out of repair; (b) any accident in or about the Building; or (c) directly or indirectly, any act or neglect of any tenant or occupant of the Building or of any person, including Landlord and Landlord's agents, servants, guests, and invitees. This section shall apply especially, but not exclusively, to damage caused by the flooding of basements or other subsurface areas, refrigerators, sprinkling devices, air-conditioning apparatus, water, snow, frost, steam, excessive heat or cold, falling plaster, broken glass, sewage, gas, odors or noise, or the bursting or leaking of pipes or plumbing fixtures and shall apply equally whether the damage results from the act or neglect of Landlord or its contractors, agents, or employees or of other tenants of the Building or of any other person and whether that damage caused or resulted from any thing or circumstance above mentioned or referred to, or any other thing or circumstance, whether of a like or of a wholly different nature.

2. If any damage to the Premises or the Building or to any equipment or appurtenance thereto or any part thereof or to Landlord or other tenants in the Building results from any act, omission, or neglect of Tenant or of Tenant's contractors, agents, or employees, Landlord may, at Landlord's option, repair that damage, and Tenant shall, upon demand by Landlord, reimburse Landlord immediately for the total cost of those repairs in excess of the amount, if any, paid to Landlord under insurance, if any, covering these damages.

3. All property situated in the Building or the Premises and belonging to Tenant, its agents, contractors, employees, or invitees, or any occupant of the Premises shall be situated there at the risk of Tenant or such other person only, and Landlord shall not be liable for damage, theft, misappropriation, or loss of that property.

4. To the extent that Tenant carries hazard insurance on any of its property in the Premises, each policy of insurance shall contain, if obtainable from the insurer selected by Tenant, a provision waiving subrogation against Landlord.

5. Tenant agrees to hold Landlord and its contractors, agents, and employees harmless from and indemnified against all claims, liability, and costs (including but not limited to attorneys' fees and costs) for injuries to persons and damage to, or the theft, misappropriation, or loss of, property arising from occurrences in or about the Premises or the Building caused, in whole or in part, by the act, omission, or negligence of Tenant or its agents, contractors, employees, or invitees.

B. [3.90] Tenant's Version — Sample Language

1. Each party agrees to hold harmless and indemnify the other party and its agents, contractors, and employees from and against all claims, liability, and costs (including but not limited to attorneys' fees and costs) for injuries to persons and damage to or the theft, misappropriation, or loss of property arising from occurrences in or about the Premises or Building caused, in whole or in part, by the act, omission, or negligence of such indemnifying party or its agents, contractors, employees, or invitees.

2. Landlord waives any and every claim that arises or may arise in its favor and against Tenant during the Term of this Lease or any renewal or extension for any and all loss of, or damage to, the Premises, the Building, or any of its property located within or upon the Premises or the Building, which loss or damage is covered by or could have been covered by typical fire and extended coverage insurance policies. This waiver shall be in addition to, and not in limitation or derogation of, any other waiver or release contained in this Lease with respect to any loss of, or damage to, property of Landlord. Inasmuch as the above waiver will preclude the assignment of any prior claim, by subrogation or otherwise, to an insurance company (or any other person), Landlord agrees immediately to give to each insurance company that has issued policies of fire and extended coverage insurance written notice of the terms of such waiver and to have those insurance policies properly endorsed, if necessary, to prevent the invalidation of the insurance coverage by reason of such waiver.

C. [3.91] Comment

1. General provisions relieving a landlord from liability for damages resulting from the negligence of the landlord or its agents, servants, or employees are void in Illinois. *See, e.g., Economy Mechanical Industries, Inc., v. T.J. Higgins Co.,* 294 Ill.App.3d 150, 689 N.E.2d 199, 228 Ill.Dec. 327 (1st Dist. 1997), in which it was held that all claims, whether in contract or in negligence, are barred if based on a lease provision that would require the tenant to indemnify the landlord from a claim based on the landlord's own negligence. A lease provision that is void for one purpose is void for all purposes. 765 ILCS 705/1 provides:

> [E]**very covenant, agreement, or understanding in or in connection with or collateral to any lease of real property, exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his or her agents, servants or employees, in the operation or maintenance of the demised premises or the real property containing the demised premises shall be deemed to be void as against public policy and wholly unenforceable.**

Nevertheless, many of the office leases commonly in use contain a broad waiver of liability provision similar to that contained in paragraph 1 of the landlord's version. The only advantage for including such a provision in a lease is that to the extent 765 ILCS 705/1 does not prohibit waiver of claims by a tenant, especially in cases not involving negligence of the landlord, the waiver will serve to protect the landlord. For example, this type of provision will limit the damages recoverable when a tenant's property is damaged by a leaky roof that the landlord agreed, and made good-faith

attempts, to repair. *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 5 Ill.Dec. 282 (2d Dist. 1977). However, a landlord using such a provision should be aware that, notwithstanding this language, under current Illinois law the landlord will not be protected against claims for injury to person or property resulting from the negligence of the landlord or its agents, servants, or employees. The landlord must insure against this risk.

2. Paragraph 2 of the landlord's version gives the landlord the right to repair damage caused by the tenant resulting from the act, omission, or negligence of the tenant and requires the tenant to pay the cost of those repairs. Such a provision should prevent the landlord from falling within the rule that repairs made by a landlord pursuant to a right to reentry do not create any obligation of the tenant to pay for those repairs, absent a provision to the contrary in the lease. *Rose v. Stoddard,* 181 Ill.App. 405 (1st Dist. 1913).

3. In Illinois, the tenant — and not the owner of the building — is generally responsible for injuries occurring on the premises and resulting from a defective condition of the premises, unless otherwise specifically provided in the lease. *Hardy v. Montgomery Ward & Co.,* 131 Ill.App.2d 1038, 267 N.E.2d 748 (5th Dist. 1971). The landlord may be liable for injuries occurring on premises leased to a tenant and not under the landlord's control in the following circumstances: (a) if there is a latent defect in the premises that the landlord should have known about; (b) if the landlord fraudulently conceals a known dangerous condition; (c) if there is a defect that amounts to a nuisance or, perhaps, a violation of a statute or ordinance; or (d) if, after agreeing to repair the premises, the landlord fails to use reasonable care in doing so and thereby creates an unreasonable risk. *Dapkunas v. Cagle,* 42 Ill.App.3d 644, 356 N.E.2d 575, 577, 1 Ill.Dec. 387 (5th Dist. 1976). The landlord's reservation of a right to make repairs within the premises if the tenant fails to do so will not by itself constitute "control" of the premises by the landlord. *Bielarczyk v. Happy Press Lounge, Inc.,* 91 Ill.App.3d 577, 414 N.E.2d 1161, 47 Ill.Dec. 45 (1st Dist. 1980). In addition, if damage is caused to the building or to other tenants of the building resulting from a fire caused by the negligent conduct of the tenant within the premises, the tenant may not be liable for the damages caused unless expressly stated to the contrary in the lease. See the cases discussed in §3.62 above.

4. The waiver of subrogation clause in the second paragraph of the tenant's version is very important to the tenant. Rather than relying on the cases discussed in §3.62 above, this clause requires the landlord to waive its (and its insurers') rights against the tenant for insured risks. This allocation of risk is generally accepted by insurers and is very much the norm in today's office leases.

5. The waivers and releases contained in both the landlord's version and the tenant's version must be broadened depending on the type of entity being indemnified. If the indemnified entity is a corporation, the indemnification should run to its officers and directors. If the entity being indemnified is a partnership, the benefits should run to the partners. If the entity being indemnified is a land trust, the indemnification should run to the beneficiaries of the trust and to the components of the various beneficiaries (*e.g.,* to the partners if a beneficiary is a partnership).

6. Both the landlord's and the tenant's indemnification provisions expressly include attorneys' fees and costs. Absent express language, those costs will not be covered by a general indemnification. *Johnston v. Suckow,* 55 Ill.App.3d 277, 370 N.E.2d 650, 653, 12 Ill.Dec. 846 (5th Dist. 1977).

XXIV. SUBORDINATION TO MORTGAGES AND GROUND LEASES

A. [3.92] Landlord's Version — Sample Language

1. This Lease is subject and subordinate to all present and future ground or underlying leases of the Land underlying the Building (Land) and/or the Building and to the lien of any mortgage or mortgages now and after this date in force against the Land or the Building and to all renewals, modifications, consolidations, replacements, and extensions of such mortgage or mortgages or leases and to all advances made or to be made on the security of such mortgage or mortgages. Tenant agrees to promptly execute any further instruments as shall be requested by Landlord in confirmation of such subordination. Tenant, by this Lease, irrevocably appoints Landlord as attorney in fact for Tenant with full power and authority to execute and deliver in the name of Tenant any such instrument or instruments if Tenant fails to do so, provided that such power of attorney shall in no way relieve Tenant from the obligation of executing those instruments of subordination.

2. Tenant covenants and agrees, (a) in the event any proceedings are brought for the foreclosure of any such mortgage or mortgages (at the option of any purchaser at a foreclosure sale or under a deed in lieu of foreclosure, to be evidenced by written notice of election to Tenant), to attorn to such purchaser and to recognize such purchaser as the Landlord under this Lease to the same extent as the original Landlord under this Lease; and (b) in the event of the termination of any ground or underlying lease, referred to in Paragraph 1 above, at the option of the holder of the reversion under that ground or underlying lease, to be evidenced by written notice of election to Tenant, to attorn to that holder and to recognize that holder as the then Landlord under this Lease to the same extent and effect as the original Landlord under this Lease.

While this provision shall be self-executing and shall not require any further writing to be effective, Tenant agrees to execute and deliver, at any time and from time to time, upon the request of Landlord or of any such holder, any instrument that, in the sole judgment of Landlord, may be necessary or appropriate in any of such events to evidence such attornment. Tenant, by this Lease, irrevocably appoints Landlord and the holder of such mortgage or such ground lessor (as the case may be), or either of them, to execute and deliver for and on behalf of Tenant any such instrument, provided that such power of attorney shall in no way relieve Tenant of the obligation to execute any such instrument of attornment. Tenant further waives the provisions of any statute or rule of law, now or after this date in effect, that may give or purport to give Tenant any right or election to terminate or otherwise adversely affect this Lease and the obligations of Tenant under this Lease in the event any such foreclosure proceeding is brought or such ground or underlying lease is terminated.

B. [3.93] Tenant's Version — Sample Language

Tenant agrees

1. **to subordinate its rights under this Lease at all times to (a) the lien of any mortgage or mortgages designated by Landlord and to all advances made or to be made on the security thereof, or (b) all future ground leases or underlying leases of the Land and the Building designated by Landlord and to execute any agreements as may be required by the mortgagee or ground or underlying lessor, as the case may be, evidencing such subordination; and**

2. **to attorn to and to recognize the purchaser at a foreclosure sale as Landlord in the event of a foreclosure of such mortgage or the ground or underlying lessor as Landlord in the event of the termination of such underlying or ground lease**

in return for and upon delivery to Tenant by such mortgagee or ground or underlying lessor, as the case may be, of a subordination, non-disturbance, and attornment agreement, in form and substance satisfactory to Tenant, agreeing that in the event of a foreclosure of such mortgage or termination of such ground or underlying lease, Tenant may remain in possession of the Premises and exercise all of its other rights hereunder pursuant to the terms of this Lease as long as Tenant continues to perform its obligations and further agreeing that the purchaser at a foreclosure sale or ground or underlying lessor, as the case may be, will assume all of the obligations of Landlord in such case. As a condition to Tenant's obligations under this Lease, Landlord shall, within _____ days after execution of this Lease, cause all existing mortgagees and ground and underlying lessors to execute and deliver to Tenant such an agreement.

C. [3.94] Comment

1. The sample provisions define the rights of the tenant with respect to a mortgagee of the building and the land underlying the building and with respect to a ground lessor holding a lease on the building or the underlying land. In the landlord's version, the tenant subordinates the tenant's rights under the lease to the rights of the mortgagee or ground lessor and agrees, upon request of a purchaser at a foreclosure sale following foreclosure or a ground lessor following termination of the underlying lease, to attorn to such purchaser or ground lessor. The tenant's version of the sample provision also contains an agreement by which the tenant subordinates its rights to the rights of a mortgagee or ground lessor and attorns to the purchaser at a foreclosure sale or the ground lessor but conditions this agreement on delivery by the mortgagee or ground lessor of a subordination, non-disturbance, and attornment agreement (commonly called an SNDA) allowing the tenant to continue to enjoy the benefits of its lease following a foreclosure or termination of a ground lease as long as the tenant continues performing its obligations under its lease.

2. The rights of a mortgagee with respect to a tenant in the building differ depending on whether the lease was made before or after the date the mortgage was recorded. As stated by the court in *Reichert v. Bankson,* 199 Ill.App. 95, 97 – 98 (4th Dist. 1916):

> **If the interest of the landlord is sold under a judgment, mortgage or other lien, which is subsequent to the lease, the purchaser becomes the landlord in the former owner's place, since the reversion passes by the sale. In such case the purchaser takes only what the lessor has, that is, his estate in reversion, and the rights of the tenant under the outstanding lease remain such as they would be in the case of a voluntary transfer of the reversion. If, on the other hand, the premises are sold under a judgment, mortgage or other lien prior to the lease, the purchaser comes in by title paramount to the lease, and he is entitled to possession as against the tenant thereunder. And as the tenant under a lease has no rights in the land as against the purchaser under a prior incumbrance, so such purchaser has, apart from statute, no rights as landlord against such tenant, unless the latter accepts a new lease from the purchaser, or, which is the same thing, attorns to him.** Quoting Herbert Thorndike Tiffany, THE LAW OF LANDLORD AND TENANT §147, p. 876 (1910).

The mortgagor-landlord mortgages only the interest that it owns. If the mortgage is recorded prior to execution of the lease, the mortgagor-landlord has mortgaged its entire interest in the realty, and consequently when it executes a subsequent lease, that lease is carved out of its equity of redemption and remains subject to all rights of the mortgagee. On the other hand, if the mortgage is recorded subsequent to the execution of the lease, the mortgagor-landlord can mortgage only its reversionary interest. Consequently, the mortgagee takes its interest subject to the rights of the tenant under the lease.

3. If the mortgage precedes the lease and the tenant refuses to attorn to the mortgage, a purchaser at a foreclosure sale has no privity of estate with the tenant and, accordingly, has no right to proceed in an action to collect rent from the tenant. *West Side Trust & Savings Bank v. Lopoten,* 358 Ill. 631, 193 N.E. 462 (1934); *Reichert, supra; Reed v. Bartlett,* 9 Ill.App. 267 (2d Dist. 1881). In such a case, however, the purchaser at a foreclosure sale does have the right, by statute, to proceed against the tenant to recover possession. 735 ILCS 5/9-201. Similarly, a foreclosing mortgagee may leave subordinate occupancy tenants in place by not naming them as parties to the foreclosure action. The fact that the mortgagee takes possession of the property during the foreclosure will not be deemed to terminate subordinate tenancies. 735 ILCS 5/15-1701(e).

4. Before preparing a clause for insertion in any particular lease, the landlord's attorney would be well-advised to check with any known present or future mortgagee or ground lessor to determine whether the mortgagee or ground lessor wishes the occupancy lease to be prior or subordinate to the mortgage or lease. Many mortgagees and ground lessors want their mortgage or lease to be subordinate to the occupancy leases so that, upon foreclosure or termination of the ground lease, there is no question that the occupancy leases remain in full force and effect. Absent effective occupancy leases, the building often has substantially less value.

5. From a tenant's viewpoint, if the building is subject to a prior mortgage or underlying ground lease when the lease is executed, the tenant should enter into a non-disturbance agreement with any ground lessor or mortgagee at the same time that it enters into the lease. It is dangerous to make a substantial investment in leasehold improvements if the tenant can be evicted (or subjected to renegotiation of its rent) upon a foreclosure. Typical non-disturbance agreements will, however,

still release the mortgagee or ground lessor from certain obligations of the landlord, such as those that accrue prior to the date that party takes control of the building or that require major involvement, such as completing construction of a new building.

XXV. ESTOPPEL CERTIFICATE

A. [3.95] Landlord's Version — Sample Language

Tenant agrees that, from time to time, upon not less than _____ days' prior notice by Landlord, Tenant will deliver to Landlord or to such other person or persons as Landlord shall designate in such notice, a statement in writing certifying (1) that this Lease is unmodified and in full force and effect and contains the full agreement between the parties (or, if there have been modifications or additional agreements, that the lease is in full force and effect as modified and identifying the modifications thereof or additional agreements); (2) the dates to which the Base Rent, Additional Rent, and other charges due under this Lease have been paid; and (3) that, insofar as Tenant knows, Landlord is not in default under any provision of this Lease and has performed all of the obligations to be performed by Landlord to date (or, if Tenant has knowledge of any default by Landlord or of any unperformed obligations by Landlord, a statement of the nature thereof).

B. [3.96] Tenant's Version — Sample Language

Each party agrees from time to time, upon not less than _____ days' prior notice to the other, to deliver to such person or persons as the party making the request shall designate in such notice a statement in writing certifying (1) that this Lease is unmodified and in full force and effect and contains the full agreement between the parties (or, if there have been modifications or additional agreements, that the lease is in full force and effect as modified and identifying the modifications thereof or additional agreements); (2) the dates to which the Base Rent, Additional Rent, and other charges due under this Lease have been paid; and (3) that, insofar as the party making the statement knows, the other party is not in default under any provision of this Lease and has performed all of the obligations to be performed by the other party to date (or, if the party making the statement has knowledge of any default or of any unperformed obligations, a statement of the nature thereof).

C. [3.97] Comment

1. The tenant's obligation to provide an estoppel certificate could be of great importance to the landlord. If the landlord at any time after the lease is in effect undertakes to sell the building, a sophisticated purchaser will request evidence from the landlord that the existing occupancy leases (on which the purchase price will be based at least in part) are in the exact form, including all amendments; that the purchaser has reviewed them; that they are in full force and effect; and that no defaults exist thereunder. A lender providing mortgage financing to the landlord will also require independent verification of the existing leases (which are again an important consideration in determining the amount of mortgage financing). Absent a specific provision in the lease requiring

the tenant to furnish an estoppel certificate, the tenant is not under an obligation to furnish such a certificate, and the landlord may not be able to meet the estoppel certificate requirements of a buyer or lender.

2. The tenant's version of the sample provision requires the landlord as well as the tenant to deliver an estoppel certificate, if so requested. If the tenant has occasion to assign its leasehold interest, either in connection with a decision that the tenant no longer wishes to occupy the premises prior to the end of the lease term or perhaps in connection with the sale of the tenant's business or assets, an assignee may well request evidence that the lease is in full force and effect and no default exists thereunder.

XXVI. MONEY DUE BUT UNPAID

A. [3.98] Landlord's Version — Sample Language

All amounts (other than Rent) owed by Tenant to Landlord shall be paid within _____ days from the date Landlord renders statements of account. Amounts, including Rent, that are not paid when due shall bear interest at _____ percent over the per annum prime rate or corporate base rate announced from time to time by a Chicago bank selected by Landlord, but not in excess of the maximum rate of interest permitted by law in such circumstances, in order to reimburse Landlord for the loss Tenant agrees Landlord will incur by reason of Tenant's failure to pay that amount in a timely manner.

B. [3.99] Tenant's Version — Sample Language

Except as otherwise provided in this Lease, any amount owed by one party under this Lease to the other shall be paid within _____ days after due (if a due date is set forth in this Lease) or, if no due date is set forth, within _____ days from the date the debtor receives a statement of account therefor. Such amounts, if not paid when due, shall bear interest at the rate of 9 percent per annum after that date until paid in order to reimburse the party to whom such amount is due for the loss that the other party agrees will result from the other party's failure to pay the amount due in a timely manner.

C. [3.100] Comment

A good argument exists that a provision in a lease imposing a penalty on the tenant for a late payment of rent or on either of the parties for a failure to pay an amount due, if phrased simply in terms of a percentage of the amount due, will be subject to the limitations of the Illinois usury law. The interest being charged is interest on money due and owing, which may constitute a loan. *See Adams v. Shirk,* 117 F. 801 (7th Cir. 1902), to this effect. Note that the tenant's version limits the interest to nine percent per annum, the maximum rate of interest allowable under Illinois law for loans that are not exempt from the Illinois usury laws. 815 ILCS 205/4(1). The landlord's prime-related rate will probably not run afoul of the Illinois usury laws since the loan, if one is found to exist, should be a corporate loan or a business loan exempt from the interest limitations under the provisions of 815 ILCS 205/4(1)(a) and 205/4(1)(c).

The effects of the Illinois usury laws may also be avoided if, as in the sample provisions, late charges are tied to the costs incurred by the party to whom the money is owed by reason of the late payment. Illinois courts have held, in cases unrelated to late payments on leases, that charges to be paid to reimburse a creditor for expenses incurred as a result of the debtor's default are not to be considered interest and are, accordingly, not subject to the usury laws. For example, attorneys' fees incurred by the holder of a note in connection with the default by the maker of the note, which the maker agreed in the note to pay, were held not to constitute interest (*Barton v. Farmers' & Merchants' Nat. Bank of Vandalia, Ill.,* 122 Ill. 352, 13 N.E. 503 (1887)) even when those payments were quantified as a percentage of the outstanding principal amount of the note as long as that percentage did not result in unreasonable fees. *Dorsey v. Wolff,* 142 Ill. 589, 32 N.E. 495 (1892). See also Frank L. Winter, *The New Chicago Real Estate Board Lease,* 57 Chi.B.Rec. 44 (1975), reaching this conclusion with respect to the late charge imposed in the Chicago Real Estate Board Unfurnished Apartment Lease.

XXVII. NOTICES, DEMANDS, AND SUBMISSIONS

A. [3.101] Landlord's Version — Sample Language

All notices, waivers, demands, requests, submissions, or other communications required or permitted under this Lease shall, unless otherwise expressly provided, be in writing and shall be deemed properly served, given, and received (1) if delivered by hand or by messenger, when delivered; (2) if mailed, on the [second**] business day after deposit in the United States mail, certified or registered, postage prepaid, return receipt requested; (3) if delivered by a reputable overnight express courier, freight prepaid, the [**next**] business day after delivery to such courier; or (4) if transmitted by facsimile transmission with proof of transmission and a copy of the notice being sent by regular mail, when transmitted, in every case addressed to the party to be notified as follows:**

1. **if to Landlord, then to: [**address at which Landlord desires to receive notices**]**

   Attention: [name of individual or title of officer of Landlord to whose attention notices should be directed**]**

   Fax: _____; or

2. **if to Tenant, then to the Premises (Tenant's facsimile number is _____);**

or to such other address or addressee as either party may give to the other in the manner provided in this Lease for the service of notices. The above notwithstanding, if Landlord is unable to serve any such notice or demand on Tenant as provided above, a notice or demand to Tenant shall be deemed properly served if affixed to any door leading into the Premises, in which event the notice or demand shall be deemed to have been served at the time the copy is so affixed.

B. [3.102] Tenant's Version — Sample Language

All notices, waivers, demands, requests, submissions, or other communications required or permitted under this Lease shall, unless otherwise expressly provided, be in writing and shall be deemed properly served, given, and received (1) if delivered by hand or by messenger, when delivered; (2) if mailed, certified or registered, postage prepaid, return receipt requested, upon receipt; (3) if delivered by a reputable overnight express courier, freight prepaid, the [next**] business day after delivery to such courier; or (4) if transmitted by facsimile transmission with proof of transmission and a copy of the notice being sent by regular mail, when transmitted, in every case addressed to the party to be notified as follows:**

1. **if to Landlord, then to the address fixed for the payment of Rent under this Lease; (Landlord's fax number is _____); or**

2. **if to Tenant, then to: [**address at which Tenant desires to receive notices**]**

   Attention: [name of individual or title of officer of Tenant to whose attention notices should be directed**]**

   Fax: _____;

or to such other address or addressee as either party may give to the other in writing.

C. [3.103] Comment

1. Note that in both the landlord's and the tenant's versions of the sample provision, when notices are to be served at a specific address, the party to whose attention the notice must be addressed is also specified. This should help avoid a situation in which a notice not addressed to a specific individual is simply delivered to an office and left unattended while the period in which to cure a default or otherwise act begins to run. Consideration should also be given, in a long-term lease or when the party to receive the notice is a large organization, to simply using the title of an officer as the person to whose attention notices should be given (*e.g.,* "President") instead of using the name of a designated individual who may leave the employ of the recipient of the notice after the lease is signed since this will ensure that notice will be directed to the proper party.

2. The tenant's version of the sample provision states that mailed notices are effective when received. Absent such a provision, or at least a provision requiring a return receipt, under the "mailbox rule" adopted by Illinois law, there is a rebuttable presumption that a notice was received if properly mailed and that it was effective upon mailing. *Sjostrom & Sons, Inc. v. D. & E. Mall Restaurant, Inc.,* 29 Ill.App.3d 1082, 332 N.E.2d 62 (2d Dist. 1975); *Liquorama, Inc. v. American National Bank & Trust Company of Chicago,* 86 Ill.App.3d 974, 408 N.E.2d 373, 41 Ill.Dec. 951 (1st Dist. 1980). If a notice is deemed served when mailed, any delay experienced in the mail will deprive the party receiving notice of at least some of the advantage of any period in which to cure or take other action. While making service effective upon receipt forces the party serving the notice to procure evidence of receipt of the notice in order to avoid uncertainty as to the effective date of

the notice, it is in accord with the requirement that statutory notices to quit are effective only upon receipt. *Avdich v. Kleinert,* 69 Ill.2d 1, 370 N.E.2d 504, 12 Ill.Dec. 700 (1977). However, under the tenant's version, the tenant can ignore the notice delivered by the postal service or refuse to sign the receipt, thereby effectively avoiding service and negating the effectiveness of the notice. To avoid such a result, the landlord's version states that mailed notice is effective two business days after mailing, so even if the tenant refuses to accept the notice from the postal service, the notice shall be deemed received two businesses days after the mailing. Since both versions of the provision state that notices are to be mailed by certified or registered mail, return receipt requested, the party giving the notice will have evidence of both the date of mailing and the date of receipt through the signed receipt procured by the United States Postal Service. Private delivery services have similar receipt records that are available to the sender.

3. Note that the landlord's version allows the landlord to serve notices on the tenant, if all other methods of serving notice fail, by posting the notice on the door of the premises. See generally Chapter 8 of this handbook with respect to serving notices of default.

XXVIII. PARKING BY TENANT

A. [3.104] Landlord's Version — Sample Language

Unless specifically provided for in this Lease, nothing in this Lease shall be construed as granting to Tenant or its customers, patrons, invitees, visitors, or employees a right to park any cars or other vehicles in any parking facilities in or about the Building, except on such terms and conditions as such parking facilities shall be available to the general public.

B. [3.105] Tenant's Version — Sample Language

Landlord hereby grants to Tenant [the nonexclusive right to the use of any and all parking in or about the building**] [**the exclusive right to the use of _____ parking spaces in or about the building**] for the free parking of Tenant's vehicles and those of its customers, patrons, invitees, visitors, and employees.**

C. [3.106] Comment

1. This provision is included in order to remind the drafter of an office lease to cover the question of the tenant's parking, if appropriate. In many leases, particularly for suburban locations, parking is a primary issue. The ratio of spaces to rentable area, assigned spaces, caps on parking rates, remedies for condemnation of parking areas, or damage to parking garages all may be addressed if the tenant's employees or expected visitors to the tenant's premises need parking at the building.

2. Note the alternative provisions in the tenant's version, giving the tenant either a nonexclusive right to all parking spaces affiliated with the building or a specific right to certain spaces. Once again, the exact wording of such a provision will have to be tailored to the exact

conditions of the lease. Giving one tenant rights to use a parking lot in common with other tenants will prevent a landlord from subsequently assigning exclusive parking spaces to another tenant. *Mutual of Omaha Life Insurance Co. v. Executive Plaza, Inc.,* 99 Ill.App.3d 190, 425 N.E.2d 503, 54 Ill.Dec. 638 (2d Dist. 1981).

XXIX. COVENANTS AND CONDITIONS

A. [3.107] Landlord's Version — Sample Language

All of the covenants of Tenant under this Lease shall be deemed and construed to be "conditions" if the Landlord so elects as well as "covenants" as though the words specifically expressing or importing covenants and conditions were used in each separate instance.

B. [3.108] Tenant's Version — Sample Language

All of Landlord's covenants set forth herein and Tenant's covenants to pay Rent set forth herein are dependent covenants.

C. [3.109] Comment

1. The difference between a covenant and a condition is set forth in David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 332:

> **There is a difference in legal effect between a covenant and a condition. Ordinarily a breach of covenant will subject the promisor to a suit for damages. It will not work a forfeiture of the tenant's interest or terminate the relationship of landlord and tenant. On the other hand, a breach of condition ordinarily will terminate the relationship. Whether a given provision should operate as a condition or covenant or both is held to be a matter of the intention of the parties. . . . Because courts do not favor forfeitures an effort is made to construe provisions as covenants rather than as conditions.**

The landlord's version of the sample provision states that all of the tenant's covenants under the lease are also deemed to be conditions if the landlord so elects. If this provision is upheld by a court, a breach of any covenant will be construed as a breach of a condition, allowing the landlord to terminate the lease. As stated in Levinson's article, however, this interpretation runs contrary to the tendency of courts to construe conditions as covenants in order to avoid a forfeiture.

2. The tenant's version states that all of the landlord's covenants and the tenant's covenant to pay rent are dependent covenants. The basic rule in Illinois is that most covenants in leases are independent covenants, so that the breach by the landlord of one of the landlord's basic covenants in the lease may not excuse the tenant from performing its covenant to pay rent. Again, as set forth in 1952 U.Ill.L.F. at 332 – 333:

With respect to dependent covenants, the performance by each party of his covenant is a condition precedent to his right to recover for the breach of the covenant of the other. If the covenants are independent, it is no excuse for the non-performance by one party that the other has not performed. Most covenants in a lease are held by the courts to be independent covenants — and thus the general rule is that the covenant of the landlord to repair or make improvements and the covenant of the lessee to pay rent are independent.

It is hoped the tenant's version of the provision will give the tenant a basis on which to argue that a breach of the landlord's covenants (*i.e.,* failure to provide promised services) entitles the tenant to withhold rentals, at least to the extent of the tenant's damages. This may help overcome the risk to the tenant pointed out in §§3.56 and 3.62 above if the tenant sets off its damages against rent due.

XXX. LANDLORD'S PERMISSION AND CONSENT

A. [3.110] Landlord's Version — Sample Language

Wherever in this Lease Landlord's permission or consent is required, that permission or consent may be given or withheld by Landlord in the exercise of Landlord's sole and unbridled discretion.

B. [3.111] Tenant's Version — Sample Language

Wherever in this Lease Landlord's consent, approval, or permission is required or requested, such consent, approval, or permission shall not be unreasonably withheld or delayed.

C. [3.112] Comment

1. Most of the Illinois cases dealing with the granting or withholding of consent fall into the area of the approval by the landlord of the assignment of a tenant's leasehold rights. Generally, the cases state that the landlord may not withhold its consent unless it has commercially reasonable grounds for withholding its consent based on the specific facts involved. *Mowatt v. 1540 Lake Shore Drive Corp.,* 385 F.2d 135 (7th Cir. 1967); *Reget v. Dempsey-Tegler & Co.,* 70 Ill.App.2d 32, 216 N.E.2d 500 (5th Dist. 1966); *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 60 Ill.Dec. 703 (1st Dist. 1982). The same standard was applied in determining whether a tenant who had the right to approve other tenants in certain areas of an office building unreasonably withheld its consent to a proposed tenant. *Arrington v. Walter E. Heller International Corp.,* 30 Ill.App.3d 631, 333 N.E.2d 50 (1st Dist. 1975). It would seem likely that an Illinois court would extend this concept of commercial reasonableness to all consents that a landlord is required to give under the lease. If it is commercially reasonable for the landlord to consent to a request of the tenant after a consideration of the facts involved, it is possible that an Illinois court, applying the principles of the cases cited above, would require that consent to be given. In the absence of any definite Illinois caselaw outside the assignment of lease area other than

Arrington, the landlord's version will help buttress the landlord's argument that consent, approval, or permission need not be given. It is also useful for the landlord to be specific in the various provisions of its form lease about the grounds on which the landlord's decision will be made. See, for example, the language regarding consent in the landlord's version of the assignment and subletting clause in §3.86 above.

2. From the tenant's viewpoint, use of the tenant's version serves to incorporate, by contract, the current Illinois standard governing the granting of consents to subleases and lease assignments.

Note also that the tenant's version requires that the landlord's permission be neither unreasonably withheld nor delayed. By delaying the granting of permission, a landlord can, in many instances, thwart an intended result the tenant wishes to accomplish with almost the same force as if the consent were denied altogether.

XXXI. LEASE MODIFICATIONS; ATTACHMENTS; INSERTIONS AND RIDERS

A. [3.113] Version Suitable for Both Landlord and Tenant — Sample Language

1. All negotiations, considerations, representations, and understandings between Landlord and Tenant are incorporated in this Lease and may be modified or altered only by an agreement in writing between Landlord and Tenant.

2. Provisions typed on the back of this Lease and signed by Landlord and Tenant and all riders attached to this Lease and signed by Landlord and Tenant are now a part of this Lease as though inserted at length in this Lease.

B. [3.114] Comment

1. In preparing a lease, the drafter should attempt to be as exact and clear as possible. Notwithstanding the language of paragraph 1 of the sample provision, if a lease provision is ambiguous, Illinois courts will look beyond the language of the lease to extrinsic aids, if necessary, in order to ascertain the meaning of the parties. *Dangeles v. Marcus,* 57 Ill.App.3d 662, 373 N.E.2d 645, 15 Ill.Dec. 299 (1st Dist. 1978); *Coney v. Rockford Life Insurance Co.,* 67 Ill.App.2d 395, 214 N.E.2d 1 (3d Dist. 1966); *Book Production Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881 (2d Dist. 1961); *Schmohl v. Fiddick,* 34 Ill.App. 190 (2d Dist. 1889).

2. The drafter should bear in mind that the construction of an ambiguous provision created by the drafter of the provision in order to induce the other party to execute the lease will be considered by the court in construing the ambiguous provision. As stated by the court in *Coney, supra:*

> **Evidence showing the contemporaneous construction placed upon the contract by the parties themselves is entitled to great weight in finding the intention of the parties. . . . [**W**]here the evidence shows that one party to the contract understood the agreement in a particular sense, and the other party knew it to be so understood, the undertaking will be so defined if it is compatible with the language used. [**Citation omitted.**]** 214 N.E.2d at 3.

See also Schmohl, supra, in which the court enforced against the landlord a construction placed on an ambiguous provision by the landlord who had drafted the lease.

3. A drafter of a lease should also be aware that while a court will attempt to construe the entire lease as a whole without invalidating any clause, a clause inserted in a typewritten rider or insertion will prevail over a printed clause if an irreconcilable conflict exists. As stated in *Book Production Industries, supra:*

> **A lease should be construed from within the four corners thereof and the Court may not add to, or detract from[,] the instrument. A clause inserted in a lease in typewriting should prevail over a printed clause if they are in conflict, but the rule that effect must be given, if possible, to all of the terms of a lease applies to a lease which is partly typewritten and partly printed, and neither the printed portion nor the typewritten portion should be disregarded unless there is a conflict between the two.** 178 N.E.2d at 885.

XXXII. SUCCESSORS AND ASSIGNS

A. [3.115] Landlord's Version — Sample Language

1. Subject to the limitations of the following sentence, each provision of this Lease shall bind, extend to, and inure to the benefit of Landlord and Tenant and their respective heirs, administrators, devisees, legal representatives, successors, and assigns. The above notwithstanding, this Lease shall not inure to the benefit of any assignee, heir, administrator, devisee, legal representative, transferee, or successor of Tenant except upon the prior written consent or election of Landlord.

2. The term "Landlord," as used in this Lease, means only the owner or the mortgagee in possession of the Building or the tenant under an underlying or ground lease of the whole Building or of the Land and the Building, so that in the event of any sale or conveyance of the Building or in the event of a lease of the entire Building, or of an assignment of any underlying or ground lease of the whole Building or of the Land and the Building, as the case may be, all parties at any time liable as Landlord under this Lease, other than the then-current owner of the Building or the then-current lessee of the entire Building or the Land and entire Building, as the case may be, shall be and hereby are entirely freed and relieved of all covenants and obligations of Landlord under this Lease.

B. [3.116] Tenant's Version — Sample Language

1. Each provision hereof, being a covenant running with the Land, shall extend to and shall, as the case may require, bind and inure to the benefit of Landlord and Tenant and their respective heirs, administrators, devisees, legal representatives, successors, and assigns in the event this Lease has been assigned as provided in this Lease.

2. In the event of any transfer or transfers of the interest of Landlord in the Building (and in the case of any subsequent transfer), transferring Landlord shall be relieved from and after the date of the transfer of all liability with respect to the performance of any of Landlord's covenants or agreements contained in this Lease and to be performed after the date of that transfer upon satisfaction of the following conditions:

a. the transferee is, in Tenant's reasonable judgment, an entity of sufficient financial strength to enable such entity to carry out Landlord's covenants and agreements contained in this Lease; and

b. the transferee expressly assumes in writing the performance of all of Landlord's covenants and agreements contained in this Lease.

In the absence of the fulfillment of the above conditions, transferring Landlord shall remain liable for the performance of Landlord's covenants and agreements herein for the remainder of the Lease Term.

C. [3.117] Comment

1. See Chapter 6 of this handbook for a discussion of questions arising from assignment and subletting.

2. Absent any provision in the lease to the contrary, after a sale of the property by the landlord or a lease of the building or land and building by the landlord to another party, the landlord may remain liable on certain contractual provisions in the lease (such as a security deposit), although it is no longer liable with respect to those covenants that, by law, are incident to the status of landlord and thereby become the responsibility of the new landlord. *McDonald's Corp. v. Blotnik,* 28 Ill.App.3d 732, 328 N.E.2d 897, 900 (3d Dist. 1975); David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321, 338. With this in mind, the landlord's version expressly provides that in any case the landlord is relieved of all liability under the lease after a sale or lease of the entire building. Similarly, the tenant's version, which is rarely seen in practice, provides that the landlord remains liable on all of its covenants under the lease unless certain stated conditions are met that will serve to demonstrate that the new landlord is at least as financially reliable as the former landlord and thus equally able to fulfill the landlord's obligations under the lease.

3. 735 ILCS 5/9-215 gives the landlord's successor the same remedies its predecessor had for breach by the tenant of any provision of the lease, for the recovery of rent, and in the event of waste by the tenant. The assigns of a tenant have a similar statutory right to the same remedies the original tenant would have against the landlord and its grantees or assigns for any breach of covenants running with the land. 735 ILCS 5/9-216.

4. The language of the provision will have to be modified depending on the nature of the landlord and the tenant (*e.g.,* if the landlord or the tenant is a partnership, corporation, etc.).

XXXIII. OPTION TO EXTEND LEASE

A. [3.118] Landlord's Version — Sample Language

1. Tenant shall have the right, to be exercised as provided below, to extend the Term of this Lease for _____ additional consecutive periods of _____ years each, upon satisfaction of the following terms and conditions:

a. that, at the time of the exercise of such right and at the time the extension Term begins, Tenant shall not be in default in the performance of any of the terms, covenants, and conditions contained in this Lease;

b. that this Lease shall not have been terminated during the initial Term or any additional extension of the Term and shall be in full force and effect at the date of such exercise of the right to renew and at the date the renewal Term begins;

c. that such extension shall not be effective as to any portions of the Premises that are subleased at any time between the date of exercise of such right and the date the extension Term begins; and

d. that such extension shall be on the same terms, covenants, and conditions contained in this Lease except that the Base Rent for each extension Term shall be the greater of (i) the Base Rent for the Lease Term just ended, or (ii) the then-current fair market Base Rental for the Premises, as determined by Landlord in its reasonable business judgment, that Landlord could obtain in an arm's-length transaction with a willing and informed tenant for a term equal to the extension period.

2. Tenant shall exercise its rights of extension for each extension of the Term granted hereby only in the following manner: at any time after the commencement of this Lease, but not later than _____ months prior to the end of the then-current Term, Tenant shall notify Landlord in writing of its election to exercise the right to extend the Term of this Lease for one or more additional periods, pursuant to any rights granted by this Lease. This notice of election shall be given in the manner provided in this Lease for the giving of notices to Landlord.

3. At the request of Landlord, Tenant shall, prior to the beginning of any extension Term, execute a written memorandum confirming the Base Rent for the extension Term.

4. When reference is made in this Lease to the Term of the Lease or to the Term of the demise under this Lease, the reference shall include any and all extensions of the Term resulting from the exercise of one or more of the options conferred under this Lease, unless the context requires otherwise.

B. [3.119] Tenant's Version — Sample Language

1. Tenant (including any assignee pursuant to an assignment in accordance with the terms of this Lease) shall have the right, to be exercised as provided below, to extend the Term of this Lease for _____ additional consecutive periods of _____ years each upon satisfaction of the following terms and conditions:

a. that such extension of the Term shall be on the same terms, covenants, and conditions contained in this Lease; and

b. that this Lease shall not have been terminated during the initial Term or any extension of the Term and shall be in full force and effect at the date of such exercise of the right to renew.

2. Tenant shall exercise its right of extension for each extension of the Term in the following manner: at any time after the commencement of this Lease but at least _____ days prior to the expiration of the then-current Term, Tenant shall notify Landlord in writing of its election to exercise the right to extend the Term of this Lease for one or more consecutive additional periods. This notice of election shall be given in the manner provided in this Lease for the giving of notices to Landlord.

3. When reference is made in this Lease to the Term of the Lease or the Term of the demise under this Lease, the reference shall include any and all extensions of the Term resulting from the exercise of any one or more of the options conferred on Tenant under this Lease unless the context otherwise requires.

C. [3.120] Comment

1. Any option to renew should specify those terms and conditions of the lease that, during the extension term, will differ from the terms and conditions of the lease during the original term. Absent such a provision, the terms and conditions of the original lease, including rent to be paid, will govern the extension term. Under Illinois law, a general option to renew the lease term is construed to mean that other than the right to renew the lease again, the renewal will be on the same terms and on the same rent as the original lease term. *Schumacher v. Fatten,* 18 Ill.App.2d 387, 152 N.E.2d 402 (2d Dist. 1958).

The landlord should be certain that the terms of the renewal option are clear. Illinois courts have held that in the case of any ambiguity in the terms of renewal options, the tenant is favored because the landlord, "having the power of stipulating in his own favor, has neglected to do so." *Launtz v. Kinloch Telephone Co.,* 239 Ill.App. 204, 209 (4th Dist. 1925). In light of the basic rule of construction that the lease is construed against the party that drafted the lease, this rule may well be subject to change if the tenant has drafted the lease. See §3.114 above.

2. Note that in the landlord's version the tenant is not entitled to extend its lease term if the tenant is in default either on the date the option is exercised or on the date the renewal term begins. This avoids the problem created if the tenant is not in default when the option is exercised but is in

default when the extension term is to begin — the landlord is excused from allowing a defaulting tenant to begin an extension term. Such a right forces a tenant to cure any defaults at both critical times in order to preserve its right to extend the lease term. Similarly, the extension is not effective as to sublet space. The theory is that the renewal right relates to the original tenant's use of the space and is not a device to permit the tenant to continue to make a profit on the space if it is not really needed.

3. Note also that the landlord's version provides for a rent increase if the then-current market rate for the space exceeds the rate stated in the lease. A tenant will want to expand on this concept to ensure that consideration is given to the fact that the landlord will not be paying for tenant improvements or offering rent concessions and that the size of the premises and length of the lease extension term are taken into account. Some tenants will seek to have the fair market rental determined by a more objective party than the landlord, such as a panel of three appraisers. The possibility of a lengthy and unpredictable appraisal process usually induces the landlord and tenant to negotiate more sincerely to reach agreement on the renewal rate. In any event, landlords have become much more reluctant to agree to fixed-rate renewals, even those based on consumer price index increases. If any provision other than a specific renewal rate is used, it is desirable to have the parties execute a memorandum confirming the base rent during the extension term to avoid disputes later and to assist the parties in demonstrating the rent payable to any third party (*e.g.,* a buyer of the building, a mortgage lender, or an assignee of the tenant's rights under the lease). However, such a memorandum should be explicitly limited to stating the rent so that it will not be construed as superseding the lease. *See Dangeles v. Marcus,* 57 Ill.App.3d 662, 373 N.E.2d 645, 15 Ill.Dec. 299 (1st Dist. 1978).

4. From a landlord's point of view, the right to extend the lease term should be exercised on or before a date that gives the landlord sufficient time to relet the premises if the tenant decides not to extend. Unfortunately, a tenant may be able to exercise its renewal right even after the stated date if "special circumstances rising to the level of undue hardship to lessee are established." *Ceres Terminals, Inc. v. Chicago City Bank & Trust Co.,* 117 Ill.App.3d 399, 453 N.E.2d 735, 739, 72 Ill.Dec. 860 (1st Dist. 1983). In *Ceres,* late exercise of a renewal option by the tenant was not permitted since the court held that the tenant's expenses incurred in reliance on the renewal did not benefit the landlord and were not required under the lease.

XXXIV. ADDITIONAL SPACE

A. [3.121] Version Suitable for Both Landlord and Tenant — Sample Language

1. Landlord grants Tenant the option (Expansion Option) to lease Suite _____, adjoining the Premises as shown on Exhibit _____ attached hereto (Expansion Space) and containing approximately _____ rentable square feet of space commencing on a date (Expansion Date) during the period from the _____ to the _____ anniversaries of the Commencement Date (Expansion Window), as specified by Landlord in a written notice to Tenant given not later than _____ months prior to the first day of the Expansion Window. If Tenant desires to exercise the Expansion Option, it shall notify Landlord of that intention on or before the date _____ months prior to the first day of the Expansion Window (Exercise Date).

2. Tenant's right to exercise the Expansion Option is subject to the following conditions, each of which may be waived by Landlord in its sole discretion:

a. Tenant shall not have subleased any portion of the Premises or assigned this Lease to a party other than an affiliate of Tenant at the time the Expansion Option is exercised or on the Expansion Date.

b. Tenant shall not be in default beyond any applicable cure period under any of its obligations under this Lease at the time the Expansion Option is exercised or on the Expansion Date.

c. Neither this Lease nor Tenant's possession of the Premises has been terminated at the time the Expansion Option is exercised or on the Expansion Date.

3. The Expansion Space shall be leased in its "then-existing" condition (it being expressly understood by Tenant that Landlord shall not be required to perform any of the initial work that was performed by Landlord to prepare the original Premises for occupancy) and otherwise on the terms, conditions, and provisions of this Lease, except as follows:

a. The rentable area of the Premises shall be increased by the aggregate number of rentable square feet of the Expansion Space.

b. Tenant's Proportionate Share shall increase by an amount equal to the percentage derived by dividing the aggregate number of rentable square feet of the Expansion Space by the rentable area of the Building.

c. The annual Base Rent due under this Lease shall be increased by an amount equal to the product of (i) the rentable square feet of the Expansion Space, and [(ii) the rent per square foot of the Premises applicable from time to time under this Lease**] [**(ii) the then-current market rental rate per square foot for similar space in the Building as established by Landlord**].**

d. Tenant shall commence paying Rent for the Expansion Space on the Expansion Date.

4. If Tenant exercises the Expansion Option and the Base Rent is at the same per-square-foot rate payable with respect to the balance of the Premises, Landlord shall provide Tenant an allowance for improvements to the Expansion Space equal to (a) the number of rentable square feet of the Expansion Space multiplied by (b) the tenant improvement allowance per rentable square foot of the original Premises multiplied by (c) a fraction, the numerator of which is the number of full months from the Expansion Date to the Termination Date and the denominator of which is the number of full months from the Commencement Date to the Termination Date. Such allowance shall be payable on the same terms and conditions as provided in the work letter.

5. If Tenant exercises the Expansion Option, Landlord and Tenant shall execute a written supplement to this Lease confirming the terms, provisions, and conditions of this Lease applicable to the Expansion Space, provided that the execution of a written supplement to this Lease shall not be a precondition to the effectiveness of Tenant's election to lease the Expansion Space.

6. Tenant shall have no right or interest in any of the Expansion Space to the extent that Tenant fails to exercise the Expansion Option on or before the applicable Exercise Date, and, after such date, Tenant shall be deemed to have waived all of its rights under the Expansion Option and, thereafter, the Expansion Option shall be null and void and of no further effect.

7. If at any time during the Term of this Lease any space becomes available for leasing on the floor containing the Premises due to expiration or termination of an existing lease or tenancy (provided that Landlord may, without offering such space to Tenant, renew or extend any expiring lease with any occupant of such space), and if at such time all of the conditions in Paragraph 2 above shall be satisfied, Landlord shall not lease such space to a third party without first giving Tenant (a) notice of the availability of such space, which shall include a description thereof and Landlord's good-faith determination of the then-current market rate therefore; and (b) _____ days after the date of such notice in which to elect by written notice to Landlord to lease such space. If Tenant fails to elect to lease such space within such _____-day period, Landlord shall have the right to lease the space to any third party or parties on such terms as are acceptable to Landlord, subject to Tenant's Expansion Option, if applicable.

8. Landlord's determination of "current market rate" shall be equal to the prevailing market rate, including the prevailing market escalations for the portion of the Term thereafter and reflecting customary rental concessions, abatements, and tenant improvement allowances for similar space in the Building as of the first day that the Premises shall include the Expansion Space.

B. [3.122] Comment

1. The goal of this lease provision is to accommodate the tenant's desire to have room for future growth of its business. By giving the tenant an option or more limited right to lease additional space, the landlord guarantees that the tenant will be able to efficiently use its initial premises for the full lease term since most tenants do not want to operate from multiple locations if it is at all possible to avoid this result. The tenant would like to have a specific commitment from the landlord to deliver specified space (ideally contiguous to the existing space) on specific dates as requested by the tenant. Most expansion options give the tenant such fixed rights for a specified range of square footage. The sample provision includes such a specific expansion space. The numbers of days, months, or years contained in the provision can, of course, be modified by the parties to reflect the terms of their specific agreement.

Often the landlord will seek to obtain more flexibility by simply stating that a certain square footage will be made available at a location to be designated by the landlord in the future. This can be done once the landlord knows what the other leases in that area will permit. The guiding light

for a landlord in negotiating these provisions is flexibility. Each right and option that a tenant has increases the chance that the landlord may suffer economically, either by having to lease space for a shorter term at a discount, due to the tenant's future rights, or by simply being unable to lease the space at all. One way to protect the landlord is to allow delivery of the space within a "window" as shown in the sample provision. This permits the landlord to lease the expansion space for a commercially acceptable term (usually at least five years) and does not require the landlord to lease the space for an odd number of months. Most expansion spaces are available at roughly two- or three-year intervals, and expansion windows are typically six – twelve months.

2. The right of first offer contained in paragraph 7 of the sample provision is sometimes used as an alternative to a fixed-expansion right. The right of first offer has the advantage of presenting the tenant with a larger number of opportunities to lease space during its lease term. However, the tenant must be ready and able to make a quick decision and is not guaranteed of having any space offered to it at all if the area in question is leased on a long-term basis. A tenant may also find, if it waives its first-offer rights on certain space early in its lease term, that it is unable to expand later because the landlord has tied up the previously offered space for a long term.

Landlords like the first-offer provision better than a fixed-expansion right because a quick decision is available and there are no restrictions on the space once the tenant has waived its right. Landlords have also used the first-offer rather than first-refusal approach to make sure that they do not go to the effort of obtaining another tenant and fully negotiating the lease terms only to have the original tenant take the deal away at the last minute for its expansion needs. By going to the tenant with the expansion right before going to the market, the landlord determines whether the tenant has a need for the space. This is obviously consistent with the landlord's desire to accommodate its existing tenants as well.

The major source of dispute in negotiating a right-of-first-offer provision is the tenant's concern that the landlord will not offer the tenant a "fair" rate. Since an existing tenant looking to expand is in many respects a captive audience for the landlord, it has not been unusual for tenants seeking additional space to pay more than outside tenants leasing their initial space in the building. To protect the tenant against this problem, right-of-first-offer clauses may require that the space be offered to the tenant at the "fair market rate" for that space. Alternatively, and more commonly, the first-offer provision will protect the tenant by requiring the landlord to reoffer the space to the tenant if the landlord, after offering the space to the tenant and having the tenant reject it, proposes to lease the space at a significantly lower rental rate to another party. In these situations a negotiated first-offer right will require the landlord to reoffer the space to the original tenant at the lower rental rate before it can proceed with the other leasing prospect.

3. The exercise of an expansion right or first-offer right will often be subject to special conditions like those shown in the sample provision. A tenant that is in default is not a good candidate to lease additional space. (At times, these provisions deny the tenant its option right or right of first offer if an event has occurred that, with the passage of time, will ripen into an event of default if not cured by the tenant. This approach means, however, that the tenant can lose valuable rights even though the cure period has not expired.) Similarly, a tenant that has sublet a portion of its premises should arguably not have the right to expand its premises if it is not even using the space that it initially bargained for. Sometimes a tenant takes the position that expansion

rights and first-offer rights are valuable items that make the lease more marketable if the tenant is forced to assign or sublet all of its space. Usually, the landlord naturally disagrees, and many leases will deem these rights to be "personal" to the original tenant and prohibit subtenants or assignees from exercising them. Dispute over this provision is heightened by the landlord's natural desire to remove any encumbrances from its leasing of other space in the building at the best possible rate.

4. A well-drafted expansion clause must address not only the rental rate at which space will be added to the premises but also the availability of any tenant improvements or allowances. One approach when a relatively small expansion space is being provided is to have the expansion space subject to the same rental rates that apply to the original premises with a tenant improvement allowance of a percentage of the original allowances equal to the percentage of the lease term remaining when the expansion is effective. The sample provision takes this approach. In most larger leases, expansion rights are at fair market rates. In defining the fair market rate, it is important for a tenant to make sure that the market rate is an "effective" rent, *i.e.,* a rent that reflects the net value to the landlord after deducting any rent abatement periods or tenant improvement allowances that are then being offered by the landlord to other tenants. In some situations, the tenant may be able to negotiate for third-party determination of the fair market rate through arbitration. Alternatively, the landlord can demonstrate what leases have been entered into at the building on or about the time of the expansion to confirm that the landlord's offer is consistent with the then-current market conditions.

XXXV. GENERAL PROVISIONS

A. [3.123] Version Suitable for Both Landlord and Tenant — Sample Language

1. Nothing contained in this Lease shall be deemed or construed by the parties to this Lease, or by any third party, to create the relationship of principal and agent, partnership, joint venture, or any association between Landlord and Tenant, it being expressly understood and agreed that neither the method of computation of Rent nor any other provisions contained in this Lease nor any acts of the parties to this Lease shall be deemed to create any relationship between Landlord and Tenant other than the relationship of landlord and tenant.

2. The various rights and remedies contained in this Lease are reserved to each of the parties and shall not be considered as exclusive of any other right or remedy of such party, but shall be construed as cumulative and shall be in addition to every other remedy now or in the future existing at law, in equity, or by statute. No delay or omission of the right to exercise any power by either party shall impair that right or power, nor shall any delay or omission be construed as a waiver of any default or as acquiescence therein. One or more waivers of any covenant, agreement, term, or condition of this Lease by either party shall not be construed by the other party as a waiver of a subsequent breach of the same covenant, agreement, term, or condition. The consent or approval by either party to or of any act by the other party of a nature requiring consent or approval shall not be deemed to waive, or render unnecessary, consent to or approval of any subsequent act.

3. The invalidity or unenforceability of any provision of this Lease shall not affect or impair any other provision.

4. The laws of the State of Illinois shall govern the validity, performance, and enforcement of this Lease.

5. The headings contained in this Lease are for convenience only and shall not be used to define, explain, modify, or aid in the interpretation or construction of the contents.

6. The words "Landlord" and "Tenant," when used in this Lease, shall be construed to mean "Landlords" or "Tenants" in all cases in which there is more than one landlord or tenant, and the necessary grammatical changes required to make the provisions of this Lease apply either to corporations or to individuals, men or women, shall in all cases be assumed as though in each case fully expressed.

B. [3.124] Comment

These provisions, which benefit both parties, are the type of boilerplate provisions normally found in office leases. Their effect is to express what is obviously intended by the parties and to negate any inferences to the contrary. As with any of the other sample provisions, these boilerplate provisions must be studied carefully with respect to any particular lease so that the drafter can determine whether they apply (*e.g.,* whether the parties intend Illinois law to govern).

XXXVI. SPECIAL LANDLORD'S PROVISIONS — NO GUARANTY OF TENANT'S LIGHT AND AIR; LANDLORD'S USE OF SPACE IN BUILDING; LIMITATION ON LANDLORD'S LIABILITY; RELOCATION OF TENANTS; TERMINATION OF LEASE BY LANDLORD WITHOUT CAUSE

A. [3.125] Sample Provisions

1. This lease does not grant any rights to light or air except over public streets kept open by public authority.

2. It is understood that Landlord or Landlord's agents may occupy portions of the Building in the conduct of Landlord's business. All references in this Lease to other tenants of the Building (including all references in the Additional Rent provisions of this Lease) shall be deemed to include Landlord.

3. Landlord's liability under this Lease shall be limited to its interest in the Building, and Tenant hereby waives its rights to recover against any other assets of Landlord, its partners, or its shareholders.

4. Landlord may, upon _____ days' written notice, relocate Tenant to another space in the Building if Landlord deems such relocation to be necessary, provided that (a) unless notice

of such relocation shall be given by Landlord to Tenant at least _____ days prior to the commencement of the Lease Term or prior to the date Tenant shall have commenced leasehold improvement work in the Premises, whichever date shall first occur, Landlord shall pay for the direct costs of such relocation, including moving expenses and costs and expenses of improving the new space to be substantially similar to the original Premises; and (b) such relocation will not substantially change the size or character of the Premises.

5. Landlord may terminate this Lease on the _____ day of [month**] in any year (a) if Landlord proposes or is required, for any reason, to remodel, remove, or demolish the Building or any substantial portion of it; (b) if Landlord decides to sell the Building and the Land under it; (c) if — Landlord being a corporation — Landlord's stockholders decide to sell _____ percent or more of Landlord's capital stock; (d) if — Landlord being a ground lessee — Landlord decides to convey the prime leasehold; or (e) if Landlord decides to make an underlying or ground lease of the Land under the Building and the Building or a lease to one tenant for a term of _____ years or more of either all the Building or all the Building except the ground floor. Such termination shall become effective and conclusive by Landlord's notice to Tenant not less than _____ days prior to the _____ day of [**month**] fixed in the notice. No money or other consideration shall be payable by Landlord to Tenant for this right. The right reserved by Landlord shall inure to all purchasers, assignees, lessees, transferees, and ground or underlying lessees, as the case may be, and is in addition to all other rights of Landlord.**

B. [3.126] Comment

The sample provisions in §3.125 above are included so that a drafter representing a landlord may consider them for inclusion in any lease being prepared, should the situation warrant. In connection with these sample provisions, the following should be noted:

1. Paragraph 2 of the sample provision makes the landlord or the landlord's agent, when occupying portions of the building, a tenant within the meaning of the lease. By doing this, the duties of the tenant to the other tenants in the building inure to the landlord or the landlord's agent to the extent the landlord or its agent also occupies part of the building. In addition, this provision ensures that, when calculating additional rent, the operating expenses incurred in connection with space occupied by the landlord or the landlord's agent will be included in calculating the tenant's share of additional rent. This will avoid the windfall to the tenant that would occur if the landlord or the landlord's agent occupied any substantial portion of the building and the amount spent in maintaining that portion of the building were not included in the calculation of additional rent.

2. Paragraph 3 of the sample provision covers the landlord's limited liability. This clause is almost universally found, and accepted, in office lease forms. By limiting its risk to the equity in a single building, the landlord parallels its nonrecourse financing and protects the balance of its assets in the event of a major problem at one building. This clause becomes problematic when real estate values decline and an existing landlord loses all or most of its equity in a building. In these circumstances, the tenant must seek other assurances, including rent offsets for landlord defaults and strong non-disturbance agreements, to preserve the benefits of the lease.

3. Paragraph 4 of the sample provision gives the landlord the right to relocate the tenant to new, but equivalent, premises. Such a provision is valuable to the landlord since it allows the landlord the flexibility to move one tenant to other equivalent space, freeing the first space, which may be necessary to assemble a large space for a second tenant. A tenant may object to this kind of provision, however, if the specific premises leased were important in the tenant's decision to locate in the building in question. At a minimum, if a landlord chooses to relocate a tenant, the tenant should have the right to insist that it obtain the benefit of more favorable rent for the relocated premises if the relocated premises are located in a portion of the building that commands less rent than the original premises (*e.g.,* a lower floor or space with less desirable views). A tenant can also request the payment of a fee, wholly apart from the out-of-pocket costs incurred in connection with the move, as partial compensation for the downtime resulting from moving its operations.

4. Paragraph 5 of the sample provision allows the landlord to terminate the lease without cause and without payment to the tenant if any of the triggering events set forth occur. (Note that the occurrence of each of these triggering events is within the landlord's control.) While this provision allows the landlord to arbitrarily deprive the tenant of its bargain, Illinois courts have generally upheld the validity of a lease that gives either party the unilateral right to terminate the lease prior to the end of the stated term. *Cox v. Grant,* 57 Ill.App.3d 922, 373 N.E.2d 820, 15 Ill.Dec. 474 (5th Dist. 1978). If there is a disparity in bargaining power between the landlord and the tenant, the enforcement of this provision may not be assured. *See, e.g., Sweney Gasoline & Oil Co. v. Toledo, Peoria & Western R.R.,* 42 Ill.2d 265, 247 N.E.2d 603, 605 (1969).

XXXVII. SPECIAL TENANT'S PROVISIONS — COMPLIANCE WITH GOVERNMENTAL REGULATIONS; ZONING AND OTHER ORDINANCES; LIABILITY

A. [3.127] Landlord's Version — Sample Language

Tenant shall comply with all applicable governmental laws, ordinances, codes, rules, and regulations and applicable orders and directions of public officers thereunder, with all applicable Board of Fire Underwriters regulations and other requirements, and with all notices from any mortgagee or ground lessor respecting all matters of occupancy, condition, or maintenance of the Premises, whether any of the foregoing shall be directed to Tenant or Landlord. Tenant shall not make or permit any use of the Premises or the Building, or do or permit to be done anything in or on the Premises or the Building, or bring or keep anything in the Premises or the Building, that directly or indirectly is forbidden by any of the foregoing or that may be dangerous to persons or property, or that may invalidate or increase the rate of insurance on the Building or its appurtenances, contents, or operations or that may cause a default by Landlord under any mortgage or ground lease. Tenant shall procure and maintain all licenses and permits legally necessary for the operation of Tenant's business and allow Landlord to inspect them upon reasonable prior request.

B. [3.128] Tenant's Version — Sample Language

1. Landlord by this Lease agrees that if any federal, state, or municipal government, or any department or division thereof, shall condemn the Building, the Premises, or any part thereof as unsafe or as not in conformity with the laws and regulations relating to the use and occupancy thereof or shall order and require any rebuilding, alteration, or repair thereof, Landlord shall immediately, at its own cost and expense, rebuild or make any alterations or repairs as may be necessary to comply with such laws, regulations, orders, or requirements. If Tenant is deprived of the use of the Premises by reason of any condemnation or order as specified, (a) the Base Rent and Additional Rent provided for in this Lease shall abate during the period of such deprivation, on a per diem basis; and (b) Tenant may cancel and terminate this Lease while Tenant is so deprived of the use of the Premises, thereby being released from all of the terms and conditions contained in this Lease, as of the date notice of the exercise of such option is given to Landlord.

2. Landlord represents and warrants that the zoning laws and the building ordinances and other governmental rules and regulations affecting the Building permit the construction of the Building and the Premises and the use of the Premises contemplated by the parties. In the event that the zoning or other governmental rules and regulations concerning the Building should be interpreted, altered, or changed in any manner by any governing authority having jurisdiction over the Building that will interfere with, or prohibit, either in whole or in part, the use of the Premises as stated in this Lease, (a) the Base Rent and Additional Rent set forth in this Lease shall abate until the zoning or other rules and regulations are consistent with the purposes of this Lease; and (b) Tenant may cancel and terminate this Lease while such use is interfered with or prohibited, thereby being released from all of the terms and conditions contained in this Lease, as of the date notice of the exercise of such option is given to Landlord.

3. Landlord acknowledges and agrees that Tenant's liability under this Lease shall be limited to Tenant's partnership assets and that none of the present or future partners in Tenant shall have any personal liability for the obligations of Tenant under this Lease.

C. [3.129] Comment

1. The sample provisions in §§3.127 and 3.128 above are included so that a drafter representing a landlord or tenant may consider them for inclusion in the lease. These provisions allocate to the landlord or the tenant the cost of complying with existing and, more importantly, future laws. The most notable of these laws are laws regarding asbestos removal or abatement and providing access to the physically challenged. The tenant's version also deals particularly with the special situation in which an appropriate governmental authority requires the landlord to make repairs to the building or premises or when the contemplated use of the premises is prevented or interfered with because of any change in or interpretation of any zoning laws, building ordinances, or other rules or regulations. While a tenant can take the position that the covenant of quiet enjoyment given by the landlord covers these situations, the tenant's position is strengthened by spelling out the rights and remedies in these particular cases.

If asbestos removal or abatement is likely to be required as a result of improvements to the premises or the building, the allocation of costs between the landlord and the tenant should be addressed specifically.

Allocation of the cost of compliance with the requirements of Title III of the Americans with Disabilities Act of 1990 (ADA), Pub.L. No. 101-336, 104 Stat. 328, codified at 42 U.S.C. §12101, *et seq.,* and its accompanying regulations, 28 C.F.R. pt. 36, also deserves special attention — especially if modifications to the premises or the building are likely to be required (and, in some circumstances, even if no modifications are planned). The law divides office facilities into "public accommodations" and "commercial facilities." A "public accommodation" is generally defined as a facility operated by a "private entity" whose operations affect commerce and whose operations fall into 1 of 12 specified categories. 42 U.S.C. §12181(7). The private entity, in the context of an office building, can be either the landlord or the tenant. Included within the 12 categories, and particularly relevant to mixed-use retail and commercial office buildings whose operations affect commerce, are the following:

a. an auditorium, convention center, lecture hall, or other place of public gathering;

b. a bakery, grocery store, clothing store, hardware store, shopping center, or other sales or rental establishment;

c. a laundromat, dry cleaner, bank, barbershop, beauty shop, travel service, shoe repair service, office of an accountant or lawyer, pharmacy, insurance office, professional office of a healthcare provider, or other service establishment;

d. a museum, library, gallery, or other place of public display or collection;

e. a day-care center, senior citizen center, or other social service center; and

f. a gymnasium, health spa, or other place of exercise or recreation. *Id.*

Some or all of these categories may well be included in a modern office building that includes offices, retail facilities, and other facilities for the benefit of building tenants and outsiders. All other portions of the office building probably fall within the ADA's definition of a "commercial facility." See 42 U.S.C. §12181(2).

With regard to public accommodations, §302 of the ADA prohibits, as a general rule, discrimination on the basis of disability "in the full and equal enjoyment of the goods, services, facilities, privileges, advantages, or accommodations of any place of public accommodation by any person who owns, leases (or leases to), or operates a place of public accommodation." 42 U.S.C. §12182(a). Among the obligations imposed on public accommodations, and particularly applicable to an office building, is the requirement to remove architectural barriers and structural communication barriers from existing facilities when such removal is "readily achievable." 42 U.S.C. §12182(b). "Readily achievable" is defined in §301(9) of the ADA to mean "easily accomplishable and able to be carried out without much difficulty or expense." 42 U.S.C. §12181(9). This definition is broad, however, and will depend on the circumstances of the particular

case. Section 301(9) provides four factors to be considered in deciding whether an action is readily achievable:

a. the nature and cost of the action;

b. the overall financial resources of the facility or facilities involved; the number of persons employed at such facility or facilities; and the effect on expenses, resources, and operation of the facility or facilities;

c. the overall financial resources of the public accommodation; the overall size of its business with respect to the number of its employees; and the number, type, and business of its facilities; and

d. the type of operation or operations of the public accommodation (including the composition, structure, and functions of its workforce) and the separateness and administrative or fiscal relationship of the facility or facilities to the public accommodation. *Id.*

These factors, like the definition, are flexible, allowing for application on a case-by-case basis.

The regulations issued in connection with Title III of the ADA offer some examples of steps that can be taken to remove barriers. These steps include installing ramps, making curb cuts in sidewalks and entrances, repositioning shelves, widening doorways, and designating accessible parking spaces. 28 C.F.R. §36.304(b).

Recognizing that public accommodations may have limited resources, the regulations set priorities that should be used in determining what barriers to remove. These priorities are the following:

a. access to the place of public accommodation from public sidewalks, parking, or public transportation;

b. access to the areas within the place of public accommodation where goods and services are made available to the public;

c. access to restrooms; and

d. any other measures necessary to provide access to the goods or services of the place of public accommodation. 28 C.F.R. §36.304(c).

The obligation to achieve barrier removals is a continuing obligation. What might not be readily achievable today may be readily achievable tomorrow.

Section 303 of the ADA requires operators of both public accommodations and commercial facilities to design and construct facilities that are readily accessible to and usable by individuals with disabilities in the context of new construction or alterations of existing space. The law does

not require changes if the changes would be "structurally impracticable." 42 U.S.C. §12183. The regulations provide, however, that full compliance is considered structurally impracticable "only in those rare circumstances when the unique characteristics of terrain prevent the incorporation of accessibility features." 28 C.F.R. §36.401(c). The design criteria include accessibility for individuals with wheelchairs to altered restrooms, telephones, drinking fountains, and many other items. Reference must be made to the specific regulations issued in connection with the ADA as to the design criteria applicable to a specific public accommodation or commercial facility.

The ADA regulations leave the allocation of responsibility for compliance with the ADA to the landlord and the tenant — providing that "[a]s between the parties, allocation of responsibility for complying with the obligations [imposed by Title III] may be determined by lease or other contract." 28 C.F.R. §36.201(b). This clause reflects the desire of the Department of Justice (which authored the regulations) to leave untouched existing landlord-tenant responsibilities already set forth in leases.

A landlord whose building might not fall within the requirements of the ADA but for the tenant's particular use of the premises would argue that it is more equitable for the tenant to bear all or a portion of the cost of remodeling for compliance. On the other hand, a tenant in a multi-tenant office building would typically not expect to bear the cost of any capital improvements to the building's entryways, lobbies, or restrooms that might be necessitated by the ADA. Accordingly, a tenant might consider a provision in its lease similar to the following:

Landlord represents and warrants that the Building and the Premises are in full compliance with all laws, including without limitation the Americans with Disabilities Act. In the event any future law generally applicable to the Premises and similar leased premises requires structural or capital improvements to be made to the Premises, the cost of said improvements shall be borne by Landlord. Tenant shall be responsible for the costs of complying with any future law only if the law is applicable to the Premises solely because of Tenant's specific use thereof.

This compromise is consistent with comments of the Department of Justice made in connection with the ADA regulations. The Department suggests that the landlord may be assigned responsibility for making readily achievable changes in common areas and modifying policies, practices, or procedures applicable to all tenants. The tenant, on the other hand, may be allocated the same responsibilities as the landlord only in its own place of public accommodation and during alterations or construction of the premises.

2. In the tenant-oriented office lease market of the first part of the 1990s, tenants with market power demanded, and often were accorded, provisions that limited the tenant's liability under a lease. An example is included as paragraph 3 of the sample provisions in §3.128 above. This type of limitation is especially important to tenants that are partnerships since, absent this protection, each of the general partners of the partnership will be jointly and severally liable for the tenant's obligations under the lease. Many landlords take the position that while they are willing to grant limited liability protection to tenants, this limited liability should not extend to the obligation to pay the landlord damages at least equal to the unamortized value of the leasehold improvements and other out-of-pocket expenses incurred by the landlord in order to place the tenant in possession

(*e.g.,* free rent periods and brokers' commissions). Often a letter of credit or other security deposit (as described in §§3.21 – 3.23 above) will be used to secure these basic tenant obligations.

3. These provisions will have to be tailored to the particular lease in question. For instance, if the tenant has undertaken to maintain the premises in accordance with applicable laws, the tenant cannot look to the landlord to make the premises comply with applicable building codes. *See, e.g., Hollywood Bldg. Corp. v. Greenview Amusement Co.,* 315 Ill.App. 658, 43 N.E.2d 566 (1st Dist. 1942), in which the court held that the tenant's agreement to make changes, structural or otherwise, in the premises in compliance with police regulations required the tenant to make alterations to a theater marquee required by city law because of a widening of the street abutting the demised premises.

4. Another recent phenomenon in office leases is the widespread development of tenant form leases by national companies with many branch offices. These forms contain many specialized provisions, some relating to the technical needs of the tenant, and some, such as the right to perform the landlord's defaulted obligations and offset the costs against rent, reacting to the frustration of dealing with cash-poor and uncaring landlords. Most landlords will respond to these concerns but must avoid the more severe clauses, such as liberal termination rights and blanket self-help rent offsets, that may impair the value of the lease and the building in the eyes of a lender or purchaser.

XXXVIII. SPECIAL LEASING AGENT'S PROVISION

A. [3.130] Sample Provision

In the absence of fraud, no person, firm, or corporation executing this Lease as agent, as trustee, or in any other representative capacity or the heirs, administrators, executors, legal representatives, successors, or assigns or any such person, firm, or corporation shall ever be deemed or held individually liable under this Lease for any reason or cause.

B. [3.131] Comment

1. This provision protects a leasing agent or any other person who signs a lease on behalf of a landlord from personal liability arising from any of the landlord's obligations under the lease, except in the case of fraud by the signatory agent or representative.

This provision can be omitted if the landlord personally signs the lease. In addition, the same legal effect can probably be achieved if the agent or representative signing the lease on behalf of the landlord expressly puts the tenant on notice of the representative capacity of the signatory, such as by using the following form of signature:

XYZ CORPORATION, Landlord,

By ABC CORPORATION, its
duly authorized agent
and not as a principal

By _____
Its [position of signer**]**

2. The use of a provision similar to the sample provision presupposes a duly executed agency agreement between the signatory and the landlord. A tenant accepting a lease by the landlord's agent should require evidence of the grant of agency power to the signatory in order to ensure that the agent's execution of the lease binds the landlord as owner of the building. This evidence can be in the form of a copy of the agency agreement or a statement from the landlord confirming the signatory's agency powers.

3. A land trustee executing a lease as landlord or as tenant will require the lease to contain specific exculpatory language limiting the liability of the trustee as landlord or tenant to the assets of the trust. In the case of a land trustee-landlord, these assets will be at least the landlord's interest in the building and perhaps also its interest in the underlying land. In the case of a land trustee-tenant, the asset will be at least the tenant's rights in the leased premises. Some land trustees, when executing a lease as tenant, if the sole asset of the trust is the leasehold interest created by the lease, require a special amendment to the land trust agreement to reflect this fact.

XXXIX. SPECIAL ENVIRONMENTAL PROVISIONS

A. Landlord's Version — Sample Language

1. [3.132] Body of Lease

Tenant shall not, without the prior written consent of Landlord, cause or permit any Hazardous Substances (defined below) to be brought or remain on, kept, used, discharged, leaked, or emitted in or about, or treated at, the Premises or the Building. As used in this Lease, "Hazardous Substances" means any hazardous, etiological, toxic, or radioactive substance, material, matter, or waste that is or becomes during the Lease Term regulated by any applicable federal, state, or local law, ordinance, order, rule, regulation, or code, or any governmental restriction or requirement, and shall include but not be limited to asbestos, petroleum products, polychlorinated biphenyls, and substances or materials included in the terms "Hazardous Substance" and "Hazardous Waste" as defined in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, 42 U.S.C. §9601, *et seq.,* and the Resource Conservation and Recovery Act of 1976, as amended, 42 U.S.C. §6901, *et seq.* "Hazardous Substances" shall not include substances that are used or consumed in the ordinary course of a business similar to Tenant's as permitted pursuant to this Lease (*e.g.,* copier toner and cleaning supplies), provided, however, that such substances are used, handled, transported, stored, discharged, disposed of, or emitted in compliance with all applicable federal, state, or local laws, rules, regulations, codes, or ordinances, or any other governmental restrictions or requirements. If such substances are not so used, handled, transported, stored, discharged, disposed of, or emitted, then they shall be deemed "Hazardous Substances" for purposes of this Lease. Notwithstanding such consent, Landlord may revoke its consent upon (1) Tenant's failure to remain in full compliance with applicable environmental permits and any other requirements under any federal, state, or local law,

ordinance, order, rule, regulation, or code, or any other governmental restriction or requirement related to environmental safety, human health, or employee safety; (2) Tenant's business operations posing a human health risk (as determined by the federal, state, or local governmental agency with the responsibility or jurisdiction to make that determination) to other tenants; or (3) Tenant's expanding its use, storage, or treatment of any Hazardous Substances in a manner inconsistent with the safe operation of the Building. Should Landlord consent in writing to Tenant bringing, using, storing, or treating any Hazardous Substances in or on the Premises or the Building, Tenant shall strictly obey and adhere to any and all applicable federal, state, or local laws, ordinances, orders, rules, regulations, or codes, or any other governmental restrictions or requirements, that in any way regulate, govern, or impact Tenant's possession, use, storage, treatment, or disposal of said Hazardous Substances. In addition, Tenant represents and warrants to Landlord that (1) Tenant shall apply for and remain in compliance with any and all applicable federal, state, or local permits in regard to Hazardous Substances; (2) Tenant shall report to any and all applicable governmental authorities any release of reportable quantities of any Hazardous Substances as required by any and all federal, state, or locals laws, ordinances, orders, rules, regulations, or codes, or any other governmental restrictions or requirements; (3) Tenant shall, within _____ days of its receipt, send to Landlord a copy of any notice, order, inspection report, or other document issued by any governmental authority relevant to Tenant's compliance status with environmental or health and safety laws; and (4) Tenant shall remove from the Premises at the termination of this Lease all Hazardous Substances that Tenant brought or permitted to be brought into or on the Premises or the Building.

In addition to, and in no way limiting, Tenant's duties and obligations as set forth in this Lease, should Tenant breach any of its duties and obligations as set forth in this section, or if the presence of any Hazardous Substances on the Premises or the Building results in contamination of the Premises or the Building, any property other than the Building, the atmosphere, or any water or waterway (including groundwater), or if contamination of the Premises or the Building by any Hazardous Substances otherwise occurs for which Tenant is otherwise legally liable to Landlord for damages resulting therefrom, Tenant shall indemnify, hold harmless, and, at Landlord's option, defend Landlord and its contractors, agents, employees, partners, officers, directors, and mortgagees, if any, from any and all claims, demands, damages, expenses, fees, costs, fines, penalties, suits, proceedings, actions, causes of action, and losses of any and every kind and nature, including without limitation diminution in value of the Premises and the Building, damages for the loss or restriction on use of the rentable or usable space or of any amenity of the Premises or the Building, damages arising from any adverse impact on marketing space in the Building, and sums paid in settlement of claims and for attorneys' fees, consultants' fees, and experts' fees that may arise during or after the Lease Term or any extension of that Term as a result of that contamination. This includes, without limitation, costs and expenses incurred in connection with any investigation of site conditions or any cleanup, remedial, removal, or restoration work required by any federal, state, or local governmental agency or political subdivision thereof because of the presence of Hazardous Substances on or about the Premises or the Building or because of the presence of Hazardous Substances anywhere else that came or otherwise emanated from Tenant or the Premises. Without limiting the foregoing, if the presence of any Hazardous Substances on or about the Premises or the Building caused or permitted by Tenant results

in any contamination of the Premises or the Building, Tenant shall, at its sole expense, promptly take all actions necessary to return the Premises and the Building to the condition existing prior to the introduction of any Hazardous Substances to the Premises or the Building, provided, however, that Landlord's written approval of these actions shall first be obtained.

2. [3.133] Form for Inclusion in Rules and Regulations

Tenant shall not cause or permit any Hazardous Substances (defined below) to be used, stored, generated, or disposed of on or in the Premises or the Building without Landlord's prior written consent, except for normal office products and supplies of the type, and in the amount, used in the normal course of business and in compliance with applicable laws, rules, or regulations. If Tenant causes or permits the presence of any Hazardous Substances on or in the Premises or the Building, Tenant, at its sole cost and expense, shall promptly take any and all actions necessary or required to return the Premises and the Building to the condition existing prior to the presence of any Hazardous Substances. Tenant shall obtain Landlord's written consent prior to commencing any such remedial action. As used in this Lease, "Hazardous Substances" means any substance that is toxic, etiological, ignitable, reactive, or corrosive or that is regulated by any federal, state, or local governmental agency, law, rule, or ordinance and includes without limitation asbestos, polychlorinated biphenyls, petroleum products, substances that are or may be toxic to humans, animals, plants, or the environment, and any and all materials or substances defined as "hazardous waste," "extremely hazardous waste," or a "hazardous substance" pursuant to any federal, state, or local governmental agency, law, rule, or ordinance.

B. [3.134] Tenant's Version — Sample Language

In no way limiting Landlord's duties and obligations as set forth in this Lease, Landlord shall not place any Hazardous Substances (defined below) in the Premises after Tenant's occupancy. As used in this Lease, "Hazardous Substances" means any hazardous, etiological, toxic, or radioactive substance, material, matter, or waste that is or becomes during the Lease Term regulated by any applicable federal, state, or local law, ordinance, order, rule, regulation, code, or any other governmental restriction or requirement, and shall include but not be limited to asbestos, petroleum products, polychlorinated biphenyls, and substances or materials included in the terms "Hazardous Substance" and "Hazardous Waste" as defined in the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. §9601, *et seq.,* and the Resource Conservation and Recovery Act of 1976, as amended, 42 U.S.C. §6901, *et seq.* If the presence of any Hazardous Substances in the Premises that were placed in the Premises or the Building by Landlord or its agents, employees, or contractors or that existed in or on the Premises or the Building prior to Tenant's taking possession of the Premises results in contamination of the Premises or the Building, or if contamination of the Premises or the Building by any Hazardous Substances otherwise occurs for which Landlord is otherwise legally liable to Tenant for damages resulting therefrom, Landlord shall indemnify, hold harmless, and, at Tenant's option, defend Tenant and its agents, employees, officers, and directors, if any, from any and all claims, demands, damages, expenses, fees, costs, fines, penalties, proceedings, actions, causes

of action, and losses of any and every kind and nature, including without limitation diminution in value of the Premises, damages for the loss or restriction on use of the rentable or usable space or of any amenity of the Premises or any amenity of the Building, loss of business from the Premises, and reasonable attorneys' fees that may arise during the Lease Term or any extension thereof as a result of that contamination. This includes, without limitation, costs and expenses incurred in connection with any investigation of site conditions or any cleanup, remediation, removal, or restoration work required by any federal, state, or local governmental agency or political subdivision thereof because of Hazardous Substances present on or about the Premises (excluding those Hazardous Substances that were caused or permitted, knowingly or unknowingly, by Tenant, to be brought or remain on or kept or used in or about the Premises). Without limiting the above, if the presence of any Hazardous Substances on or about the Premises or the Building caused or permitted by Landlord results in any contamination of the Premises, Landlord shall, at its sole expense, promptly take all actions required by law to return the Premises and the Building to the condition existing prior to the introduction of any such Hazardous Substances to the Premises or the Building.

Should the presence of Hazardous Substances in or on the Premises or the Building, or for which Tenant is not liable pursuant to this section, effectively prohibit Tenant from conducting business from the Premises for more than _____ consecutive business days, Tenant shall have the right to terminate this Lease upon _____ days' written notice to Landlord, which termination shall be effective upon the expiration of said _____-day period.

C. [3.135] Comment

1. Although environmental provisions similar to the above are more important in industrial or shopping center leases, both landlords and tenants are well-advised to consider environmental issues in office leases. Because of the tremendous potential financial liability related to environmental problems, both landlords and tenants will want to be protected from environmental problems caused by the other party.

2. A tenant might also desire representations from the landlord as to the absence of environmental problems with respect to the building in which the premises are located. These problems could include ground contamination and the presence of asbestos in an older building. If extensive improvements to the premises by the tenant are contemplated for the future, the tenant might require an inspection of the building by an outside inspector to determine whether asbestos is present. The presence of asbestos might make future improvements by the tenant impossible, while leaving the tenant with only a lawsuit for damages against the landlord for breach of the landlord's representation on the absence of asbestos. A landlord cannot safely make a representation on the absence of asbestos until a thorough inspection of the building has been conducted.

3. Note that the sample provisions permit the tenant to use substances such as copier toner and cleaning supplies that might otherwise fall within the definition of "Hazardous Substances," provided their use conforms with applicable laws.

4. In August 1994, the Occupational Safety and Health Administration (OSHA) asbestos regulations were extensively revised to establish affirmative asbestos-containing material evaluation and record-keeping duties on building owners. 29 C.F.R. §1910.1001, *et seq.* Significantly, "building/facility owner" is defined as "the legal entity, *including a lessee,* which exercises control over management and record keeping functions relating to a building." [Emphasis added]. 29 C.F.R. §1910.1001(b). The revised regulations require that a building owner determine the presence, location, and quantity of asbestos-containing materials (ACM), as well as presumed asbestos-containing materials (PACM), in areas of its building in which renovation, reconstruction, or asbestos removal is being performed. In addition, the building owner must inform tenants as well as contractors performing the renovation work of the presence and location of ACM and/or PACM in such areas. Thus, if a building owner becomes aware that construction or renovation work will be undertaken by a tenant, the owner must exercise due diligence to determine whether ACM or PACM are present in the area where the work is to be performed. Due diligence requires that a reasonable owner, informed of this standard and other pertinent regulations, must inquire into the possibility that a building material is asbestos-containing. The required extent of the inquiry may vary depending on the prevalence of the ACM for the specific use in the specific location, previous surveys, inspections, and other knowledge. Thus, while the revised regulations do not require wall-to-wall building asbestos inspections by a building owner, the building owner must take steps to determine whether areas in which construction or renovation is to be conducted are contaminated with ACM or PACM. When such construction or renovation is anticipated or even possible, the lease should contain the following paragraph disclosing the presence and location of ACM and/or PACM on the premises:

Landlord hereby advises Tenant that there are located on or in the Premises, at the locations and/or in the materials identified hereinafter, asbestos-containing materials and/or presumed asbestos-containing materials: _____.

ACM and PACM should be defined in the lease consistent with the meaning contained in the OSHA regulations.

The revised OSHA regulations impose other obligations on building owners that are not relevant to the landlord-tenant relationship; building owners and their counsel should become familiar with these regulations in their entirety.

XL. SECURITY

A. [3.136] Introduction

In a typical multi-tenant office building, the landlord undertakes the responsibility to ensure that the building is safe and secure from third-party acts such as crimes. In the wake of the September 11, 2001, terrorist attacks on the Word Trade Center and the Pentagon, however, the landlord is faced with issues regarding security against future terrorist attacks that are quite different from the issues it faced in providing security against more conventional crimes. A duty of the landlord to provide tenants with security against explosive, chemical, or biological attacks may

well evolve from the landlord's pre-September 11th duty to prevent foreseeable crimes such as robberies and assaults. This evolving duty may well be shaped by issues such as the foreseeability of a terrorist attack on a particular building, a landlord's assumption of liability by voluntarily taking on new responsibilities to provide security, and applicable statutory requirements.

B. [3.137] Landlord's Duties

Generally, a landlord owes its tenants a duty to protect its tenants and others from injuries in common areas over which the landlord maintains control and from injuries caused by common facilities that the landlord controls. 1 Andrew R. Berman, FRIEDMAN ON LEASES §10:2 (6th ed. 2019). While a landlord has typically owed a duty to provide its tenants and others with safe common areas, as a general rule the landlord has traditionally not been obligated to prevent the criminal acts of third parties in those common areas. *See Kline v. 1500 Massachusetts Avenue Apartment Corp.,* 439 F.2d 477 (D.C.Cir. 1970). A modern legal trend, however, has developed in many jurisdictions and led to a common-law duty imposed on a landlord to take measures that prevent foreseeable criminal acts of third parties within both common areas and demised premises. See 1 FRIEDMAN ON LEASES §10:2.7. This ever-evolving body of law is complicated by the case-by-case manner in which duties are imposed by courts looking at the foreseeability of a crime in hindsight. The prudent building owner of a higher profile building in a city that is a potential future target must take a hard look at what is foreseeable given contemporary terrorist attacks and act accordingly.

Leases entered into after September 11th may reflect the changed state of affairs created by the terrorist attacks. As tenants seek more security from landlords and landlords seek to make their buildings competitive, leases may provide for important security measures. As these lease provisions develop, however, the traditional assumption of liability theory will mean that the landlord's obligations to take all reasonable steps to provide the promised security measures will be the basis for the presence or absence of liability should a future terrorist attack occur.

The landlord may seek to limit liability by including an exculpatory clause that defines the security measures the landlord will undertake but that limits liability if the measures fail; however, this type of contractual attempt to limit liability seems to fly in the face of the pre-September 11th judicial disfavor with which courts have looked at these type of provisions — at least in the presence of the landlord's negligence. Other strategies are available to possibly minimize the landlord's liability in the wake of the terrorist attacks. These other strategies can be summarized by three principles:

1. Know the local laws regarding security and tenant safety and follow them (especially in light of the pre-September 11th judicial findings that a violation of statutory obligations is strong evidence of a violation of a duty to provide premises safe from third-party criminal acts — even if the acts are not foreseeable). Although the definition of "foreseeability" is expanding, a landlord-defendant has a better chance of prevailing when it has complied with the local laws. Once a landlord has failed to comply with the local laws, the landlord may be liable regardless of foreseeability.

2. Avoid unwarranted express and implied promises to provide specific security measures and to protect from specific injuries in order to avoid having unwittingly assumed a greater duty than the law would otherwise dictate. Lease provisions as well as assertions in promotional materials that address security commitments may create contractual obligations that exceed the reasonableness standards that landlords must meet in order not to be negligent. Howard A. Steindler, *The Purchase and Sale of Real Property Post-closing Issues,* National CLE Conference Real Estate Law 2002.

3. Act with all reasonable care in the fulfillment of the security measures that have been promised. Landlords will presumably, as in the case of the pre-September 11th law, not be deemed insurers against terrorist attacks but only be obligated to take reasonable steps to prevent these attacks by carrying out those measures that have been promised.

A number of steps can be taken by a landlord to evidence the fact that it has attempted to act reasonably. A reasonable landlord should have a written security plan and should follow the plan. *Id.* The landlord's security plan should consider the following:

1. employing a security staff (possibly 24-hour);

2. conducting periodic reviews and repairs of electronic locks;

3. utilizing local law enforcement officials as consultants;

4. ensuring adequate lighting;

5. investigating potential problems;

6. employing central phone numbers for emergencies and suspicious activities;

7. requiring identification badges for office tenants;

8. limiting access to parking and monitoring parking areas; and

9. implementing an emergency evacuation plan. *Id.*

Since leases often contain provisions to pass through costs for maintenance of common areas, tenants may be hit with dramatic and unexpected increased costs associated with further security enhancements. Operating cost pass-through provisions must be carefully drafted to make clear the extent of the parties' respective obligations to pay for these greater costs. Absent such a clear statement, a landlord may have a difficult time requiring its tenants to pay for the enhanced security.

C. [3.138] Terrorism Risk Insurance

One area of particular concern to landlords, tenants, and insurers in the wake of the September 11th attacks has been the cost and availability of terrorism risk insurance for office buildings. Following the September 11th attacks, insurance coverage for terrorism attacks almost completely

disappeared from the commercial marketplace. Statement of Richard J. Hillman, Director, Financial Markets and Community Investment, U.S. General Accounting Office, Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, *Terrorism Insurance: Effects of the Terrorism Risk Insurance Act of 2002,* GAO-04-806T (May 18, 2004) (*Terrorism Insurance*), www.gao.gov/new.items/d04806t.pdf. In response, Congress enacted the Terrorism Risk Insurance Act of 2002 (TRIA), Pub.L. No. 107-297, 116 Stat. 2322, which created a cap on insurer liability, established a system to process claims, and provided for reimbursement to insurers for portions of losses in the event of terrorist attacks. However, despite the ensuing increased availability of such insurance, according to the General Accounting Office, many commercial property owners have refused to purchase terrorism insurance policies. *Terrorism Insurance,* p. 3. TRIA expired December 31, 2005, was extended through December 31, 2007, by the Terrorism Risk Insurance Extension Act of 2005, Pub.L. No. 109-144, 119 Stat. 2660, and was further extended through December 31, 2014, by the Terrorism Risk Insurance Program Reauthorization Act of 2007, Pub.L. No. 110-160, 121 Stat. 1839. Congress failed to renew TRIA in 2014. However, on January 12, 2015, TRIA was further extended through December 31, 2020, by the Terrorism Risk Insurance Program Reauthorization Act of 2015, Pub.L. No. 114-1, 129 Stat. 3, and in 2019 TRIA was again extended through December 31, 2027, by the Terrorism Risk Insurance Program Reauthorization Act of 2019, Pub.L. No. 116-94, 133 Stat. 3026. The expiration of TRIA in 2027 without further extension may cause the market for such policies to disappear yet again. Landlords, especially those in metropolitan areas with a higher potential for being targeted, should investigate whether terrorism risk insurance coverage will be available should TRIA be allowed to expire again at the end of 2027 — if for no other reason because the landlord's mortgage lender may require this type of coverage.

D. [3.139] Firearm Concealed Carry Act

An area of interest for many office landlords and tenants is the enactment in July 2013 of the Firearm Concealed Carry Act (FCCA), 430 ILCS 66/1, *et seq.,* which permits licensed permit holders to carry concealed firearms publicly. The FCCA contains several provisions that may need to be resolved or discussed in lease negotiations.

The FCCA permits the "owner of private real property" to "prohibit the carrying of concealed firearms on the property under his or her control" by posting signage at each entrance to the building in the form promulgated by the Illinois State Police. 430 ILCS 66/65(a-10). The FCCA does not address a prohibition covering only a portion of a property, such as an office suite contained in a building. Therefore, for an office tenant in a multi-tenant building, the FCCA may not permit the tenant to enact a prohibition, only the landlord/owner of the property. However, the requirement that the owner have "control" of the property poses an interesting question when an office building is leased solely to a tenant that exercises effective control of the premises, as in that case the owner may lack the requisite control to enact a prohibition. Accordingly, if a tenant or landlord desires to prohibit concealed firearms in a building or in any leased premises, the parties should include such a requirement in the lease or specify who has the power to make such a decision. Notwithstanding the foregoing, as long as the lease and landlord do not expressly prohibit posting prohibition signage in an office, a tenant that wishes to prohibit concealed firearms may elect to post the requisite signage at the entrances to its premises so as to place individuals on notice that concealed firearms are not allowed by the tenant in those premises.

In addition, the FCCA does not presently contain an immunity provision to protect landlords from liability if they elect not to prohibit concealed firearms on their property. Some other states' concealed carry laws contain such an express immunity provision. Accordingly, attorneys should discuss the effect of not enacting a prohibition with their landlord and tenant clients to apprise them of potential risks and liability arising from firearms in an office setting.

Caselaw is relatively nonexistent on some of the issues that may confront landlords and tenants in connection with concealed firearms on their premises. Lawyers should continue to stay abreast of any amendments to the FCCA and future court decisions that impact liability and responsibility for concealed firearms.

XLI. [3.140] CONCLUSION

Negotiating an office lease involves more than a "battle of forms." A good lawyer should remember that unlike a purchase agreement or a mortgage, an office lease is only the prospectus for a long-term business relationship that will require quality service from the landlord to help the tenant operate effectively and meet its financial obligations. The sample provisions in this chapter show the huge differences between the ideal legal positions for each side. The authors hope that lawyers will always be ready to accommodate well-reasoned concerns on either side by clear and effective drafting.

4 Pre-Construction Leases

SUSAN I. MATEJCAK
Quarles & Brady LLP
Chicago

The author thanks Rebecca Stern for her assistance in the preparation of this chapter.

IICLE® gratefully acknowledges Theodore I. Yi and Sara A. Cooper, who provided this chapter for the previous edition and on whose material this edition is based.

I. [4.1] SCOPE OF CHAPTER

This chapter considers leases of space in proposed buildings and buildings under construction. The intent is not to duplicate discussions found elsewhere in this handbook regarding leases generally, but to focus on issues that are either unique or heightened in a new construction situation.

Although there are issues that are common to office, retail, and industrial properties, this chapter deals mainly with issues that arise in the negotiation of leases in to-be-constructed office buildings. Many of these office building issues, however, have corollaries in new construction for retail and industrial uses.

II. [4.2] BACKGROUND

The lease is both a conveyance instrument and a contract under which both landlord and tenant undertake certain performance obligations. These performance obligations include the payment of rent, the provision of services, agreements regarding maintenance and repair of the building and premises, and agreements regarding the allocation of risk in the event of unforeseen circumstances, such as a casualty or condemnation.

The unique feature of pre-construction leasing is that the building has not yet been constructed. Because the building is not yet constructed, the landlord takes on the additional obligation of constructing the actual building, and there are a number of additional contingencies and risks that need to be addressed and allocated. As anyone who has undertaken even a simple home construction project knows, any construction project entails additional risks, including delay, cost overruns, and injury, all of which must be addressed in a well-drafted pre-construction lease.

In light of the additional risks and obligations imposed by a pre-construction lease, both landlord and tenant may require the services of experienced design and construction professionals in addition to the professional advice of a broker and a lawyer.

The tenant may be advised on construction issues by a construction expert in the tenant's real estate brokerage firm or may separately retain a design professional or construction consultant. Sophisticated tenants with large portfolios may even have their own in-house design and space-planning departments. This may be particularly true of major retail tenants. When the tenant will construct its own tenant improvements after the landlord has completed construction of the base building, the tenant will also employ a general contractor or construction manager.

The landlord, of course, has a building architect, a building engineer, and a general contractor or construction manager for construction of the base building, as well as for construction of the tenant improvements if the landlord has undertaken that obligation. The landlord also interacts with the design and construction professionals overseeing the project on behalf of the landlord's lender or investors or both.

As is the case with leases of space in existing properties, in almost all cases the landlord's lawyer drafts the lease and any negotiated lease revisions, but strong tenants may gain the right to

control the drafting. This is particularly true in a retail setting in which the form lease of the anchor tenant may be used. Regardless of who controls the drafting, all leases for the project, whether in an office building or in a retail shopping center, must be carefully crafted to coordinate with each other so as not to create any conflicting obligations.

A sample provision relating to new construction of a building is included in §4.15 below. This language in the sample (a) is intended to address some of the major issues arising between the landlord and the tenant and (b) is designed for inclusion in the building standard work letter.

III. [4.3] LANDLORD CONTINGENCIES

The pre-construction lease may be entered into prior to site acquisition or prior to the landlord's having obtained financing. Accordingly, the landlord may desire to make the lease contingent on site acquisition or may seek to include contingencies for financing or equity investment. The landlord may also desire to make the lease contingent on issuance of construction permits or receipt of zoning approvals. These contingencies impose additional risks on the tenant and, in many instances, may not be acceptable, depending on the tenant's timing requirements and appetite for risk. These are all matters subject to negotiation and, in many instances, can be settled even before beginning the process of preparing and negotiating the actual lease document.

If there are such contingencies in the lease, the tenant, in particular, will want definitive and early dates for satisfaction of the contingencies, along with an obligation on the part of the landlord to use good-faith efforts to satisfy the various contingencies. The schedule of definitive dates, sometimes referred to as a "milestone date schedule," may include site acquisition, closing of the construction loan, obtaining necessary permits, commencement of excavation, commencement of vertical construction, "topping off" the building, and enclosing the building, as well as other interim steps. The lease may also provide for some compensation to the tenant, such as reimbursement for costs and expenses incurred in the event the contingencies are not satisfied and the lease is terminated.

If the contingencies are not satisfied and the lease is terminated, the tenant may incorporate provisions in the lease prohibiting the landlord from developing the site for some period of time or, if the landlord does go forward with development of the site, permitting the tenant to reinstate the lease at its option. This sort of remedy typically would be available only to a major anchor tenant of the site.

A sample landlord contingency provision is included in §4.16 below.

IV. [4.4] GOVERNMENTAL INCENTIVES

In some instances, tenants entering into pre-construction leases may be simultaneously negotiating various incentives with applicable governmental authorities wishing to entice such tenants to relocate or to remain in the area. The tenant must be aware that it may risk losing its incentives if it signs the lease before the incentives have been formally awarded. For example, to

be eligible for the EDGE tax credit (see the Economic Development for a Growing Economy Tax Credit Act, 35 ILCS 10/5-1, *et seq.*), a tenant must show, among other things, that if not for the tax credit, the tenant's project (*i.e.,* its leasing of space in the building) would not occur. 14 Ill.Admin. Code §527.30(d). Thus, if the tenant signed the lease before the tax credit was formally awarded, the tenant technically would fail to meet this "but-for" test (see the discussion below regarding a contingency).

An incentives package is often a significant factor in the tenant's decision to enter into a lease at a particular location. If the incentives are not ultimately obtained, the lease may no longer be feasible for the tenant. The tenant should, therefore, include a governmental incentives contingency provision in the lease allowing the tenant to terminate the lease if it does not obtain the incentives it desires. In most cases, such a contingency is also sufficient to preserve the but-for test. A sample governmental incentives provision is included in §4.17 below.

V. [4.5] BUILDING PLANS

In a typical case, the lease includes a base building description. The base building description serves two functions. First, it describes the quality and other details of building construction, such as but not limited to features of the building's structural framing and exterior; the type of heating, ventilating, and air-conditioning system (HVAC); performance specifications for the HVAC; performance specifications for the elevators; parking facility requirements; finishes for lobbies, corridors, and washrooms; electrical and floor load capacities; any sustainability plans, including plans for obtaining Leadership in Energy and Environmental Design (LEED) or Energy Star certifications; and required amenities, such as a fitness center, conferencing facilities, and cafeteria or other eating facilities. Second, the base building description also serves as the basis for allocating costs of construction between the landlord and tenant. The base building work will be performed at the landlord's cost, without application of the tenant improvement allowance.

In some cases, however, plans and specifications for the base building may not be complete when a lease is signed. For an additional building in a multi-building project, for example, the lease may simply refer to an existing building in the project as the model for the plans to be developed. In other circumstances, outline specifications or perhaps design criteria may be attached to the lease. In most cases, both parties would prefer that the base building description be as complete as possible, although the landlord will want to retain flexibility in modifying the plans and specifications to accommodate changes in conditions or future tenant requests. In any event, if the plans for the base building are not complete, agreement should be reached on a process and schedule for completion of plans and specifications.

Anchor tenants or other tenants with sufficient bargaining leverage may have the right to review and approve base building plans as they are developed. If construction plans are available, the tenant may review and evaluate them and seek to approve changes. The landlord will want to retain rights to make alterations and modifications to the plans and specifications as they are developed. However, the landlord will probably be restricted from making changes that would materially affect the tenant's premises, the appearance of the building, or the quality of building systems.

Major tenants may also want the right to require that changes be made in the base building during construction in order to accommodate the tenant's planning. Such a right, however, presents a significant issue of delays to the landlord and may affect the landlord's relationships with other tenants and its lender.

VI. [4.6] DELAY IN CONSTRUCTION SCHEDULE

A typical lease provides that the tenant's obligations under the lease will not be affected by a failure to deliver the premises by the date set forth in the lease as the commencement date, except that typically, but not uniformly, the commencement date will be deferred until the premises are delivered. This approach essentially shifts the risk of delays in construction to the tenant. The landlord will still have the incentive to complete the project on schedule and on budget because it will be required to carry its debt at the higher construction loan rates and will not be receiving any income until the leases commence. Nonetheless, this approach does not provide any compensation to the tenant for delays that, in many or most instances, are beyond the tenant's control.

A significant tenant risk resulting from construction delays is the possibility that the delay may force the tenant into a holdover situation in its existing premises. The tenant is looking in the market at buildings that are scheduled for completion at about the time its current lease expires. The tenant does not want to move before its existing lease expires and thus be required to pay rent for both its previous location and its new space (a situation that would call for its new landlord to provide an additional concession in the form of either paying the rent for the previous space or abating rent on the new space until the previous lease expires). As a result, the timing of completion of the new space becomes critical. Holdover liability to which the tenant may be subject may include paying rent at a multiple of — often double — the rent in effect before the lease expiration date, being responsible for damages incurred by its existing landlord if it is unable to deliver space to a new tenant on time, and having its lease renewed for an additional one-year period. Accordingly, the tenant may require the new landlord to indemnify it for holdover liability if construction is delayed.

The landlord has fewer alternatives in the event of delay in the new construction situation than with an existing building in which, for example, the landlord may be able to provide temporary space until the tenant's space in the building is completed. Specific performance is most often of little use to the tenant in the new construction context, even if enforcement would be available, as is a general claim for damages, inasmuch as a failure to perform usually arises from a lack of funds. A lack of funds will make specific performance unachievable and make payment of unlimited damages impossible.

To protect its interest in the event the project is delayed, the tenant may attempt to negotiate the right to terminate the lease if construction of the base building or its premises (if the landlord is building out the tenant improvements in the premises) is not substantially completed within a defined period of time. By that time, though, the tenant's options to locate to other space may be limited because of the lead time required. For that reason, the tenant may seek the right to terminate the lease if critical steps in the development and construction process are not completed by earlier, agreed-on dates. As discussed in §4.3 above, if the lease includes site acquisition, financing, zoning, or permitting contingencies, the tenant may negotiate termination rights if those contingencies are

not satisfied by stated dates. Also, the tenant may seek the right to terminate if construction is not started by a certain date. "Start of construction" may be defined within a range bounded by site preparation through beginning excavation through starting foundation construction, which represents the greater commitment to construction and indication that plans for the project, as well as permits, are substantially in place. The tenant may also seek to terminate the lease if construction fails to proceed in a timely fashion relative to "milestone dates" in the construction schedule. These milestone dates may include completion of the foundation, erection of structural steel, or enclosing of the building.

In all of these cases, the landlord and tenant will negotiate to allocate the various construction delay risks. Force majeure delays may be the most difficult issue in the negotiation of construction delay remedies. Sensitivity to force majeure delays was further heightened in the immediate wake of the COVID-19 pandemic when supply chain issues impacted virtually every construction project. The landlord will not want to be subject to liability or have a lease terminated because of delays that are beyond its control, nor will its lender want its borrower exposed to those consequences. On the other hand, particularly in the context of the right to terminate the lease because of delays, the cause of the delays is irrelevant to the tenant's need to cover its additional expense or to change course and terminate the lease.

In addition to termination rights, the tenant may seek compensation for damages caused by delays. The practitioner should keep in mind that delay damages are intended to compensate the tenant for damage caused by any delay in the construction process. Recovery of punitive damages, in contrast, is unlikely, as they are disfavored in the law. *Klucznik v. Nikitopoulos,* 152 Ill.App.3d 323, 503 N.E.2d 1147, 105 Ill.Dec. 141 (2d Dist. 1987). *But see Poeta v. Sheridan Point Shopping Plaza Partnership,* 195 Ill.App.3d 852, 552 N.E.2d 1248, 142 Ill.Dec. 507 (2d Dist. 1990). If, as may be the case, actual damages would be uncertain in amount and difficult to prove, liquidated damages may be both appropriate and enforceable. *Grossinger Motorcorp, Inc. v. American National Bank & Trust Co.,* 240 Ill.App.3d 737, 607 N.E.2d 1337, 180 Ill.Dec. 824 (1st Dist. 1992). Damages may include compensating the tenant for any additional occupancy cost at its existing location in the event of any such delay, and in the event of a termination requiring the tenant to seek an alternative location, damages may include the additional costs of acquiring the alternate space, including increased rentals for the alternate space.

VII. [4.7] LANDLORD CREDIT ISSUES

The landlord will have significant construction and financial obligations in a new construction situation. Among the financial obligations that may be encountered are a covenant to provide an allowance to the tenant for construction of tenant improvements and an agreement to pay damages in the event of delays in the construction process. During construction, the value of property, after deduction of encumbrances, is speculative at best. The issue of the landlord's ability to cover its monetary obligations and to satisfy any damage claims becomes critical to the tenant. These same issues are present with existing properties, but the inherent added risk of construction projects makes them more prominent with new construction.

Most leases of space in sizeable office buildings contain exculpatory provisions to the effect that the tenant's recourse for default by the landlord under the lease will be limited to the landlord's interest in the property. In addition, the landlord may be a limited liability entity formed for the single purpose of developing and holding title to the property.

In situations in which the tenant is constructing its own improvements with a tenant improvement allowance from the landlord, the issue of how to secure the landlord's obligation to pay the allowance will be a significant concern to the tenant. In such case, the tenant will be contractually obligated to pay its contractors whether the landlord pays the allowance or not. Further, while the tenant may have the right to terminate the lease if the landlord runs into financial trouble on the project, by the time construction has progressed to the point that the tenant can take possession of the premises and begin incurring construction costs, the tenant's options to move elsewhere will be much more limited. The tenant's best approach may be to complete the improvements and take possession of the premises.

The tenant may be able to obtain a letter from the landlord's construction lender confirming that financing will be available to fund the allowance upon compliance with the requirements of the lease. The landlord may also, or alternatively, provide a letter of credit to secure its obligation to pay the allowance. Occasionally, the landlord may be induced to deposit its equity share of the tenant allowance (the portion not being borrowed) in a bank or title company escrow. The escrow agreement will provide that the funds can be withdrawn only to pay the allowance, as long as there is no tenant default under the lease. In the meantime, the funds can be invested by the escrowee, although there will probably be some loss in return on the funds. In rare cases, guaranties are provided, sometimes by an individual but more likely by one or more of the constituent entities of the landlord.

Absent security, a right to set off unpaid amounts against rent may be negotiated as a remedy for the landlord's failure to pay amounts due. The landlord and its lender will be opposed to granting a right of setoff but may concede. As negotiated, the right of setoff may be available when amounts are not paid within a certain number of days after they become due, or it may be exercisable only after the tenant has obtained a final judgment against the landlord. It may apply to all amounts due to the landlord, or it may permit setoff only against "net" rent, requiring the tenant to pay its share of taxes and operating expenses and charges for special services without offset. In any event, some delay in obtaining reimbursement will be involved, if only because the amounts may become due before the object of the setoff — rent under the lease — begins to accrue and because the amounts may be significantly larger than monthly rent, requiring a period of time to satisfy the amounts due to the tenant.

Following the financial crisis that began in 2007, there is an increased appreciation of the risks associated with the financial condition of letter-of-credit issuers. Burdensome obligations of failed banks can be repudiated by the Federal Deposit Insurance Corporation. Such burdensome obligations may include letters of credit. It is advisable for the intended beneficiary of a letter of credit to attempt to negotiate a right under its lease to require delivery of a replacement letter of credit from another issuer if the financial condition of an issuer deteriorates, either in the judgment of the beneficiary in its discretion or as measured by rating agency ratings or other bank ratings specified in the lease.

Another concern that developed from the financial crisis relates to cancellation of letters of credit. A letter of credit may provide that it will automatically renew annually unless cancelled by the issuer by notice to the beneficiary a specified amount of time prior to the renewal date. During the financial crisis, such letters of credit were cancelled by issuers in significant numbers rather than being permitted to renew.

In either case, the presumed security may be lost if the letter-of-credit applicant is unable to obtain a replacement letter of credit or, in the alternative and if permitted by the lease, post cash security.

VIII. [4.8] TENANT CREDIT ISSUES

If the cost of the improvements to be constructed by the tenant is anticipated to exceed the amount of the tenant improvement allowance, the landlord may request that the tenant deposit the excess amount with the landlord. However, if the excess is sufficiently large to justify examining an escrow deposit or other alternative security in lieu of a direct deposit with the landlord, that circumstance may be indicative of the tenant's being sufficiently creditworthy to avoid doing so. In any event, if the tenant is performing the tenant improvements, the tenant may argue that the deposit need not be for the full amount of the construction costs, but only for the estimated costs that could be incurred before the contractors would stop work if not paid.

The same issues noted in §4.7 above regarding landlord letters of credit arise with letters of credit posted by tenants as security.

IX. [4.9] LENDERS

The lawyer representing the tenant should ascertain whether any mortgages or ground leases encumber the property. If there is a mortgagee or ground lessor, then in many cases the relationship among the landlord, the tenant, and such third-party financing source will need to be agreed on and documented in a three-party agreement, commonly known as a subordination, non-disturbance, and attornment agreement (SNDA). The SNDA will provide that the mortgage or ground lease is superior to the lease, but that even if this superior mortgage is foreclosed or the ground lease is terminated, the lease will not be terminated as long as the tenant is not in default. In addition to this ordering of relative priorities between the mortgage or ground lease and the tenant's lease, the SNDA may attempt to modify or limit the mortgagee's or ground lessor's obligations under the lease in the event the mortgagee or ground lessor becomes the landlord under the lease. In particular, a typical provision in a standard SNDA is that the mortgagee or ground lessor will not be obligated to complete construction or pay allowances. This again raises the issues of the tenant's damages and security discussed in §§4.6 and 4.7 above.

X. [4.10] TENANT IMPROVEMENTS

In addition to completion of the base building, the lease will need to address construction of tenant improvements within the tenant's premises. Many of the issues are the same as issues raised elsewhere in this handbook, but in the context of construction of a new building, certain coordination issues will arise.

The landlord will, of course, need to construct the base building structure before tenant improvements are commenced. However, not all of the landlord construction may be completed prior to commencement of tenant improvements. In addition, there may very well be other tenants in the building working on tenant improvements at the same time. All of the various construction forces will need to be coordinated. Even in a large project, the building can become a very small place when there are multiple construction teams attempting to meet tight deadlines. Use of the loading dock and vertical transportation systems in particular will need to be scheduled, and relative priorities may need to be assigned.

In some cases, the landlord and tenant have attempted to overcome these coordination issues by engaging the same contractor to perform the tenant improvements and the base building improvements. If the landlord is responsible for constructing the tenant improvements as well as the base building improvements, this does not raise many issues. If, however, the tenant is responsible for completing its tenant improvements, but it elects to engage the same contractor the landlord has engaged to perform the base building improvements, the delay issues become more clouded. Good documentation during the construction period will be required in order to unravel any delay disputes.

In any event, whether one or multiple contractors are used for the landlord base building work and the tenant improvement work, union issues may arise, and coordination will be required between and among the contractors. In some jurisdictions, these issues will become critical to jobsite harmony and timely completion of projects. In addition to union labor issues, if financing for the project is provided in part through public sector financing methods, such as tax increment financing, other labor issues may need to be addressed in the lease. For example, local labor requirements as well as women-owned business enterprise and/or minority-owned business enterprise requirements may need to be addressed in both base building work and tenant improvement work.

XI. [4.11] MEASUREMENT

Because the building is under construction at the time the lease is executed, the rentable square footage of the building and the premises in the lease will necessarily be estimates based on current plans and specifications. Unless the parties are prepared to mutually agree to use the estimated square footages throughout the lease term, the lease will typically include a process for measuring the square footage of the premises and the building upon completion. The lease should specify a standard for measurement of the rentable square footage. Often the standards promulgated by the Building Owners and Managers Association International (BOMA) are adopted. If BOMA standards are used, the lease should specify which version will be used. In 2017, BOMA reissued

its OFFICE BUILDINGS: STANDARD METHODS OF MEASUREMENT (ANSI/BOMA Z65.1-2017). Keep in mind that if the 2017 BOMA standards are used, the lease does need to specify which method of measurement will be used, either Method A (the "Multiple Load Factor Method") or Method B (the "Single Load Factor Method"). To protect itself from any material fluctuations from the estimated square footages, (a) the tenant may consider capping any increases resulting from such remeasurement or (b) if the tenant is a significant enough pre-construction anchor tenant, it may negotiate some controls over any redesign of the building or premises that would cause the rentable area of the premises to materially increase.

A sample measurement provision is included in §4.18 below.

XII. [4.12] INSURANCE AND INDEMNITY

The insurance and indemnity provisions of the lease will need to contemplate possible casualties and third-party liabilities during the construction period. Proper insurance will need to be obtained by all contractors on the job. In addition, the damage and destruction provisions of the lease may need to specifically address casualty during the period of construction, including what effect a casualty will have on timing of commencement of the lease and various delay damages.

XIII. [4.13] REAL ESTATE TAXES

Generally, a new building is not fully assessed for real estate tax purposes until it has been substantially completed (see §9-180 of the Property Tax Code, 35 ILCS 200/9-180). A tenant leasing space in a new building that has been constructed on land previously assessed at a lesser value (whether as unimproved or with improvements of lesser value) can expect to see a benefit, resulting from the previous lower assessments in the amount of the tenant's liability for general real estate taxes for the initial year or years of its lease. In addition, under the Illinois arrangement in which general real estate taxes assessed in one calendar year are not payable until the following calendar year, a landlord may "pass through," as additional rent, general real estate taxes in a particular calendar year either as a matter of practice on the basis of the amount assessed for such calendar year, or on the basis of the general real estate taxes payable in such calendar year (which will be the general real estate taxes assessed for the prior calendar year). As between the two, the benefit of early low taxes to a tenant of a newly constructed building should generally be expected to be greater if taxes are charged to the tenants of the building on a cash basis (when payable) rather than an accrual basis (as assessed). Note, though, that if a tenant is obligated to pay a proportionate share of taxes over a "base year" or "stop," rather than a proportionate share of all taxes (as is the case under a "net lease"), the tenant should require that the base year or stop reflect a fully assessed property. One approach is to require that real estate taxes for the base year be "grossed up" (*i.e.,* adjusted to reflect full assessment and full or substantially full occupancy).

NOTE: Similar concerns should be considered in connection with initial "operating expenses" of the building. More information about net leases, leases with base years or stops, and gross up can be found in Chapters 3 and 5 of this handbook.

XIV. [4.14] MEMORANDA FOR RECORDING

Because notice of the existence of a lease and of the tenant's rights affecting portions of the property outside its premises can be given either by recording or by possession, and possession is not available in the case of new construction, recording a memorandum of the lease assumes additional importance in new construction.

XV. APPENDIX — FORMS

A. [4.15] Sample Provision for New Construction of a Building Shell and Core

1. *Construction of the Building Shell and Core.* As of the date hereof, construction of the Building in which the Premises are to be located is not completed. The Landlord presently intends, at its sole cost and expense, to complete the Shell and Core (as hereinafter defined) of the Building substantially in accordance with those preliminary plans and specifications (hereinafter "Building Plans") prepared by _____, dated _____, 20__, subject, however, to the following terms and conditions.

***a. Completion of Shell and Core.* The term "Shell and Core" means that portion of the construction of the Building specifically described in the Building Plans and excludes any other work that may be performed at, on, or within the Building (including without limitation any work related to tenant improvements to be constructed or installed within the Premises or within any other tenant's premises). The term "complete," insofar as it relates to the Shell and Core, means that (i) the structure (steel and concrete erection) of the Building will be completed; (ii) the Building will be enclosed and waterproof; (iii) all utility and service lines and equipment relating thereto will be brought to the floor on which the Premises are located, be extended to a point at which one of the demising walls of the Premises will be located, and be in good operating condition; (iv) the HVAC system to the floor on which the Premises are located will be in operation; (v) the freight elevator will be operational; (vi) there will be at least one passenger elevator for space occupied by tenants then in possession of portions of the Building; (vii) the elevator lobby on the floor in which the Premises are located and the public corridor leading from that elevator lobby to the Premises will be completed (excluding from the completion of the foregoing painting and floor covering; provided, however, that when the floor on which the Premises are located is two-thirds occupied, such painting and floor covering shall be completed); (viii) the restrooms on the floor on which the Premises are located will be completed; and (ix) the ground floor lobby and the ground floor elevator lobby will be complete to the extent of providing a method of safe ingress to and egress from the elevators servicing the floor on which the Premises are located from and to the exterior of the Building, and the floors in the areas providing such ingress and egress will be covered with hard or soft floor covering.**

Either of the following shall be evidence that the Building Shell and Core is complete, and such evidence shall be conclusive and binding on the Tenant: (i) the certification of either the Landlord's architect or the Landlord's engineer that the Shell and Core is substantially complete; or (ii) the issuance of an occupancy certificate for the Building by the applicable governmental authority.

b. Modification of Building Plans. **The Landlord reserves the right, from time to time and at the Landlord's sole discretion, to modify, amend, change, detail, or amplify the Building Plans without the consent or approval of the Tenant, provided that such modifications, amendments, changes, detailing, or amplifying does not either (i) materially and substantially reduce the area of the Premises or (ii) materially and substantially change the location of the Premises, or change the location of any portion of the Premises from one floor to another floor of the Building.**

c. Completion Date for Shell and Core. **In the event the Shell and Core is not complete by the stated commencement date of the term of the Lease for any reason, the Landlord shall not be liable or responsible for any claims, damages, or liabilities in connection therewith or by reason thereof; however, the commencement date of the Lease term shall be extended until the Shell and Core is so completed. Notwithstanding the foregoing, the Shell and Core shall be deemed "complete" for purposes of this work letter upon that date that the Shell and Core would have been complete but for Tenant Delay (as defined in this work letter). Further, in the event the Tenant uses or occupies any portion of the Premises prior to completion of the Shell and Core for any purpose, the date of completion of the Shell and Core shall be deemed to be the date on which such use or occupancy commenced.**

B. [4.16] Sample Landlord Contingency Provision

___. *Landlord's Right To Terminate Lease.* **Notwithstanding anything contained in this Lease to the contrary, if, within one year after the date of execution of this Lease by the Landlord, the Landlord determines, for any reason or for no reason, that it shall not pursue efforts to obtain or is unable to obtain (a) a construction loan (with the lender being prepared to make the first disbursement thereunder) and other financing necessary for the Landlord to proceed with the construction and development of the Building, (b) a building permit and other applicable approvals for construction of the Building, or (c) the approval of any mortgagee of the Landlord of this Lease, the Landlord shall have the right to elect to terminate this Lease as hereinafter provided. The Landlord shall give written notice to the Tenant of its election to terminate within sixty days after the end of such one-year period. The date of termination shall be the date the Tenant receives or is deemed to have received the Landlord's notice of its election to terminate. Furthermore, if any lender financing the construction by or on behalf of the Landlord of all or any portion of the Building or the Project shall require a change or changes in this Lease as a condition of such financing and if the Tenant refuses to agree thereto, the Landlord may terminate this Lease at any time prior to the time possession of the Premises is delivered to the Tenant effective upon notice to the Tenant as aforesaid.**

C. [4.17] Sample Governmental Incentives Contingency Provision

___. *Governmental Approvals and Incentives.* **The Tenant's obligations under this Lease are contingent upon the Tenant obtaining such approvals and incentives in connection with its use and occupancy of the Premises for the uses permitted under this Lease (the "Project") as are satisfactory in form and substance to the Tenant in its sole discretion (collectively, "Approvals"), including but not limited to:**

a. governmental and quasi-governmental incentives and approvals of any type received directly or indirectly from any federal, state, or local unit of government or any other applicable taxing district, including but not limited to awards or grants, tax abatements, tax increment financing, tax credits, and other matters relevant to the Project as determined by the Tenant in its sole discretion;

b. all permits, approvals, and authorizations relating to or necessary for any development, construction, use, and occupancy of the Premises and the Project, including but not limited to building and occupancy permits, zoning and land use approvals, and other site improvement and related approvals, if applicable; and

c. any other permit, approval, or authorization of any type or description determined by the Tenant in its sole discretion to be necessary for its implementation of the Project.

The Landlord shall fully and timely cooperate with the Tenant in connection with the Approvals and shall promptly execute and deliver to the Tenant such petitions, applications, documents, instruments, authorizations, and certifications as may be necessary or appropriate from time to time in furtherance of the Tenant's obtaining of the Approvals.

It is the intent of the Landlord and the Tenant that 100 percent of the benefit of any such Approvals inures to the benefit of the Tenant. The Landlord agrees that if necessary to effectuate such intent, the Landlord shall enter into an amendment to this Lease and provide the Tenant with such benefits, which amendment may include without limitation adjusting the method of the Tenant's payment of the Tenant's proportionate share of taxes for the Building.

The Landlord acknowledges and agrees that without the governmental incentives described in subsection a above, the Tenant would not have undertaken the Project in _____, Illinois (the "City"), and entered into this Lease. One of the incentives, among others, offered to the Tenant by the taxing districts in which the Premises are located, as a material inducement for the Tenant to relocate to the City, involves an agreement by such taxing districts to abate the Taxes payable by the Tenant under this Lease or to make payments to the Tenant in an amount equal to the Taxes paid by the Tenant under this Lease. Consequently, the Landlord agrees that any such abatement of Taxes, or payment in lieu thereof, attributable to the Tenant or the Tenant's occupancy in the Building belongs to, and shall accrue solely for the benefit of, the Tenant. The Landlord, for itself and its successors in interest and assigns, hereby waives any right, title, or interest in such abatement and/or payment in lieu thereof and agrees, when required to effectuate such incentives, either to act as a conduit to pass through to the Tenant such abatement or to allow the Tenant to offset against Rent the amount of the abatement that was intended by the provisions of this Article to go to the Tenant but instead was received by the Landlord or otherwise reduced the Taxes levied against the Building, and the Landlord further agrees to otherwise cooperate with the Tenant to effectuate the purposes of the above-described incentive. When requested by the Tenant, the Landlord shall join in any application or provide any certificates required by any

taxing authority confirming Taxes paid or payable by the Tenant pursuant to the terms and provisions of this Lease to facilitate any refund or reimbursement. The Landlord and the Tenant shall amend this Lease as necessary to fully implement the intent of the parties expressed in this Article ____.

If the Tenant does not obtain, or determines in its sole discretion that it will not obtain, any one or more of the Approvals on or before _____, 20__, the Tenant shall have the right, at its sole option, to terminate this Lease by giving notice to the Landlord on or before _____, 20__, in which event this Lease shall be of no further force or effect. Absent such notice, this Lease shall remain in full force and effect.

D. [4.18] Sample Measurement Provision

This Lease is based on the Premises containing _____ rentable square feet and the Building containing _____ rentable square feet. As soon as practical and before the Commencement Date and after substantial completion of the Landlord's Work, the Landlord shall cause the Premises and the Building to be measured to determine the rentable square footage of the Premises and the Building. The Tenant shall have the right to confirm such measurement. Upon completion of such measurement and the Tenant's confirmation thereof, the Base Rent and the Tenant's Proportionate Share, as well as the Landlord Contribution (as defined in the Work Letter), shall be recomputed, and the revised figures shall be included in the Acceptance Letter and the Confirmation of Lease Terms. Except for space subsequently added to or subtracted from the Premises, the figures so included in the Confirmation of Lease Terms shall govern and control over the figures contained in the Schedule to this Lease.

Notwithstanding anything contained herein to the contrary, in no event shall the rentable area of the Premises or the Tenant's Proportionate Share be increased by more than ____ percent over the figures contained in the Schedule to this Lease. The Building, the Premises, and all other leased area within the Building shall be determined in accordance with [insert standard**] promulgated by the Building Owners and Managers Association International (BOMA) (the "BOMA Standards"). The Landlord agrees that notwithstanding anything contained herein to the contrary, in no event shall the add-on factor used in determining rentable areas of the Premises or the Building exceed ____ percent (*i.e.,* rentable area shall not exceed usable area, as determined under BOMA Standards, multiplied by ____).**

5 Sale-Leaseback Transactions

KARL L. MARSCHEL
JAMES C. BRESCOLL
Bryan Cave Leighton Paisner LLP
Chicago

The contribution of Gregory R. Andre to previous editions of this chapter is gratefully acknowledged.

I. [5.1] SCOPE OF CHAPTER

This chapter is an analysis of the law and practical considerations involved in sale-leaseback financing transactions, including certain relevant tax aspects. When appropriate, sample provisions of purchase and sale agreements, leases, and deeds peculiar to sale-leaseback financing transactions are presented.

II. INTRODUCTION

A. [5.2] In General

When appropriate in this chapter, reference is made to applicable law and publications on sale-leaseback financing. Since there is so little Illinois law on this subject, citations and references are not restricted solely to Illinois cases but include cases from other jurisdictions and publications and works that consider problems involved in sale-leaseback financing on a nationwide basis. See §5.88 below for additional sources.

A sale-leaseback transaction is what its name implies. In its simplest form, the owner of the property sells it to an investor, who then leases the property back to the seller for a term of years pursuant to a net, long-term lease. The seller realizes cash for the property while retaining the use of the property during the lease term. The purchaser acquires the reversionary rights in a valuable asset in the form of the land and the improvements situated thereon and a means of producing a return on the investment in the form of rent payable under the lease during the lease term.

There are basically two types of sale-leaseback transactions, with countless variations from each type:

1. The first basic type involves either the sale of land and/or improvements that are then leased back to the seller, or the sale and leasing back of unimproved land together with the agreement of the buyer-landlord to construct certain improvements on the land for use by the seller-tenant. In this type of transaction, the buyer-landlord owns both the improvements and the land if it has been sold — the seller-tenant's interest in the improvements (and the land if it has been sold) being solely as a tenant. This type is especially prevalent in transactions in which the buyer-landlord is interested in maximizing tax benefits.

2. The second basic type of sale-leaseback transaction involves the sale and leasing back of land only. Ownership of existing or yet-to-be-constructed improvements is retained by the land seller-tenant during the term of the lease. *See, e.g., PCH Associates v. Liona Corp. (In re PCH Associates),* 55 B.R. 273 (Bankr. S.D.N.Y. 1985), *aff'd,* 60 B.R. 870 (S.D.N.Y.), *aff'd,* 804 F.2d 193 (2d Cir. 1986); *In re Kassuba,* 562 F.2d 511 (7th Cir. 1977). The buyer-landlord acquires ownership of the land and a reversionary or future interest in the improvements, either existing or yet to be constructed. At the end of the lease term, title to the improvements often passes to and vests in the buyer-landlord. This type is especially prevalent in transactions in which the seller-tenant wishes to retain maximum tax benefits.

At times, the sale-leaseback format is also accompanied with an option by the seller-tenant to repurchase the subject property at some future time.

This chapter considers two basic types of sale-leaseback transactions: (1) the buyer-landlord buys and leases back all of the interest of the seller-tenant in the land and existing improvements; and (2) the buyer-landlord buys and leases back only the land, with the seller-tenant retaining ownership of existing or future improvements. The different ramifications of these two basic types of sale-leaseback transactions are discussed throughout this chapter. See S. Douglas Weil, *Land Leasebacks Move Up Fast as Financing Technique,* 1 Real Est.Rev., No. 4, 65 (Winter 1972), for useful examples of the business effect of sale-leaseback financing transactions.

B. [5.3] Background

The sale-leaseback technique in its simplest form has been in use in England since the late 19th century. An 1882 English case, *Yorkshire Railway Wagon Co. v. Maclure,* 21 Ch.D. 309 (1882), involved such a transaction. Sale-leaseback transactions first became popular in the United States during the 1940s. The early sale-leasebacks were simple transactions generally involving institutions with special tax advantages, *e.g.,* educational institutions, pension funds, or other tax-free institutions, as the buyer. The seller-tenants were generally large corporations with substantial amounts of their assets tied up in real estate. Since the 1950s, developers and financiers have expanded the basic sale-leaseback concept to dizzying heights of complication. These developments were in large part pioneered by William Zeckendorf, who developed the "pineapple" theory of sale-leaseback financing. The basis of this theory is that if a piece of real estate could be broken into separate estates (*e.g.,* fee interest in the land and reversionary interest in the building, fee interest in the building, sublease of the building, management agreement to operate the building, subleases of parts of the building, etc.), each held by different entities, the total value of all the parts would be worth more than the value of the undivided property before the carving-up process began. Over the years, the complicated financing techniques developed during the past decades have been embraced and expanded by syndicators and financial institutions as a means of maximizing economic returns and tax benefits from the subject properties. William L. Cary, *Corporate Financing Through the Sale and Lease-Back of Property: Business, Tax, and Policy Considerations,* 62 Harv.L.Rev. 1 (1948); SALE AND LEASEBACK FINANCING, xvi – xvii (PLI, 1973); S. Douglas Weil, *Land Leasebacks Move Up Fast as Financing Technique,* 1 Real Est.Rev., No. 4, 65 (Winter 1972).

Over the years, sale-leaseback financing transactions have proved to be good investments for buyer-landlords such as charitable and educational institutions, pension funds, institutional investors, and real estate investment trusts looking for a "bond-like" passive investment as well as for individual investors and syndicated partnerships primarily seeking tax shelters. Sale-leasebacks, in their more complicated guises, have also been used by buyer-landlord investors as a means to participate in a portion of the cash flow of the leasehold estate and of the proceeds of financing the leasehold estate. Similarly, the sale-leaseback transaction has proved an effective vehicle for seller-tenant entities attempting to raise funds in excess of first mortgage proceeds (thereby avoiding the necessity of often more expensive second mortgage financing or of refinancing an advantageous first mortgage), for entities attempting to obtain funds in tight mortgage markets and in mortgage markets dominated by high interest rates, and for entities seeking the tax advantages more fully described in §5.4 below.

C. [5.4] Advantages of Sale-Leaseback to Seller-Tenant

There are many situations in which sale-leaseback financing transactions afford particular advantages to a seller-tenant. The advantages will vary, of course, according to the particular circumstances of the seller-tenant.

In general, the seller-tenant will realize a greater amount of cash from the sale of the property than would be obtained by means of a single loan with property given as security. A buyer-landlord investor will pay full or close to full value when purchasing property, especially if the seller-tenant has a good credit rating, whereas in a loan transaction, the same investor might, because of legal or policy limitations, lend up to only 60 to 70 percent of the value of the property. See, for example, the various restrictions contained in §126.15 of the Illinois Insurance Code, 215 ILCS 5/126.15, which limits the loan-to-value ratio of an Illinois insurance company's investment in various types of loans secured by mortgages on real estate. After a sale-leaseback, the seller-tenant has an asset with greater liquidity, having converted a fixed asset — real property — into cash that can be used for various purposes related or unrelated to the land sold.

In a tight mortgage market, investors who may be unwilling to lend money might enter into a sale-leaseback transaction if it can be structured to offer a hedge against inflation. For example, the lease could require that the rental payments be adjusted in accordance with changes in a specified price index. Similarly, when interest rates on borrowed funds are high, the fixed rent payable in a sale-leaseback transaction over a long lease term, which either is a substitute for mortgage financing or is entered into in connection with the refinancing of a mortgage, may well necessitate lesser outlays of funds on a monthly basis than would be required for equivalent mortgage financing. Such a lower fixed rent can be accomplished, perhaps, by allowing the buyer-landlord to realize part of its return through additional rent measured by a portion of net cash flow or proceeds of financing of the leasehold estate.

Distinct tax advantages can be gained by the seller-tenant in a sale-leaseback of vacant land or in a sale-leaseback of land only, with the seller-tenant in either case retaining title to existing or future improvements. Although taxation issues are beyond the scope of this handbook, the following general principles apply:

1. A sale-leaseback of land only will convert land, a non-depreciable asset for tax purposes, into a leasehold, allowing the seller-tenant to deduct rent payments over the life of the lease. In addition, if the transaction is properly structured so that (a) the seller-tenant's title to the retained improvements is upheld or the seller-tenant constructs the improvements subsequent to the sale and (b) the initial term of the lease is not less than the recovery period of the improvements (or useful life, if applicable), the seller-tenant can depreciate the improvements on an accelerated basis (assuming all the other requirements for accelerated depreciation are met).

2. If improved property has been fully depreciated or if, because of the use of accelerated depreciation, the amount of depreciation deductions will decline, a seller-tenant can sometimes gain a tax advantage by the sale and leasing back of the land and improvements. The rental over the term of the lease will result in expense deductions against the seller-tenant's ordinary income. The deduction for rent will offer a tax shelter in lieu of any lost depreciation deduction that provided a tax shelter prior to the sale.

Raising money by means of a sale-leaseback, instead of incurring debt liability by means of a note or mortgage, can help improve a seller-tenant's balance sheet. Raising money by means of a mortgage loan will result in the creation of a corresponding liability; a sale-leaseback may transform a fixed asset — the real estate — into cash without creating a liability. Avoiding new liabilities permits the seller-tenant to present a more favorable financial statement and may improve its credit rating.

To avoid constituting a liability, however, the lease must be an "operating" lease as defined by the rules of the Financial Accounting Standards Board (FASB). The FASB rules class leases as either "capital" leases or "operating" leases. A lease that transfers substantially all the risks and benefits of ownership to the lessee constitutes a capital lease that must be reported as a debt obligation by the lessee. FASB Statement of Financial Accounting Standards No. 13, *Accounting for Leases* §7 (Nov. 1976), as amended and interpreted. All other leases are operating leases, which are accounted for as the rental of property. In addition, the seller-tenant must be careful to measure the respective costs of borrowing and leasing. Some commentators argue that the perceived advantage of improving a seller-tenant's balance sheet is an illusion that can result in disaster. See Frank C. Bernard and Sidney M. Perlstadt, *Sale and Leaseback Transactions,* 1955 U.Ill.L.F. 635, 636, and the authorities cited therein. In addition, there is increasing pressure in the accounting community to change the accounting treatment of long-term leases in general. In the not too distant future, all long-term leases may have to be reflected as liabilities on the seller-tenant's balance sheet. See generally FASB Statement of Financial Accounting Standards No. 98, *Accounting for Leases* (May 1988), for current accounting views, including treatment of sale-leasebacks.

There are times when an owner is restricted from borrowing money by limitations imposed by indentures or loan agreements or by state or federal regulations. A sale-leaseback as a means of raising additional funds can be useful in these situations unless the indenture, loan agreement, or regulations contain specific covenants to prevent sale-leaseback financing.

D. [5.5] Advantages of Sale-Leaseback to Buyer-Landlord

The most obvious advantage to the buyer-landlord is that of a good return on the investment. The rent under the lease usually is predicated on the complete amortization of the purchase price over the primary term of the lease, often at a higher interest rate than that available on loaned mortgage funds. Even if the fixed rent is at a lower rate than interest rates on loaned funds, additional rent, in the form of a participation in net cash flow and proceeds of financing of the leasehold estate, can increase the buyer-landlord's yield if the project is successful to a return greater than would be realized from a corresponding loan. If the seller-tenant exercises one or more options to extend the term of the lease even at a substantially lower fixed rate of rental, the buyer-landlord, who has had its investment completely amortized perhaps at a higher rate of interest than in case of a mortgage loan, will derive additional return during the option periods. This results in a higher rate of return, which helps make a sale-leaseback investment attractive to a buyer-landlord. Frank C. Bernard and Sidney M. Perlstadt, *Sale and Leaseback Transactions,* 1955 U.Ill.L.F. 635, 646.

Unlike a mortgage loan and absent an option in the seller-tenant to repurchase the property, the buyer-landlord has both a noncallable investment and a reversion in the property after expiration

of the lease. At the end of the lease term, the buyer-landlord will have the "total" ownership interest of the land and buildings even after being "repaid" for the property by having its investment amortized through rental payments during the term of the lease. See §5.7 below with regard to the problems raised by the return of land improved with worn-out structures. This may provide a hedge against inflation. In the event of the seller-tenant's default during the lease term, and assuming the problems of the equitable mortgage (discussed in §§5.11, 5.56, and 5.57 below) are overcome, the buyer-landlord can terminate the lease and obtain clear title and possession generally faster than a mortgagee, who would have to go through the process of foreclosure to realize on the mortgage security. In addition, if equitable mortgage problems are again overcome, the buyer-landlord is not faced with the rights of redemption of the creditors of the seller-tenant, as would be the case in a mortgage foreclosure, and with the right of redemption of an individual seller-tenant, which, in the case of a mortgage transaction, could not be waived. Finally, if the default provision of the lease is properly structured (see §5.68 below), the buyer-landlord will be able to sue the seller-tenant for the present value of the lost future rentals, much the same as the mortgagee would have rights to a deficiency judgment.

A lease that calls for participation in the "upside" of the project through payment of part of net cash flow or proceeds of financing of the leasehold estate as additional rent may withstand the problems of a seller-tenant's bankruptcy better than a corresponding mortgage loan with equivalent "kicker" interest if the mortgagor is subject to bankruptcy proceedings. In a lease situation, the trustee can either assume the lease, in which case the additional rent provisions will survive, or reject the lease, in which case the buyer-landlord will succeed to title to the property free of the lease. 11 U.S.C. §365. In a loan situation, the mortgagee may well have to content itself with a return of the principal plus, perhaps, accrued interest while forgoing future kicker interest — the inducement for making the loan in the first place. 11 U.S.C. §501, *et seq.* See §5.6 below for a discussion of the problems a landlord probably will face on any attempt to collect future rent if a bankrupt tenant rejects the lease.

In some instances, a buyer-landlord can gain a cash-flow advantage by mortgaging the fee interest in the property, subject to the lease, and pledging the lease rentals to secure the payment of the loan while retaining the excess rentals over the debt service. Even if the rentals are used entirely to pay debt service, the mortgage proceeds are available to the buyer-landlord, as are the proceeds of future financing once the current mortgage is fully paid. In such a case, it is of paramount importance that the obligations of the seller-tenant with respect to the leased premises extend beyond the obligations of the buyer-landlord under the mortgage. See §§5.46 and 5.47 below. In addition, if the buyer-landlord is a taxpaying entity, the investment will also operate as a tax shelter, permitting the buyer-landlord to take depreciation on the improvements as an offset against taxable income. In those cases in which the seller-tenant retains title to the improvements during the term of the lease, this depreciation, of course, belongs to the seller-tenant and is accordingly unavailable for the buyer-landlord's use.

Because of the net lease features of sale-leaseback financing, the investment is quite suitable for an institutional investor that lacks the capacity to manage real estate investments actively.

E. [5.6] Disadvantages of Sale-Leaseback to Seller-Tenant

Unlike a borrower in a mortgage loan transaction, the seller-tenant is exchanging a permanent property right for a leasehold interest for a stated term, after which the seller-tenant will have no further interest in the property. The seller-tenant has no ability to reacquire the fee unless it has a repurchase option, which can cause problems for the buyer-landlord and the seller-tenant if the repurchase option is for less than fair market value. Reversion of the fee at the end of the lease term may result in a loss to the seller-tenant if the fee has appreciated substantially in value during the lease term, especially if the seller-tenant has improved the land extensively. (Even if the seller-tenant can repurchase the fee at fair market value, it must make the equivalent of a loan repayment, plus pay the buyer-landlord the appreciated value.) See the discussion of repurchase options in §§5.11, 5.56, and 5.57 below.

The seller-tenant runs the risk that there may have been a miscalculation of the anticipated tax advantages because of overoptimism, overoperating results, unfavorable treatment by the IRS or the courts, or a change in the tax laws.

The seller-tenant may experience difficulty in obtaining financing for enlarging or remodeling of the improvements. The only financing readily available is through a leasehold mortgage, which is frequently difficult to obtain on reasonable terms. An owner of the fee who has borrowed money under a mortgage loan can refinance the loan, either with the holder of the mortgage or with a third party. It is much more difficult to persuade a buyer-landlord under a lease to make additional improvements for the tenant's benefit, to furnish funds for the improvements, or to subordinate its fee interest to the seller-tenant's leasehold lender even though the seller-tenant offers the buyer-landlord a good return in the form of increased rent.

In proceedings involving the landlord under the Bankruptcy Code, 11 U.S.C. §101, *et seq.,* the landlord may be deprived of some of its rights against the tenant arising under the lease. While a landlord-debtor or a trustee of a bankrupt landlord may reject an unexpired lease of real property as being an executory contract, §365(h) of the Bankruptcy Code limits such rights as follows:

> **(h)(1)(A) If the trustee rejects an unexpired lease of real property under which the debtor is the lessor and —**
>
> > **(i) if the rejection by the trustee amounts to such a breach as would entitle the lessee to treat such lease as terminated by virtue of its terms, applicable nonbankruptcy law, or any agreement made by the lessee, then the lessee under such lease may treat such lease as terminated by the rejection; or**
> >
> > **(ii) if the term of such lease has commenced, the lessee may retain its rights under such lease (including rights such as those relating to the amount and timing of payment of rent and other amounts payable by the lessee and any right of use, possession, quiet enjoyment, subletting, assignment, or hypothecation) that are in or appurtenant to the real property for the balance of the term of such lease and for any renewal or extension of such rights to the extent that such rights are enforceable under applicable nonbankruptcy law.**

(B) If the lessee retains its rights under subparagraph (A)(ii), the lessee may offset against the rent reserved under such lease for the balance of the term after the date of the rejection of such lease and for the term of any renewal or extension of such lease, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such lease, but the lessee shall not have any other right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance.

(C) The rejection of a lease of real property in a shopping center with respect to which the lessee elects to retain its rights under subparagraph (A)(ii) does not affect the enforceability under applicable nonbankruptcy law of any provision in the lease pertaining to radius, location, use, exclusivity, or tenant mix or balance.

(D) In this paragraph, "lessee" includes any successor, assign, or mortgagee permitted under the terms of such lease.

(2)(A) If the trustee rejects a timeshare interest under a timeshare plan under which the debtor is the timeshare interest seller and —

(i) if the rejection amounts to such a breach as would entitle the timeshare interest purchaser to treat the timeshare plan as terminated under its terms, applicable nonbankruptcy law, or any agreement made by timeshare interest purchaser, the timeshare interest purchaser under the timeshare plan may treat the timeshare plan as terminated by such rejection; or

(ii) if the term of such timeshare interest has commenced, then the timeshare interest purchaser may retain its rights in such timeshare interest for the balance of such term and for any term of renewal or extension of such timeshare interest to the extent that such rights are enforceable under applicable nonbankruptcy law.

(B) If the timeshare interest purchaser retains its rights under subparagraph (A), such timeshare interest purchaser may offset against the moneys due for such timeshare interest for the balance of the term after the date of the rejection of such timeshare interest, and the term of any renewal or extension of such timeshare interest, the value of any damage caused by the nonperformance after the date of such rejection, of any obligation of the debtor under such timeshare plan, but the timeshare interest purchaser shall not have any right against the estate or the debtor on account of any damage occurring after such date caused by such nonperformance. 11 U.S.C. §365(h).

Thus, if the lease is rejected by a bankrupt landlord, the tenant may elect to treat the lease as terminated or may retain possession of the leased premises for the balance of the current term plus any renewal or extension terms the tenant could have exercised without the landlord's consent. If the tenant retains possession of the premises after a rejection, the tenant has no right to force the landlord or trustee to provide services or perform the landlord's obligations promised under the

lease but can offset damages incurred by any such failure and occurring after the rejection against future rents reserved under the lease. The tenant is not entitled to any claim against the debtor for damages arising after the rejection. In a situation such as the type of net lease typically used in sale-leaseback financing in which the landlord has few, if any, continuing obligations, the rights of the tenant should not be materially affected by a rejection if the tenant elects to stay in possession. See the legislative history of 11 U.S.C. §365(h) and Patrick A. Murphy and Eric E. Sagerman, CREDITORS' RIGHTS IN BANKRUPTCY §9.16 (2d ed. 2011 – 2012).

A problem that plagued landlord bankruptcies under former law was resolved in the 1978 reformation of the Bankruptcy Code. In the much-discussed *In re Freeman,* 49 F.Supp. 163 (S.D.Ga. 1943), the court found that in an arrangement proceeding under Chapter XII of the old law, the rent under a rejected lease could be adjusted upward in order to assist in the landlord-debtor's rehabilitation. This decision was followed by some courts (*In re Schnabel,* 612 F.2d 315 (7th Cir. 1980)), rejected by others (*In re Garfinkle,* 577 F.2d 901, 904 n.4 (5th Cir. 1978)), and criticized by commentators (5 Lawrence P. King ed., COLLIER ON BANKRUPTCY §547.11[2][e] (15th rev.ed. 2005); John J. Creedon and Robert M. Zinman, *Landlord's Bankruptcy: Laissez Les Lessees,* 26 Bus.Law. 1391 (1971)). There was concern that the rationale of *Freeman* might well apply to arrangement proceedings under Chapters X and XI of the old bankruptcy law. Section 365(h) of the current Bankruptcy Code resolved this issue if the tenant remains in possession after the landlord or its trustee rejects the lease. In *In re Stable Mews Associates,* 35 B.R. 603 (Bankr. S.D.N.Y. 1983), in accord with the Bankruptcy Code, the court refuted the *Freeman* and *Schnabel* opinions and held that under §365(h) the rent owed by the tenant to the bankrupt landlord after rejection should remain the rent stated in the lease. *See also Carlton Restaurant, Inc. v. TM Carlton House Partners, Ltd. (In re TM Carlton House Partners, Ltd.),* 97 B.R. 819, 823 (Bankr. E.D.Pa. 1989); *In re Flagstaff Realty Associates,* 60 F.3d 1031 (3d Cir. 1995).

In addition, a seller-tenant should consider the risk that the following traditional legal doctrine could be applied to the sale-leaseback transaction: "[I]nstruments executed at the same time between the same contracting parties in course of the same transaction will be construed together." *See, e.g., Wipfli v. Bever,* 37 Wis.2d 324, 155 N.W.2d 71, 72 – 73 (1967). This principle was applied by the Wisconsin Supreme Court in *Harris v. Metropolitan Mall,* 112 Wis.2d 487, 334 N.W.2d 519 (1983). In that case, Metropolitan Mall, a real estate partnership, built a shopping center in Madison, Wisconsin, and subsequently entered into a sale-leaseback transaction with Harris. After 15 months, Metropolitan Mall, as seller-tenant, defaulted under the lease with Harris, the buyer-landlord, who then sued for the unpaid rent and, in addition, sought restitution of the property and cash he had already paid on the purchase price.

The Wisconsin Supreme Court agreed with the buyer-landlord, taking the position that the sale-leaseback were parts of a single transaction. In effect, the breach of the lease was a breach of the total sale-leaseback transaction, and the appropriate remedy for the buyer-landlord was the recovery of his total investment, not just the unpaid rent under the lease. As in other breach-of-contract lawsuits, the buyer-landlord was entitled to receive as damages his expected profit. To reduce the likelihood of this outcome, seller-tenants should always require language in the sales contract and the lease that explicitly provides that the sale and the lease are independent and completely separate transactions and that a default under one gives no remedy with regard to the other.

The individual guarantors on the lease in *Harris* assumed personal liability to pay the buyer-landlord "all damages that may arise in consequence of any default by the Tenant under such lease." 334 N.W.2d at 522. Again, the Wisconsin Supreme Court viewed the sale-leaseback as one transaction and ruled that the guaranty included a right to restitution under the contract. It should be noted that the guaranty was broadly worded and did not limit the obligation of the guarantors to lease-related damages. Lease guarantors in sale-leaseback transactions should always require language in the guaranty explicitly limiting their liability only to damages under the lease. See generally *Classic Cases: Canceling a Sale-Leaseback Transaction,* 29 Real Est.L.Rep. 8 (2000).

F. [5.7] Disadvantages of Sale-Leaseback to Buyer-Landlord

An investment in land and buildings is not as liquid and as readily disposable as an investment in debt obligations secured by mortgages. In addition, a sale-leaseback investment is not as readily divisible as an investment in bonds or preferred stock.

While a landlord may get the property back more quickly in a tenant's bankruptcy and the tenant's rejection of the lease than would a mortgagee in a debtor's bankruptcy, if there are substantial assets in the estate, the landlord does not have rights equivalent to those of a mortgagee if the value of the recovered property does not equal the amount of the landlord's original investment not then returned through rent payments. Future rent (including rights to participate in future net cash flow or proceeds of financing of the leasehold estate through the vehicle of additional rent) is generally not regarded as a debt so that the landlord, unlike a mortgagee, cannot accelerate the entire balance of the unpaid rent in the event of a bankruptcy arrangement or reorganization. Drafters of long-term leases have used various devices to attempt to create a provable debt in the event of a tenant's default (*e.g.,* by specifying the fixed rental for the entire term of the lease in a lump sum, but payable in installments). Nevertheless, if the lease is rejected, the landlord's damages are limited to the greater of one year's rent or 15 percent of the rent for the remaining term of the lease (not to exceed three years) in the event of a straight bankruptcy. 11 U.S.C. §502(b)(6).

One possible agreement may provide assistance to the landlord in the face of a tenant's lease rejection. The legislative history of 11 U.S.C. §502(b)(6) (formerly 11 U.S.C. §502(b)(7)) contains extensive discussions of lease financing transactions. The legislative history indicates that if

> **the lease in fact involves a sale of real estate and the rental payments are in substance the payment of the principal and interest on a secured loan . . . the lessor's claim should not be subject to the §502(b)(6) limitation. The concept of a lease as a hidden security device is well-developed in the Uniform Commercial Code (UCC) and in case law thereunder, but the UCC applies to personal property transactions, while §502(b)(6) applies solely to real estate.** Patrick A. Murphy and Eric E. Sagerman, CREDITORS' RIGHTS IN BANKRUPTCY §5:6, pp. 128 – 129 (2d ed. 2011 – 2012), citing 124 Cong.Rec. H11,093-04 (daily ed. Sept. 28, 1978), S17,410 (Oct. 6, 1978).

See William L. Cary, *Corporate Financing Through the Sale and Lease-Back of Property: Business, Tax, and Policy Considerations,* 62 Harv.L.Rev. 1, 8 (1948); Frank C. Bernard and Sidney M. Perlstadt, *Sale and Leaseback Transactions,* 1955 U.Ill.L.F. 635, 646 – 647.

The difference in position between a landlord of a bankrupt tenant and a mortgagee of a bankrupt borrower becomes less significant in the case of a nonrecourse loan or when there are insufficient assets in the bankrupt estate to pay a deficiency judgment. In either of these cases, the mortgagee will also be restricted solely to its remedies against the mortgaged property.

The Bankruptcy Code negates certain lease provisions that the landlord may have included in the lease to protect its position. Under the Bankruptcy Code, "ipso facto" clauses (which make bankruptcy, arrangement proceedings, etc., filed by the tenant under federal law an event of default) are rendered invalid. 11 U.S.C. §365(e). In addition, notwithstanding any provision in the lease prohibiting or restricting the tenant's right of assignment, a debtor-tenant or trustee may assign the lease to a new tenant if the lease is assumed, the tenant's past defaults are cured, damages from such default are compensated, or adequate assurances of such compensation are given and adequate assurance of future performance by the assignee of the lease is provided. 11 U.S.C. §§365(b)(1), 365(f)(1), 365(f)(2). In the case of leases of premises in a shopping center, the adequate assurances are described in detail. 11 U.S.C. §365(b)(3). Thus, a landlord may find itself dealing with a tenant other than a party the landlord originally bargained with and legally bound to that new tenant under the terms of the lease.

The question of the economic value of a buyer-landlord's reversion in the property is the subject of much speculation. On its face, the buyer-landlord seems to be getting a windfall by its succession to the reversion. If, however, the lease is for a significantly long term and the improvements are constructed at the beginning of the lease term and not replaced during the term, the value of the improvements on the land at the end of the lease term may have substantially depreciated, and in fact the buyer-landlord may incur substantial expense in demolishing the improvements.

Difficulties for the buyer-landlord could arise if the sale-leaseback transaction is deemed to be an equitable mortgage or a disguised joint venture, whether in a state court proceeding or if the seller-tenant files for bankruptcy. Aside from the tax consequences, if the transaction is found to be an equitable mortgage, the buyer-landlord would have greater difficulty in realizing on its "security" since the usual rights a mortgagee builds into mortgage instruments in the event of a borrower's default, such as a waiver of the borrower's right of redemption, will be missing. In addition, as a joint venturer, the landlord (who has been recharacterized as a joint venturer) may be jointly and severally liable for the debts of the venture owed to those parties. *PCH Associates v. Liona Corp. (In re PCH Associates),* 55 B.R. 273 (Bankr. S.D.N.Y. 1985), *aff'd,* 60 B.R. 870 (S.D.N.Y.), *aff'd,* 804 F.2d 193 (2d Cir. 1986). If the transaction is found to be a joint venture, many of the devices that would be built into a joint venture agreement to protect a passive investor will not be available for the buyer-landlord. See the discussion of the concept of equitable mortgage and disguised joint venturers in §§5.11, 5.56, 5.57 below and the discussion of recharacterization in bankruptcy proceedings in §§5.72 – 5.79 below. See generally Lewis D. Solomon and William H.D. Fones, Jr., Est. of Franklin *Sale-Leasebacks and the Shelter-Oriented Investor: An Analysis of* Frank Lyon Co., 56 Taxes 618, 619 (1978); Kenneth L. Stewart, *Taxation of Sale and Leaseback Transactions — A General Overview,* 32 Vand.L.Rev. 945, 948 – 951 (1979); Thomas C. Homburger et al., *Unresolved Questions in Sale-Leaseback Transactions: A Look at Real Estate, Tax, and Bankruptcy Law Issues,* 19 Real Prop.Prob. & Tr. J. 941 (Winter 1984); Lewis R. Kaster, *Income Tax Characterization of Net Lease and Sale-Leaseback Transactions,* 269 PLI/Tax 335 (1988).

III. AGREEMENT OF PURCHASE AND SALE

A. [5.8] Commitment

Unless the parties have agreed on the precise form of the lease so that a specimen can be attached to the contract as an exhibit, a formal contract of purchase and sale serves little purpose. Such a contract might well be held not to be specifically enforceable (except perhaps as an agreement of the parties to negotiate a lease in good faith) because of uncertainty as to the form of the lease, even if certain of the basic terms are spelled out in the contract. Frequently, however, the parties wish to evidence their intent without waiting to have all the details of the lease spelled out. This condition prevails especially if the transaction contemplates the construction of improvements by the seller-tenant that will be sold to the buyer-landlord upon completion of construction. Under these circumstances, the seller-tenant will find it helpful to have a so-called commitment or letter of intent from the buyer-landlord for the purchase of the property and to use this to obtain interim financing.

In general, commitments can fall into one of three categories: (1) a binding contract that the parties can enforce with respect to the transaction outlined in the commitment (*see Quake Construction, Inc. v. American Airlines, Inc.,* 141 Ill.2d 281, 565 N.E.2d 990, 152 Ill.Dec. 308 (1990)); (2) not a contract to consummate the transaction outlined in the commitment, but rather a contract creating an obligation of the parties to negotiate in good faith (*see Berco Investments, Inc. v. Earle M. Jorgensen Co.,* 861 F.Supp. 705 (N.D.Ill. 1994)); or (3) a simple term sheet outlining the discussions of the parties but creating no obligation either to consummate the transaction or even to negotiate in good faith (*see Philmar Mid-Atlantic, Inc. v. York Street Associates II,* 389 Pa.Super. 297, 566 A.2d 1253 (1989)). Which category a commitment or letter of intent falls under is a question of the intent of the parties as determined by a court.

The parties to a commitment must decide whether they wish to impose on themselves an obligation to negotiate in good faith, execute a binding contract, or create no obligations whatsoever. The answers to these questions should be clearly stated in any written commitment. Thus, for example, if the parties wish to impose an obligation to continue negotiations in good faith and nothing more, the commitment should contain language similar to the following:

This document contains an enumeration of certain business understandings that the parties have reached that may become part of a contract if the parties eventually enter into such a contract. Standing on its own, however, this document is not intended to impose any obligations whatsoever on either party, except for the sole exception of an obligation to bargain in good faith based on the business understandings enumerated herein. The parties do not intend to be bound by any other agreement until both agree to and sign a formal written contract, and neither party may reasonably rely on any promises inconsistent with this paragraph. Until such a definitive agreement is finalized, approved by the respective boards of directors (which approval shall be in the sole subjective discretion of the respective boards of directors), and properly executed, neither party shall have any obligation to the other (whether under this commitment or otherwise), with the sole exception of a legal duty as aforesaid to continue negotiations in good faith toward the goal of reaching such a definitive agreement. This paragraph supersedes all other conflicting language in this document.

A properly drafted commitment can protect both sides of the transaction, and the commitment can form a basis by which either party may resist any attempt by the other to vary the basic terms of the transaction contained in the commitment. In addition, the commitment can form the basis of an action for damages against the buyer-landlord if, during the negotiations on the lease term, the buyer-landlord was to act in obvious bad faith in refusing to agree on the terms of the lease. *See A/S Apothekernes Laboratorium for Specialpraeparater v. I.M.C. Chemical Group, Inc.,* 873 F.2d 155 (7th Cir. 1989). The seller-tenant's burden of proof necessary to establish the unreasonableness of the buyer-landlord is, however, a substantial one and difficult to meet. *Sonnenblick-Goldman Corp. v. Murphy,* 420 F.2d 1169, 1173 (7th Cir. 1970); *Boston Road Shopping Center, Inc. v. Teachers Insurance & Annuity Association of America,* 13 A.D.2d 106, 213 N.Y.S.2d 522, 527 (1961), *aff'd,* 11 N.Y.2d 831 (1962). At least one court has found specific performance to be an appropriate remedy for a breach of a commitment. *First National State Bank of New Jersey v. Commonwealth Federal Savings & Loan Association of Norristown,* 610 F.2d 164 (3d Cir. 1979) (commitment for permanent mortgage loan financing specifically enforced). *See generally Empro Manufacturing Co. v. Ball-Co Manufacturing, Inc.,* 870 F.2d 423 (7th Cir. 1989).

A refundable commitment fee or standby fee is often paid by the seller-tenant just as in a mortgage loan commitment. This fee is refunded upon the consummation of the transaction. If the seller-tenant fails to comply with the requirements of the commitment within the time period provided, the commitment fee can be retained by the buyer-landlord to pay its liquidated damages. *See, e.g., Boston Road Shopping Center, supra,* a mortgage commitment case, in which the court held the lender could retain the commitment fee paid by the borrower. A condition of the commitment requiring that certain occupancy leases must be in a form satisfactory to the lender did not render the commitment an illusory contract since the court would impose a reasonable standard on the exercise of the lender's judgment. *See also Sonnenblick-Goldman, supra,* 420 F.2d at 1173, another case dealing with the enforceability of a mortgage commitment in which the court, in finding that a lender cannot act arbitrarily in demanding the creation of loan reserves, quoted with approval the following:

> **The fact that the parties have left some matters to be determined in the future should not prevent enforcement, if some method of determination independent of a party's mere 'wish, will, and desire' exists, either by virtue of the agreement itself or by commercial practice or other usage or custom. This may be the case, even though the determination is left to one of the contracting parties, if he is required to make it 'in good faith' in accordance with some existing standard or with facts capable of objective proof. Corbin on Contracts, §95, pp. 401 – 402; §97, pp. 425 – 426.**

Presumably, this same standard would apply in the case of a commitment issued in a sale-leaseback transaction.

Often, commitments contain a time limit for agreement on the form of lease so that, in case of failure of the parties to agree on a form, the commitment will expire by its terms. While such a provision is often inserted by a buyer-landlord in an attempt to pressure the seller-tenant into agreeing to the terms of a lease within a reasonably short period, such a provision can turn into a double-edged sword, working toward the detriment of the buyer-landlord. If the form of lease is not agreed on within the required time period, the seller-tenant is then presented with a means by

which the commitment can be terminated and, possibly, the return of a standby deposit demanded. In order to avoid such a problem, the buyer-landlord's commitment should contain a provision empowering the buyer-landlord, at its sole discretion, either to extend by written notice to the seller-tenant the period of time during which the form of lease can be agreed on (thereby obviating the need to obtain the seller-tenant's consent to such an extension) or to terminate the commitment and retain the standby deposit.

B. [5.9] Contract

If a contract is used, either when the form of lease has been finalized or because the parties elect not to use a commitment (notwithstanding the problems raised in §5.8 above), the contract most likely will be in the usual form of a purchase and sale contract commonly used in the location of the property, with a condition that the lease be executed and delivered concurrently with and as a condition of the closing. Usually, any requirement for prorations is eliminated since any adjustments between buyer and seller, which would normally be part of a sale, would be offset by adjustments between the landlord and tenant under the lease. For example, no point is served by an allowance of accrued real estate taxes by the seller to the buyer since it will become the seller's obligation as tenant under the net lease to pay the very same taxes for which it will have given a credit.

C. [5.10] Basic Terms of Commitment and/or Contract

While, of course, each commitment or contract will be subject to the terms agreed on by the parties and tailored to the basic transaction, the following is a summary of some of the basic types of terms that could be expected to be found in a commitment or contract for a sale-leaseback transaction:

1. If the buyer is an institutional investor, the commitment and even any final contract entered into will frequently contain broad provisions requiring documents; title matters; evidence of compliance with zoning, building, EPA, and flood control ordinances and regulations; and related matters to be generally acceptable to the buyer and to be subject to unqualified approval by the buyer's counsel. Sometimes, there is a requirement for an opinion by the seller's counsel as well. Some institutional buyers also require the seller to make various representations and warranties, particularly if the buyer is relying on the credit standing of the seller as a prospective tenant. As long as the conditions and requirements are enunciated in such a fashion that a reasonable standard can be applied to determine whether they have been complied with, these conditions should not render the commitment or contract illusory. *Sonnenblick-Goldman Corp. v. Murphy,* 420 F.2d 1169 (7th Cir. 1970); *Boston Road Shopping Center, Inc. v. Teachers Insurance & Annuity Association of America,* 13 A.D.2d 106, 213 N.Y.S.2d 522 (1961), *aff'd,* 11 N.Y.2d 831 (1962). See §5.9 above.

2. If a purchase is to be made by an institutional investor, the contract or commitment will, as in the case of mortgage loans, usually require the seller to bear all expenses, including the buyer's out-of-pocket expenses and attorneys' fees.

3. If the transaction does not involve the sale of an existing project, the contract or commitment will most likely include the obligation of the buyer or the seller (depending on the

nature of the transaction) to construct certain improvements on the land in accordance with agreed-on plans and specifications. If title to the improvements is to be vested in the landlord during the term of the lease, construction of these improvements may be either the tenant's or the landlord's obligation, depending on the agreement of the parties. If title to these improvements is to be vested in the tenant, with the landlord receiving only the title to the land and a reversionary interest in the improvements, the seller-tenant will most likely be required to complete the improvements.

4. The date of closing will depend on the structure of the transaction. If the sale-leaseback involves an existing, completed project, the parties can close as soon as the form of lease is agreed on and the other conditions of closing are met. If, however, the sale involves vacant land only on which improvements are to be constructed, the party not charged with the obligations of construction will not want to close until it has been presented with suitable evidence that the improvements have been constructed in accordance with the agreement of the parties (such as an architect's certificate of at least substantial completion and a certificate of origin).

5. Unless a so-called "New York style" closing is utilized by the parties, transactions are frequently closed through a deed and money escrow in which provision is made for a return of the buyer's money if title fails, subject to the buyer's reconveyance to the seller. A memorandum of lease setting forth the existence of the lease, its terms, and all options and contracts contained in the lease will often be deposited in the escrow to be recorded immediately after the deed from the seller to the buyer. This memorandum should impart constructive notice on third parties of the existence of the lease (*Bezin v. Ginsburg,* 59 Ill.App.3d 429, 375 N.E.2d 468, 16 Ill.Dec. 595 (1st Dist. 1978)), of any special agreements between the parties of which third parties should be placed on notice (*e.g.,* no right of the tenant to subject the landlord's reversion to a lien), and of any option or right in the tenant to purchase the landlord's reversion (although some authorities contend that the mere possession of the demised premises by the tenant is sufficient notice of an option to purchase) (Robert T. Kratovil, *Lease Draftsmanship: Problems of Lessees and Their Lenders,* The Guarantor (Apr. 1970)). In order to remove any cloud on the title resulting from the recording of the lease or of a memorandum of lease, the escrow frequently requires the deposit of a lease cancellation agreement, which the escrowee will record if the lease is terminated prior to the expiration of its scheduled term.

6. The buyer will generally require an American Land Title Association Owner's Policy with special insurance against possible mechanics lien claims, rights of parties in possession, unrecorded easements and encroachments, and a current survey of the property showing all existing improvements. The seller may also obtain a policy insuring the leasehold estate and, if applicable, the separate estate in the improvements.

7. In some cases, the purchase price is not fixed but is to be based on the cost of construction of improvements with a certain dollar amount as a ceiling. An institutional investor also often requires that the price it pays be supported by a good appraisal as to whether the price is fixed.

If the contract price is flexible, the lease rental will often be stated in the commitment or contract in terms of a percentage of the purchase price. When the lease itself is executed, the dollar amount of rental is inserted since, at the time of execution, the purchase price will usually have been determined. In some instances, the lease itself contains a formula rather than a dollar figure

for the amount of rent. In these circumstances, once the amount of rent has been determined and agreed on, it is advisable for the parties to execute a supplement to the lease or, at least, an informal writing setting forth the dollar amount of rental that the parties have agreed on. Note, however, the problems raised in §5.11 below with respect to commitments or leases stating rent as a formula based on the amortization of the purchase price plus an interest factor.

8. The contract will require evidence that if the seller is a corporation, its board of directors has duly authorized the sale. In addition, if the sale involves all or substantially all the assets of a corporate seller, evidence of the approval of the requisite number of the corporation's shareholders must be provided. This might cause problems if a large number of dissenting shareholders express their disapproval of the sale-leaseback transaction and demand payment of the fair value of their shares pursuant to statute. 805 ILCS 5/11.60, 5/11.65, 5/11.70; William L. Cary, *Corporate Financing Through the Sale and Lease-Back of Property: Business, Tax, and Policy Considerations,* 62 Harv.L.Rev. 1, 16 (1948). If the buyer is a corporation, the seller may require evidence that the buyer's board of directors has authorized the lease of the premises after closing. If either party is a partnership or limited liability company, evidence may be required (perhaps in the form of an attorney's opinion) that the partner executing the required instruments on behalf of the partnership or limited liability company has the requisite authority to do so.

D. Equitable Mortgages; Disguised Joint Ventures

1. [5.11] Avoiding Finding of Equitable Mortgage

As stated in §5.7 above, one danger inherent in an improperly structured sale-leaseback transaction is that a court will find the transaction not to be a sale and lease at all but rather a disguised loan of money with the buyer-landlord's rights in the property constituting an equitable mortgage. Apart from the serious tax consequences of such a finding, both to the buyer-landlord and to the seller-tenant, which are beyond the scope of this handbook, the landlord-mortgagee is, in the case of default, faced with the problems of foreclosing a mortgage without the benefit of a waiver of the rights of redemption and without the benefit of the various covenants usually contained in a mortgage and applicable in the case of default (*e.g.,* an agreement that the mortgage secures all money expended by the mortgagee to cure the mortgagor's default, notwithstanding that the total amount secured by the mortgage exceeds the face amount of the note).

Whether a deed or other conveyance that appears to be absolute on its face is, in fact, merely given as security for a loan depends on the facts and circumstances of the particular transaction that evidence that the parties intended the transaction to be a financing instead of a conveyance and lease. A seller-tenant or other party (*e.g.,* a creditor of the seller-tenant seeking to redeem) alleging that, for other than tax purposes, a sale was really an equitable mortgage must produce clear, satisfactory, and convincing evidence of the intent of the parties. Parol evidence is admissible. In determining whether a sale is really a loan secured by an equitable mortgage, Illinois courts have considered factors such as the ratio of consideration paid to fair market value of the property (*e.g.,* if the value of the property "purchased" was substantially in excess of the consideration paid, it evidences a loan instead of a purchase), the actions of the "tenant" with respect to the property (*e.g.,* if the seller-tenant improves the property although not required to do so by the lease), the existence of an option to repurchase the property at an amount that does not reflect the fair market

value of the property, and the agreement of the seller-tenant to repay a fixed sum plus interest within a fixed time (which obligation could be read into improperly drawn rent-payable provisions). *Leeds & Lippincott Co. v. United States,* 276 F.2d 927 (3d Cir. 1960) (per curiam); *Commissioner v. F. & R. Lazarus & Co.,* 101 F.2d 728 (6th Cir.), *aff'd,* 60 S.Ct. 209 (1939); *Wilkinson v. Johnson,* 29 Ill.2d 392, 194 N.E.2d 328 (1963).

Another problem that may result in many jurisdictions from the finding of an equitable mortgage and concomitant loan is that the transaction is usurious. Often, the percentage rate of return built into a sale-leaseback transaction (or the combined rate or return from the lease and the interest paid by the seller-tenant as leasehold mortgagor to the buyer-landlord as leasehold mortgagee pursuant to a separate leasehold mortgage made as part of the whole transaction) will exceed the interest rate permissible under applicable state law. Since, however, Illinois has both the business loan exception to the usury laws (815 ILCS 205/4(1)(c)), which sets no limits on interest payable in connection with any loan made for a business purpose, and an exemption from maximum interest limitations for loans "secured" by real estate (815 ILCS 205/4(1)(*l*)), this problem will not exist in any sale-leaseback transaction covered by Illinois law. If Illinois law does not govern the transaction, the problem of usury must be seriously considered.

During the 1972 session on sale-leaseback financing held in New York City under the auspices of the Practising Law Institute, one panelist suggested the following ground rules used by one institutional investor in order to avoid having a sale-leaseback construed as a mortgage:

a. Avoid characterizing the transaction as a mortgage transaction; contracts, commitments, and leases should not use such terms as "interest rate" and "amortization." Avoid side agreements that make a transaction look like a loan. *See Sun Oil Co. v. Commissioner,* 562 F.2d 258, 266 (3d Cir. 1977), *cert. denied,* 98 S.Ct. 2845 (1978), a tax case, in which the court was influenced by the use of such mortgage loan terms as "principal," "interest," "standby fees," and loan "commitment fees."

b. Have the lease look like a lease and not like a bond or a mortgage.

c. Avoid great disparity between the purchase price and the actual value of the property. The value of the property should be supported by impartial evidence, such as an appraisal. In addition, the rental should, if possible, reflect the fair market value of the property and not simply an amortization of the purchase price plus an "interest factor."

d. Avoid granting the seller-tenant an option to repurchase the property for substantially less than the fair market value of the property at the time of the repurchase.

e. Avoid any requirement that the seller-tenant must repurchase the property at the end of the lease term. In addition, avoid making the term of the lease — the basic term and all option terms granted to the seller-tenant — so much shorter than the useful life of the improvements that the seller-tenant will be obligated to exercise an option to repurchase or to negotiate with the buyer-landlord for a right to repurchase in order to avoid losing much of the remaining usable life of the improvements. Lyn R. Oliensis, SALE AND LEASEBACK FINANCING, p. 92, *et seq.* (PLI, 1973).

In addition, a number of judicial opinions arising in the context of whether, for tax purposes, a sale-leaseback transaction is a true sale and lease give guidance regarding the characteristics necessary to avoid the treatment of a sale-leaseback as a financing arrangement. In *Sun Oil, supra,* 562 F.2d at 268 – 269, the court focused on the "attributes of ownership." The important factors delineated by the *Sun Oil* court include the following:

Risks and responsibilities. The burdens and risks on the buyer-landlord and seller-tenant should be consistent with customary substantive bargains made in the marketplace between landlords and tenants.

Benefits of the transaction. Granting the seller-tenant broad powers regarding benefits traditionally reserved to the owner of the property will be deemed as benefits characteristic of ownership of property rather than those of a leasehold.

Rentals. Rental should reflect the fair rental value of the property. In negotiation and documentation, the use of terms common in mortgage financing and not traditional in a landlord-tenant relationship should be avoided.

Options to repurchase. The repurchase provision should not be geared to the unamortized principal advanced by the buyer-landlord. See §§5.56 and 5.57 below for a discussion of the "equitable mortgage" problem in the context of repurchase options. *See also Frank Lyon Co. v. United States,* 435 U.S. 561, 55 L.Ed.2d 550, 98 S.Ct. 1291 (1978).

While *Sun Oil* and *Frank Lyon* deal with the tax treatment of sale-leaseback transactions, the consideration by the courts of the various characteristics of a transaction they found persuasive is instructive.

Of course, the parties to a sale-leaseback transaction may not be able to comply with all the foregoing guidelines and still have the transaction make business sense. An effort should be made, however, to comply with as many of the guidelines as possible.

2. [5.12] Avoiding Partner or Joint Venturer Relationship

In one type of sale-leaseback transaction currently in vogue, if the buyer-landlord receives fixed rent and also participatory rent equal to a part of the net cash flow and proceeds of sale and refinancing from the seller-tenant's property, the buyer-landlord must take care lest a court reconstrue the buyer-landlord's relationship with the seller-tenant as one of partners or joint venturers.

The basis of such a finding would be that the buyer-landlord has a proprietary interest in the seller-tenant's property through ownership of the land, is involved in the conduct of the seller-tenant's business, and shares in the profits of the enterprise because of its participation in the seller-tenant's profit via the payment of participatory ground rent. Such a finding would leave the buyer-landlord open to a third-party claim arising from the seller-tenant's actions and to a possible reallocation of the tax benefits arising from the transaction. In addition, if the buyer-landlord is found to be a joint venturer, it may lose its rights as a landlord to terminate the lease and regain possession and may be forced to sue in equity for an accounting.

The danger that the buyer-landlord might be found to be a partner or joint venturer with the seller-tenant is increased as the buyer-landlord inserts into the lease documents provisions that give the buyer-landlord the types of safeguards normally desired by one interested in the success of an enterprise. The buyer-landlord has a definite interest in seeing that the seller-tenant's business is managed in such a way as to maximize net cash flow and that any sale or refinancing is done in such a way as to maximize proceeds. The greater these amounts, the greater the amount of participatory rent the buyer-landlord receives. However, the more controls the buyer-landlord builds into the ground lease in order to achieve the goal of maximizing net cash flow and proceeds of sale and refinancing, the more fuel the buyer-landlord provides to the argument that it has stepped beyond the landlord's role and into the role of a partner or a joint venturer.

Arguments can be made against holding the buyer-landlord to be a partner or joint venturer. First of all, many commercial landlords, especially of tenants in the retail business, now share in their tenant's profits via percentage rent. These commercial landlords, having an interest in the tenant's success, build in some control over the tenant's business via the lease. The buyer-landlord in a participatory lease of land only has similar interests and goals. Holding a buyer-landlord of the land only to be a partner or joint venturer could open the door for all these retail leases to be attacked. Second, most ground leases do not give the buyer-landlord real control over the operation of the seller-tenant's business venture — a key element of a partnership or joint venture. Third, while the real investment incentive for the buyer-landlord in entering into the transaction may be its participatory features and not the fixed-rent payments, the buyer-landlord receives a certain bottom-line return as to whether the seller-tenant's business is successful. The buyer-landlord gets the fixed rent during the lease term and generally the improvements at the end of the term regardless of whether the seller-tenant's business is successful. Since the buyer-landlord's return from the enterprise does not rest wholly on its success, the community of interest and the duty to share profits and losses necessary for a partnership or joint venture do not exist. Fourth, at least between the buyer-landlord and the seller-tenant, the parties have knowingly chosen the lease format with its participatory features. The seller-tenant should not later be heard to argue that, notwithstanding the lease format knowingly entered into, the transaction is indeed a partnership or joint venture. *See, e.g., In re Kassuba,* 562 F.2d 511 (7th Cir. 1977).

The buyer-landlord can take a number of preventive steps when entering into a sale-leaseback transaction in order to strengthen its arguments against a contention by the seller-tenant or a third party that the relationship is indeed a joint venture, partnership, or loan.

For example, in leases in which the amount of rent is determined at least in part by participation in the seller-tenant's income from the property, the buyer-landlord should avoid acquiring controls of such a nature that the buyer-landlord could be deemed to be in joint control of the seller-tenant's business. The buyer-landlord's legitimate desire to maximize cash flow and the proceeds of any sale or refinancing can be accomplished largely by requiring the buyer-landlord's approval of certain vital features of the enterprise that affect profitability (such as annual budgets) and by restricting actions of the seller-tenant that favor the seller-tenant to the detriment of the enterprise (such as making payment to the seller-tenant or a related entity of fees in excess of market prices). In this way, the buyer-landlord can justify limited controls as necessary to protect its interest in maximizing participatory rent without initiating actions and operating the business.

Second, the lease documents should contain a clear recital that the buyer-landlord and the seller-tenant are entering into a lease arrangement and not a partnership, joint venture, or loan; that the buyer-landlord would not have entered into the transaction if a partnership, joint venture, or loan would be the result; that the seller-tenant has been represented by experienced legal counsel who has advised the seller-tenant of the rights and duties of a seller-tenant; and that the seller-tenant will not raise a partnership, loan, or joint venture defense if the buyer-landlord subsequently seeks to enforce legal rights as lessor. If the parties to the transaction are sophisticated and represented by competent counsel, such a recital should help a court conclude that the seller-tenant is bound by the format the seller-tenant knowingly chose and is estopped from raising such defenses.

Third, to ensure the buyer-landlord at least secured creditor status if the transaction is recharacterized as a loan in bankruptcy and to weaken any argument by a third party that a loan or joint venture arrangement exists, a duly recorded memorandum of lease should spell out clearly the nature of the lessor-lessee relationship. If the transaction is recharacterized as a loan, the buyer-landlord may be regarded as an unsecured creditor in the absence of appropriate recorded documents. Similarly, escrow arrangements in which title to the property is not conveyed immediately should be avoided. If the escrowee holds the title deed without recordation, the buyer-landlord cannot assert its title to the real estate against a bankrupt seller-tenant standing in the trustee's shoes. 11 U.S.C. §544; *Capital Center Equities v. Estate of Gordon (In re Capital Center Equities),* 137 B.R. 600 (Bankr. E.D.Pa. 1992).

Fourth, the parties should avoid characterizing the transaction as a mortgage transaction. Contracts, commitments, leases, and other documents should not use loan terms such as "interest rate" and "amortization." Side agreements that cause a transaction to look like a loan should be avoided.

Fifth, the parties should avoid great disparity between the purchase price and the actual value of the property. Any difference should be supported by impartial evidence, such as an appraisal. In addition, the rental should seek to reflect the fair market value of the property and not simply an amortization of the purchase price plus an interest factor.

Sixth, the parties should avoid granting the seller-tenant an option to repurchase the property for substantially less than the fair market value of the property at the time of the repurchase.

Seventh, the parties should avoid any requirement that the seller-tenant must repurchase the property at the end of the lease term. In addition, they should avoid making the term of the lease — the basic term and all option terms granted to the seller-tenant — so much shorter than the useful life of the improvements that the seller-tenant effectively will be compelled to exercise an option to repurchase or to negotiate with the buyer-landlord for a right to repurchase to avoid losing much of the remaining usable life of the improvements.

Finally, the adverse effects to the buyer-landlord resulting from a successful attempt by a bankrupt seller-tenant to recharacterize a sale-leaseback transaction might be substantially reduced by using credit enhancement. The obligations of the seller-tenant could be backed by a guarantee, letter of credit, or other type of credit enhancement. In the event of a bankruptcy of the seller-tenant and a successful attempt to recharacterize the transaction, the buyer-landlord would have recourse to the credit enhancer to the extent the buyer-landlord is not made whole through the bankruptcy proceedings.

E. Forms

1. [5.13] Provision in Contract to Which Copy of Lease Is Attached as Exhibit

Concurrently with the delivery of the Deed and as an integral part of this transaction, Buyer, as landlord, and Seller, as tenant, shall execute and deliver a lease substantially in the form attached to this contract and marked [Exhibit A**], with the blanks to be completed appropriately in accordance with the provisions of this contract.**

NOTE: The time of commencement of the lease, original term, provisions for any fractional month, formulae for determining dollar amount of rent, and like matters, if left blank in the lease attached as an exhibit, and any other blanks in the lease will then have to be provided for appropriately in the body of the contract.

2. [5.14] Provision in Commitment or Contract in Which Form of Lease Has Not Yet Been Agreed On

Concurrently with the delivery of the Deed and as an integral part of the transaction, Buyer, as landlord, and Seller, as tenant, shall execute a lease in accordance with the provisions of this document in such form as the parties shall mutually agree on. In case the parties shall not have agreed on a form of lease within _____ days from the date of this document or by such further date as Buyer may extend this period by written notice to Seller (but not beyond _____ days from the date of this document), this agreement shall terminate and be of no further force and effect.

NOTE: In some instances, depending on the relationship of the parties, it will be appropriate to provide that if the parties do not agree on a form of lease, the buyer will retain a deposit as liquidated damages or the seller will retain the earnest money as liquidated damages unless the failure to reach an agreement is the result of the failure of the party retaining the deposit or earnest money to act in good faith.

IV. LEASE

A. [5.15] In General

The lease will follow the form of a typical long-term net lease but will not often be favorable to the buyer-landlord. One of the penalties the seller-tenant must pay for the financial advantages of the transaction is that the form of lease will necessarily minimize the buyer-landlord's risks of loss to the greatest extent possible and will confer broad remedies on the buyer-landlord for the seller-tenant's defaults. As discussed in §§5.11 and 5.12 above, the buyer-landlord must exercise great care to see that the lease retains the basic characteristics of a lease and does not become a mortgage, bond indenture, or disguised joint venture.

B. Net Lease

1. [5.16] Characteristics of Net Lease

The lease will be a so-called "net lease." In common parlance, it will sometimes be characterized as "net-net" or even "net-net-net." While these terms defy definition, their implication is clear. The seller-tenant, almost invariably, agrees (a) to pay all taxes and assessments that are unpaid and have accrued at the commencement of the term and that continue to accrue during the term of the lease; (b) to carry, at the seller-tenant's expense, various kinds of insurance for the benefit of the buyer-landlord, including fire and extended coverage, boiler and other types of casualty insurance, and liability insurance; and (c) to bear all costs of maintenance and repair. Frequently, the lease contains a general statement of the intent of the parties that it shall be a net lease so that the buyer-landlord will receive the fixed rent and any additional rent to which it may be entitled by reason of the success of the project without reduction or diminution of any kind. This provision is, of course, merely declaratory, and the lease always contains detailed provisions that spell out the various obligations of the seller-tenant to render the lease a net lease. See §5.39 below on the non-abatement of rent following destruction of the improvements by fire or other casualty and following partial condemnation.

2. [5.17] Forms of Provisions To Establish Intention That Lease Will Be Net Lease

This provision is to be coupled with specific provisions for the seller-tenant to pay taxes and insurance premiums, maintain the property, comply with ordinances, etc. See §§5.61 and 5.65 below for examples of these types of provisions.

1. The Basic Rent shall be absolutely net to Landlord so that this Lease shall yield, net, to Landlord the specified Basic Rent in each year during the term of this Lease, and so that every item of expense of every kind, except as otherwise provided in this Lease, for the payment of which Landlord is, shall, or may be or become liable by reason of its estate or interest in the Demised Premises or of any rights or interests of Landlord in, under, or arising from the ownership, leasing, operation, or management of the Demised Premises or by reason of or in any manner connected with the maintenance, repair, rebuilding, remodeling, renovation, use, or occupancy of the Demised Premises or any buildings or improvements on those Premises shall be borne by Tenant. Except as otherwise specifically provided, damage to or destruction of any portion or all of the buildings, structures, and fixtures on the Demised Premises by fire, the elements, or any other cause whatsoever, whether with or without fault on the part of Tenant, shall not terminate this Lease or entitle Tenant to surrender the Demised Premises or entitle Tenant to any abatement of or reduction in the rent payable or otherwise affect the respective obligations of the parties to this provision, any present or future law to the contrary notwithstanding. If the use of the Demised Premises for any purpose should at any time during the term of this Lease be prohibited by law or ordinance or other governmental regulation or prevented by injunction or if there is any eviction by title paramount, this Lease shall not, except as otherwise specifically provided, be thereby terminated, nor shall Tenant be entitled by reason thereof to surrender the Demised Premises or to any abatement or reduction in rent, nor shall the respective obligations of the parties to this provision be otherwise affected.

2. The Basic Rent shall be paid to Landlord without notice, abatement, deduction, or setoff.

3. Tenant shall also pay without notice, abatement, deduction, or setoff, as additional rent, all sums, impositions costs, expenses, and other payments that Tenant in any of the provisions of this Lease agrees to pay. In the event of any nonpayment of any of the foregoing, Landlord shall have all the rights and remedies provided for by law in the case of nonpayment of the Basic Rent.

NOTE: See §5.65 below for a clause defining the "impositions."

C. [5.18] Term of Lease

The lease is usually for a fairly long term. The minimum is usually 20 to 30 years. The seller-tenant is frequently given renewal options to extend the term up to as long as 80 to 90 years. Tax considerations are often important in determining the length of the term.

D. Rent

1. [5.19] Factors in Determining Amount of Rent

Basic rent in the typical sale-leaseback transaction is computed so that the buyer-landlord's investment, with interest at a fixed rate at times slightly in excess of the prevailing market rate for mortgage loans, will be amortized over the primary term of the lease. In some instances, the basic rental is reduced during the renewal option periods since the original investment plus interest has been returned. In this respect, the lease in a sale-leaseback transaction is different from the usual ground lease. Under the ground lease not involving a sale-leaseback, the ground rental the tenant is paying represents a fair market rental for the use of the land on which the tenant has erected or will erect the building. Since the land is not subject to physical depreciation, ground lease rent will most likely remain constant throughout the term of the ground lease (or will be subject to periodic upward adjustments, based on reappraisals). In a sale-leaseback transaction, on the other hand, the basic rent is designed to return the buyer-landlord's original investment plus interest so that it is possible for the seller-tenant to negotiate reduced basic rental payments during the extension terms. As discussed in §§5.11 and 5.12 above, great care must be taken in structuring the rent payments to avoid the appearance of a loan so that a court will not find the transaction to be, in fact, a loan secured by an equitable mortgage.

Some buyer-landlords, in an effort to maintain a constant fixed return in real money terms during an inflationary economy, require the seller-tenant to pay, in addition to the fixed rent, an "inflation hedge" of a portion of the gross income realized per annum by the seller-tenant from the property. Often, in computing the gross income figure, the seller-tenant is allowed to exclude any amounts collected from the occupancy tenants as a result of tax or escalation clauses. An alternative method of protecting the buyer-landlord's return against dilution from inflation is to require the seller-tenant to pay additional rent based on a cost-of-living escalation provision. In addition, in an effort to maintain a fixed return, a buyer-landlord may require the seller-tenant to reimburse the

buyer-landlord for any state or local taxes imposed on the buyer-landlord by reason of the transaction (although perhaps this obligation might be found already in the rent absolute language set forth in §5.17 above). S. Douglas Weil, *Land Leasebacks Move Up Fast as Financing Techniques,* 1 Real Est.Rev., No. 4, pp. 65, 68 (1972).

In times of extremely high interest rates, investors have made sale-leaseback financing available for a consideration consisting of fixed rent below the then-current interest rates plus additional rent measured by net cash flow and proceeds of financing of the leasehold estate. This allows the seller-tenant to enter into the financing at a level of fixed cost that may be more manageable than the cash outlay that would be necessary to service conventional mortgage financing while still enabling the buyer-landlord, if the transaction is successful, to realize a return substantially in excess of the lender's return in conventional mortgage financing. See §5.5 above for a discussion of the bankruptcy ramifications of this device and §§5.11 and 5.12 above for a discussion of the danger that participation by the buyer-landlord in the "upside" may cause the financing to be deemed a disguised joint venture.

2. [5.20] Form of Provision for Additional Rental

Tenant further covenants and agrees to pay Landlord a portion of the net cash flow from the Property as Additional Rental. "Additional Rental" shall be paid by Tenant to Landlord monthly in the amount of _____ percent of net cash flow (as defined in this document) from the Property in excess of $_____. The term "net cash flow" shall mean all income received by Tenant from the operation of the Property, including, without limitation, all rents, use and occupancy fees, charges, and other income from or with respect to the Property and its operation; all proceeds of any condemnation of Tenant's leasehold estate in the Property (that is not accompanied by a condemnation of Landlord's interest in the Property); and all proceeds of any loan secured by the Tenant's leasehold estate in the Property.

E. Insurance and Tenant's Indemnification

1. [5.21] Liability and Dramshop Insurance

Even though the seller-tenant is in complete control of the property, the lease should require the seller-tenant to carry liability insurance in sufficient amounts and with adequate coverage, protecting the seller-tenant as owner of the leasehold estate and the buyer-landlord as owner of the fee and a reversionary interest in the improvements. Because of the pattern of constantly awarding greater judgments in litigation involving claims covered by liability insurance, a procedure should be built into the lease to provide for periodic increases of the limits of liability insurance — perhaps measured by cost-of-living increases.

In Illinois, if the sale or giving away of alcoholic liquors can subject the landlord to liability and the property to a judgment lien unless the landlord prohibits the tenant from selling and giving away alcoholic liquors (235 ILCS 5/6-21), the tenant should be required to carry dramshop insurance at all times when any alcoholic liquors may be sold or given away on the premises. This insurance must cover the interest of the landlord, the tenant, and any leasehold or fee mortgagee.

2. [5.22] Casualty Insurance

The seller-tenant should also be required to carry insurance against damage and destruction of improvements by fire and other casualty, naming the buyer-landlord and seller-tenant as insureds. Sometimes the lease requirement is for insurance for the replacement costs of the improvements above foundations, sometimes for the full insurable value, and other times for a stated percentage (usually 80 percent or 90 percent) of insurable value. In some instances, the requirement is couched in language requiring the seller-tenant to carry insurance in an amount sufficient to prevent the insured from being a coinsurer.

As a precaution against inflationary economic conditions that might reoccur in the future, there should be a provision for periodic insurance appraisals, with coverage of casualty insurance policies being adjusted annually between appraisals to reflect increases in an appropriate cost-of-living index. Many appraisal companies, insurance companies, and insurance agents offer a service to calculate the annual increase in coverage.

Parties to a lease frequently overlook the fact that a stated amount of casualty insurance is only a maximum figure and that the loss for which the issuer will be liable (subject to this maximum) will be measured not by the face amount of insurance but by the actual depreciated value of the improvements. If the parties or either of them wishes to create a sufficient fund to pay for the replacement of depreciated improvements, the lease must require the seller-tenant to carry a replacement cost form of insurance.

Blanket or multiple location insurance is quite common, especially for large corporate tenants having property rights in many scattered locations. While such insurance would be acceptable if otherwise satisfactory to the buyer-landlord, the buyer-landlord should be certain that the policy does not contain a coinsurance provision based on the value of all the seller-tenant's locations covered by the policy. If such a clause is contained in the policy and the total coverage on all properties does not equal the required percentage of the total value of all the seller-tenant's property, the amount of insurance payable in the event of a loss to the sale-leaseback parcel could be reduced by the coinsurance factor. In addition, the buyer-landlord will want a special endorsement added to the blanket policy reserving insurance proceeds provided by the blanket policy in an amount equal to the replacement cost of the sale-leaseback property.

From a practical viewpoint, the seller-tenant should see that a blanket or multiple location insurance policy, naming the buyer-landlord as an insured, limits the buyer-landlord's insurable interest to casualties occurring to improvements on the sale-leaseback parcel only. If this is not done, the insurer will most likely issue a check in payment of any loss to any property covered by the blanket policy in the name of the buyer-landlord and the seller-tenant even though the buyer-landlord has no interest in the damaged property. The seller-tenant will then be required to procure the buyer-landlord's endorsement on this check before using the insurance proceeds to restore the unrelated improvements. Limiting the buyer-landlord's interest to the sale-leaseback parcel will avoid this practical problem.

Either the seller-tenant and the buyer-landlord or both should be named as insured in the casualty insurance policy or the seller-tenant should obtain an agreement in the lease exonerating

itself from liability for negligence to the extent of insurance proceeds. Absent either of these two precautions, the insurer may well seek to recover from the seller-tenant for the seller-tenant's negligence by way of subrogation to the rights of the buyer-landlord.

The buyer-landlord should be certain that all casualty insurance policies carried by the seller-tenant with respect to the improvements name the same insureds, cover the same property, protect against the same perils in the same amount, and otherwise contain concurrent terms. If, for example, the seller-tenant carried two fire insurance policies and the buyer-landlord was named in only one, the two companies would be coinsurers, and the buyer-landlord would not be able to recover the full amount of the proceeds.

Provisions differ with respect to the manner in which casualty insurance proceeds are to be allocated and paid out. Most commonly, insurance proceeds are paid to the buyer-landlord and made available to the seller-tenant as construction progresses. Any money in excess of the insurance proceeds required to complete the rebuilding must either be deposited with the buyer-landlord or first be paid by the seller-tenant to the parties restoring the improvements before the buyer-landlord disburses any insurance proceeds. This will help ensure that the improvements are restored and that the buyer-landlord will be afforded protection against mechanics lien claims by parties performing the restoration work or supplying materials for the work.

Often the buyer-landlord will agree, with regard to casualties below a certain fixed-dollar amount, that the seller-tenant will have a right to adjust the claims and collect proceeds. This avoids undue complications, burdens, and expenses in connection with relatively minor casualties. The credit standing of the seller-tenant is to be considered by the buyer-landlord before consenting to this provision.

As a practical matter, insurers often ignore the provision of the policy that the loss be payable directly to the buyer-landlord or to the seller-tenant and make checks payable to all insureds (*i.e.,* the buyer-landlord, the seller-tenant, and the mortgagee). In this event, the parties must endorse the checks over to the party entitled by the lease to hold the proceeds.

In some cases, especially when the seller-tenant has any question about the financial condition of the buyer-landlord, provision is made to pay the insurance proceeds to a trustee under a so-called insurance trust. The trustee is then directed to make disbursements under conditions similar to those in which the buyer-landlord holds the proceeds. The parties must remember, however, that corporate trustees must be compensated for their services and require exoneration from liability and protective provisions for assuming the duties of an insurance trustee.

Serious consideration should be given to requiring the seller-tenant to procure rent insurance in the buyer-landlord's name or to procure rental value insurance in the seller-tenant's name (or naming the seller-tenant and buyer-landlord as joint payees) to ensure the buyer-landlord a source of funds for the payment of rent during the period following any fire or other casualty. Availability of such a fund could become quite important for a buyer-landlord in the case of a seller-tenant without sufficient financial resources to pay rent during the restoration period. The seller-tenant will also benefit from the carrying of rent insurance even if not required by the lease since, as discussed in §5.39 below, the obligation to pay in a sale-leaseback situation does not abate because of damage or destruction to the improvements.

From a seller-tenant's point of view, it is preferable to carry rental value insurance naming the seller-tenant as at least a coinsured. This avoids the possibility of a claim under a rent loss insurance policy by the insurer, who first pays the buyer-landlord the rent due and then, by subrogation to the buyer-landlord's position under the lease, requires the seller-tenant to pay the rent to the insurer. This would result in the tenant's paying for the rent loss insurance policy while still being required to make the rent payment.

The buyer-landlord's best option may be the rent loss insurance policy naming it as the insured. All proceeds will then be payable to the buyer-landlord. In a rental value insurance policy, the seller-tenant is the payee (or at least the copayee if the buyer-landlord is an additional insured), requiring the seller-tenant's endorsement on all checks issued by the insurer.

3. [5.23] Relationship of Insurance Provisions to Lease Requirements of Mortgages and Subleases

If there is a mortgage on the fee, on the leasehold estate, or both, provision will also have to be made in the lease to permit the inclusion of appropriate mortgage clauses in the insurance policies and to govern the respective rights and priorities of the parties to the insurance proceeds. If a mortgagee seeks to require the use of insurance proceeds to reduce the mortgage debt, the money that would otherwise be available to pay the cost of repair or reconstruction will be depleted. If possible, the mortgage provisions on insurance proceeds should be conformed with the lease provisions to ensure the availability of insurance proceeds to pay for the restoration.

If the lease relates to property that is intended to be subleased, (*e.g.,* a high-rise apartment building, an office building, or a shopping center), the subleases should be carefully drawn to correlate provisions regarding insurance and rebuilding with the provisions of the principal lease in order to avoid giving rights to subtenants in the insurance proceeds that conflict with the interests of the buyer-landlord, the seller-tenant, and the mortgagee in the insurance proceeds and their use.

4. [5.24] Indemnification Provisions

In addition to the insurance provisions, the lease should contain broad indemnity provisions from the seller-tenant to the buyer-landlord for anything that happens in, on, or about the leased premises arising other than by reason of the buyer-landlord's negligence or willful misconduct.

5. [5.25] Forms

The requirements for insurance are usually quite detailed, particularly with respect to fire and extended coverage and liability insurance. If the lease contains no detailed provisions, it should at least contain a broad requirement for the seller-tenant to furnish such insurance as the buyer-landlord reasonably requires and as is customary in the locality for buildings and operations of the type involved. Sections 5.26 – 5.32 below contain some suggested sample forms.

a. [5.26] Provision Regarding Casualty Insurance and Rent Loss Insurance

Tenant covenants and agrees that it will at all times, at its sole cost and expense, keep the building or buildings and improvements on the Demised Premises insured against loss by fire

with extended coverage if and when such insurance is available from an agency of the United States of America, for not less than [80 percent of its or their full insurable value above foundations, or any additional amount sufficient to prevent Landlord or Tenant from becoming a coinsurer within the terms of the applicable policies**] [**its or their full insurable value above foundations**] [**its or their full replacement costs by a so-called "replacement cost" form policy in which the insurer will undertake to pay the full cost of repair or replacement of the damages or destroyed improvements and against such additional perils as Landlord may reasonably request**], will procure rental insurance in an amount not less than one and one-half year's Basic Rent insuring the rents from the Demised Premises, and will keep all such insurance in force and effect during the entire term of this Lease. Such insurance shall be procured from a responsible insurance company or companies reasonably satisfactory to Landlord and authorized to do business in the state in which the Demised Premises are located and shall provide for payment of loss [**to Landlord**] [**as provided below**]. The policies or certificates evidencing such insurance shall be delivered to Landlord upon the execution of this Lease, and renewals shall be delivered to Landlord at least [**30**] days prior to the expiration dates of the respective policies. Each such policy or certificate shall specifically provide that the policy may not be canceled by the insurer without [**10**] days' prior written notice to Landlord. The rental insurance to be provided under this Lease may, at Tenant's option, be afforded by means of an endorsement placed on any policy of business interruption insurance carried by Tenant, insuring Landlord, as its interests may appear, with respect to any loss or damage under such policy that is attributable to the rental required to be paid by Tenant to Landlord under this Lease, which endorsement shall further provide that, in case the proceeds of insurance are insufficient to pay all loss or damage, the portion of the loss payable to Landlord by virtue of said endorsement shall first be paid.**

b. [5.27] Provision for Payment of Casualty Insurance Proceeds to Tenant or Mortgagee

In the event of damage to any of the buildings and improvements situated on the Demised Premises from time to time by fire or other casualty, if Tenant is not in default under this Lease, and the net insurance proceeds payable as a result of such fire or other casualty equal not more than $_____, such proceeds shall be paid to Tenant for restoration and rebuilding unless the loan documents evidencing and securing a leasehold mortgage permitted by this Lease or a mortgage on the fee require the insurance proceeds to be held by Mortgagee, in which case the insurance proceeds shall be paid to such Mortgagee to be disbursed by it to Tenant from time to time pursuant to the terms of this Lease to reimburse Tenant for the cost of repair, restoration, or rebuilding of the buildings and improvements, as Tenant incurs such costs.

c. [5.28] Provision for Payment of Casualty Insurance Proceeds to Insurance Trustee

At any time that _____ is not the landlord under this Lease, then, at Tenant's election or at the election of a permitted mortgagee that is the holder of a leasehold mortgage on the leasehold estate under this Lease, insurance proceeds, in lieu of being paid to and held by Landlord as provided in this Lease, shall be paid to and held by a bank or trust company to be selected by, and whose fees and charges shall be paid by, Tenant, in trust, for the

purposes and pursuant to the terms and provisions by which the proceeds would have been paid to and held by Landlord pursuant to this Lease. The bank or trust company shall have its principal office in the City of _____, State of _____, and shall have a capital and surplus of not less than [$15 million**].**

d. [5.29] Provision for Periodic Insurance Appraisal

Not less frequently than [once**] in each [**5**] years after the commencement of the term of the Lease, Tenant shall furnish at its own expense to Landlord insurance appraisals such as are regularly and ordinarily made by insurance companies for such purpose in order to determine the then [**insurable value**] [**replacement cost**] of the buildings and improvements on the Demised Premises, above foundation. In addition, at the end of each [**12**]-month period following the last appraisal, the amount of each type of insurance coverage under the insurance policies provided by Tenant will be increased by the percentage increase in the [**appropriate cost-of-living index**] for such [**12**]-month period.**

e. [5.30] Provision for Liability Coverage

Tenant covenants and agrees that it will at all times during the term of this Lease carry and maintain, for the mutual benefit of Landlord and of Tenant, general public liability insurance against claims for personal injury, death, or property damages occurring in, on, or about the Demised Premises or buildings and improvements situated on the Demised Premises or in, on, or about the streets, sidewalks, or premises adjacent to the Demised Premises, under policies in form and companies approved by Landlord, such insurance to afford protection to the limit of not less than $_____ in respect to injury to or death of a single person, to the limit of not less than $_____ in respect to any one accident, and to the limit of not less than $_____ in respect to property damage, and will also carry to the mutual benefit of Landlord and of Tenant steam boiler insurance (casualty and liability coverage) on all steam boilers, pressure boilers, and other apparatus, if any, and escalator and elevator liability insurance on all escalators or passenger or freight elevators (if any) that may be in and on the Demised Premises or the buildings and improvements situated on the Demised Premises, in an amount, in form, and with companies reasonably satisfactory to Landlord. On the expiration date of each such policy, any replacement policy shall afford protection minimum limits increased from the minimum limits then in effect under this Lease by multiplying the then-current minimum limits by a fraction, the numerator of which shall be the [appropriate cost-of-living index**] on the first day of the last month of the expiring policy term and the denominator of which shall be such index on the first day of the first full month of the expiring policy term, except that in no instance shall the amount of the minimum limits be decreased. Tenant shall also carry a policy insuring against liability under the statutes of the state in which the Demised Premises are located relating to the sale or dispensation of alcoholic liquors, naming Landlord and any mortgagee of the fee or leasehold as insureds, in the same limits as provided in the following part of this document with respect to general public liability insurance. Tenant shall furnish landlord with a duplicate certificate or certificates of the insurance policy or policies that state the number of each such policy, the name of each insurer, the amount of insurance under each such policy, and the date of**

expiration of each such policy, and containing the insurer's agreement not to cancel or terminate any such insurance coverage without giving Landlord not less than [10**] days' prior written notice. Tenant further agrees that it shall from time to time, whenever required, satisfy Landlord that such policy or policies is or are in full force and effect.**

f. [5.31] General Insurance Provision

Tenant will also maintain at its expense such other insurance in such amounts as are or shall be customarily carried and insuring against such insurable hazards as are or shall be customarily covered with respect to buildings similar in construction, general location, use, and occupancy to the buildings from time to time on the Demised Premises, as and when insurance against such insurable hazards is obtainable.

g. [5.32] General Indemnity Provision

Tenant covenants and agrees with Landlord that Tenant will indemnify and keep Landlord harmless at all times against any loss, damage, cost, or expense (including, but not limited to, attorneys' fees and expenses) incurred by Landlord and will defend Landlord in all proceedings (unless Landlord elects to assume its own defense as hereinafter provided), arising by reason of or growing out of (1) Tenant's failure in any way to maintain the Demised Premises and the buildings and improvements situated on the Demised Premises as required by this Lease; (2) any accident, loss, or damage resulting to persons or property from any use that may be made of the Demised Premises and the buildings and improvements situated on the Demised Premises; (3) any act or thing done or omitted to be done or any occurrence on the Demised Premises and the buildings and improvements situated on the Demised Premises; and (4) any damage that may be sustained by adjoining property or adjoining owners or other persons or property in connection with any remodeling, altering, or repairing of any building or buildings on the Demised Premises or the erection of any new building or buildings on the Demised Premises. Tenant further covenants and agrees that in case Landlord shall, without fault on its part, be made a party to any litigation involving the Demised Premises or buildings and improvements situated on the Demised Premises and Landlord elects to assume its own defense, then Tenant shall and will pay all costs and expenses, including all attorneys' fees and expenses, incurred by or imposed on Landlord by or in connection with such litigation. Landlord's election to assume its own defense in any such litigation shall in no way limit Tenant's indemnification obligations contained in the first sentence of this paragraph. Tenant finally covenants and agrees to pay all costs and expenses, including attorneys' fees and costs, that may be incurred by Landlord in enforcing any of the covenants and agreements under this Lease. Any such costs and expenses that tenant has agreed to pay in this paragraph shall be so much Additional Rental due on the next rent date after such payment or payments, together with interest at the rate of _____ percent per annum from the date of payment of costs and expenses by Landlord until repayment of costs and expenses by Tenant to Landlord.

F. Rebuilding and Termination

1. [5.33] General Requirements

The seller-tenant is almost always required to rebuild following damage to or destruction of the improvements on the demised premises with the right to use insurance proceeds for this purpose. The lease must clearly impose this obligation to rebuild on the seller-tenant since, at common law, the seller-tenant is under no obligation to rebuild or restore after a fire or other casualty. *Lewis v. Real Estate Corp.,* 6 Ill.App.2d 240, 127 N.E.2d 272 (1st Dist. 1955).

Generally, the seller-tenant's obligation of repair or replacement will be stated in terms of valuation (*i.e.,* that after restoration the improvements shall have the same value, rental and otherwise, as immediately prior to the damage or destruction). In some cases, particularly if the improvements are unique, the seller-tenant may be required to restore them substantially to their former state.

If the proceeds of insurance are not sufficient to permit the seller-tenant to repair or restore in accordance with the lease, the seller-tenant is usually required to supply the necessary excess funds. By the same token, if the insurance proceeds exceed the costs of restoration, the seller-tenant usually is entitled to retain them if not in default.

A buyer-landlord may be willing to give the seller-tenant an election not to rebuild or restore if the damage or destruction to the improvements occurs near the end of the term of the lease or of a renewal term (usually during the last two or three years) and exceeds a stated amount (for example, 50 percent or more of insurable value) or constitutes damage that cannot be restored in a fixed period of time (for example, within 90 days). If the seller-tenant is excused from rebuilding, the lease terminates, and proceeds of insurance paid by reason of the destruction of the buildings and improvements are usually paid to and retained by the buyer-landlord; insurance proceeds paid for the seller-tenant's trade fixtures and other personal property are paid to and retained by the seller-tenant.

A seller-tenant with some bargaining power might be able to negotiate an arrangement by which, upon an early termination of the lease following total destruction of the improvements by fire or other casualty, the buyer-landlord will receive a distribution in the form of the seller-tenant's interest in the property and insurance proceeds equal to the sum of the present value of the buyer-landlord's lost income stream from the rentals during the balance of the lease term plus the present value of the reversion to which the buyer-landlord would have been entitled at the end of the lease term. Any insurance proceeds remaining after this distribution to the buyer-landlord will be paid to the seller-tenant. This form, similar in many ways to the allocation of condemnation proceeds, will place the buyer-landlord in the same position as if the lease had run its full course and will prevent the buyer-landlord from realizing a windfall by reason of the early termination of the lease.

See §5.39 below for a discussion of the seller-tenant's obligation to pay rent during the period of repair or restoration.

2. Forms

a. [5.34] Provision for Tenant To Restore in Case of Damage or Destruction

In the event of destruction of or damage to the buildings and improvements on the Demised Premises by fire or other casualty, Tenant shall promptly at its own expense repair, restore, or rebuild them so that, upon the completion of repairs, restoration, or rebuilding, the value and rental value of the buildings and improvements shall be substantially equal to the value and rental value of the buildings and improvements immediately prior to the fire or other casualty.

Unless this Lease is terminated following the fire or other casualty as provided below, the insurance proceeds payable by reason of such damage or destruction shall be paid to and held by Landlord, to be paid by Landlord to Tenant upon receipt of architects' certificates, contractors' and subcontractors' sworn statements, and waivers of lien to reimburse Tenant for the expense of repairing or rebuilding the buildings and improvements that have been damaged or destroyed; provided, however, that it shall first appear to the satisfaction of Landlord that the amount of insurance money in its hands, together with any additional funds deposited with Landlord or expended by Tenant, shall at all times be sufficient to pay for the completion of said repairs or rebuilding, free and clear of liens and claims for lien. Upon the completion of the repairs or rebuilding, free from all liens of mechanics and material suppliers and others, any surplus of insurance money shall be paid to Tenant, provided Tenant is not in default under any of the provisions of this Lease, in which event of Tenant's default Landlord may apply the surplus against the default. If this Lease is terminated by reason of any default by Tenant, all insurance proceeds in the hands of Landlord and all claims against insurers shall become the absolute property of Landlord. If the insurance proceeds shall be insufficient to cover the cost of repairs and restoration of the buildings and improvements, the deficiency shall be paid by Tenant. In the event of loss covered by rental insurance, the proceeds received by Landlord shall be credited against the Basic Rent.

b. [5.35] Provision Allowing Termination of Lease Following Destruction by Fire or Other Casualty

If, within _____ years prior to the expiration of the initial term of this Lease (unless the initial term of this Lease has been renewed) or, if the initial lease term has been renewed, at any time within _____ years prior to the expiration of the last exercised renewal term, the buildings and improvements shall be destroyed or damaged by fire or other casualty [to render at least _____ percent of the net rentable area untenantable**] [**to the extent of at least _____ percent or more of the then full insurable value**] and provided that at the time of the destruction or damage all insurance required to be maintained pursuant to this Lease shall then be in full force and effect and Tenant shall not be in default under this Lease, Tenant shall have the option of restoring, repairing, replacing, rebuilding, or altering the buildings and improvements as stated above or of terminating this Lease by giving written notice of the election to Landlord within [**90**] days after the destruction or damage, the notice to specify a date, not less than [**10**] days from the date of delivery of the notice to Landlord, on which Tenant elects to terminate this Lease. If the Lease is terminated, Tenant shall not be required**

to restore, repair, replace, rebuild, or alter the building or to pay the cost of those remedies, and all proceeds of insurance paid by reason of the destruction of the buildings and improvements shall be retained by Landlord as and for its own absolute property. Tenant shall be entitled, in this case, to the proceeds of insurance paid by reason of the destruction of Tenant's trade fixtures and personal property. Tenant's rights to terminate this Lease, as provided above, shall be subject to the condition that Tenant pays the Basic Rent, Additional Rental, and all other charges payable by Tenant under this Lease up to the date specified in the notice of termination given by Tenant to Landlord as provided above simultaneously with the giving of notice.

G. Condemnation

1. [5.36] In General

In Illinois, in the absence of a lease provision to the contrary, tenants under long-term ground leases are not entitled to an abatement of rent following a partial condemnation. However, the law

> **is well established that lessees for years holding under a valid lease have such an interest in real property as to be classified as owners in the constitutional sense and are entitled to compensation for the taking of their interest in the property.** *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607, 610 (1st Dist. 1963).

In a total taking, the court explained in *Metropolitan Life,* the condemnation award is divided as follows (assuming the absence of a specific condemnation provision in the lease to the contrary):

> **The tenant's liability for rent having necessarily ceased, the landlord's share of the award was set as the sum of: (a) The present value of the rents reserved, and (b) The present value of the reversionary interests. The tenant was to receive . . . [t]he value of the leasehold, subject to the rents covenanted to be paid.** 192 N.E.2d at 611.

In a partial taking, the *Metropolitan Life* court endorsed two alternative formulae that could be employed to compute the landlord's and tenant's shares of the partial condemnation award, again assuming no specific lease provision to the contrary. Under the first formula, "the landlord is entitled to (1) the present value of rents reserved, except where rent is not abated or terminated, and (2) the present value of his reversionary interest [in the portion of the property taken], except in long-term lease situations." 192 N.E.2d at 612. The exception is made for the present value of the landlord's reversionary interest in long-term lease situations because, as the court stated, "Illinois courts have consistently held that a reversion after a long-term lease has no market value." 192 N.E.2d at 611 – 612.

Under the second formula endorsed by the court — the "bonus value" formula — the court, in a reversal of the first formula, first determines the tenant's interest in the partial taking award and then allocates the residue to the landlord. 192 N.E.2d at 612 – 613. In this case, the present value of the rentals to be paid for the taken portion of the property over the balance of the lease term is deducted from the present value of the lost portion of leasehold, and this amount is paid to the

tenant; the balance is paid to the landlord. In *Metropolitan Life,* the application of either formula resulted in a de minimis distribution to the landlord, so the court allocated the entire partial taking award to the tenant. *See also Department of Public Works & Buildings of State of Illinois v. Blackberry Union Cemetery,* 32 Ill.App.3d 62, 335 N.E.2d 577 (2d Dist. 1975), in which the court followed the partial taking test set forth in *Metropolitan Life*.

It should be noted that inherent in the two alternative formulae for the allocation of a partial condemnation award is the concept that the tenant continues to be obligated to pay rent on the lost portion of the leasehold. If the tenant is relieved from paying rent on the lost portion of the leasehold, the formula to be applied most likely would be a variation of the formula for a total taking, as set forth above.

In *Metropolitan Life,* the court also considered, as an element of the tenant's damages, the fact that the tenant had negotiated a ground lease rental in an amount substantially under the current market rental for property comparable to the taken property. Accordingly, the court also awarded the tenant an amount representing a loss of its special bargain. 192 N.E.2d at 613. This most likely would apply only in a bargain-rent situation.

In a long-term ground lease, if the tenant has the right, on the expiration of the term, to remove fixtures, structures, or other improvements installed by the tenant on the property, the tenant is also entitled to be compensated for the taking of these fixtures, structures, or other improvements. Whether the tenant has a right to compensation for the taking of these items will often resolve who is entitled to receive the award made by reason of the taking of these items. *Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82 (2d Dist. 1975).

Great difficulties are encountered in drafting and negotiating condemnation provisions despite the remoteness of the contingency involved. As the caselaw discussed above in this section indicates, such condemnation provisions can have substantial and far-reaching effects should a total or partial condemnation occur during the usually long term of the lease. In addition, care must be taken to coordinate the condemnation provisions of the lease with corresponding provisions of any mortgage affecting the property.

There are infinite varieties of condemnation provisions, rendering it difficult to select specific provisions as being "typical." The most that can be done in this limited discussion is to mention a few types of provisions. Regardless of which alternative is used, the parties should avoid adopting a solution that would make the transaction appear as though it were a masked mortgage loan secured by an equitable mortgage (*i.e.,* stating that the rent payments would be reduced because of a return of part of the landlord's investment as opposed to a rental reduction reflecting the rental value of the diminished premises). See §5.11 above.

2. General Description of Some Types of Condemnation Provisions in Use in Sale-Leaseback Transactions

a. [5.37] Total Taking

The lease may require the seller-tenant to waive all rights to the award or all rights with respect to its leasehold estate (reserving only rights for leasehold improvements paid for by the seller-

tenant). The lease may award the buyer-landlord damages for the land and provide for the buyer-landlord and the seller-tenant to share the award with respect to the improvements in accordance with their respective interests therein or provide for separate awards to the buyer-landlord and the seller-tenant as their interests may appear.

While providing generally for separate awards, the lease may require that the buyer-landlord receive a stated minimum out of the award before the seller-tenant can participate in the award. This minimum award may be set forth in the form of either a fixed-dollar figure or a formula to give the buyer-landlord the equivalent of the unamortized portion of the buyer-landlord's investment or to give the buyer-landlord the present value of the lost income stream and the present value of the reversionary interest in the property. (In some cases, there is an additional requirement that if the total award is not sufficient to make the buyer-landlord whole, the seller-tenant must pay the deficiency even though the seller-tenant will receive no portion of the award; the disadvantage of this approach, however, is that it lends the appearance of a loan instead of a lease to the transaction.)

The lease may obligate the seller-tenant to purchase the premises from the buyer-landlord at an agreed price (or with the purchase price based on an agreed formula) so that the seller-tenant will be entitled to the entire award upon payment of the purchase price of the buyer-landlord.

b. [5.38] Partial Taking

The seller-tenant may have an election to terminate the lease if the taking exceeds a certain percentage, affects certain portions of the property vital for the seller-tenant's effective use of the property, or otherwise renders the property unfit for its stated use. The buyer-landlord may have a similar option, either with or without that option being afforded to the seller-tenant. In either of these situations, if the lease terminates, the provisions for total taking will then apply. If the lease does not terminate, the seller-tenant is obligated to restore any improvements that are physically damaged with the right to use the proceeds of the award for this purpose. Either this right can be limited to the proceeds specifically awarded to the seller-tenant, or the award can be treated as a lump sum for this purpose with any surplus going to the buyer-landlord. In any case, provision must also be made for the seller-tenant to pay any deficiency using the seller-tenant's funds before using the award. Disbursement of these funds to pay for rebuilding will follow the mechanics for disbursements of insurance proceeds following destruction by fire or other casualty.

After the award is used for rebuilding or after any other distribution provided for, appropriate provision must be made as to whether there is to be an adjustment of rent. In some cases, the seller-tenant continues to remain liable for the full amount of rent despite the buyer-landlord's receipt of a portion of the award; in this case, the allocation formulae set forth in *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607 (1st Dist. 1963), would apply in the absence of a contrary lease provision.

Rent can be adjusted based on the percentage of area taken or of the relative value of the land remaining (determined by the court or perhaps by appraisal) as compared to the value of the whole before taking.

Rent can also be adjusted by treating the buyer-landlord's share of the award (or the portion remaining after rebuilding if any of the buyer-landlord's share is used for that purpose) as a repayment of the buyer-landlord's original investment and by reducing the rent to produce the same rate of yield or the same rate of amortization applied to the reduced amount of the buyer-landlord's investment. Note, however, that this type of adjustment would support a recharacterization agreement by the seller-tenant that the lease is, in fact, a mortgage security or loan.

The rent may be reduced in a manner that is equitable, leaving it to a court or to arbitrators to decide what is "equitable."

H. [5.39] Non-Abatement of Rent

In another type of lease, rental never abates by reason of damage or destruction to the improvements by fire or other casualty unless the seller-tenant has an election to terminate the lease, as mentioned in §5.33 above, and exercises this option or unless the lease provides otherwise. This principle is well established under Illinois law if the tenant has a leasehold interest in land as well as improvements. In *Humiston, Keeling & Co. v. Wheeler,* 175 Ill. 514, 51 N.E. 893 (1898), the court stated that if the tenant has leased both the land and the improvements, rent must be paid after total destruction of the building by fire or other casualty since the lease was of the land and building and there remained something to which the lease attached even if the building was destroyed. *See also Lewis v. Real Estate Corp.,* 6 Ill.App.2d 240, 127 N.E.2d 272 (1st Dist. 1955). Similarly, a taking by condemnation or eminent domain that does not result in a taking of the entire demised premises does not result in an abatement of rent unless the lease provides otherwise. *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607 (1st Dist. 1963); *Great Atlantic & Pacific Tea Co. v. State of New York,* 22 N.Y.2d 75, 238 N.E.2d 705, 291 N.Y.S.2d 299 (1968); *Turner v. Mantonya,* 27 Ill.App. 500 (1st Dist. 1888); *Nonotuck Silk Co. v. Shay,* 37 Ill.App. 542 (1st Dist. 1890). This rationale is even more compelling in the type of sale-leaseback situation in which the seller-tenant has leased the land only and holds title to the buildings during the term of the lease.

The seller-tenant can protect itself from loss in the case of destruction of the improvements by means of rent loss insurance or rental value insurance. Provision is often made in leases requiring the seller-tenant to carry this type of insurance. See §5.22 above.

See §5.17 above for a sample provision expressing the concept of non-abatement of rent and §5.26 above for a sample provision requiring the seller-tenant to carry rental insurance.

I. Fixtures and Improvements

1. [5.40] Fixtures

The lease should include a provision governing the rights of the buyer-landlord and the seller-tenant with regard to fixtures installed in the improvements. In one of the basic types of sale-leaseback transactions, if the seller-tenant has sold the buyer-landlord all the improvements, the buyer-landlord will also succeed to title to all fixtures located in the improvements. There may be instances, however, even in this basic type of transaction, in which the seller-tenant retains title to

certain fixtures. The retained fixtures may constitute the seller-tenant's trade fixtures or even building fixtures that the parties may have agreed have not been included in the agreed dollar amount of the purchase price, even though the buyer-landlord has acquired title to the improvements. Appropriate provisions in this regard should be incorporated in the deed from the seller-tenant to the buyer-landlord and in the lease since, in the absence of agreement between the parties, the tenant has a statutory right to remove all removable fixtures erected on the property by it during the term of the lease while it remains in possession as tenant. 735 ILCS 5/9-319.

In the second basic type of transaction, if the buyer-landlord purchases the land only, the seller-tenant retains title to and the right to depreciate the fixtures. In this instance also, the lease should clearly spell out which fixtures, if any, the seller-tenant may remove prior to the end of the lease term and which fixtures pass to the buyer-landlord after the end of the lease term.

Agreement as to the seller-tenant's right to remove fixtures (including buildings, as discussed in §5.41 below) can be of particular importance with regard to the allocation of an award resulting from a condemnation of the property. In *Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82 (2d Dist. 1975), involving a dispute between the landlord and tenant over the allocation of a condemnation award, the court held that since the tenant had the right, prior to expiration of the lease term, to remove fixtures, structures, and other improvements installed and erected by him on the property, he was entitled to be compensated for such improvements from the condemnation award. The seller-tenant's right to remove buildings or fixtures was material in the apportioning of the condemnation award between the buyer-landlord and seller-tenant. See §5.36 above.

2. Improvements

a. [5.41] Vesting of Title to Improvements

In the type of sale-leaseback transaction in which the buyer-landlord acquires both the land and improvements, title to the improvements immediately vests in the buyer-landlord, subject only to the seller-tenant's leasehold estate. At the end of the lease term, the seller-tenant's lease rights terminate, and the buyer-landlord succeeds to unencumbered title to the improvements.

More complicated questions are presented, however, in the type of transaction in which the buyer-landlord acquires the land only, while the seller-tenant retains title to present or future improvements during the lease term. Many leases used in this type of sale-leaseback transaction provide that the seller-tenant retains ownership of the improvements during the lease term but that the buyer-landlord automatically becomes the owner of the improvements upon termination or expiration of the lease. These concepts pose the following problems for the buyer-landlord and the seller-tenant that the drafter must analyze carefully in view of the particular set of circumstances in order to provide adequate safeguards of each party's interest:

1. The buyer-landlord has purchased and owns the land and residual interest in the improvements. The buyer-landlord's funds have been used almost exclusively to purchase the land since the reversionary interest in the improvements at the end of a long-term lease is almost valueless at the time of purchase. The rent is, therefore, based principally on a return of the buyer-

landlord's investment in the land. However, the buyer-landlord has purchased the land and made the lease in anticipation of receiving the benefit of ownership of the improvements when the lease expires. The buyer-landlord consequently must be assured that, upon termination of the lease, clear title to the improvements will be vested in it.

2. The seller-tenant, on the other hand, has invested its money in the improvements and should be afforded all the rights of ownership of them while the lease is in effect, including the right to take depreciation on the improvements for tax purposes.

Leases used in land-only sale-leasebacks often provide that any improvements owned by the seller-tenant remain the seller-tenant's property during the lease term but that, upon termination of the lease, title to the improvements automatically vests in the buyer-landlord. Courts have enforced these so-called "automatic vesting" provisions. In *Royal Neighbors of America v. Bank of Commonwealth,* No. 77-1226 (E.D.Mich. Dec. 27, 1976), *aff'd in unpublished op.,* 595 F.2d 1225 (6th Cir. 1979), in which a landlord brought suit to quiet title to the improvements in itself upon termination of the lease by default, the court was required to interpret a lease provision that provided:

> [U]**pon termination of the leasehold estate hereunder, either by lapse of time on November 30, 1998, or otherwise prior thereto, the Building shall thereupon, without any act by either party, be and become the absolute property of the Lessor, who shall thereupon be and become the owner of the Building, free and clear of all rights or claims of Lessee.**

The court granted the landlord's motion for summary judgment and held that the landlord automatically became the fee owner of the improvements upon termination of the lease. In *Uvesco, Inc. v. Petersen,* 295 So.2d 353, 354 (Fla.App. 1974), the court was faced with a lease provision that provided, upon default, that the tenant's interest would terminate and the title to and ownership of all buildings would automatically vest in the landlord. The court rejected the tenant's contention that the landlord could terminate the lease and obtain clear title to the improvements only through foreclosure proceedings and held that, in accordance with the lease, the landlord could terminate the lease upon the tenant's default and obtain title to the improvements. *Id.* Finally, in *In re Kassuba,* 562 F.2d 511, 513 – 514 (7th Cir. 1977), the court enforced an automatic vesting provision in a lease that provided, upon termination of the lease either at the end of the term or upon default, that ownership of the improvements would vest in the landlord even though the tenant defaulted early in the lease term and thus forfeited most of the improvements' value.

Different considerations prevail in automatic vesting clauses, depending on whether the improvements in question predated or postdated the beginning of the land lease. The general rules regarding the title to improvements constructed by the tenant on the leasehold after the beginning of the lease term are well summarized in *Chicago Title & Trust Co. v. Fox Theatres Corp.,* 164 F.Supp. 665 (S.D.N.Y. 1958), as follows: (1) in the absence of an agreement to the contrary, title and ownership of structures erected by one party on the land of another is in the landowner; (2) buildings erected by the tenant for trade purposes will be deemed trade fixtures that, in the absence of a provision to the contrary, are the tenant's property and removable by it during the term of the lease or within a reasonable time thereafter; and (3) if the lease between the parties covers the

disposition of the improvements, the court will give effect to the intent of the parties as expressed in the lease. The court held that under the terms of the lease in question, the parties intended that the buildings erected by the tenant would be the property of the landlord at the end of the lease term and that the tenant had no right to remove them or to force a sale of land and improvements and a division of the proceeds.

Automatic vesting provisions, when the tenant constructs the improvements after the lease has been entered into, can be upheld on a number of theories. At common law, title to any improvements constructed by the tenant on the landlord's property vests immediately in the landlord, giving the landlord a present interest in the improvements as soon as they are constructed. *Id.* By the terms of the lease in a sale-leaseback transaction in which title to the improvements is retained by the seller-tenant, the parties delay the passage of title to the improvements and, therefore, create, at the very least, a future interest in the improvements in the buyer-landlord. An argument can be made, however, that the buyer-landlord has a present interest in the improvements (which can be insured by a title insurer at the inception of the transaction) instead of merely a future interest. If, by common law, title to the improvements automatically vests in the landlord, arguably the ground lease reserving title to the improvements merely creates an estate for years in the improvements in the tenant with the reversion in the landlord creating a present (and insurable) interest.

Another theory supporting the automatic vesting of title can be derived from the judicial treatment of fixtures and improvements the tenant has installed on a leasehold estate and that the tenant has a right under the lease to remove. The courts have recognized that a tenant may be granted the right in the lease to remove improvements from the leased premises, meaning that the fixtures are the tenant's property. *Id.* This right lapses, however, if not exercised by the end of the lease term, with the title thereafter automatically vesting in the landlord. For example, in *Fitzgerald v. Anderson,* 81 Wis. 341, 51 N.W. 554 (1892), the court stated that while a tenant under a lease may have the right to remove improvements constructed by it, such removal right must be exercised by the tenant while it is still rightfully in possession under the lease or the right will be lost. The landlord will then succeed to title to the improvements. In *Dreiske v. People's Lumber Co.,* 107 Ill.App. 285 (1st Dist. 1903), the court treated buildings as removable trade fixtures but held that since the tenant failed to remove them before expiration of the lease, he could not claim ownership of them against the owner of the land. *See also Young v. Consolidated Implement Co.,* 23 Utah 586, 65 P. 720 (1901).

From this concept, it is just a short step to the ownership of the buildings and improvements by the seller-tenant during the lease term and the automatic vesting of title in the buyer-landlord when the lease term ends. Under this theory, however, it is more difficult to find a present interest of the buyer-landlord in the improvements that is insurable by title insurance at the inception of the sale-leaseback transaction and will withstand a challenge that the automatic vesting provision may be a future interest, unenforceable as a violation of the rule against perpetuities.

While the foregoing might justify automatic vesting in cases in which improvements postdate the lease, more difficult theoretical problems are presented when the improvements are in existence at the time of the sale-leaseback. The buyer-landlord, who never received an interest in the improvements by a conveyance, cannot rely on the cases described above in this section to obtain

a present or future reversionary interest in the improvements by operation of law. The improvements were not constructed on land in which the buyer-landlord held a reversionary interest at the time of construction. Furthermore, as previously noted in this section, a provision in the lease that provides that title to the improvements will vest in the buyer-landlord at the end of the lease term may be a future interest, unenforceable as a violation of the rule against perpetuities. Nevertheless, as noted above, in *Royal Neighbors, supra,* in which the improvements predated the sale-leasebacks, the court enforced the automatic vesting provision contained in the ground lease and held that the buyer-landlord became the owner of the improvements upon the termination of the lease. Although the court could not pigeonhole the type of estate the lease provision created, it found (1) that there was a clear agreement between the parties to convey the improvements to the buyer-landlord and (2) that during the term of the lease the buyer-landlord was in the position of a vendee under an executory land contract and had a vendee's equitable interest in the building. Thus, the court reasoned, the automatic vesting provision could be enforced.

Even if an automatic vesting lease provision is held not to create an enforceable legal or equitable interest in the buyer-landlord in the improvements (whether existing or to be constructed), two theories might be used by a court to conclude that title to the improvements automatically vested in the buyer-landlord at the end of the lease term. First, the lease provision calling for title to pass to the buyer-landlord at the end of the lease term may be specifically enforceable in the same manner as any contract calling for a conveyance of real property. For example, in *Kassuba, supra,* in which the improvements predated the sale and lease, the court simply enforced the lease provision for the automatic vesting of title to improvements upon termination of the lease in the same manner as a court would enforce any contractual provision. In so doing, the court took comfort in enforcing the intent of the parties from the fact that the seller-tenant, when agreeing to the automatic vesting provision, was "sophisticated in matters of real estate financing." 562 F.2d at 515. Another rationale courts may use to find that title to improvements automatically vests in the landlord is that if the seller-tenant improvements remain on the buyer-landlord's property after the termination of the lease, the improvements may be deemed abandoned property and, as such, pass to the buyer-landlord by operation of law. *Tkach v. American Sportsman, Inc.,* 316 N.W.2d 785 (N.D. 1982); *Lilenquist v. Pitchford's, Inc.,* 269 Or. 339, 525 P.2d 93 (1974). See also 2 Milton R. Friedman, FRIEDMAN ON LEASES §22-8, p. 22-33 (5th Randolph rev. ed. 2007).

Even though automatic vesting provisions in leases have received judicial endorsement, doubts still prevail as to the rights of the buyer-landlord to receive good title to the improvements at the end of the lease term simply by virtue of these lease provisions. Many title insurers refuse to insure the buyer-landlord's interest in the improvements when only automatic vesting provisions are used, especially in cases in which the improvements predate the sale and lease. These title insurers fear that the lack of a specific conveyance of the improvements or the failure to create a present estate in the improvements may cloud the buyer-landlord's title to the improvements. To overcome these doubts, the following suggestions should be considered:

1. The buyer-landlord could, by a lease provision, require the seller-tenant, at the buyer-landlord's request upon termination of the lease, to execute, acknowledge, and deliver a quitclaim deed and bill of sale conveying the improvements to the buyer-landlord. Brian J. Strum, *Sale-Leasebacks: Protection for Accelerated Depreciation Deduction and Clear Title,* 7 Real Prop.Prob. & Tr.J. 785, 786 (1972) (Strum). However, this approach is unsatisfactory. A seller-tenant in

default is unlikely to voluntarily execute a deed to the improvements. The buyer-landlord would therefore be required to litigate its rights to the improvements by an action in the nature of specific performance, depriving the buyer-landlord of the right to speedy possession of title to the improvements. This alternative offers little (if any) advantage over the automatic vesting provisions discussed earlier in this section. It also offers no inducement to a title insurer to insure, at the inception of the sale-leaseback transaction, the buyer-landlord's rights in the improvements upon termination of the lease.

2. A similar approach would be to require the seller-tenant, at the time the sale-leaseback of the land is closed, to appoint the buyer-landlord as its attorney-in-fact with power to execute, acknowledge, and deliver a deed and bill of sale upon termination of the lease. This approach, however, has deficiencies if the buyer-landlord attempts to terminate the lease by reason of the seller-tenant's default. Even though the buyer-landlord could execute and record the deed following the seller-tenant's default, the seller-tenant could contest the validity of the deed and the buyer-landlord's title to the improvements on the grounds that the buyer-landlord had no basis for terminating the lease and thus no power to execute the deed. The buyer-landlord may well be forced to bring an action to quiet title. Again, this alternative will not induce a title insurer to insure the buyer-landlord's interest in the improvements at the inception of the sale-leaseback transaction.

3. The seller-tenant could place a deed to the improvements into an escrow when the sale-leaseback of the land is closed, subject to escrow instructions that provide that the deed is to be recorded at the end of the lease term or on the occurrence of an event of default that allows the buyer-landlord to terminate the ground lease. Two problems must be considered if this structure is adopted.

First, the seller-tenant may deny that a default has occurred that would justify the lease termination and recording of the deed. In such a case, the seller-tenant's demand on the escrowee or, if necessary, the seller-tenant's initiating legal proceedings for a court order preventing recording of the deed may well dissuade the escrow agent from recording the deed. This in turn will force the buyer-landlord to litigate its right to the improvements. As a result, the buyer-landlord will be denied the remedy of obtaining speedy title to the improvements upon a seller-tenant's default — a major inducement for using the sale-leaseback structure over a mortgage in which foreclosure is required to obtain title to the improvements. Again, there is no inducement to a title insurer to give the desired insurance.

Second, placing the deed to the improvements into an escrow subject to certain limitations that the seller-tenant may well insist on may not constitute proper delivery of the deed. To have an effective delivery of a deed to an escrow agent (thus allowing a title insurer to give the required insurance at the inception of the sale-leaseback transaction), the grantor must abandon both possession and control of the deed so that the grantor no longer retains any right to recall the deed or control its use in the future. *See, e.g., Johnson v. Johnson,* 24 R.I. 571, 54 A. 378 (1903). By placing the deed to the improvements into escrow in a manner that would constitute effective delivery of the deed (the seller-tenant having abandoned possession with no right to recall the deed or to direct the escrow agent to change the use of the deed in the future), a seller-tenant may have surrendered rights to contest the validity of the deed in the event the buyer-landlord contends that it is entitled to the deed by reason of a default and early termination of the lease. A

solution — conditioning delivery of the deed from escrow on a judicial determination of default and proper lease termination — may well be acceptable to the seller-tenant but not to the buyer-landlord and the title insurer. Such a solution deprives the buyer-landlord of the ability to gain title to the improvements upon default without litigating the matter.

4. The parties could structure the transaction using an estate for years, especially in the more troublesome situation in which the improvements predate the sale-leaseback. If the improvements are in existence at the time of the sale-leaseback, the seller-tenant could, at the date of sale, convey title to the improvements to the buyer-landlord subject to the reservation of an estate for years in the seller-tenant, coextensive in duration with the term of the lease of the land. Both the deed and the ground lease would provide that the estate for years would be cut short if the seller-tenant defaulted under the ground lease. Since the buyer-landlord obtains a present interest in the improvements, the estate for years structure avoids any potential future interest problem or any question concerning the type of estate created in the buyer-landlord. As noted in *Royal Neighbors, supra,* the court held that the buyer-landlord did not have a legal estate in the improvements because it did not have a present interest in the improvements. By using the estate for years structure, the buyer-landlord would clearly have a present legal estate in the improvements and would not have to rely on a court's finding, as in *Royal Neighbors,* that the buyer-landlord had an equitable interest in the property.

This current interest of the buyer-landlord in the improvements, subject to the seller-tenant's estate for years, should be as insurable by a title insurer as the buyer-landlord's interest in the land is subject to the tenant's leasehold estate. The estate for years concept should be acceptable to the seller-tenant also, since the seller-tenant has not given up its right to contest the early termination of this interest in the improvements, should the seller-tenant dispute a lease default alleged by the buyer-landlord.

Arguably, the estate for years structure may also be used when the seller-tenant is to construct the improvements after the sale-leaseback has been consummated, if the seller-tenant conveys by warranty deed any after-acquired improvements to the buyer-landlord, subject to an estate for years reserved to the seller-tenant.

At common law, a deed conveying property in the nature of an expectancy is void. *See, e.g., Harper v. Harper,* 241 Ga. 19, 243 S.E.2d 74 (1978); *Trammell v. West,* 224 Ga. 365, 162 S.E.2d 353 (1968). However, some courts, applying equitable principles, have held that a grantor of a warranty deed conveying property that the grantor does not own but to which it subsequently acquires title is estopped from denying the validity of the deed with respect to the grantee named in the deed. *See, e.g., Pure Oil Co. v. Miller-McFarland Drilling Co.,* 376 Ill. 486, 34 N.E.2d 854 (1941). Although a buyer-landlord relying on this equitable theory might be able to assert a present interest in the improvements after the time they are constructed by the seller-tenant, a warranty deed of improvements not yet constructed would not serve to create any present interest in the improvements on the date the deed is delivered. Accordingly, such a deed should not be sufficient to allow a title insurer to insure the buyer-landlord's interest in the improvements at the inception of the sale-leaseback transaction (although, as discussed above in this section, because of the established common law, courts are more likely to honor (and title insurers to rely on) lease

provisions calling for automatic vesting of improvements constructed after the beginning of the lease term). See generally Strum, *supra;* Thomas C. Homburger et al., *Unresolved Questions of Sale-Leaseback Transactions — A Look at Real Estate, Tax and Bankruptcy Law Issues,* 19 Real Prop.Prob. & Tr.J. 941 (Winter 1984).

b. [5.42] Protection of Buyer-Landlord's and Seller-Tenant's Interests in the Improvements

One of the buyer-landlord's concerns in a sale-leaseback transaction is the nature of the improvements to which it will succeed to title upon termination of the ground lease. When the seller-tenant retains title to the improvements and the buyer-landlord is relying solely on an automatic vesting lease provision, the buyer-landlord must be concerned with the seller-tenant's ability to deal with the improvements in any manner the seller-tenant pleases during the term of the lease. In *Mid-Continent Petroleum Corp. v. Donelson,* 189 Okla. 273, 116 P.2d 721 (1941), the court held that the landlord had no cause of action against a tenant who removed his improvements before the end of the lease term since, by the terms of the lease, the landlord had no interest in the improvements until the lease was terminated. To ensure that the seller-tenant cannot remove the improvements before the end of the lease term without the buyer-landlord's consent, the buyer-landlord should (1) place a provision in the ground lease that prevents the seller-tenant from removing any improvements without the buyer-landlord's consent and providing that any attempt to do so will constitute a default under the ground lease that immediately terminates the lease or (2) structure the transaction so that the buyer-landlord has a present interest in the improvements by using, for example, the estate for years structure discussed in §5.41 above. Absent solutions such as those described above, the buyer-landlord, under common law, may lose the right to determine the nature of the improvements that will be received when the ground lease terminates.

When the seller-tenant retains title to the improvements until the lease is terminated, the seller-tenant should be concerned with how to protect its interest in valuable improvements if the lease is terminated early in the lease term because of a default by the seller-tenant. In this case, the buyer-landlord will receive a windfall since the buyer-landlord has paid for the land only. To protect its interest, the seller-tenant should consider a lease provision that provides that if the lease is terminated before a certain amount of time has passed, the buyer-landlord must pay an agreed-on sum for the improvements, that the seller-tenant has a lien for this sum, and that the seller-tenant can remain in possession until this sum is paid. *See, e.g., Cohen v. East Netherland Holding Co.,* 258 F.2d 14 (2d Cir. 1958), which provides support for this type of provision.

The buyer-landlord may well refuse to agree to a provision for a payment to the seller-tenant if the lease terminates early because of a default, taking the position that in the event of an early termination of the ground lease by reason of the seller-tenant's default, the value of the improvements constitutes liquidated damages. Consideration should be given by the buyer-landlord to stating (1) this liquidated damages rationale clearly in the lease and (2) that liquidated damages are sustainable (*i.e.,* damages would be difficult to ascertain and the liquidated damage amount is reasonable (810 ILCS 5/2-718(1)) in order to avoid the seller-tenant's argument that forfeiture of valuable improvements constitutes an unenforceable penalty under the lease.

In most sale-leaseback transactions, the parties contemplate that the seller-tenant's improvements will become the buyer-landlord's property at the end of the lease term. However, a seller-tenant may desire to retain the right to remove the improvements, or the buyer-landlord may want the right to request the seller-tenant to remove the improvements.

A seller-tenant, by express agreement, may retain the right to remove improvements it constructs on the buyer-landlord's property. In Illinois, unless the parties' agreement provides otherwise, the seller-tenant can exercise its right to remove the improvements only before the lease terminates. *See, e.g., Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82 (2d Dist. 1975); *Dreiske v. People's Lumber Co.,* 107 Ill.App. 285 (1st Dist. 1903). If the seller-tenant is given a right to remove its improvements, the buyer-landlord should require the seller-tenant to remove all its improvements and return the property to the original condition. Since the seller-tenant's right to remove its improvements ends when the lease is terminated, the seller-tenant may want additional time to remove its improvements or, alternatively, to require the buyer-landlord to pay for the improvements. Some Illinois courts allow the tenants to exercise their right to remove improvements within a reasonable time after termination of the lease. *See, e.g., Getzendaner v. Erbstein,* 341 Ill.App. 594, 94 N.E.2d 746 (1st Dist. 1950); *Revzen Business Interiors, Inc. v. Carrane,* 72 Ill.App.3d 601, 391 N.E.2d 24, 28 Ill.Dec. 825 (1st Dist. 1979). Furthermore, in some jurisdictions, the tenant is generally accorded a reasonable time after termination of the lease to remove its improvements. *See, e.g., Paulina Lake Historic Cabin Owners Ass'n v. U.S.D.A. Forest Service,* 577 F.Supp. 1188 (D.Or. 1983); *Coleman v. Owens,* 254 S.W.2d 341 (Ky.App. 1953); *Tilchin v. Boucher,* 328 Mich. 355, 43 N.W.2d 885 (1950).

A seller-tenant's right to remove its improvements does not give the buyer-landlord the right to require the seller-tenant to remove improvements, and, in the absence of a lease provision to the contrary, the seller-tenant is not required to remove all its improvements or to return the property to its original condition. *See, e.g., Savage v. University State Bank of Champaign,* 263 Ill.App. 457 (3d Dist. 1931); *Duvanel v. Sinclair Refining Co.,* 170 Kan. 483, 227 P.2d 88 (1951); *Fox v. Cities Service Oil Co.,* 201 Okla. 17, 200 P.2d 398 (1948); *Gulf Oil Corp. v. Horton,* 143 S.W.2d 132 (Tex.Civ.App. 1940); *Arkansas Fuel Oil Co. v. Connellee,* 39 S.W.2d 99 (Tex.Civ.App. 1931). The buyer-landlord who is concerned about receiving badly deteriorated or useless improvements that may have a negative value should provide in the lease that, at the buyer-landlord's option upon notice from the buyer-landlord to the seller-tenant, the seller-tenant will remove all improvements it has placed on the leased premises upon termination of the lease term and return the premises to the original condition.

3. Forms

a. [5.43] Provisions Relative to Fixtures

1. "Building Fixtures" shall mean all plumbing, heating, lighting, electrical, and air-conditioning fixtures and equipment and all other fixtures, equipment, and articles of personal property used in the maintenance or operation of the buildings, structures, and improvements situated on the Demised Premises (as distinguished from operations incident to the business of Tenant and of any tenants and occupants of such buildings, structures, and improvements holding through Tenant) that are either attached to or situated in or on the Demised Premises or any buildings, structures, and improvements now or after this date located thereon or therein. The Building Fixtures shall be and remain a part of the real estate and shall constitute the property of Landlord.

2. "Tenant's Equipment" shall mean all trade fixtures and all personal property, fixtures, apparatus, machinery, and equipment now or after this date located in the buildings, structures, and improvements situated on the Demised Premises, either owned by Tenant and incident to the business of Tenant conducted in such buildings, structures, and improvements or owned by any other tenants and occupants of such buildings, structures, and improvements holding through Tenant, whether or not they are affixed thereto. All of Tenant's Equipment shall be and remain the personal property of Tenant or such other occupants.

The Tenant's Equipment may be removed from time to time by Tenant or other occupants of the Demised Premises; provided, however, that if such removal shall injure or damage the Demised Premises or the buildings, structures, or improvements thereon, Tenant shall repair the damage and place the premises and the buildings, structures, and improvements in the same condition as they would have been if such equipment had not been installed.

b. [5.44] Provision for Use in Ground Lease When Tenant Reserves Estate for Years in Buildings Until Expiration of Lease

"Buildings" shall mean all buildings, structures, and improvements now located on the real estate and all Building Fixtures, together with any and all buildings, structures, improvements, and Building Fixtures at any time after this date erected, constructed, or situated in or on the Demised Premises, or any part of the Demised Premises, during the continuance of the term of the Lease, and together with any and all other Building Fixtures after this date affixed or attached to or located on or within any such building, structure, or improvement or Building Fixture. For purposes of this definition of "Buildings," building structures and improvements include (in addition to Building Fixtures), but are not limited to, all footings, foundations, appliances, machinery, piping, sewers, retaining walls, landscaping, streets, equipment, apparatus, fixtures reasonably deemed to be part of the Demised Premises, and all personal property of every kind and description presently or after this date situated, placed, or constructed on the Demised Premises and not included within the definition of "Building Fixtures" or "Tenant's Equipment."

In and by a warranty deed of even date with this instrument from Tenant to Landlord (Warranty Deed), Tenant has excepted and reserved an estate in the Buildings for a term of years, ending _____, 20__. It is expressly understood and agreed that in the event of the termination of the leasehold estate under this instrument prior to _____, 20__, the estate for years in the Buildings so excepted and reserved shall forthwith cease, without any act by either party, and Landlord shall automatically, without payment therefor, be and become the absolute owner of and vested with full title to and ownership of the Buildings, free and clear of all rights or claims of Tenant and all persons after this date claiming by, through, or under Tenant. It is the intention of the parties by this Section

1. that the estate of Tenant in and to the Buildings shall constitute a retained continuing interest in the Buildings for and during the duration of this Lease and shall constitute real estate and not personal property;

2. that, subject to the continuing interest in the Buildings by Tenant for and during the duration of this Lease, Landlord has acquired a present interest in the Buildings, the interest to constitute real estate and not personal property and being the residue of the full ownership of and title to the Buildings after the expiration of Tenant's estate in the Buildings so reserved and retained by Tenant; and

3. that by the recording of the Warranty Deed and of a short-form lease in accordance with the provisions of this Lease, Landlord's rights in and to the Buildings are by this instrument made prior and superior to any and all rights in and to the Buildings that may after this date be created or arise, whether by act of Tenant or by operation of law.

It is the intention and agreement of the parties that Tenant's interest in this Lease and all of Tenant's right, title, and interest in and to the Buildings shall be non-separable and that any attempts to transfer or mortgage either of the interests shall be void and ineffective unless there shall be a complete transfer or mortgage, as the case may be, of Tenant's interest in this Lease and of all Tenant's right, title, and interest in and to the Buildings to the same party.

Although the provisions of this instrument are intended to be self-executing, Tenant hereby agrees, upon such earlier expiration or termination of this Lease, to execute any further deed, bill of sale, or document requested by Landlord to confirm Landlord's sole ownership of and fee simple title to the Buildings and to warrant and defend Landlord's title to the Buildings against the claims of all persons except persons claiming by, through, or under the Landlord. Tenant hereby irrevocably appoints Landlord as its attorney in fact, coupled with an interest, to execute, acknowledge, and deliver on its behalf such deed, bill of sale, or document.

Tenant's estate or interest in the Buildings, as distinguished from its leasehold interest, shall not extend to any airspace or property other than the Buildings nor to any airspace occupied by the Buildings.

Notwithstanding anything to the contrary, the exception and reservation of an estate for a term for years in the Buildings contained in the Warranty Deed shall in no way affect Tenant's rights to depreciate the Buildings (including additions thereto built by Tenant on the Demised Premises). Landlord agrees, while the estate for years in the Building remains in Tenant, not to claim any depreciation of its interest in the Buildings.

NOTE: In the provision above, "Demised Premises" is defined to mean land only.

c. [5.45] Form of Deed When Grantor Reserves Estate for Years in Buildings Until Expiration of Ground Lease

[Grantor conveys to Grantee**] all that certain real estate, with the buildings and improvements on that real estate legally described as follows:**

[legal description of real estate**]**

TOGETHER WITH the appurtenances and all the estates and rights of Grantor in and to said premises.

EXCEPTING AND RESERVING unto Grantor until [date of expiration of last renewal term of the lease**], or until the earlier expiration or termination of the Lease, an estate in and to any and all Buildings and Building Fixtures, it being intended and agreed hereby that such estate so excepted and reserved unto Grantor and all the interest in the Buildings and Building Fixtures by this instrument conveyed to Grantee shall each constitute real estate and not personal property.**

Simultaneously with the acceptance of this deed, Grantee is leasing back to Grantor the real estate and premises being conveyed by this instrument pursuant to a certain Lease (Lease) of even date herewith. It is the intention of Grantor and Grantee that title to the real estate being conveyed by this instrument shall be separated from the estate or interest in the Buildings and Building Fixtures. The estate or interest in the Buildings and Building Fixtures is excepted and reserved by Grantor as stated above until the earlier of [date of expiration of last renewal term**] or the expiration or termination of the Lease, on which the estate for years by this instrument reserved and all estate and interest of Grantor in the Buildings and Building Fixtures shall terminate and the Buildings and Building Fixtures shall be surrendered to Grantee or its successors and assigns, all as more particularly set forth in Section _____ of the Lease, the provisions of which are by this instrument incorporated herein by reference as if fully set forth herein. The estate or interest in the Buildings and Building Improvements by this instrument excepted and reserved by Grantor does not extend to any airspace or property other than the Building, nor to any airspace occupied by the Building. A Memorandum of Lease is intended to be recorded immediately following the recording of this deed.**

NOTE: "Buildings," "Building Fixtures," and "Tenant's Equipment" are defined in §§5.43 and 5.44 above.

J. Non-Disturbance, Subordination, and Mortgaging of Fee and Leasehold

1. [5.46] Mortgaging of Fee

If the landlord wishes to be in a position to obtain mortgage financing on the strength of the lease, it may require an agreement by the tenant to subordinate the lease to future mortgages if the landlord should so request. Absent a subordination of the lease to a future fee mortgage upon foreclosure, the fee mortgagee will take the property subject to the terms of the lease. The greater burden to the mortgagee's security in such a case may well be reflected in higher interest rates. As stated by the court in *Reichert v. Bankson,* 199 Ill.App. 95, 97 – 98 (4th Dist. 1916), quoting with favor from Herbert Thorndike Tiffany, THE LAW OF LANDLORD AND TENANT, p. 876 – 877 (1910):

> **If the interest of the landlord is sold under a judgment, mortgage or other lien, which is subsequent to the lease, the purchaser becomes the landlord in the former owner's place, since the reversion passes by the sale. In such case the purchaser takes only**

> **what the lessor has, that is, his estate in reversion, and the rights of the tenant under the outstanding lease remain such as they would be in the case of a voluntary transfer of the reversion. If, on the other hand, the premises are sold under a judgment, mortgage or other lien prior to the lease, the purchaser comes in by title paramount to the lease, and he is entitled to possession as against the tenant thereunder. And as the tenant under a lease has no rights in the land as against the purchaser under a prior incumbrance, so such purchaser has, apart from statute, no rights as landlord against such tenant, unless the latter accepts a new lease from the purchaser, or, which is the same thing, attorns to him.**

In the past, the cases in Illinois, including *Reichert, supra,* followed the title theory of mortgages, that a mortgagee has title paramount to all other interests subsequent to the execution of the mortgage. Under this theory, if the lease is executed prior to the mortgage, the mortgagor-landlord mortgages only the interest that it owns — its equity of redemption. If the mortgage is recorded prior to execution of the lease, the mortgagor-landlord has mortgaged the entire interest in the realty and, consequently, when it executes a subsequent lease that lease is carved out of the equity of redemption and remains subject to all rights of the mortgagee.

However, the Illinois courts later adopted the lien theory of mortgages. *Harms v. Sprague,* 105 Ill.2d 215, 473 N.E.2d 930, 85 Ill.Dec. 331 (1984); *Kelley/Lehr & Associates, Inc. v. O'Brien,* 194 Ill.App.3d 380, 551 N.E.2d 419, 141 Ill.Dec. 426 (2d Dist. 1990); *Scott v. O'Grady,* 760 F.Supp. 1288 (N.D.Ill. 1991). The court in *Kelley/Lehr* discussed this issue as follows:

> **Although the above cases provide precedent regarding the issue before the court, we cannot follow them for the following reasons. The cases apply the rule that a mortgagee has paramount title and has the right of possession against all other interests subsequent to the execution of the mortgage. However, the State of Illinois has recently adopted the "lien theory of mortgages," and a mortgagee is not deemed to own the title of the property but only a mere lien. (*Harms v. Sprague* (1984), 105 Ill.2d 215, 222 – 23, 85 Ill.Dec. 311, 473 N.E.2d 930.) The adoption of the lien theory of mortgages created a legal environment where many issues of mortgage law remained unresolved. . . . [**T**]he question of whether a mortgage foreclosure cuts off the rights of junior lessees in Illinois has never been definitively decided, because a lease has been cut off upon a mortgagee's taking possession prior to foreclosure; however, now that a mortgagee is deemed to have only a lien and not title prior to foreclosure, Illinois courts would have the opportunity to determine the scope of the lessee's rights since the lease would not be cut off merely by the mortgagee's entry into possession. . . . Similarly, there has been no reported case in Illinois which deals with the possessory rights of a mortgagee whose interest is derived from a lien rather than a title. [**Citations omitted.**]** 551 N.E.2d at 423.

Under the lien theory, even though the mortgage is recorded prior to execution of the lease, the lease will survive the mortgagee's possession prior to foreclosure and bind both the tenant and the mortgagee. The Illinois Mortgage Foreclosure Law, 735 ILCS 5/15-1101, *et seq.,* was also changed to support this outcome. Section 15-1701 of the Law provides that "[t]he holder of the certificate of sale or deed . . . shall be entitled to possession of the mortgaged real estate, as of the date 30 days

after the order confirming the sale is entered," until which time the lessee retains a leasehold interest. 735 ILCS 5/15-1701(d). Furthermore, the lessee cannot be evicted unless personally named as a party to the foreclosure or eviction action. *Id. See also Agribank, FCB v. Rodel Farms, Inc.,* 251 Ill.App.3d 1050, 623 N.E.2d 1016, 191 Ill.Dec. 426 (3d Dist. 1993). Under these circumstances, fee mortgage lenders may require the mortgagor-landlord to accept the same terms and conditions regarding future leases into the mortgage.

Some fee mortgage lenders are careful to see that the lease is prior to the mortgage so that, following foreclosure, the lease will survive. If the lease is a reasonable one, the fee may be more salable if the foreclosing mortgagee can sell both the reversionary interest in the land and the improvements and the income-producing potential of the property during the term of the lease through continued realization of the rental stream.

The best method of handling the problem of lease subordination to a fee mortgage is to give the landlord the election, in the future, either to keep the lease ahead of future mortgages or to subordinate the lease to future mortgages. This approach allows the landlord the ultimate flexibility to comply with the then-unknown desires of a future fee mortgagee, although many tenants will not agree to a subordination of the lease to a fee mortgage.

If the lease contains a purchase option in favor of the tenant, the lease should limit the principal amount of any fee mortgage loan to an amount less than the purchase price and should require that the landlord reserve necessary prepayment rights so that the tenant will be able to obtain title free and clear of the mortgage without paying more than the option price. The tenant may also wish to require that any fee mortgage permits (or at least does not prohibit) the transfer of the fee title to the land and the landlord's future interest in the buildings and improvements from the landlord to the tenant so that, if the tenant acquires title to the land and to the landlord's reversionary interest in the buildings and improvements, the tenant can continue to enjoy the benefits of the fee mortgage.

In structuring the lease, the landlord should attempt to make the tenant's obligations with respect to the property coextensive with the landlord's obligations as mortgagor under any fee mortgage known at the time the lease is executed. Since the landlord is principally a passive investor with few or no rights of control over the property in the absence of a default by the tenant, the lease will have to obligate the tenant to maintain the property in accordance with the requirements of the mortgage. A default by the tenant in performing these obligations will be a default under the lease giving rise to all the landlord's rights upon default (including the right to perform the tenant's obligations at the tenant's expense). If a period to cure defaults is given in the lease, it should be shorter than any cure period for the same default provided in the mortgage so that the landlord will have adequate time to effect a cure of the mortgage default if the tenant fails to meet the mortgage obligations. In addition, as discussed in §§5.23 and 5.36 above, the fee mortgagee's rights with respect to insurance and condemnation proceeds must be consistent with the rights of the tenant under the lease to the insurance and condemnation proceeds.

2. [5.47] Leasehold Financing

Quite commonly, the seller-tenant procures permanent financing through a combination of the proceeds of a sale-leaseback transaction and the proceeds of a leasehold mortgage loan secured by

a pledge of the seller-tenant's leasehold interest and, if the seller-tenant has title to the improvements, by a pledge of the seller-tenant's rights in the improvements. In addition, once the sale-leaseback is consummated, the only way the seller-tenant can borrow money to finance any alteration or addition to the improvements, using the improvements as security, is through leasehold financing.

If the seller-tenant wishes to be in a position to obtain financing by leasehold mortgage, not only should this right be reserved in the lease, but the lease should contain provisions protecting the rights of the leasehold mortgagee in and to the security for its land, including

a. adequate notice of default to the leasehold mortgagee and opportunity to cure defaults, including a sufficient time to conclude a foreclosure if this is required to enable the leasehold mortgagee to cure the defaults;

b. avoidance of termination of the lease by reason of the seller-tenant's bankruptcy or insolvency since these are defaults that the leasehold mortgagee cannot cure or, if such contingencies remain in the lease, an agreement by the buyer-landlord to give the leasehold mortgagee a new lease upon termination of the original lease by reason of the seller-tenant's default;

c. provisions regarding the rights of the leasehold mortgagee under casualty insurance policies, including the affixing of a mortgage clause in favor of the leasehold mortgagee;

d. provisions exonerating the leasehold mortgagee from personal liability, at least until the leasehold mortgagee acquires the leasehold estate through the foreclosure, and making inapplicable to the purchaser at a foreclosure sale any requirements for assumption of any liability of the prior tenants arising before the purchase; and

e. provisions permitting the leasehold mortgagee to exercise any options conferred on the seller-tenant and to receive payment of any money payable to the seller-tenant.

As stated in §5.46 above, the leasehold mortgage must conform with the terms of the ground lease with respect to availability of insurance and condemnation proceeds.

On occasion, a buyer-landlord will agree to subordinate its fee as additional security for the seller-tenant's mortgage in order to assist the seller-tenant in obtaining mortgage financing at a more favorable rate or to make financing available to a seller-tenant with a questionable credit record. The ability of the seller-tenant to perform the economic terms of a sale-leaseback transaction may well turn on the availability of reasonable leasehold financing interest rates. The effect of a subordination of the fee by the buyer-landlord is a pledge of the buyer-landlord's reversionary interest in the land and improvements as additional security for the loan to the seller-tenant. Thus, the mortgagee has received a pledge of all legal interests in the property — the seller-tenant's leasehold interest in the land and present interest in the improvements (if any), and the buyer-landlord's reversionary interest in the land and improvements — and can foreclose out all interests in the property upon the seller-tenant's default in the same way a mortgage on a fee interest without a lease could be foreclosed. The buyer-landlord does not sign the mortgage note or assume any personal liability for the mortgage debt; the buyer-landlord simply pledges its interest in the property as security for the loan.

A foreclosure of a mortgage, when the buyer-landlord has subordinated its fee, will jeopardize the buyer-landlord's fee interests in the premises. Accordingly, a buyer-landlord who has subordinated its fee will normally insist that the mortgage loan be amortized, by its own terms, before the end of the lease term and that the mortgage contain a provision giving the buyer-landlord notice of the seller-tenant's default and an opportunity to cure the default for a period that is longer than the cure period granted the seller-tenant (thus enabling the buyer-landlord to cure the default and preserve the estate). The lease will also provide that a default under the mortgage will be a default under the lease, entitling the buyer-landlord to terminate the lease or to exercise any of the other remedies available to the buyer-landlord in case of the seller-tenant's default under the lease that the buyer-landlord must cure.

If the buyer-landlord and the leasehold mortgagee are the same person, a danger exists that a court may construe the sale-leaseback and the leasehold mortgage transactions as part of one mortgage financing transaction in which the landlord-lender can exercise its rights only through foreclosure. This danger would seem to be exacerbated if the sale-leaseback and leasehold mortgage transactions were entered into simultaneously and the documents for the two transactions contained cross-default provisions. If the landlord and mortgagee are the same and the landlord-mortgagee is entitled to proceed under either the lease or the mortgage, the landlord-mortgagee would be more likely to exercise its speedier remedies under the lease documents (allowing the recovery of title to both land and improvements free of liens created on the leasehold estate or the tenant's interest in the improvements) than to exercise its rights as mortgagee. Since most mortgage foreclosure statutes provide a mortgagor with greater protection before the mortgagor is deprived of the equity of redemption than is provided at law for a defaulting tenant, the mortgagor tenant loses its "day in court" under the protection of the applicable foreclosure act if the landlord-mortgagee proceeds under the lease. Courts in this era, when judicial recharacterizations of one form of interest into another (especially in the context of a bankruptcy) are becoming more common, would be likely to look hard at this type of situation in order to allow the mortgagor-tenant to benefit from the protections of the applicable mortgage foreclosure act and the Bankruptcy Code.

The landlord-mortgagee's best defense to such an argument would appear to be that the landlord-mortgagee should not be penalized because it also made additional money available to the tenant-mortgagor under the leasehold mortgage format and that the tenant-mortgagor entered into this type of dual transaction knowingly, aware of its risks. Under the rationale of *MacArthur v. North Palm Beach Utilities, Inc.,* 202 So.2d 181 (Fla. 1967), the landlord should not be prejudiced just because it accommodated its tenant by providing leasehold financing, particularly since the tenant will end up in the same position it would have been in had the landlord and leasehold mortgagee been different persons. In either case, the defaulting tenant would lose its title and right to possess the land and the improvements. The only difference would be that when the landlord is also the leasehold mortgagee, the tenant-mortgagor would lose these rights more quickly since there would be no required foreclosure. When the parties are sophisticated and the tenant-mortgagor enters into dual sale-leaseback and leasehold mortgage transactions knowing that it may lose its rights in the improvements upon a default under the ground lease, the courts should not penalize the landlord-mortgagee by forcing it to go through foreclosure when the parties consciously chose the structure of the transaction. Courts have found, when sophisticated parties have entered into a sale-leaseback format, that the seller-tenant subsequently cannot reject the format chosen when the

buyer-landlord seeks to enforce its legal rights. *In re Kassuba,* 562 F.2d 511 (7th Cir. 1977); *In re San Francisco Industrial Park, Inc.,* 307 F.Supp. 271 (N.D.Cal. 1969). Conversely, a tenant-mortgagor who wishes to avoid the loss of its day in court because a default under a leasehold mortgage triggers a default under the ground lease should see that the lease does not provide that a default under the leasehold mortgage is a default under the lease. If the tenant-mortgagor agrees to full cross-default provisions in this type of complex and sophisticated transaction, the tenant-mortgagor should be bound by its agreement.

3. [5.48] Non-Disturbance Agreements with Occupancy Tenants

At times, it may be in the best interests of the buyer-landlord, the seller-tenant, and a mortgagee whose mortgage is prior to the rights of the seller-tenant's subtenants to enter into a subordination non-disturbance agreement with the various occupancy subtenants to whom the seller-tenant has leased portions of the improvements. Such an agreement will ensure the subtenants continued use of the leased premises in the event of a termination of the lease or a foreclosure of either a leasehold or fee mortgage and will help reduce the possibility of a claim by the subtenants against the seller-tenant for breach of any covenant of quiet enjoyment contained in the subleases. This protection will induce occupancy tenants to enter into subleases of the property, thus helping ensure the economic success of the sale-leaseback and financing transactions. In addition, such agreements will help ensure to the buyer-landlord in the event of a termination of the underlying lease, and to the mortgagee in the event of a foreclosure, that the occupancy tenants will remain in possession and will continue paying rent. See §5.55 below for a sample of a conditional assignment of subleases from the seller-tenant to the buyer-landlord.

4. Forms

a. [5.49] Provision Permitting Leasehold Mortgage

Tenant and its successors and assigns shall have the right to mortgage or pledge this Lease and Tenant's interest in the buildings and improvements on the Demised Premises, in whole or in part, provided that any mortgage or pledge shall include the entire interest in each or, in case of a mortgage or pledge of a part interest, the same fractional interest in each, to the end that the lien or title of the mortgagee or pledgee in this Lease and in the buildings and improvements, whether in whole or in part, shall be inseparable. Any leasehold mortgage shall be subject and subordinate to the rights of Landlord under this Lease both in the land and in the buildings and improvements, including Landlord's rights in and to the buildings and improvements upon the termination of this Lease. Any mortgage shall provide in substance that in the event of a foreclosure of mortgage or of any other action or proceedings for the enforcement thereof or of any sale thereunder, the leasehold estate under this Lease and Tenant's interest in the buildings and improvements shall be sold as one parcel. No holder of any leasehold mortgage shall be entitled to any rights or benefits under or by virtue of the provisions of this paragraph or of [the paragraph giving rights to the leasehold mortgagee**], nor shall the provisions of this paragraph be binding on Landlord unless and until an executed counterpart of the leasehold mortgage, or a copy thereof certified by the mortgagee to be true, or a copy thereof certified by the recording officer of the county in which the mortgage is recorded, shall have been delivered to Landlord and Landlord shall have been duly notified by Tenant or by the mortgagee under the mortgage of the name and address of the mortgagee.**

b. [5.50] Provision Giving Certain Rights to Leasehold Mortgagee

If Tenant or its successors or assigns shall mortgage this Lease in accordance with the provisions of this Lease and Landlord shall have been given due notice thereof as provided in this Lease, provided that the mortgage shall have been given as security for a bona fide loan of money of not less than $_____ made to Tenant and shall be owned and held by a person having no financial interest in or connection with Tenant, the following provisions shall apply as long as the leasehold mortgage shall remain unsatisfied of record or (to the extent applicable) after acquisition of the leasehold estate pursuant to any foreclosure of the leasehold mortgage or in lieu of foreclosure thereof:

1. Landlord and Tenant shall not enter into any agreement providing for surrender or modification of this Lease without the prior consent in writing of the mortgagee under such mortgage.

2. Landlord shall not be empowered to terminate the leasehold estate under this Lease by reason of the occurrence of any default unless Landlord shall have served on the mortgagee under the leasehold mortgage, at the address furnished to Landlord and otherwise in the manner provided below for the service of notice, a notice of default such as Landlord may be required by the terms of this Lease to serve on Tenant.

3. Any such mortgagee shall have the right to remedy any default under this Lease or cause it to be remedied, and Landlord shall accept such performance by or at the instance of such mortgagee as if performance had been made by Tenant. There shall be added to any grace period allowed by the terms of this Lease to Tenant for curing any default an additional period of _____ for the mortgagee to cure the default beyond the time allowed to Tenant. If the mortgagee shall fail to remedy any such default within any such additional period of time, Landlord may then pursue all remedies in accordance with the default provisions of this Lease.

4. Any money held by Landlord under the provisions of this Lease that may be or become payable to Tenant (including, but not limited to, deposits for payment of real estate taxes, proceeds of casualty insurance, or proceeds of condemnation awards) shall be payable upon demand to the mortgagee under any leasehold mortgage as the interest of such mortgagee may appear. If Landlord should at any time be in doubt as to whether this money is payable to the mortgagee or to Tenant, Landlord may pay this money into court and file an appropriate action of interpleader in which all of Landlord's cost and expenses, including attorneys' fees and costs, shall first be paid out of the proceeds so deposited.

5. No mortgagee under any leasehold mortgage or holder of indebtedness secured thereby or purchaser at a foreclosure sale shall incur or be required to assume liability for the payment of rental under this Lease or for the performance of any of Tenant's covenants and agreements contained in this Lease unless and until such mortgagee or holder of indebtedness shall have become the owner of the leasehold estate under this Lease by foreclosure or by assignment in lieu of foreclosure, whereupon the liability of this person shall be only that as may arise thereafter by operation of law or by reason of privity of estate.

6. Casualty insurance policies may contain mortgage clauses covering the mortgage as the interest may appear provided that they contain an express recital that the rights of the mortgagee are at all times subject to the rights of Landlord under this Lease.

K. [5.51] Covenant of Quiet Enjoyment

Under Illinois law, a covenant of quiet enjoyment by the landlord will be implied even if not specifically provided in the lease. *Wade v. Halligan,* 16 Ill. 507 (1855); *Sixty-Third & Halsted Realty Co. v. Chicago City Bank & Trust Co.,* 299 Ill.App. 297, 20 N.E.2d 162 (1st Dist. 1939). Accordingly, since the buyer-landlord will have acquired title to the property from the seller-tenant, any covenant of quiet enjoyment by the buyer-landlord should be limited to the acts of the buyer-landlord and those claiming under the buyer-landlord (other than the seller-tenant). Any other format would lead to a probable circuity of action. Some leases further limit the covenant of quiet enjoyment by providing that the covenant is effective only as to the original landlord. Assignees of the original landlord take their interest free of the covenant of quiet enjoyment. This addition may make the original landlord's right of reversion more readily salable.

L. Assignments and Subleases

1. [5.52] Assignment of Lease by Tenant

There is no uniform policy regarding the assignment of a tenant's interest to a successor. Absent a provision to the contrary, a tenant has the right to assign its interest under a lease. *Edelman v. F.W. Woolworth Co.,* 252 Ill.App. 142 (1st Dist. 1929); *Chanslor-Western Oil & Development Co. v. Metropolitan Sanitary District of Greater Chicago,* 131 Ill.App.2d 527, 266 N.E.2d 405 (1st Dist. 1970).

Since the lease is for a relatively long term, there is seldom an absolute restriction against assignment. In some instances (*e.g.,* the lease provides for percentage rent payment and the buyer-landlord believes a particular seller-tenant will produce substantial percentage rents), assignments without the buyer-landlord's consent are limited to assignees that are corporate affiliates of the seller-tenant or successors to the seller-tenant's business. At times, a prohibition against assignment without the buyer-landlord's consent is tempered by a provision that the buyer-landlord's consent will not be unreasonably withheld or delayed. Under Illinois law, even if the lease does not contain a provision that the buyer-landlord will not unreasonably withhold its consent to an assignment of the seller-tenant's interest, the buyer-landlord may not withhold its consent unless it has commercially reasonable grounds, based on specific facts, for so doing. *Reget v. Dempsey-Tegler & Co.,* 70 Ill.App.2d 32, 216 N.E.2d 500 (5th Dist. 1966); *Mowatt v. 1540 Lake Shore Drive Corp.,* 385 F.2d 135 (7th Cir. 1967). If the buyer-landlord has reserved the right to consent to the seller-tenant's assignment, however, the seller-tenant will not be willing to rely on the Illinois caselaw described above in this section with respect to the buyer-landlord's consent to assignment. The seller-tenant will want the protection of standards enunciated in the lease governing the buyer-landlord's approval and of lease provisions requiring the buyer-landlord to reply promptly to a request for approval of assignment and to state the reasons for any disapproval. In addition, the seller-tenant may seek a provision that a buyer-landlord's failure to respond within a specified time period will be deemed to be an approval by the buyer-landlord.

Leases usually provide that a permitted assignment must be recorded and must include an assumption of the lease by the assignee and that a copy of the assignment or notice thereof must be served on the buyer-landlord.

If the improvements themselves afford good security and the credit of the seller-tenant is not a material factor in the transaction, provision is often made to relieve each successive tenant-assignor of liability upon assumption by an assignee of the tenant's obligations under the lease. If, however, the creditworthiness or business reputation of the seller-tenant is important to the landlord, the buyer-landlord may want to provide that the seller-tenant's liability under the lease survives an assignment of the seller-tenant's interest under the lease.

In order to facilitate leasehold financing, the lease should contain a provision granting a leasehold mortgagee who forecloses or takes title to the leasehold estate by deed in lieu of foreclosure the right to assign the lease without the buyer-landlord's consent. This right is important to leasehold mortgagees since most lenders are not in the business of operating property and will be seeking a purchaser for that leasehold as soon as they can obtain title.

Note that under §365(f) of the Bankruptcy Code, in the event of a tenant's bankruptcy, lease provisions prohibiting or restricting assignments by the tenant of the leasehold estate are invalid if the lease is assumed and the conditions for curing the tenant's defaults and giving adequate assurances of future performance by the assignee are met. 11 U.S.C. §365(f). See §5.7 above for a more complete discussion of the rights of assignment under the Bankruptcy Code.

2. [5.53] Subletting of Portions of Property by Tenant

If the use of the premises is intended to be restricted, then, normally, the right to sublet would be restricted in the same way that the right to assignment would be restricted. On the other hand, if the improvements are intended for rental (for example, an office building, shopping center, or high-rise apartment building), then there will be no restriction on subleasing portions of the premises although there may still be a restriction against subleasing all or substantially all the premises without the buyer-landlord's consent. In addition, the lease may require that subleases be made expressly subject to the right of the buyer-landlord and that no subleasing will relieve the seller-tenant from its duties under the lease.

In many cases, the lease will include an assignment by the seller-tenant under the underlying lease of all rentals and of the sublessor's rights under subleases, given for the purpose of securing the payment of rent under the underlying lease. The assignment should assist the buyer-landlord, if the underlying lease is terminated, to establish privity with the seller-tenant's sublessees and to enforce the subleases if the buyer-landlord so desires. See §5.48 above.

3. Forms

a. [5.54] Provision Concerning Assignment of Tenant's Interest

1. Except as otherwise provided in this article, Tenant shall not allow or permit any transfer by operation of law of this Lease or of any interest under this Lease or of Tenant's interest in the building and improvements, or assign, convey, mortgage, pledge, or encumber

this Lease or any interest under this Lease, or Tenant's interest in the buildings and improvements, or permit the use or occupancy of the premises or any part thereof by anyone other than Tenant or Tenant's subtenants, without, in each case, Landlord's written consent first being obtained. No assignment or subletting (with or without Landlord's consent) shall release Tenant from any of its obligations under this Lease.

2. Any assignment of this Lease by Tenant shall be evidenced by an instrument in writing (a copy of which shall be delivered to Landlord) duly executed and acknowledged by the assignor and the assignee and duly recorded in the recorder's office of the county where the Demised Premises are situated, in which and through which the assignee shall expressly accept and assume all of the terms and covenants in this Lease contained to be kept, observed, and performed by Tenant and shall further acknowledge that all interest in the land and buildings and improvements situated therein acquired by virtue of this assignment is expressly subject to paramount rights of Landlord, including those under the provisions of this Lease providing for the succession of Landlord to full title to the buildings and improvements at the end of the term of this Lease.

3. No assignment, transfer, or mortgage of Tenant's interest under this Lease shall be made or shall be valid unless any such assignment, transfer, or mortgage shall also include Tenant's interest in the buildings and improvements, or, in case of a partial assignment and transfer of Tenant's interest under this Lease, the same fractional interest in each, to the end that the ownership of Tenant's interest in this Lease and in the buildings and improvements, whether in whole or in part, shall be inseparable. Tenant shall not assign or transfer or suffer or permit any transfer by operation of law of Tenant's interest in the buildings and improvements separate and apart from tenant's interest under this Lease.

4. Any attempted assignment, transfer, or mortgage in violation of any of the provisions of this Article shall be null and void and of no force and effect.

b. [5.55] Provision for Assignment to Landlord of Subleases Made by Tenant

1. Effective in the event of a default under this Lease that would entitle Landlord under the provisions of this Lease governing defaults to elect to terminate this Lease and reenter the premises, whether or not Landlord may have made such election, and, in any event, upon termination of this Lease (unless Landlord elects not to accept this assignment), Tenant hereby assigns to Landlord all of its right, title, and interest in and to the _____ lease and _____ lease and all rents due and to become due under the Lease and to all subleases hereafter made by Tenant for the buildings and improvements or portions thereof and all rents due and to become due under the leases. After the effective date of the assignment (unless Landlord has elected not to accept the assignment), Landlord is hereby empowered to collect, sue for, settle, compromise, and give acquittances for all of the rents that may become due under said leases and avail itself of and pursue all remedies for the enforcement of said leases and of Tenant's rights in and under said leases as Tenant might have pursued but for this assignment. The assignment contained in this section, at the expiration of the term of this Lease by lapse of time or otherwise, shall be and become absolute. Tenant represents and warrants that it has not collected and agrees that it will not

collect any rent, income, and profits arising or accruing under any leases in advance of the time when they become due under the terms of the leases. Tenant further agrees that it will not assign or encumber its interest in any leases or in any of the rents, income, or profits thereof, except that Tenant may assign them to any assignee of its interest under this Lease or to any mortgagee under any leasehold mortgage.

2. As additional security for the payment by Tenant to Landlord of all rentals and other sums becoming due and owing by Tenant to Landlord under this Lease from time to time, Tenant has executed and delivered a separate assignment to Landlord of _____ leases. Tenant agrees that any default by Tenant in the observance or performance of any of Tenant's covenants or agreements contained in said assignment shall constitute a default under this Lease.

See Chapter 6 of this handbook for a more detailed discussion of assignments and subleases.

M. [5.56] Seller-Tenant's Repurchase Options

There is no set pattern regarding to repurchase options. In the past, they were frequently avoided because of the income tax problems they entail. More recently, there has been a tendency to include these provisions, with due regard, of course, to tax consequences. It should be noted, however, that if there is a right in the buyer-landlord to put the fee to the seller-tenant or an economic compulsion on the seller-tenant to exercise a repurchase option (*e.g.,* because of a short lease term or a repurchase price substantially below fair market value), the transaction may be recharacterized as a loan, and, apart from the tax consequences, the buyer-landlord as mortgagee may find itself facing great difficulties in realizing on the security. Consequently, in the case of the seller-tenant's default, the buyer-landlord as mortgagee will have to act without many of the rights it would otherwise reserve in a mortgage, such as a waiver of the right of redemption. *Frito-Lay, Inc. v. United States,* 209 F.Supp. 886 (N.D.Ga. 1962). See §5.11 above. In addition, it is probable that the buyer-landlord will be precluded from making a claim under the American Land Title Association Owner's Policy obtained at the time of acquisition because applicable policy exclusions will excuse the insurer from either indemnifying or defending the buyer-landlord.

In some instances, instead of a purchase option, the buyer-landlord will afford the seller-tenant a right of first refusal, giving the seller-tenant the privilege of meeting a bona fide offer received from a third-party purchaser the buyer-landlord is prepared to accept.

Buyer-landlords and seller-tenants have also used a device known as the "rejectable offer." The seller-tenant is permitted to make an offer to the buyer-landlord for the purchase of the property at a fixed price or at a price to be computed under a definite formula. If the buyer-landlord rejects the offer, the seller-tenant may then terminate the lease. *See Sun Oil Co. v. Commissioner,* 562 F.2d 258, 267 – 268 (3d Cir. 1977), *cert. denied,* 98 S.Ct. 2845 (1978), in which the court found that a rejectable offer that allowed the seller-tenant to repurchase the property for less than fair market value helped, for tax purposes, make the transaction in question a loan instead of a sale and lease.

The parties to a sale-leaseback transaction should also consider whether the seller-tenant's repurchase option violates the rule against perpetuities. The rule against perpetuities generally holds that no estate in property shall be valid unless it must vest, if at all, not later than 21 years after the end of one or more lives in being at the creation of the estate. The rule seeks to ensure the productive use and development of property, free from extended restraints on alienation.

In *Symphony Space, Inc. v. Pergola Properties, Inc.,* 88 N.Y.2d 466, 669 N.E.2d 799, 646 N.Y.S.2d 641 (1996), the New York Court of Appeals struck down the option component of a sale-leaseback transaction while allowing the rest of the transaction to stand. The parties to the sale-leaseback were corporations, and the option did not refer to any living persons as potential "measuring lives" for the rule against perpetuities. Thus, the option would be void under the rule if it could vest more than 21 years after its creation. The seller-tenant's option in that case was created in 1978 but could be exercised as late as 2003. The option created an estate in land that could vest more than 24 years later and was thus void as against the rule against perpetuities. To avoid this result, seller-tenants should always include a "savings clause" in the option, providing that notwithstanding anything contained in the option to the contrary, the option shall terminate, if it has not previously terminated, 21 years after the death of the survivor of at least one of the individuals involved in the transaction. See Alvin L. Arnold, *Sale-Leasebacks: Option Violates Rule Against Perpetuities,* 26 Real Est.L.Rep. 3 (1996).

N. [5.57] Buyer-Landlord's Purchase Options

Sale-leaseback transactions have included a right in the buyer-landlord to acquire the leasehold estate and improvements for an agreed-on sum at a point before the expiration of the lease term. Concerns have grown, however, about the enforceability of these options in light of the long-established common-law prohibition against "clogging the mortgagor's equity of redemption." See Howard E. Kane, *The Mortgagee's Option To Purchase Mortgaged Property,* FINANCING REAL ESTATE DURING THE INFLATIONARY 80S, p. 123 (1981) (Kane). The buyer-landlord's option to acquire the leasehold estate and improvements is often a crucial element of the transaction from the buyer-landlord's viewpoint. A finding that the buyer-landlord's option was unenforceable by reason of the doctrine of clogging of the equity of redemption could have devastating effects on the buyer-landlord's economic expectations from the transaction.

Clogging the equity of redemption is an equitable doctrine developed by the English Chancery Courts as a type of common-law consumerist remedy to protect the "impecunious landowner in the toils of a crafty moneylender." *Samuel v. Jarrah Timber & Wood Paving Corp.,* 1904 App.Cas. 323, 327 (1904) (similar to unconscionability doctrine used today to protect unwary consumers). Essentially, the doctrine prohibits a lender in a mortgage transaction from exacting any agreement from a borrower that, upon full payment of the indebtedness plus legal interest, prevents the borrower from regaining the exact title, control, and use of the property it had before entering into the mortgage transaction. Thus, for example, a mortgagee could not, as part of the mortgage transaction, obtain an option to purchase the mortgaged property since the exercise of the option would prevent the mortgagor from regaining the property even if the debt and interest were fully paid.

In the United States, the clogging doctrine has, on occasion, been applied to render agreements between parties to a mortgage transaction unenforceable. For example, in *Humble Oil & Refining Co. v. Doerr,* 123 N.J.Super. 530, 303 A.2d 898 (1973), the leading modern American application of this doctrine, the New Jersey chancellor invalidated an option to purchase the mortgaged property, granted to a party acting in the nature of a guarantor, as an unenforceable clog.

Contemporary American courts have, however, avoided rendering contractual agreements void by application of the doctrine. In *MacArthur v. North Palm Beach Utilities, Inc.,* 202 So.2d 181 (Fla. 1967), the Florida Supreme Court refused to invalidate a seller-lender's option to repurchase the property as a clog on the purchaser-borrower's equity of redemption because of the complex nature of the transaction. In *In re Mondelli,* 349 Fed.Appx. 731 (3d Cir. 2009), the United States Court of Appeals for the Third Circuit refused to invalidate a right of first refusal contained in a lease granted to a third party that was a condition precedent to the grant of a mortgage. The court reasoned that such right would not impermissibly clog the debtor's ability to redeem, but rather would only affect the debtor's ability to sell to a third party. The court also refused to find that the landlord's obligation to subordinate its interest to financing obtained by the tenant did not constitute a clogging of the equity of redemption. Further, the *Mondelli* court noted that the clogging doctrine, when applicable, only invalidates the offending provisions of an agreement and not the entire agreement. Indeed, "even if the right of first refusal did clog the equitable right of redemption, the remedy would be to render the provision unenforceable, not to invalidate the entire lease." 349 Fed.Appx. at 733. In *Lincoln Mortgage Investors v. Cook,* 659 P.2d 925 (1983), the Oklahoma Supreme Court refused to construe a due-on-sale clause in a mortgage as an impermissible clog on the borrower's equity of redemption. *See also Coursey v. Fairchild,* 1967 O.K. 252, 436 P.2d 35 (1967); *Crestview, Ltd. v. Foremost Insurance Co.,* 621 S.W.2d 816 (Tex.Civ.App. 1981); *Bromley v. Bromley,* 106 Ga.App. 606, 127 S.E.2d 836 (1962).

In a sale-leaseback transaction in which the buyer-landlord buys and then leases land back to the seller-tenant and in which the buyer-landlord will succeed to full title to the improvements upon the termination of the lease, the clogging doctrine should not apply. The doctrine rests on the theoretical underpinning that a borrower's common-law equity of redemption must be returned to it in its pre-mortgage state if the borrower faithfully repays the loan. No such redemption rights arise in a sale-leaseback transaction. The seller-tenant has parted with its equity of redemption in the land upon consummation of the sale. After the sale, the only right of the seller-tenant in the land is a leasehold estate arising by virtue of the lease. The passing of title to the improvements occurs either by operation of law or, if some of the suggestions discussed above in this section are followed, by reason of the original instrument of conveyance when the land was sold.

The seller-tenant may allege, however, that the sale-leaseback transaction should be recharacterized as a financing device (*e.g.,* an equitable mortgage) giving rise to an equity of redemption in the seller-tenant and, therefore, in a default under the ground lease, the buyer-landlord cannot gain title to the improvements without foreclosing the equity of redemption. *See In re Kassuba,* 562 F.2d 511 (7th Cir. 1977). If the sale-leaseback is the only transaction between the parties concerning that particular property and no purchase or repurchase options are granted to either the buyer-landlord or the seller-tenant, a court seems unlikely to find the transaction to be an equitable mortgage financing giving rise to redemption rights in the seller-tenant. However, when the seller-tenant receives an option to repurchase the land or the buyer-landlord also makes a loan

to the seller-tenant with the improvements and leasehold estate as collateral, there is concern that the clogging doctrine could be invoked to invalidate a purchase option granted to the buyer-landlord, particularly if the buyer-landlord's option to purchase the improvements was contained in the leasehold mortgage documents. This risk is diminished if the option is contained in the sale-leaseback documents. Kane, *supra,* p. 138.

Even if a sale-leaseback (alone or in conjunction with leasehold financing from the buyer-landlord) is found to be a financing device in the nature of an equitable mortgage, an option of the buyer-landlord to purchase the leasehold estate and improvements before the end of the lease term may not be rendered unenforceable by a clog on the equity of redemption if (1) the equity of redemption was released in a subsequent transaction, (2) the option is a collateral advantage, or (3) the complex nature of the transaction and the sophistication of the parties render the doctrine inapplicable.

A debtor can release this equity of redemption in a subsequent transaction if there is adequate consideration and no fraud, oppression, or unfair advantage. *See, e.g., Peugh v. Davis,* 96 U.S. 332, 24 L.Ed. 775 (1877); *Smith v. Shattls,* 66 N.J.Super. 430, 169 A.2d 503 (1961). Accordingly, an option to the buyer-landlord to acquire the leasehold estate and improvements may withstand a challenge under the clogging doctrine if granted in a transaction subsequent to the sale and lease. However, the law regarding the amount of time required to separate the mortgage transaction from the release of the equity of redemption provides little guidance. In *Reeve v. Lisle,* 1902 App.Cas. 461, an 11-day separation was deemed sufficient. In *Coursey, supra,* on the other hand, an 11-day gap between the date of the mortgage and the date of an oil and gas lease granted as additional consideration was held insufficient when the parties had agreed that these instruments formed part of a single transaction. Moreover, in *Ringling Joint Venture II v. Huntington National Bank,* 595 So.2d 180 (Fla.App. 1992), although the conveyance agreement resulting in taking the mortgagor's right of redemption was created in conjunction with the mortgage documents and therefore was not technically a "subsequent agreement," the court decided it was an agreement subsequent to the mortgage because the mortgagor received valuable consideration and it was not an unfair scheme. In order to decide whether a mortgagor releases its right of redemption in a "subsequent" transaction, the duration of time will not be a definitive factor.

A purchase right granted to the buyer-landlord may be supportable as a collateral advantage. As the clogging doctrine is applied to financing, additional rights in the debtor's property granted to lenders may be enforceable as valid collateral advantages as long as these additional rights are fair and do not interfere with the borrower's equity of redemption. Simply stated, a collateral advantage is an agreement entered into by a borrower and lender, separate from the loan agreement, giving the lender certain rights regarding the borrower's property. For example, in *Kreglinger v. New Patagonia Meat & Cold Storage Co.,* 1914 App.Cas. 25, the lender's five-year option to purchase all the sheepskins produced by the borrower's meat-packing business at the highest price offered by anyone else was held to be an enforceable collateral advantage. The court interpreted the transaction as essentially two contemporaneous contracts — one for the loan and the other for the purchase of sheepskins. Even though the borrower would not necessarily receive his property back in the same condition after redemption if the borrower repaid the loan before the expiration of the five-year option, the court held that the borrower's right to redeem was not impaired and refused to invalidate the lender's right of first refusal. Relying on *Kreglinger,* if the buyer-landlord

structures its interest in the seller-tenant's property as a right of first refusal instead of as an option, the right of first refusal would probably be an enforceable collateral advantage. A buyer-landlord's option to purchase the improvements may also be upheld as a valid collateral advantage if the transaction is structured so that the option is fair and does not interfere with the seller-tenant's equity of redemption. For example, the buyer-landlord might allow the seller-tenant to negate the option by paying a premium to the buyer-landlord. The seller-tenant would then retain its ability to redeem its property even though it would require an additional payment. Kane, *supra,* p. 137, suggests these approaches but notes that the latter type of agreement calling for the payment of a premium may be unconscionable.

Finally, even if the sale-leaseback is found to be a financing device and none of the above theories is available to avoid the effects of the clogging doctrine, the doctrine may be deemed inapplicable to this type of complex business transaction between sophisticated parties. The clogging doctrine was originally established to protect unsophisticated, desperate borrowers from submitting to harsh conditions forced on them by their desperation and their inferior bargaining positions. In complex transactions between sophisticated businesspeople, one court refused to apply the clogging doctrine, and a second court refused to find an equity of redemption in a seller-tenant. In *MacArthur, supra,* the Florida Supreme Court refused to apply the clogging doctrine to invalidate the seller-lender's option to repurchase the property at below fair market value. The court opined that had the seller made the loan, its repurchase option would clearly have been enforceable. The court felt that it did not make sense to invalidate the option merely because the seller accommodated the buyer by making the loan. The court considered the complex nature of the transaction, the various agreements of the parties, and the sophistication of the parties and decided that the clogging doctrine was inapplicable to this type of complex business transaction between sophisticated parties mixing elements of sale and mortgage.

In *Kassuba, supra,* the buyer-landlord purchased the land only and leased it back to the seller-tenant for a term of years. As part of the lease, the buyer-landlord granted the seller-tenant an option to repurchase the land at a set price after the fourth lease year but before the term expired. When the seller-tenant went bankrupt, he sought to defeat the buyer-landlord's action to terminate the lease and obtain clear title to the land and improvements by alleging that the transaction was really a mortgage transaction that gave rise to an equity of redemption in the seller-tenant extinguishable only through foreclosure proceedings. The court rejected this argument; it refused to recognize an equity of redemption in the seller-tenant because the parties were sophisticated in real estate matters, were represented by counsel, and, in testimony and in the documents, admitted they intended the transaction to be a sale-leaseback.

These two cases appear to support an argument that the clogging doctrine should not be used to invalidate complex business arrangements between sophisticated parties. *Kassuba* supports the proposition that no equitable right of redemption should arise in complex sale-leaseback arrangements between sophisticated parties. These concepts may well be applicable to support an option granted as part of a complicated sale-leaseback transaction against an attack based on the clogging doctrine.

O. Estoppel Certificates

1. [5.58] In General

Leases in sale-leaseback transactions generally contain a requirement that either party to the lease, upon the request of the other, will deliver an estoppel certificate to the requesting party setting forth basic information concerning the status of the lease. It is of vital importance to each party that it be able to obtain such an estoppel certificate. The buyer-landlord's ability to assign its reversionary interest and mortgage the fee likely will rest on the strength of the ground lease. The estoppel certificate that the buyer-landlord obtains from the seller-tenant will enable the buyer-landlord to demonstrate to the assignee or mortgagee that the lease is in full force and effect. Similarly, the seller-tenant may desire to assign its leasehold interest and its interest in the buildings and improvements or to mortgage these interests at some time during the lease term. Since all the seller-tenant has to sell to an assignee with regard to the land is the leasehold interest therein and all the seller-tenant has to pledge to a leasehold mortgagee is the leasehold (and since, in either case, the seller-tenant's interest in the improvements depends on the validity of the leasehold), the seller-tenant must also be in a position to demonstrate that the lease is in full force and effect.

2. [5.59] Form of Provision for Delivery of Estoppel Certificate by Landlord and Tenant

Landlord and Tenant agree at any time and from time to time, upon not less than [10**] days' prior written request by either, to execute, acknowledge, and deliver to the other a statement in writing certifying that this Lease is unmodified and in full force and effect (or, if there have been modifications, that the Lease is in full force and effect as modified and stating the modifications), the dates to which the rental and other charges have been paid in advance, if any, and whether, to the knowledge of the party executing the certificate, there are then any defaults under this Lease, either by Landlord or by Tenant or both (and, if so, specifying such defaults), it being intended that any such statement delivered pursuant to this article may be relied on by any prospective purchaser of the fee or leasehold or mortgagee or assignee of any mortgage on the fee or leasehold, as the case may be.**

P. Maintenance, Repairs, and Alterations — Compliance with Laws

1. [5.60] In General

The seller-tenant will normally be required by the lease, at its expense, to maintain the improvements in good repair and to make any changes or alterations that may be required by law. The lease usually will also contain provisions requiring the seller-tenant to discharge all obligations relating to adjoining land, such as shoring up, keeping adjoining streets and sidewalks safe and free from obstruction, and like matters. These obligations to repair and maintain must be clearly spelled out in the lease in light of the general rule with respect to repairs that, absent any contrary lease provision,

> **[**t**]he relation of landlord and tenant creates no obligation or duty on the landlord to make repairs, unless he assumed such duty by express agreement with the tenant. . . . A covenant to repair by the tenant, except to prevent waste by his acts of negligence,**

> **is not implied by law and an express covenant to repair will not be enlarged by construction. [**Citation omitted.**]** *Hollywood Bldg. Corp. v. Greenview Amusement Co.,* 315 Ill.App. 658, 43 N.E.2d 566, 567 (1st Dist. 1940). *Accord Yuan Kane Ing v. Levy,* 26 Ill.App.3d 889, 326 N.E.2d 51 (1st Dist. 1975).

The lease commonly used in the typical net lease situation differs in its repair provisions from that used in a sale-leaseback transaction. In the usual type of net lease, in which the tenant has not been the previous owner of the premises, provision is frequently made for the landlord to be liable for maintenance, to remedy defects appearing during the first year, and to correct violations of legal requirements that required correction when the lease began. If, however, the tenant was the former owner of the premises and has sold it to the landlord, as in a sale-leaseback, the tenant can hardly expect to look to the landlord to make good its own shortcomings. Accordingly, the lease in a sale-leaseback transaction requires the seller-tenant to assume maintenance obligations from the beginning of the lease term.

A seller-tenant may wish to place certain limitations on the lease requirement that the seller-tenant comply with all laws, ordinances, and regulations affecting the property to avoid technical default under the lease for any violation of laws that do not affect the buyer-landlord's interest in the property. The buyer-landlord may resist such a request if the continued operation of the premises by the seller-tenant is of economic importance to the buyer-landlord. The specifics of any such limitations on the duty of the seller-tenant to comply with the applicable laws, ordinances, and regulations would have to be worked out on a case-by-case basis depending on the type of buildings and the nature of the seller-tenant's operation.

A problem arises from the seller-tenant's point of view if, due to a change in a law near the end of the lease term, the seller-tenant is required to expend substantial sums to comply with the change. If only a short period remains under the lease term, the buyer-landlord clearly will derive the major benefit from such improvements made by the seller-tenant. A provision should be made either for an equitable allocation of any such expenditure incurred by the seller-tenant within the last few years of the lease term or for giving the seller-tenant the right to terminate the lease rather than make the change. A provision allowing an early termination could take substantially the same form as the provision discussed in §5.35 above giving the seller-tenant the right to terminate the lease following damage to the improvements during the final years of the lease term.

The extent to which the seller-tenant will be allowed to construct new improvements on the premises and to make alterations to existing improvements depends, in large part, on whether the lease is based on the seller-tenant's credit. In those instances in which the lease is a credit lease and the buyer-landlord is looking more to the rent than the specific improvements, the seller-tenant will often be given broad power to make alterations to the improvements and to construct new improvements with, perhaps, only a requirement that, after completion of alterations, the altered or new improvements be of at least equal quality and rental value to those existing before commencement of the work. On the other hand, if the improvements are unique or if their physical value is of great importance, the seller-tenant will be much more restricted in its right to make material alterations.

The lease also should contain a provision that if the seller-tenant fails to make the required repairs or alterations, the buyer-landlord may step in and do the work itself and charge the seller-tenant for the cost of that work plus interest. In Illinois, if a tenant specifically covenants to keep the premises in good repair but fails to do so, a landlord who enters the premises and makes such a repair will be deemed to have acted as a volunteer and to have no right to recover for the cost of the repairs from the tenant, absent a specific lease requirement that the tenant pay for such repairs made by the landlord. *Wicker v. Lewis,* 40 Ill. 251 (1866). Similarly, a right reserved in the landlord to enter the premises to make any necessary repairs without any accompanying requirement that the tenant pay for the repairs will not obligate the tenant to pay for repairs made by the landlord. *Rose v. Stoddard,* 181 Ill.App. 405 (1st Dist. 1913). See generally Bennett I. Berman, *The Duty of Repair and Restoration of Leased Premises in Illinois,* 53 Chi.B.Rec. 373, 376 – 377 (1972). If the lease grants the landlord the right to enter into the premises and make repairs the tenant was obligated but failed to make and then to seek reimbursement from the tenant for the cost of these repairs, the landlord need not wait until the end of the lease term to recover for the cost of these repairs. *Gubbins v. Glabman,* 215 Ill.App. 43 (1st Dist. 1919).

The seller-tenant may object to a provision allowing the buyer-landlord to make repairs on behalf of the seller-tenant because a dispute may arise between the seller-tenant and the buyer-landlord as to the necessity of any repair and because the buyer-landlord could expend more money on repairs than the seller-tenant would deem necessary. Questions concerning the necessity of any repair and the reasonableness of the cost incurred by the buyer-landlord in making that repair are ideal issues to be determined by arbitration. See §5.67 below. Having these questions resolved by arbitration should help relieve the seller-tenant's anxiety. At a minimum, the seller-tenant should agree to a provision allowing the buyer-landlord to make repairs in an emergency.

The buyer-landlord will want to make certain that all repairs, improvements, or alterations to the buildings and improvements to the demised premises generally will be paid for so no mechanics liens will be filed against the property. This can be evidenced by delivery by the seller-tenant to the buyer-landlord of appropriate contractors' affidavits and lien waivers. In addition, before the work commences, the buyer-landlord may also want the seller-tenant to provide some kind of bond to be certain that this work will be paid for.

The lease provision should be coordinated with any mortgage since most mortgages contain provisions with regard to alterations in the mortgaged premises.

2. Forms

a. [5.61] Provision Governing Tenant's Obligation To Maintain Premises

Tenant has inspected the Demised Premises, finds them to be in safe and satisfactory condition, and acknowledges that Landlord has made no representation to Tenant as to the condition, safety, fitness for use, or state of repair of the Demised Premises. Landlord covenants and agrees that it will not use or permit any person to use the Demised Premises and all buildings and improvements thereon or any part thereof for any use or purposes in violation of the laws of the United States or the state in which the Demised Premises are located or of the ordinances or other regulations of the municipality or political subdivision

in which the Demised Premises are located or of any other lawful authority; that during the term of the Lease it will keep the Demised Premises and all buildings and improvements thereon in a clean and wholesome condition and good state of repair and generally that it will in all respects and at all times fully comply with all lawful health and police regulations; and that it will keep the Demised Premises and all buildings and improvements thereon and all sidewalks and areas adjacent thereto, as well as in the area thereof, safe, secure, and conformed to the lawful and valid requirements of any municipality or political subdivision in which the Demised Premises may be situated and of all other public authorities, and will make at its own expense all improvements, alterations, and repairs on the Demised Premises and all buildings and improvements thereon and to the appurtenances and equipment thereof required by any lawful authorities or that may be made necessary by the act or neglect of any other person or corporation (public or private), including supporting the streets and alleys adjoining the Demised Premises and shoring up and protecting any of the buildings and improvements thereon or strengthening the foundations of any building at any time situated on the Demised Premises.

b. [5.62] Provision Giving Tenant Right To Make Alterations

1. Tenant shall have, at its own expense and subject to the conditions of this Lease, the right at any time and from time to time during the term of this Lease to make such changes and alterations, structural or otherwise, to the buildings and improvements on the Demised Premises and to erect, place, or install on the Demised Premises buildings, structures, improvements, and equipment in addition to or in substitution for those now or after this date located thereon and to remove any building or buildings, improvements, or equipment now or after this date located on the Demised Premises upon making any replacements or substitutions therefor as Tenant may deem necessary or desirable, it being agreed that the salvage from replacements or substitutions shall become the property of Tenant and may be disposed of in any manner as Tenant may deem best.

2. Anything contained in this Lease to the contrary notwithstanding, Tenant shall not remove or alter any building or buildings, improvements, or equipment now or after this date located on the Demised Premises unless the new or altered building or buildings, improvements, or equipment, as the case may be, shall have a fair value and rental value at least equal to that of the building or buildings, improvements, or equipment so removed or altered. Tenant shall forthwith, after any removal, erect, construct, complete, and pay for any new building or buildings, improvements, or equipment, as the case may be. Tenant shall not make or suffer or permit any subtenant to make any structural change or alteration or any removal and replacement of any construction or alteration or construct any additional improvements involving a reasonably estimated cost of more than $_____ unless, before any work shall have been commenced, (a) plans and specifications for this work prepared by a reputable licensed architect shall have been submitted to and approved by Landlord, which approval shall not be unreasonably withheld or delayed; (b) Tenant shall have furnished to Landlord an estimate of the cost of the proposed work, certified to by the architect by whom such plans and specifications shall have been prepared; and (c) Tenant shall have furnished to Landlord either (i) a bond on which Tenant shall be principal and on which a surety company, authorized to do business in the state in which the Demised Premises

are situated and satisfactory to Landlord, shall be surety, and which bond shall be in form satisfactory to Landlord and shall be conditioned on the completion of and payment in full for all work within a reasonable time, subject, however, to delays occasioned by strikes, lockouts, acts of God, governmental restrictions, or similar causes beyond the control of Tenant; or (ii) other security satisfactory to Landlord to ensure payment for and completion of all work, free and clear of liens.

c. [5.63] Provision with Respect to Liens Created or Caused To Be Created by Tenant

Nothing in this Lease contained shall authorize Tenant to do any act that shall in any way encumber Landlord's title in and to the Demised Premises, nor shall the interest or estate of Landlord in the Demised Premises be in any way subject to any claim by way of lien or encumbrance, whether by operation of law or by virtue of any express or implied contract by Tenant, and any claim to or lien on the Demised Premises arising from any act or omission of Tenant shall accrue only against the leasehold estate of Tenant and Tenant's interest in the buildings and improvements situated on the Demised Premises and shall in all respects be subject and subordinate to the paramount title and right of Landlord in and to the Demised Premises and Landlord's reversionary interest in the buildings and improvements.

Tenant shall not permit the Demised Premises or buildings and improvements to become subject to any mechanics, laborer's, or material supplier's lien on account of labor or material furnished to Tenant or any subtenant in connection with work of any character performed or claimed to have been performed on the Demised Premises or in the buildings and improvements by or at the direction or sufferance of Tenant; provided, however, that Tenant shall have the right to contest in good faith and with reasonable diligence the validity of any lien or claimed lien if Tenant shall give to Landlord any reasonable security as may be demanded by Landlord to ensure payment and to prevent any sale, foreclosure, or forfeiture of the Demised Premises by reason of nonpayment thereof. Upon final determination of the lien or claim for lien, Tenant will immediately pay any judgment rendered with all proper costs and charges and will at its own expense have the lien released and any judgment satisfied. If Tenant pays any judgment rendered together with costs and charges and secures release of the lien and satisfaction of any judgment and if Tenant is not in default under the provisions of this Lease, Landlord shall return to Tenant the cash and securities deposited by Tenant pursuant to this article. In the alternative, if requested by Tenant, Landlord shall use any cash or the proceeds of any securities deposited by Tenant with Landlord, less the amount of any loss, cost, damage, and reasonable expense that Landlord may sustain in connection with the lien so contested, to pay the amount necessary to discharge any lien or judgment by liquidating any securities in the manner directed by and at the expense of Tenant and delivering to Tenant checks payable to the lienor.

If Tenant shall fail to contest the validity of any lien or claim for lien and give security to Landlord to insure payment thereof or, having commenced to contest the lien or claim and having given such security, shall fail to prosecute such contest with diligence or shall fail to have the lien released and satisfy any judgment rendered thereon or to request Landlord to do so using the cash or securities deposited by Tenant during the pendency of this contest, as provided above, or, if Tenant shall be in default under any provision of this Lease, then

Landlord may, at its election (but shall not be required so to do), remove or discharge any lien or claim for lien (with the right in its discretion to settle or compromise the lien or claim) using the cash or securities deposited by Tenant for these purposes (including the payment of any costs incurred by Landlord in so doing) or may use any deposited cash or other securities to cure Tenant's other default under this Lease. Any amounts advanced by Landlord to remove or discharge any lien or claim for lien in excess of any cash or the proceeds of the securities deposited with Landlord during this contest shall be so much Additional Rental due from Tenant to Landlord at the rate of _____ percent per annum from the date of payment thereof by Landlord until the repayment thereof by Tenant to Landlord.

Q. Tenant's Payment of Taxes and Other Impositions

1. [5.64] Customary Requirements

The lease, invariably, will include a provision requiring the seller-tenant to pay all taxes, special assessments, and other governmental impositions levied on the land and improvements.

The seller-tenant will agree to pay all taxes that have already accrued but are unpaid at the commencement of the term of the lease, there having been no allowance for these taxes in favor of the buyer-landlord in the prorations at the closing of the sale that preceded the lease. There will also be a provision to prorate the taxes for the last year of the lease term and a provision allowing the seller-tenant to protest or contest taxes, with all benefits going to the seller-tenant, as long as adequate security is posted by the seller-tenant to assure payment, after any contest terminates, of any contested tax or imposition plus all interest and penalties.

2. Forms

a. [5.65] Provision for Tenant's Undertaking To Pay Taxes, Etc.

1. Tenant shall pay as Additional Rental for the Demised Premises (and shall furnish Landlord with receipts for these payments within [30**] days after payment) all taxes and assessments, general and special, water and sewer charges, and all other impositions, ordinary and extraordinary, of every kind and nature whatsoever, that may be levied, assessed, or imposed on the Demised Premises or any part thereof, or on any buildings or improvement at any time situated thereon, becoming due and payable during the term of this Lease (including any levied or assessed on Landlord's interest under this Lease), together with all unpaid installments of special assessments levied against the Demised Premises for improvements completed or not yet completed, whether now accrued or becoming due and payable during the term of this Lease, all of which taxes, assessments, charges, and other impositions (Impositions) shall be paid by Tenant before they shall respectively become delinquent and in any case within a period of time as to prevent any sale or forfeiture therefor of the Demised Premises and the buildings and improvements situated thereon or any part thereof; provided, however, that the liability of Tenant with respect to special assessments shall be limited to the payment of any installments that mature during the term of this Lease, including the term of any renewals, together with interest thereon, and that any Impositions levied for the last calendar year of the original term, or any renewal term, shall be prorated between Landlord and Tenant on and as of the date of the expiration of the term hereof on the basis of the then last available tax bills.**

2. Nothing contained in this Lease shall be construed to require Tenant to pay any franchise, inheritance, estate, succession, or transfer tax of Landlord or any income or excess profits tax assessed on or in respect of the income of Landlord or chargeable to or required to be paid by Landlord unless this tax shall be specifically levied against the income of Landlord derived from the rent by this Lease reserved, expressly and for a specific substitute for the taxes, in whole or in part, on the Demised Premises, the buildings and improvements thereon, or any part thereof, all of which taxes so specifically levied Tenant covenants and agrees to pay as so much Additional Rental as and when they become due and payable; provided, however, that if the amount or rate of any income or excess profit taxes so levied against the income of Landlord, as a specific substitute for the taxes on the Demised Premises and/or buildings and improvements thereon or any part thereof, shall be increased by reason of any other income received or property owned by Landlord, then Tenant shall not be obligated to pay an increased amount but only that tax that Landlord would be obligated to pay in case it derived no income from any source other than the real estate hereby demised.

b. [5.66] Provision for Landlord's Right To Pay Delinquent Impositions

Landlord shall, at its option, have the right at all times during the term of this Lease to pay any Imposition remaining unpaid after it shall have become delinquent and to pay, cancel, and discharge tax sales, liens, and claims against the Demised Premises and the buildings and improvements situated on the Demised Premises and to redeem the Demised Premises, buildings, and improvements from them or any of them from time to time; and the amount so paid, including all expenses incurred, shall be so much Additional Rental due from Tenant to Landlord on the rent day after any payment, with interest at the rate of _____ percent per annum from the date of payment thereof by Landlord until the repayment thereof by Tenant to Landlord.

c. [5.67] Provision for Tenant's Right To Contest Impositions

1. Any other provision of this Lease to the contrary notwithstanding, Tenant shall not be required to pay or discharge any Imposition as long as Tenant shall in good faith and with due diligence contest it by appropriate legal proceedings that shall have the effect of preventing the collection of the Imposition so contested and the sale or forfeiture of the Demised Premises or any part thereof or any building or improvements thereon and provided that, pending any such legal proceedings, Tenant shall deposit with Landlord cash or securities satisfactory to Landlord in an amount satisfactory to Landlord to assure payment of the Imposition so contested and all interest and penalties thereon. Landlord shall not be obligated to pay Tenant any interest on any cash deposited by Tenant with Landlord pursuant thereto.

2. During compliance with the procedure set forth in Paragraph 1, Landlord shall not have the right to pay or discharge the Imposition so contested. At the conclusion of this contest, upon written request of Tenant accompanied by the bill for the Imposition then due, Landlord shall use the cash or securities so deposited, less the amount of any loss, cost, damage, and reasonable expense that Landlord may sustain in connection with the Imposition so contested, to pay this Imposition by liquidating any securities in the manner

directed by and at the expense of Tenant and delivering to Tenant checks or other vouchers payable to the proper tax authority; or if the Demised Premises and buildings and improvements thereon shall have been released and discharged from any Imposition and if Tenant is not in default under the provisions of this Lease, Landlord shall return the cash or securities so deposited to Tenant; provided, however, that if Tenant fails to prosecute this contest with due diligence or fails to maintain said deposit as above provided or if Tenant is otherwise in default under the provisions of this Lease or if, at the conclusion of this contest, Tenant fails to request Landlord to pay the Imposition, Landlord may use the cash or securities so deposited to pay any item for which Landlord would be entitled to make advances under this Lease. The amount of any money deposited by Tenant or the face amount of any bond posted by Tenant with any municipality or other governmental body to secure the payment of any Imposition in connection with any contest thereof shall be credited upon the deposit required in this paragraph to be made by Tenant with Landlord, provided that such bond shall have been approved by Landlord.

3. In the event that Tenant at any time institutes suit to recover any Imposition paid by Tenant under protest, Tenant shall have the right, at its sole expense, to institute and prosecute any suit or suits in Landlord's name, in which event Tenant covenants and agrees to indemnify Landlord and save it harmless from and against all costs, charges, or liability in connection with any suit. All funds recovered as a result of any suit shall belong to Tenant.

R. Remedies upon Default — Arbitration

1. [5.68] In General

Credit tenants frequently include a provision in their leases permitting them to cure a landlord's defaults and withhold rent to offset any sums advanced. Such a provision should not have application in a sale-leaseback context, however, since the buyer-landlord has no affirmative covenants. One exception, however, may exist if the buyer-landlord has mortgaged the fee and the seller-tenant's leasehold rights are subject to the fee mortgage.

Absent a provision allowing a tenant to cure its landlord's default, Illinois courts have held that, in a commercial lease situation, the tenant cannot withhold rent by reason of the landlord's default since the landlord's obligations under the lease and the tenant's obligations to pay the rent are independent covenants. *Truman v. Rodesch,* 168 Ill.App. 304 (2d Dist. 1912). The one established exception occurs when the landlord's default constitutes a constructive eviction, and the tenant, within a reasonable time after the breach occurs, terminates the lease and vacates the premises; in this case, the tenant's liability for rent ceases when it terminates the lease and vacates the premises. *John Munic Meat Co. v. H. Gartenberg & Co.,* 51 Ill.App.3d 413, 366 N.E.2d 617, 9 Ill.Dec. 360 (1st Dist. 1977); *Book Production Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881 (2d Dist. 1961); *Applegate v. Inland Real Estate Corp.,* 109 Ill.App.3d 986, 441 N.E.2d 379, 65 Ill.Dec. 466 (2d Dist. 1982); *C.F. Birtman Co. v. Thompson,* 136 Ill.App. 621 (1st Dist. 1907); David Levinson, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.R. 321, 326. While Illinois courts seem to have begun to move away from the absolute doctrine of independent covenants in residential leases (*Jack Spring, Inc. v. Little,* 50 Ill.2d 351, 280 N.E.2d 208 (1972); *Pole Realty Co. v. Sorrells,* 78

Ill.App.3d 361, 397 N.E.2d 539, 34 Ill.Dec. 83 (1st Dist. 1979), *rev'd in part,* 84 Ill.2d 178 (1981)), Illinois courts have expressly determined that the *Jack Spring* reasoning should not be extended to commercial leases (*General Parking Corp. v. Kimmel,* 79 Ill.App.3d 883, 398 N.E.2d 1104, 35 Ill.Dec. 154 (1st Dist. 1979); *Elizondo v. Perez,* 42 Ill.App.3d 313, 356 N.E.2d 112, 1 Ill.Dec. 112 (1st Dist. 1976); *Yuan Kane Ing v. Levy,* 26 Ill.App.3d 889, 326 N.E.2d 51 (1st Dist. 1975)). *But see Book Production Industries, supra.*

If the buyer-landlord has mortgaged the fee on the basis of a credit lease, the fee mortgagee may take exception to the seller-tenant's right to withhold rent since this jeopardizes part of the mortgagee's security. The mortgagee may insist that, at a minimum, the seller-tenant notify the mortgagee of a default by the buyer-landlord giving rise to a right to withhold rent and give the mortgagee a suitable time to foreclose the mortgage and cure.

The buyer-landlord's remedies usually will include the standard remedy of termination. An additional provision is often made for the seller-tenant's liability to survive a termination of the lease resulting from the seller-tenant's default. This result can be accomplished by providing that, notwithstanding termination of the lease, the seller-tenant remains liable for damages, payable each month, based on the excess of the monthly rent, taxes, and other carrying costs of the property paid by the buyer-landlord over the amount, if any, of the net rent received from reletting the premises. The lease may also provide for the seller-tenant to pay damages in a lump sum equal to the differences between the then-present value of the rent reserved under the lease and the rental value of the premises for the remainder of the term, notwithstanding termination of the lease. The best practice is to give the buyer-landlord an election to choose either of these alternatives so that, in the event of the seller-tenant's default, the buyer-landlord can choose the most favorable one under the particular circumstances.

Unless the lease grants the buyer-landlord the right to lump-sum damages, the lump-sum damages option is not available to it under Illinois law. 735 ILCS 5/9-201, *et seq.* If there is no provision in the lease giving the buyer-landlord the right either to terminate the lease and collect damages or terminate the right of possession without terminating the lease, the buyer-landlord must elect whether to keep the lease in force with the seller-tenant remaining in possession and sue for the rent each month or to terminate the lease and thereby release the seller-tenant from any liability for rent that has not accrued at the date of termination. *Id.*

In order to avoid releasing the seller-tenant from liability upon termination of the lease for default, an additional precaution is sometimes taken to give the buyer-landlord the election to terminate the seller-tenant's right of possession without terminating the lease. However, if, as stated above, proper provision is made for payment of damages, the termination of the lease will not release the seller-tenant from liability for damages resulting from the termination of the lease.

"Ipso facto" provisions in leases making an act of bankruptcy under the federal law an event of default under a lease have been rendered invalid by the Bankruptcy Code. 11 U.S.C. §365(e). See §5.7 above.

Since the seller-tenant's interest in a sale-leaseback transaction often represents a substantial investment in buildings and improvements, it will want to be protected from having the lease

terminated by reason of a default arising from a legitimate dispute between the seller-tenant and the buyer-landlord. The seller-tenant may request an arbitration provision in the lease covering all nonpayment defaults. If the buyer-landlord agrees to such an arbitration provision, it will want to ensure that the arbitrator's decision was made promptly so that if, for example, the disputed default involves the necessity of making certain repairs or remedying certain violations of law, the dispute will be resolved without further deterioration of the property. In fact, even if there is an arbitration provision, the buyer-landlord may still wish to retain the right to perform the disputed obligation before the decision is made by the arbitrator, with the effect that if the arbitrator finds in the buyer-landlord's favor, the seller-tenant will be required to reimburse the buyer-landlord for the cost of such performance in addition to possibly having the lease terminated. In addition, since arbitration may be appropriate with regard to certain factual disputes that arise under the terms of the lease but may not be desirable as a general means of resolving all disputes under the lease, the buyer-landlord may well wish to restrict arbitration to specific questions of fact.

At times, seller-tenants request a lease provision that in the event the net return to the buyer-landlord from reletting the premises following the seller-tenant's default exceeds the net return that would have been payable to the buyer-landlord under the defaulted lease, the defaulting seller-tenant be entitled to the excess. Such a provision is usually inappropriate since it allows a defaulting seller-tenant to profit from the default. Giving the seller-tenant the right to any excess encourages a default by the seller-tenant, especially a seller-tenant whose right to assign its lease interest is restricted, if market conditions are such that the buyer-landlord will most likely find a successor tenant who will pay a higher rental.

In certain situations, especially when the buyer-landlord has entered into the sale-leaseback transaction in reliance on the value of the improvements and not on the credit of the seller-tenant, the seller-tenant may wish to limit liability in the event of default to the buyer-landlord's right to regain possession of the premises. In Illinois, one way by which this can be accomplished is by creating a land trust, the sole assets of which are the leasehold estate and the tenant's interest in the buildings and improvements, to serve as the seller-tenant. This may require certain modifications to the land trust agreement commonly used by land trustees in the Chicago metropolitan area to allow the land trustee to hold a leasehold interest. If the land trust device is not available because the property is situated outside Illinois or because of tax considerations, the same effect can be accomplished by adding appropriate exculpatory language to the lease.

The buyer-landlord may also wish to limit liability under the lease to the period during which it is the landlord under the lease. From and after the transfer, the buyer-landlord will be relieved of any further liability under the lease as long as it has delivered to the successor landlord all funds of the seller-tenant that the assigning landlord is then holding.

2. Forms

a. [5.69] Provision for Damages by Reason of Termination of Lease Resulting from Tenant's Default

1. The foregoing provision for the termination of this Lease for any default in any of Tenant's covenants shall not operate to exclude or suspend any other remedy of Landlord for breach of any of the covenants or for the recovery of the rent or of any advance of Landlord

made thereon. In the event of the termination of this Lease as stated above, Tenant covenants and agrees to indemnify and save harmless Landlord from any loss arising from this termination and reentry in pursuance thereof, and to that end Tenant covenants and agrees to pay to Landlord after this termination and reentry, at the end of each month of the demised term, the difference between the net income actually received by Landlord from the Demised Premises during this month and the rent, Impositions, and other sums that Tenant has agreed to pay by the terms of this Lease during this month, but that Landlord has paid, together with Landlord's expenses of reletting and altering the improvements on the Demised Premises and together with all commissions and attorneys' fees and expenses incurred in connection therewith.

2. In lieu of the remedy for damages provided in the previous paragraph, Landlord may elect to recover against Tenant, as damages for loss of the bargain and not as a penalty, and Tenant at the time of this termination shall be liable for and shall pay to Landlord, on demand, an amount equal to the excess, if any, of the present value of the Basic Rent that may be payable under this Lease from the date of demand until the end of what would have been the term of this Lease had it not been terminated by reason of default (including any renewals or extensions resulting from any options that Tenant may have exercised) over the present value of the then fair rental value of the Demised Premises for the same period. Election may be made at any time after termination of this Lease and shall not affect Landlord's right to receive current damages, as provided above, that may have accrued prior to the date of demand.

b. [5.70] Provision Limiting Tenant's Liability to Leasehold Estate and Buildings and Improvements When Tenant Is Not Land Trustee

Notwithstanding that all of the covenants, agreements, conditions, and undertakings herein are in substance and in form expressed in language creating personal covenants on the part of Tenant, the liability of Tenant, its [partners, officers, directors, shareholders, and employees**], and Tenant's successors or assigns with respect to all covenants, agreements, conditions, and undertakings herein shall be limited to and shall not extend beyond Tenant's leasehold estate hereby created and Tenant's rights in the buildings and improvements. No personal liability shall be asserted or be enforceable against Tenant, its [**partners, officers, directors, shareholders, or employees**], or Tenant's successors or assigns to enforce or assert any personal obligation or liability hereunder. The parties hereto intend that the sole remedy of Landlord in enforcing Tenant's liability hereunder and all of the terms, covenants, conditions, and undertakings in this Lease contained shall be limited to Tenant's leasehold estate and interest in the buildings and improvements. This provision shall supersede any other provisions of this Lease inconsistent or apparently inconsistent herewith.**

c. [5.71] Provision Limiting Landlord's Liability to Period Before Assignment to Successor of Landlord's Interest Under Lease

"Landlord," as far as covenants or obligations on the part of Landlord are concerned, shall be limited to mean only the owner or owners of the fee of the Demised Premises at the time in question and, in the event of any transfer or transfers of the title to this fee, the

Landlord herein named (and in case of any subsequent transfers or conveyances, the then grantor) shall be automatically freed and relieved, from and after the date of the transfer or conveyance, of all personal liability as respects the performance of any covenants or obligations on the part of Landlord contained in this Lease thereafter to be performed; provided that any funds in the hands of Landlord or the then grantor at the time of the transfer in which Tenant has an interest shall be turned over to the grantee, and any amount then due and payable to Tenant by Landlord or the then grantor under any provisions of this Lease shall be paid to Tenant.

See §5.68 above for an extensive discussion of rights and remedies upon default.

V. THE RISK OF RECHARACTERIZATION IN BANKRUPTCY PROCEEDINGS

A. [5.72] In General

Federal tax cases have looked to the economic substance of a transaction to determine whether a true sale-leaseback was created for tax purposes. *See Frank Lyon Co. v. United States,* 435 U.S. 561, 55 L.Ed.2d 550, 98 S.Ct. 1291 (1978). Some courts in federal bankruptcy proceedings have adopted this analysis and focused on the economic substance of the transaction, not on the formal characterization the parties placed on the arrangement. Courts finding that the economic substance of a sale-leaseback does not support the format the parties assigned to it have recharacterized the transaction as either a joint venture or a disguised loan (with the buyer-landlord's rights in the property perhaps constituting an equitable mortgage). Other bankruptcy courts viewing similar fact situations have deferred to the negotiating terms and conditions established in the governing documents and have upheld the sale-leaseback structure.

Before reviewing several of these cases, it is necessary to consider pertinent provisions of the Bankruptcy Code and the treatment of leases, loans, and joint ventures to understand the treatment of leases in bankruptcy and the effect of sale-leaseback transactions being recharacterized as equitable mortgages or joint ventures under the Code. Because every principal case involving recharacterization of a sale-leaseback involves a bankrupt seller-tenant, this discussion focuses on the treatment of bankrupt seller-tenants rather than bankrupt buyer-landlords.

B. [5.73] Bankruptcy Code

Commercial leases typically provide that the lessee's filing of a petition in bankruptcy or the appointment of a receiver or bankruptcy trustee constitutes an event of default, allowing the lessor to terminate the lease or triggering an automatic termination of the lease. In addition, the lessee's right to assign the lease or sublet the leased premises is often prohibited or subjected to the lessor's consent. Section 70(b) of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, expressly permitted landlords to enforce lease provisions authorizing termination of the lease in the event of the lessee's bankruptcy. Thus, the Bankruptcy Act of 1898 severely limited the bankrupt lessee's ability to retain its lease or to sell the leasehold estate and use the proceeds to pay creditors. In a number of cases arising under the Bankruptcy Act of 1898, however, bankruptcy courts invoked their equitable powers to deny enforcement of such ipso facto termination provisions. *See, e.g., Queens*

Boulevard Wine & Liquor Corp. v. Blum, 503 F.2d 202 (2d Cir. 1974); *Weaver v. Hutson,* 459 F.2d 741 (4th Cir. 1972); *In re Fleetwood Motel Corp.,* 335 F.2d 857 (3d Cir. 1964). In the landmark *Queens Boulevard* decision, the court, balancing the interests of the lessor, the bankrupt lessee, and its creditors, held that the termination provision was unenforceable. 503 F.2d at 206 – 207. The 1978 Bankruptcy Code repealed the Bankruptcy Act of 1898 and incorporated the *Queens Boulevard* rule into a complex statutory scheme governing leases in bankruptcy proceedings. 11 U.S.C. §365. In addition, the Bankruptcy Code severely limited the effect of lease provisions prohibiting or restricting assignments of leases by lessees.

C. [5.74] Leases in Bankruptcy

The treatment of leases under the Bankruptcy Code differs dramatically from the treatment of loans and joint ventures under the Bankruptcy Code. Under §362(a), a debtor's filing of a petition in bankruptcy automatically stays any action to enforce a judgment obtained against the debtor prior to the filing of the petition. 11 U.S.C. §362(a). This automatic stay provision precludes a lessor from recovering possession of the leased premises or from obtaining satisfaction of a monetary award granted in an eviction action against a defaulting lessee. If a lease terminates at the expiration of its natural term, the automatic stay does not prohibit the lessor from recovering possession of the leased premises. Otherwise, unless the Bankruptcy Court grants the lessor relief under §362(d), the automatic stay suspends the lessor's right to enforce nonbankruptcy remedies against the lessee until conclusion of the bankruptcy proceedings or natural expiration of the lease. If the bankruptcy proceedings end first, the lessee will probably receive a discharge under §727, giving the lessee a fresh start and preventing the lessor from enforcing nonbankruptcy remedies against the lessee. Thus, a lessor typically is left to pursue only those remedies granted under the Bankruptcy Code.

The lessor's principal remedy against a lessee in a bankruptcy proceeding is to compel a prompt assumption or rejection of the lease pursuant to §365(d), which allows the trustee "an opportunity to determine which of the bankrupt's contracts are beneficial to the estate and on that basis make an election whether to assume or to reject them." *In re SteelShip Corp.,* 576 F.2d 128, 132 (8th Cir. 1978). Courts apply a business-judgment test to determine "whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." *Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc.,* 756 F.2d 1043, 1047 (4th Cir. 1985). *Accord In re Mallinckrodt PLC,* Civ. No. 21-167-LPS, 2022 WL 906458, *6 (D.Del. Mar. 28, 2022); *In re Financial Oversight & Management. Board for Puerto Rico,* 631 B.R. 559, 569 (D.P.R. 2021). Like the business-judgment rule of corporate governance, the business-judgment test in bankruptcy operates as a presumption that the decision of a trustee (here to accept or reject a lease) was made in good faith. The Bankruptcy Code prohibits the trustee from assuming a lease, however, if the lease "has been terminated under applicable nonbankruptcy law prior to the order for relief." 11 U.S.C. §365(c)(3). This provision is consistent with the well-established rule that the "rights of parties to real estate leases are governed by state law unless there are contrary provisions in the Bankruptcy Code." *Waldschmidt v. Appleton Investment Co. (In re Zienel Furniture, Inc.),* 13 B.R. 264, 265 (Bankr. E.D.Wis. 1981).

Under §365(d)(3), the trustee has a 60-day election period to assume or reject the lease. During this period, the trustee must timely perform all obligations of the debtor that fall due subsequent to the filing of the bankruptcy petition. If the trustee determines that a lease is of benefit to the estate, the trustee has 60 days from the date of the filing of the petition to assume the lease. If the trustee fails to timely assume the lease (and does not apply for and obtain an extension of the 60-day period), §365(d)(4) deems the lease rejected and requires surrender of the property to the lessor.

If the trustee elects to assume the lease, it must cure all existing defaults under the lease (or provide adequate assurance that it will), compensate the lessor for actual pecuniary losses arising out of the defaults (or provide adequate assurance that it will), and provide adequate assurance of future performance under the lease. 11 U.S.C. §365(b)(1). The requirement to cure defaults (or provide adequate assurances) does not apply to defaults relating to the bankruptcy of the debtor, the commencement of the bankruptcy proceedings, or the appointment of a bankruptcy trustee. 11 U.S.C. §365(b)(2). Similarly, the lease may not be terminated or modified at any time after the filing of the petition solely because of provisions in the lease conditioned on the bankruptcy of the debtor, the commencement of the bankruptcy proceedings, or the appointment of a bankruptcy trustee. 11 U.S.C. §365(e).

If the lease is assumed, it must be without modification. Once assumed, the lease may be retained by the bankrupt lessee or assigned to a new lessee, despite any provision in the lease that "prohibits, restricts, or conditions" assignment of the lease if the assignee provides adequate assurance of future performance. 11 U.S.C. §§365(f)(1), 365(f)(2). An assignment relieves the bankrupt lessee from defaults occurring subsequent to the assignment, and proceeds from assignment of the lease become property of the bankrupt estate, available to pay creditors. If the trustee elects to assume and retain the lease, however, all rents and charges that accrue after filing the petition become an administrative charge against the bankrupt estate, entitled to priority against all other unsecured claims (except certain domestic support obligations). 11 U.S.C. §507(a)(2). Thus, although the Bankruptcy Code provides numerous protections for a bankrupt lessee, the assumption of a lease can create a significant burden on the bankrupt estate.

If the trustee rejects the lease, the lessee must surrender the leased premises, and all the lessee's obligations for future performance are terminated. However, all rent and charges that accrue between filing the petition in bankruptcy and rejection of the lease are administrative expenses with priority over unsecured claims. *Id.* Finally, rejection constitutes a default under the lease, which entitles the lessor to claim damages as a general unsecured creditor, limited to the greater of one year's rent or 15 percent of the rent for the shorter of the remaining term of the lease or three years. 11 U.S.C. §502(b)(6). In addition, security deposits held by the lessor to secure the lessee's performance may be set off against prepetition rents not paid by the lessee. 11 U.S.C. §553.

D. [5.75] Loans in Bankruptcy

Notwithstanding similarities in the treatment of a lease and a loan in bankruptcy, if a sale-leaseback is recharacterized as a loan, the treatment of the transaction under the Bankruptcy Code differs significantly from the treatment of a lease. Two similarities in the treatment of a lease and a loan are that the filing of a petition in bankruptcy automatically stays any action by a lender to enforce a nonbankruptcy remedy and that the debtor's discharge prevents a lender from enforcing

nonbankruptcy remedies against the debtor after the bankruptcy case is closed. Accordingly, lenders and lessors alike must seek to enforce their claims under the Bankruptcy Code in the case of a bankruptcy. Nevertheless, although a lessor must file a claim against the bankrupt estate for prepetition unpaid rent, a lender's remedies are more complicated.

To recover against a bankrupt debtor, a lender must file a claim against the bankrupt estate as an unsecured or a secured claimant for the total amount due. 11 U.S.C. §§501 – 511. Secured claimants usually enjoy priority over unsecured claimants with respect to receiving property or proceeds out of the bankrupt estate. 11 U.S.C. §507. Typically, unsecured claimants receive a share of the net proceeds from liquidation of the bankrupt estate or from amounts available for unsecured creditors in a plan or arrangement in a reorganization proceeding. Secured claimants either recover their collateral or receive payment equal to the value of their collateral. 11 U.S.C. §361. Unsecured claimants simply file their claims against the bankrupt estate and, unless their claims are contested, wait to receive their share of net proceeds upon liquidation. Secured claimants also file claims against the bankrupt estate, but their secured status is subject to certain limitations.

During the postpetition administrative period, a secured lender is entitled to adequate protection of its interest in the property under §363 of the Bankruptcy Code, including postpetition debt service if the court finds that the value of the collateral exceeds the amount of the debt. Also, a debtor may abandon the collateral for a secured loan under §554(a) if it is burdensome or of inconsequential value (abandonment removes the property from the bankruptcy administration).

Unlike the provisions applicable to a lease, which require the debtor to assume or reject the lease without modification, under certain circumstances the Bankruptcy Code allows a debtor to "impair" or "modify" the terms of a secured loan without the consent of the secured lender. Also, a secured lender's claim in bankruptcy may be deemed partially secured (because a secured claim is limited to the value of the collateral) and partially unsecured (to the extent the claim exceeds the value of the collateral). Thus, if the secured lender is under-collateralized, the lender's secured claim will be limited to the value of the collateral, and the balance of its claim will be deemed unsecured. If entitled to do so in the loan documents, an over-collateralized lender may claim postpetition interest, attorneys' fees, and costs of collection, but only to the extent the value of the collateral exceeds the amount of the secured claim. 11 U.S.C. §506(b).

The "strong-arm" power of the bankruptcy trustee may be used to void a secured lender's lien or require a secured lender to return money or other property transferred to it by the debtor. The bankruptcy trustee is empowered to invalidate any transfer that is voidable under nonbankruptcy law as to a creditor who extended credit and obtained a lien on the date of the filing of the petition in bankruptcy or is voidable as to a bona fide purchaser of real property, whether such a creditor or purchaser actually exists. 11 U.S.C. §544. Lien invalidation converts a secured claim into an unsecured claim. *Id.* Thus, if a transfer of property from the bankrupt grantor is recorded after the date on which the bankruptcy petition is filed, the transfer may be subject to invalidation by the trustee. Also, if the transfer of property by the bankrupt grantor prior to the filing of the bankruptcy petition is deemed to be a fraudulent conveyance, the trustee is empowered to invalidate the transfer. Finally, under certain circumstances the trustee can avoid transfers of property or payments of debt by the bankrupt grantor after the filing of a bankruptcy petition and can recover the property. Thus, numerous provisions of the Bankruptcy Code may reduce the secured lender's status in a bankruptcy proceeding to that of an unsecured claimant.

E. [5.76] Joint Ventures in Bankruptcy

A court may recharacterize a sale-leaseback transaction as a joint venture between the seller-tenant and the buyer-landlord. A joint venture is an association of two or more persons to carry out a single business enterprise for profit. *Chisholm v. Gilmer,* 81 F.2d 120, 124 (4th Cir.), *aff'd,* 57 S.Ct. 65 (1936). Like partners, joint venturers are jointly and severally liable to third parties for the debts of the joint venture, but the liability of one joint venturer to account to another joint venturer is limited to a proportionate share of liability under the terms of the joint venture agreement and is not a several liability. *Reilly v. Freeman,* 1 A.D. 560, 37 N.Y.S. 570 (1896). If a joint venturer fails to perform obligations under the joint venture agreement, the other joint venturers may sue the defaulting joint venturer for contribution or damages. Upon dissolution of a joint venture, a joint venturer may commence an equitable action for an accounting against the other joint venturers to recover a share of the profits or to fix liability for losses. *Dickson v. Patterson,* 160 U.S. 584, 40 L.Ed. 543, 16 S.Ct. 373 (1896). Because every case in which courts have recharacterized sale-leasebacks as joint ventures involved a bankrupt lessee rather than a bankrupt joint venture entity, this discussion focuses only on the situation in which a joint venturer is bankrupt.

Upon filing a petition in bankruptcy, a joint venturer is entitled to the protection of the automatic stay provision, which precludes enforcement of nonbankruptcy remedies against the bankrupt joint venturer until termination of the bankruptcy case. Because the bankrupt joint venturer likely also will receive a discharge at the end of the bankruptcy proceeding, which prevents enforcement of nonbankruptcy remedies against the joint venturers, creditors must pursue remedies granted to them under the Bankruptcy Code. For example, a creditor of a bankrupt joint venturer may file a claim against the bankrupt estate. 11 U.S.C. §§501 – 511. Because of the joint venturers' joint and several liability to third parties and the effect of the automatic stay and discharge provisions, a creditor of the joint venture (who is precluded from proceeding against the bankrupt joint venturer personally) also may pursue an action to collect all or any part of a debt of the joint venture from any of the nonbankrupt joint venturers. At the same time, however, the automatic stay and discharge provisions also bar the nonbankrupt joint venturers from pursuing an action personally against the bankrupt joint venturer to contribute a share of the debts of the joint venture, leaving them to make claims against the bankrupt estate as unsecured claimants.

The effect of one joint venturer's bankruptcy on the joint venture entity depends on whether the joint venture agreement constitutes an executory contract under the Bankruptcy Code and whether the bankrupt joint venturer's duties under the joint venture agreement involve nondelegable duties under applicable state law. As a general matter, if a joint venture agreement constitutes an executory contract, it will, like an unexpired lease, be subject to the assume-or-reject provisions of Bankruptcy Code §365. Unlike unexpired leases, however, the bankruptcy trustee may not assume an executory contract involving nondelegable duties if the trustee, and not the debtor, is in possession of the joint venture interest as a result of the bankruptcy proceeding. 11 U.S.C. §365(c)(1)(A).

Thus, the threshold inquiry is whether the joint venture agreement constitutes an executory contract. If it does not, then the assume-or-reject provisions under Bankruptcy Code §365 do not apply, the bankruptcy termination provisions under applicable nonbankruptcy law or the joint venture agreement will be enforceable, and the joint venture can be terminated upon the bankruptcy

of one of the joint venturers. Even if a joint venture agreement does not constitute an executory contract, however, the automatic stay and discharge provisions still will preclude enforcement of all nonbankruptcy remedies against the bankrupt joint venturer (other than termination of the joint venture). Moreover, the bankrupt joint venturer's interest in the joint venture (regardless of whether it has been terminated) will become property of the bankrupt estate and may be sold to satisfy creditors' claims. 11 U.S.C. §541(a).

If the joint venture agreement constitutes an executory contract and the bankrupt joint venturer holds the joint venture interest as a debtor-in-possession, then the assume-or-reject provisions under Bankruptcy Code §365 apply. On the other hand, if the joint venture agreement constitutes an executory contract and the trustee holds the joint venture interest, it is then necessary to determine whether the bankrupt joint venturer's duties under applicable state law are nondelegable. If they are delegable, then the assume-or-reject provisions under §365 apply. If, however, they are not delegable and the trustee is in possession of the joint venture interest, the result is uncertain because of an apparent conflict between two Bankruptcy Code provisions.

Bankruptcy Code §365(c)(1)(A) prohibits assumptions or assignments of executory joint venture agreements if the trustee is in possession of the joint venture interest and applicable state law would excuse the nonbankrupt joint venturers from accepting performance from "an entity other than the debtor or the debtor in possession." In other words, §365(c)(1)(A) allows assumptions and assignments of executory joint venture agreements involving nondelegable duties if the bankrupt joint venturer remains as debtor-in-possession of the joint venture interest. On the other hand, §365(e)(2)(A)(i) provides that ipso facto bankruptcy termination provisions under applicable state law or the joint venture agreement are enforceable if applicable state law would excuse the nonbankrupt joint venturers from accepting performance of the bankrupt joint venturer's duties from the trustee or an assignee of the bankrupt joint venturer's interest. Thus, the conflict is that a joint venture agreement could be deemed to be an assumable executory contract under §365(c)(1)(A) and also be deemed automatically terminated under §365(e)(2)(A)(i). See Landers, *Memorandum re Joint Venture Agreements and the Effect of a Bankruptcy Proceeding Involving One of the Venturers,* in Lewis R. Kaster et al., REALTY JOINT VENTURES 1982: CAPITAL SOURCES, NEGOTIATION AND DOCUMENTATION, pp. 721, 724 – 725 (PLI 1982).

Assuming that joint venture agreements are executory contracts involving nondelegable duties, one possible interpretation is that all joint venture agreements automatically terminate upon the bankruptcy of one of the joint venturers. This interpretation would leave Bankruptcy Code §365(c)(1)(A) without meaning for joint ventures. Thus, the more likely legislative intent is that §365(c)(1)(A) supersedes §365(e)(2)(A)(i) and that all joint venture agreements do not terminate automatically if one of the joint venturers files for bankruptcy.

Although the term "executory contract" is not defined in the Bankruptcy Code, "it generally includes contracts on which performance remains due to some extent on both sides." H.R.Rep. No. 595, 95th Cong., 1st Sess. 347 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6303; S.Rep. No. 989, 95th Cong., 2d Sess. 581 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5844. In each of the two principal cases that have addressed the issue, the courts have held that partnership agreements are executory contracts under Bankruptcy Code §365. *In re Norquist,* 43 B.R. 224, 228 (Bankr. E.D.Wash. 1984), allowed a bankrupt general partner to reject the partnership agreement as an

executory contract, the court reasoning that "every contract which requires substantial performance by either party to the agreement other than the payment of money is potentially executory in the bankruptcy context." Because *Norquist* involved rejection of an executory contract, the issue of whether the agreement involved nondelegable duties was apparently not before the court. However, in *Skeen v. Harms (In re Harms),* 10 B.R. 817, 821 (Bankr. D.Colo. 1981), the court determined that a partnership agreement is an executory contract that involves nondelegable duties because it is a "contract based upon personal trust and confidence." The partnership agreement ultimately was rejected, and the other partners were not required to accept performance from a substituted partner. Thus, although the law is still being developed in this area, these cases indicate that joint venture agreements probably will be treated as executory contracts involving nondelegable duties that are assumable unless the trustee is in possession of the joint venture interest.

Assuming that a joint venture agreement constitutes an executory contract under Bankruptcy Code §365, either involving nondelegable duties of a bankrupt joint venturer as debtor-in-possession or involving delegable duties, the fact that one of the joint venturers is in bankruptcy cannot cause the joint venture to be terminated under applicable nonbankruptcy laws or the provisions of the joint venture agreement. The debtor-in-possession or, if delegable duties are involved, the bankruptcy trustee must elect to assume or reject the joint venture agreement. If the bankrupt joint venturer is not a debtor-in-possession and nondelegable duties are involved, the trustee must reject the joint venture agreement. If either the bankruptcy trustee is entitled to and elects or the debtor-in-possession elects to assume the joint venture agreement, all defaults of the bankrupt joint venturer under the joint venture agreement must be cured, and adequate assurance for future performance must be provided. 11 U.S.C. §365(b)(1). In addition, if the joint venture agreement is assumed, the bankruptcy trustee or debtor-in-possession may assign the bankrupt joint venturer's interest in the joint venture if the assignee gives adequate assurance of future performance. 11 U.S.C. §365(c). Such an assignment relieves the bankrupt joint venturer from defaults occurring subsequent to the assignment, and proceeds from sale of the joint venturer's interest become property of the bankruptcy estate. 11 U.S.C §365(k).

If the trustee or debtor-in-possession elects to assume and retain the joint venturer's interest in the joint venture, all obligations that accrue after the filing of the petition become an administrative charge entitled to priority against all other unsecured claims against the bankruptcy estate (except for certain domestic support obligations). 11 U.S.C. §507(a)(2). If the debtor-in-possession rejects the joint venture agreement or the bankruptcy trustee elects to or must reject the joint venture agreement, all the bankrupt joint venturer's obligations for future performance under the joint venture agreement are terminated. 11 U.S.C. §365(a). However, rejection of the joint venture agreement constitutes a breach of the agreement by the bankrupt joint venturer, which entitles the other joint venturers to claim damages as unsecured creditors.

F. [5.77] Effects of Recharacterization

If a sale-leaseback transaction is upheld and not recharacterized in a bankruptcy proceeding, the bankruptcy estate of the seller-tenant must elect whether to assume or reject the lease. If the lease is assumed, the buyer-landlord will continue to receive rent payments as a second priority administrative expense of the bankruptcy estate. 11 U.S.C. §507(a)(2). The bankruptcy trustee is most likely to assume the lease if the debtor's business depends on the location or suitability of the

leased premises or if the lease is valuable and can be sold to generate cash for the benefit of creditors. In either case, the buyer-landlord continues to receive the benefit of the bargain. If the lease is rejected, the buyer-landlord regains possession of the leased premises, is free to relet the leased premises, and can file an unsecured claim for unpaid rent. If, however, the lease is recharacterized as a loan or joint venture, the buyer-landlord must choose from the much more complicated, and often less advantageous, rights and remedies under the Bankruptcy Code available to lenders or nonbankrupt joint venturers. In addition, recharacterization of a sale-leaseback as a loan or a joint venture may have other ramifications.

For example, a lease calling for participation in the upside of the project — through payment of part of the net cash flow or of the proceeds from a sale or financing of the leasehold estate as additional rent — may withstand the problems of a seller-tenant's bankruptcy better than a sale-leaseback recharacterized as a secured loan (with equivalent participatory interest) or as a joint venture (with the participation recharacterized as a joint venture distribution). If the trustee assumes the lease, the additional rent provisions will survive. If the trustee rejects the lease, the buyer-landlord will acquire title to the property free of the lease and may attempt to realize the property's full potential.

If reduced to the status of a mortgagee, the buyer-landlord may be required to settle for a return of principal plus, perhaps, accrued interest while foregoing any future participatory interest — the initial inducement for entering into the transaction. If reduced to the status of a joint venturer, any claim the buyer-landlord may assert against the seller-tenant for past-due fixed and participatory rent will be reduced to an unsecured claim for joint venture distributions, which must be filed against the seller-tenant's bankruptcy estate. The buyer-landlord's ability to realize future distributions will depend on whether the joint venture is continued. If the joint venture agreement is assumed, the buyer-landlord must rely for future performance on the original seller-tenant (who has already failed once) or, perhaps, on an assignee of the bankrupt's joint venture interest. If the joint venture agreement cannot be assumed or can be assumed but is rejected and terminated, the buyer-landlord is left with an action for an accounting with the bankruptcy estate as one of the parties.

A bankrupt seller-tenant may seek to have a sale-leaseback transaction recharacterized as a loan to take advantage of the strong-arm powers of the bankruptcy trustee to gain title to the property and reduce the buyer-landlord to an unsecured creditor. If the formalities of state law dealing with passage of title are complied with in a sale-leaseback transaction, however, the risk to a buyer-landlord of both losing title to the property and becoming an unsecured creditor seems quite remote. Recordation of an absolute deed should be a sufficient perfection of the lessor's rights in the property as a mortgagee even if the deed is deemed by the bankruptcy court to be for purposes of security and not an absolute transfer. Nevertheless, the possibility of reduction to unsecured status remains theoretically viable, especially if all the formalities of state law necessary for the conveyance of title have not been followed. In rare cases, a purported buyer-landlord may find itself transformed into an unsecured lender.

A bankrupt seller-tenant also may seek to have a sale-leaseback transaction recharacterized as a secured loan to benefit from the equity of redemption and other protections afforded a mortgagor by the applicable state law. If the transaction is recharacterized as a secured loan, the buyer-

landlord-mortgagee will be faced with the problem of foreclosing a mortgage without the benefit of a waiver of the rights of redemption and without the benefit of the various covenants usually contained in a mortgage and applicable in the case of default (for example, an agreement that the mortgage secures all money expended by the mortgagee to cure the mortgagor's default, notwithstanding that the total amount secured by the mortgage exceeds the face amount of the note).

Recharacterization of a sale-leaseback transaction as a loan may, in turn, constitute a usurious loan. Often the percentage rate of return built into a sale-leaseback transaction (or the combined rate of return from the lease and the interest paid by the seller-tenant as leasehold mortgagor to the buyer-landlord as leasehold-mortgagee pursuant to a separate leasehold mortgage made as part of the whole transaction) will exceed the interest rate permissible under applicable state law.

If a seller-tenant granted a mortgage on its leasehold estate created in connection with a sale-leaseback transaction and, after becoming bankrupt, succeeds in having the underlying sale-leaseback transaction recharacterized as a secured loan, the status of the leasehold mortgage is called into question. The leasehold-mortgagee presumably could become a second mortgagee of the fee (assuming the sale-leaseback recharacterized as a secured loan is given priority) because the seller-tenant is deemed to be the owner of the fee. Alternatively, the leasehold mortgagee could be reduced to the status of an unsecured creditor because the property encumbered by the mortgage (the leasehold estate) is deemed not to exist as a matter of law.

A bankrupt seller-tenant may seek to have the transaction recharacterized as a joint venture. In such case, the court must resolve questions such as the joint venture interests of the joint venturers, the capital accounts of the joint venturers, and the other necessary components of a joint venture — issues usually negotiated at length by parties to a joint venture agreement. Although there appear to be no reported cases directly on point, a court ascertaining the buyer-landlord's interest in the joint venture presumably would determine it to be either the proportion that the purchase price paid by the buyer-landlord for the real estate bears to the total value of the real estate or, in a participatory lease situation, the buyer-landlord's share in the "upside."

If the seller-tenant is successful in recharacterizing the sale-leaseback transaction as a joint venture, the buyer-landlord's status would be reduced from the owner of the subject real estate to a coowner of the joint venture that owns the real estate. As a consequence, both the seller-tenant and the third-party creditors of the seller-tenant can attempt to take advantage of the buyer-landlord's resulting joint and several liability by shifting liability for all the debts of the seller-tenant incurred in connection with the joint venture to the buyer-landlord. At the same time, the buyer-landlord's right to contribution from the seller-tenant as a coventurer for the joint venture's debts would be barred by the automatic stay and discharge provisions. Thus, the buyer-landlord could be liable for all the debts of the joint venture and left with only an unsecured claim against the bankruptcy estate for the bankrupt joint venturer's share of the debts of the joint venture.

Finally, upon recharacterization of a sale-leaseback transaction as a loan or joint venture by a court in a bankruptcy proceeding, the nonbankrupt party runs the risk that the transaction also will be treated as a loan or joint venture for tax purposes. Although a determination by the court in a bankruptcy context is not binding on the IRS or the courts in deciding whether the transaction should be recharacterized as a loan or a joint venture for tax purposes, such a bankruptcy

determination may predispose the taxing authorities to reach the same conclusion. If the transaction is, in fact, recharacterized for tax purposes, the tax benefits will be reallocated in a manner different from that originally intended by the parties. Although a detailed discussion of the tax ramifications of the recharacterization of a sale-leaseback transaction is beyond the scope of this chapter, at issue will be the gain or loss realized on the sale of the property, deductions taken for rent under the lease, depreciation taken on improvements, and income in the form of rent or interest. In the context of a transaction such as a pre-1987 tax shelter syndication in which the nonbankrupt party has realized and intends in the future to realize substantial tax benefits from ownership of the real estate, a recharacterization for tax purposes could be disallowed, resulting in liability for past taxes plus interest and, perhaps, penalties. In addition, in transactions in which payment for the real estate by the buyer-landlord was motivated, at least in part by anticipated tax benefits, recharacterization for tax purposes could generate a major economic loss.

G. [5.78] Relevant Cases

Most reported cases concerning recharacterization of sale-leaseback transactions involve equipment leases. In these cases, courts have tended to recharacterize sale-leasebacks of equipment as loans. *See, e.g., In re Velasco,* 13 B.R. 872, 874 (Bankr. W.D.Ky. 1981); *Eastern Leasing Corp. v. Pye (In re Pye),* 13 B.R. 307, 310 (Bankr. D.Me. 1981); *Ryen v. Cottrone Development Co. (In re G.A. Giancaterin & Associates, Inc.),* 9 B.R. 26, 27 (Bankr. W.D.N.Y. 1981). *But see, e.g., In re Loop Hospital Partnership,* 35 B.R. 929, 934 – 936 (Bankr. N.D.Ill. 1983); *Fruehauf Corp. v. International Plastics, Inc. (In re International Plastics, Inc.),* 18 B.R. 583 (Bankr. D.Kan. 1982); *American Standard Credit, Inc. v. National Cement Co.,* 643 F.2d 248, 264 – 265 (5th Cir. 1981); *PSINet, Inc. v. Cisco Systems Capital Corp. (In re PSINet, Inc.),* 271 B.R. 1 (Bankr. S.D.N.Y. 2001). However, in the few reported cases involving sale-leasebacks of real estate, the courts are split on the issue of whether such transactions should be recharacterized, but the growing trend indicates that bankruptcy courts will look first to specific state law guidance as to what constitutes a lease. When there is no definitive guidance from the applicable state law, courts will most often apply an "economic realities" test to determine if the net effect of the transaction constitutes a lease or a disguised financing arrangement.

In each of six cases involving real estate sale-leaseback transactions, the seller-tenant in bankruptcy sought to have the transaction recharacterized as either a loan or a joint venture. In two of these cases, *Burke Investors v. Nite Lite Inns (In re Nite Lite Inns),* 13 B.R. 900 (Bankr. S.D.Cal. 1981), and *Fox v. Peck Iron & Metal Co.,* 25 B.R. 674 (Bankr. S.D.Cal. 1982), the court recharacterized real estate sale-leasebacks as loans. In *Nite Lite Inns,* the buyer-landlord was reduced to the status of an unsecured creditor when a proposed sale-leaseback transaction it had entered into was recharacterized as an unsecured loan. In recharacterizing this transaction, the court relied heavily on standards established in California usury cases challenging sale-leasebacks as usurious loans and on federal tax cases involving sale-leasebacks. The court determined that the buyer-landlord did not satisfy the federal test of significant and traditional lessor status and accordingly did not rise to the level of a secured lender. 13 B.R. at 913. Similarly, in *Fox,* the court ignored the structure of the transaction as a sale-leaseback and focused primarily on the economic substance of the transaction and relied on two "strong circumstance[s]" in concluding that the sale-leaseback should be recharacterized as a loan: (1) the assets transferred to the buyer-landlord were worth at least twice as much as the amount of the purchase price; and (2) the repurchase provisions allowed the property to be returned to the seller-tenant for an amount equal to the original purchase price. 25 B.R. at 688 – 689.

In *In re PCH Associates,* 804 F.2d 193 (2d Cir. 1986), the court also determined that a true lease did not exist. In examining the substance rather than the form of the agreements, the court found that the transaction contained provisions that were inconsistent with a true sale and lease. 804 F.2d at 200. Thus, the court concluded that the transaction was structured as a lease only to achieve tax benefits for the lessee and higher guaranteed returns for the lessors. *Id.* The *PCH Associates* court, however, declined to follow the lower court's findings that a joint venture had been created, stating instead that a lease did not exist and that the court did not find it necessary to identify the nature of the resulting transaction. Shortly after this ruling, the same parties brought another issue raised from the same bankruptcy procedures to the court, and, after thorough analysis, the court finally recharacterized the sale-leaseback transaction as a secured loan and the relationship between the seller-tenant and buyer-landlord as debtor and secured creditor. *In re PCH Associates,* 949 F.2d 585 (2d Cir. 1991). The latter *PCH Associates* court did not reduce the buyer-landlord to the status of an unsecured creditor, distinguishing from *Nite Lite Inns,* because the buyer-landlord in *PCH Associates* had acquired the title to the real property, while the buyer-landlord in *Nite Lite Inns* never did.

In the other two principal cases, *In re Kassuba,* 562 F.2d 511 (7th Cir. 1977), and *Chicoine v. Omne Partners II (In re Omne Partners II),* 67 B.R. 793 (Bankr. D.N.H. 1986), the courts refused to recharacterize the sale-leasebacks and upheld the form of the transactions in similar fact situations. These courts refused to substitute their judgment for that of the parties in the principal transactions. In *Kassuba,* the court upheld the provisions of a ground lease that entitled the buyer-landlord to succeed to the title to both the land and improvements as a result of the seller-tenant's default under the lease and his failure to exercise a repurchase option. 562 F.2d at 515. The court reasoned that the parties by contract may create a set of mutual economic benefits that is similar to a mortgage without conferring on each other the rights and liabilities of judicial foreclosure if that is what they actually intend. The substance of the transaction that a court of equity will examine is not its economic effect, which the parties determine by their agreement, but instead it is what their agreement is. 562 F.2d at 514.

Similarly, in *Omne Partners,* the court upheld the lease because the parties were both sophisticated in complex financing techniques and understood the terms of the transaction. There was no question, the court determined, that the parties negotiated and intended the transaction to be a sale-leaseback rather than a loan. 67 B.R. at 795. Therefore, the court upheld the lease, but the court left undecided whether the lease was terminated prior to the filing of the bankruptcy petition. 67 B.R. at 795 – 796.

In *In re Uni-Rty Corp.,* 175 F.3d 1008, 1999 WL 177273 (2d Cir. 1999), *aff'g* 1998 WL 299941 (S.D.N.Y. June 9, 1998), the court followed the logic of *Kassuba* and *Omne Partners* when it refused to disturb the findings of the bankruptcy court that the parties intended to create a true lease. In that case, the debtors sought a declaratory judgment that the agreement between the parties was not a sale-leaseback conveyance that entitled the defendants to evict them but was instead more properly construed as a mortgage. The court stated that it must "look to the economic substance of the transaction and not its form." 1999 WL 177273 at *2, quoting *International Trade Administration v. Rensselaer Polytechnic Institute,* 936 F.2d 744, 748 (2d Cir. 1991). The court concluded that the debtors adduced no credible evidence to overcome the strong presumption that the sale-leaseback of the building in question created a true lease.

The courts of the Seventh Circuit have also reviewed this issue. In *United Airlines, Inc. v. HSBC Bank USA, N.A.,* 416 F.3d 609 (7th Cir. 2005), the Seventh Circuit ruled that a court must look to the state law for the state in which the property is located in order to determine whether a lease is a "true lease" or whether it is a financing arrangement. In this case, the court overruled the district court, which had also applied a state law analysis but had determined the lease in question was a true lease. In doing so, the court determined that, under the law of the state in question (California), the lease was not a "true lease" and instead was merely a financing arrangement.

In several cases courts have refuted the attempt by the debtor-lessee to recharacterize leases that did not involve an initial sale from the debtor-lessee to the creditor-landlord. In *Morande Enterprises, Inc. v. FRVG, LLC (In re Morande Enterprises, Inc.),* 346 B.R. 886, 892 (Bankr. M.D.Fla. 2006), the court refused to recharacterize a lease as a financing transaction, holding that state law determined that the lease was a "true lease" based on the fact that the lease was structured like a typical commercial lease and, notably, did not involve an initial sale from tenant to landlord, even though the lease contained a mandatory purchase option that would divest the landlord of ownership at the end of the term. *See also Pummill v. McGivern (In re American Eagle Coatings, Inc.),* 353 B.R. 656 (Bankr. W.D.Mo. 2006) (determining that, without further evidence, there was no basis for recharacterizing lease when purchase option at end of lease did not appear to be for nominal amount).

H. [5.79] Preventing Recharacterization

The list below outlines how to structure a sale-leaseback transaction so that it will not be recharacterized as a joint venture or a partnership:

1. The lease should mirror, as closely as possible, leases being used by parties in arm's-length transactions that do not include a sale.

2. If the lease is a percentage rent lease, the lessor should present itself as a passive approver of such profit-making aspects of the lessee's business as its annual budgets, long-term employment and management contracts, expenditures in excess of budgets, changes in the basic nature of the business, and sale of all or substantially all the business's assets. The lessor could also insist that pay scales and contract prices are in line with current market standards. The fact that the lessor's involvement is limited to approving the lessee's decisions (a) safeguards its interest in achieving the maximum amount of profit and (b) reinforces its image as a passive party.

3. The lease documents should clearly state that

    a. the parties are entering into a "lease arrangement" and not a joint venture or partnership;

    b. the lessor would not have entered into the transaction if another relationship were being created; and

    c. the lessee will not challenge the characterization of the arrangement as a lease if the lessor subsequently seeks to enforce its rights under the lease as lessor.

If the parties to the transaction are sophisticated and represented by counsel, such a recital (if true) may persuade the court that the lessee knowingly entered into the transaction.

4. The lessor should insist that a memorandum of lease be duly recorded in the office of the local recorder. The document should clearly describe the lessor-lessee relationship as well as the premises and parties affected by the lease. A court of equity may freely ignore the form of the transaction if it feels that a third-party creditor would be prejudiced by upholding the form. However, the third-party creditor's burden of proving a partnership or joint venture relationship may be more difficult if a recorded notice of the lease relationship preexisted the establishment of the third party's credit relationship with the lessee.

5. The lessor might consider including a lease provision stipulating that if the transaction is recharacterized, the profits and losses will be allocated among the partners on the basis of the percentages that would have been allocated if a joint venture or partnership had been intended. The risk of adopting such a provision is that it acknowledges the possibility of a recharacterization. This could cause a court that is sympathetic to debtors to reason that a recharacterization will not be catastrophic since the buyer-lessor is aware of exactly what its profit (or loss) would be.

The effect of such a provision may be somewhat mitigated if the parties include a parallel provision stating that the parties do not intend their relationship to be construed as either a joint venture or a partnership. In any event, this entire issue is moot if there are no profits or losses to be shared.

6. The economics of the lease should be such that the lessor retains substantive economic interests in the property after the term expires. Provisions that allow the lessee to acquire the property for a de minimus amount or a payment in the form of a "balloon" payment tend to strongly indicate a financing arrangement rather than a lease.

VI. ENVIRONMENTAL CONSIDERATIONS IN SALE-LEASEBACK TRANSACTIONS

A. [5.80] In General

Environmental matters are the subject of serious and concentrated attention. This heightened attention and concern require careful consideration of environmental matters as an integral part of the planning process when structuring a sale-leaseback transaction. This planning must occur at the time a proposed transaction is structured and before the relationship between the parties as seller-tenant and buyer-landlord is in place. In addition, after the documents have been drafted and the transaction is in place, the parties must remain sensitive to environmental matters (and to the possible consequences of changing environmental circumstances) in connection with the way the seller-tenant and buyer-landlord conduct their activities for the duration of their relationship.

Sections 5.81 – 5.87 below discuss some of the matters in the area of environmental concerns that should be considered when structuring a sale-leaseback transaction and relationship. In this connection, these sections consider the ways in which the environmental concerns experienced by the parties to a sale-leaseback transaction may differ in character and consequence from the environmental concerns of those involved in other types of real estate transactions.

B. Planning Considerations

1. [5.81] Seller-Tenant's Initial Knowledge and Liability — Planning Considerations for Seller-Tenant

The prospective seller-tenant, as the owner of the property, is charged at the outset of the transaction with already knowing whatever there is to know about environmental matters affecting the property. As between the two parties to the proposed sale-leaseback transaction, the seller-tenant is initially responsible for the cleanup or other curing of existing environmental problems. Since the seller-tenant already has this level of responsibility for existing environmental conditions and since the prospective buyer-landlord has no responsibility in advance of the transaction for such initial conditions, the seller-tenant should not expect that the structure of the transaction will enable it to lay off on the buyer-landlord any of the seller-tenant's responsibility for environmental circumstances. This rule generally remains true unless the parties specifically agree that the buyer-landlord will assume these responsibilities and indemnify the seller-tenant from liability in connection with these responsibilities. Even in the case of such an agreement, the seller-tenant must rely on the ability of the buyer-landlord to perform its undertakings since such an agreement will not relieve the seller-tenant from liability to governmental authorities and other third parties.

2. [5.82] Planning Considerations for Buyer-Landlord

The buyer-landlord's goal in planning and structuring the transaction is that it may be as free as possible from liability for adverse environmental conditions existing on the property or arising at any time during the transaction.

The prospective buyer-landlord does not want to unwittingly acquire contaminated property. If the property is environmentally contaminated, the buyer-landlord upon acquiring it will in all probability become liable for cleanup costs under federal law (the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub.L. No. 96-510, 94 Stat. 2767, codified at 42 U.S.C. §9601, *et seq.*) and, in many cases, will also incur liability under state environmental protection laws.

The prospective buyer-landlord in a sale-leaseback transaction is even more concerned with protecting its position with respect to environmental matters at the pre-transaction stage than is a prospective mortgagee. The prospective mortgagee will incur liability only if it becomes the titleholder of the property following the mortgagor's default and the subsequent foreclosure of the mortgage (or if it becomes too involved with the business of a borrower that contaminates the property). On the other hand, the prospective buyer-landlord is going to go into title at the inception of the transaction. Thus, the prospective buyer-landlord immediately incurs the full range of environmental liability that comes with the ownership of the property unless a court holds differently under CERCLA or some other comparable exemption under state law.

For example, in *Kemp Industries, Inc. v. Safety Light Corp.,* 857 F.Supp. 373 (D.N.J. 1994), the court explained that CERCLA imposes liability for an environmental cleanup on the "owner" of the property but contains a secured lender exemption; in other words, it exempts a party that holds indicia of ownership primarily to protect a security interest in the property. New Jersey law

contains a similar exemption under the New Jersey Spill Compensation and Control Act, N.J.Stat.Ann. §58:10-23.11, *et seq.* The court in *Kemp* applied these exemptions to the buyer-landlord in a sale-leaseback transaction, holding that the buyer-landlord was entitled to protection under the exemptions even though (a) the buyer-landlord held fee simple title to the property, (b) the seller-tenant had no repurchase option, (c) the buyer-landlord took income tax deductions for the depreciation of the property, and (d) the buyer-landlord was entitled to any condemnation award should the government take the property.

In coming to this conclusion, the *Kemp* court looked to whether the totality of the circumstances indicated that the transaction was intended to be a "true lease" or a security interest, as determined by the intent of the parties at the time the transaction was entered into. 857 F.Supp. at 387. The court ultimately decided that the buyer-landlord, who never had possession of the property and lacked the capability to run the facility on the property, sought a fixed return on its investment rather than a profit from the appreciation or operation of the property, and thus held title as a security interest. *See also Waterville Industries, Inc. v. Finance Authority of Maine,* 984 F.2d 549 (1st Cir. 1993); *In re Bergsoe Metal Corp.,* 910 F.2d 668 (9th Cir. 1990).

Despite the holding in *Kemp,* the prospective buyer-landlord has a pressing need to have full knowledge of the environmental condition of the property proposed for the transaction and the costs of curing any environmental contamination before entering into any binding arrangement to purchase it and to lease it back to the prospective seller-tenant.

In addition to the foregoing, there are state statutory considerations that make it advisable for a buyer-landlord to enter into a transaction only after it has complete knowledge of the environmental condition of the property. An increasing number of states have enacted laws requiring, in effect, that the purchaser become familiar with the environmental condition of property being purchased. Under these laws, when the prospective purchaser subsequently seeks to sell the property, it is charged with providing detailed information concerning the environmental history of the property in question. This history includes not just events that took place during prior ownership. The prospective buyer-landlord should obtain this latter information from its prospective seller-tenant and from examination of the property itself and then evaluate it before becoming the owner of the property.

Ideally, from the prospective buyer-landlord's viewpoint, as much due diligence as possible should be accomplished by the prospective buyer-landlord even before the parties enter into a contract. If property being considered for purchase by a prospective buyer-landlord is environmentally contaminated, the value of that property to the buyer-landlord may be substantially reduced by the cleanup costs. Whether the cleanup is to be performed by the prospective seller-tenant or the buyer-landlord, if the cleanup and related curative costs are large, the amount of cash remaining available to the prospective seller-tenant for other purposes may be substantially reduced. This reduction in the amount of the purchase price available to the prospective seller-tenant could in some cases render the transaction commercially undesirable. Accordingly, the financial impact of any required environmental cleanup should be determined as early in the planning process as possible in order to determine whether it will have a fatal impact on the transaction. If this is the case, all parties would be well served in not continuing to expend valuable resources and time on a transaction that will ultimately fail because of environmental problems.

To help evaluate adverse environmental consequences that may have resulted from prior uses of the property, the prospective buyer-landlord should familiarize itself with the past and present uses made of the property by the prospective seller-tenant, by its lessees, and, to the extent possible, by prior owners and occupants. In addition, the likely environmental consequences of the uses the prospective seller-tenant (and those who will be its sublessees) intends to make of the property during the lease term should be considered carefully.

The prospective buyer-landlord should, at a minimum, inspect the site to determine whether any obvious environmental contamination exists. If practical, during the pre-transaction planning stage (and certainly before consummating its purchase), the prospective buyer-landlord should also require an environmental examination and assessment of the property to be conducted by professional environmental inspectors satisfactory to it. The extent of the required environmental examination will best be determined after consultation with the professional engaged to conduct it. The buyer-landlord should maintain the flexibility to require as thorough an examination as may be recommended by its environmental experts, based on the apparent condition and past history of use of the property. Because the environmental inspection can be costly, the prospective seller-tenant may be unwilling to pay for the inspection before a binding contract or commitment is entered into even though it probably cannot sell the property without such a study having been made. One solution that would at least allow the initial environmental audit to go forward at an early planning stage, in order to determine whether insurmountable environmental problems exist, is for the prospective buyer-landlord to pay the cost of the environmental examination initially with the understanding that if a contract or commitment to do the contemplated transaction is subsequently entered into, the buyer-landlord will receive a credit to the purchase price for the amount paid during the pre-transaction planning phase.

During the pre-transaction stage, the prospective buyer-landlord should review whatever available records may exist concerning the property. These records should include the latest title insurance policy (including any new title commitment that may be available), the latest plat of survey, copies of leases from the seller-tenant to its lessees, any environmental certifications that the seller-tenant may have received from its predecessors in title, and copies of any documents relating to environmental enforcement actions instituted or threatened by federal or state authorities with respect to the property. Information derived from these sources can help the prospective buyer-landlord evaluate environmental risks associated with the property being considered.

Obtaining information on environmental conditions of adjacent property may also benefit the prospective buyer-landlord. Some types of environmental contamination on adjacent property could have migrated (or might migrate in the future) from the adjacent property and create a risk of environmental problems for the property being considered for purchase.

If the prospective buyer-landlord determines that there are known or suspected cleanup costs affecting the property but the parties still wish to try to proceed with the transaction, the prospective buyer-landlord should consider how best to structure the transaction to ensure that the necessary cleanup will take place without adverse economic consequences to itself.

C. [5.83] Preparation of Documents

If the prospective parties have decided to proceed with the transaction after analyzing the environmental issues during their pre-transaction planning, they must then determine what provisions as to environmental matters should be included in two principal operative documents — the contract and the lease. Often, the best alternative from the buyer-landlord's perspective is to require the prospective seller-tenant to take the necessary corrective action prior to the closing of the acquisition. If the seller-tenant is to cure environmental defects but this cannot be done before closing, at a minimum the operative documents should include (1) a covenant that the seller-tenant will cure the problem at its expense within a certain time, failing which the buyer-landlord may take necessary corrective action at the seller-tenant's expense, and (2) an indemnification and hold-harmless agreement by which the seller-tenant will protect the prospective buyer-landlord against any cost or liability arising by reason of the environmental defect. The buyer-landlord might require a holdback at closing of a portion of the purchase price as a fund to protect it against exposure to expense from post-closing environmental cleanup. The level of protection the prospective buyer-landlord can achieve will depend on the relative bargaining strengths of the parties.

1. [5.84] Contract or Commitment

The contract or commitment should include provisions that will cover the concerns of both parties as to environmental matters with respect to the property. Agreed solutions to known or potential environmental problems — often of significant importance to the bringing about of the parties' meeting of minds on the whole transaction — should be clearly spelled out in the contract. In addition to provisions agreed to by the parties on the curing of known environmental defects, as set out in §5.83 above, the contract or commitment should include the provisions outlined in §§5.85 – 5.87 below.

2. [5.85] Facts at the Outset — Seller's Representations, Warranties, and Covenants

From both the buyer-landlord's and the seller-tenant's viewpoints, the contract or commitment should include complete representations and warranties by which the seller-tenant provides the buyer-landlord with all information the seller-tenant has concerning the present and prior use of the property in question. The seller-tenant should describe not only the use or uses made by it of the property in question, but also the use or uses made of the property by its present or past lessees and, to the extent seller-tenant has knowledge, by the seller-tenant's predecessors in title, their lessees, and the other prior occupants of the property. If appropriate, the seller-tenant should provide similar information, to the extent that the seller-tenant has it, as to adjacent properties. A complete disclosure will allow the buyer-landlord to make an informed decision to purchase.

From the seller-tenant's viewpoint, if there are any adverse environmental conditions affecting the property or any risks of environmental enforcement actions and the buyer-landlord is willing to accept these conditions or risks, the acceptable conditions or risks should be detailed in the contract or commitment. A detailed statement of these conditions or risks will provide a defense to the seller-tenant against claims by the buyer-landlord for environmental defects and their consequences since the buyer-landlord entered into the transaction knowing of the defects.

The buyer-landlord should require the seller-tenant to warrant the truth of all the information given or provided by it to the buyer-landlord concerning the environmental condition of the property and related environmental circumstances. The buyer-landlord's decision to proceed with the transaction may have been based in part on this information.

If statements about environmental matters with respect to the property are required by applicable law to be given by sellers to buyers, the buyer-landlord is well served if the contract requires the seller-tenant to prepare and deliver these statements for review and evaluation by the buyer-landlord well in advance of the proposed closing. This tool will again aid the buyer-landlord to make a knowledgeable decision to consummate the transaction in light of any environmental defects that are disclosed.

The seller-tenant should also state the uses it and those who may hold possession under it (*e.g.,* any sublessees) plan to make of the property. The seller-tenant should represent that none of these uses will have an adverse environmental effect on the property. (The accuracy of this representation should be independently verified by the buyer-landlord.) The seller-tenant should also covenant that no use of the property by the seller-tenant or by anyone holding possession under the seller-tenant during the term of the leaseback to it from the buyer-landlord will create any new situations involving violation of environmental laws or regulations or will expose the property or the buyer-landlord to environmental enforcement actions. (As stated below in this section, this covenant should also be included in the lease as a lessee's covenant.)

All these representations, warranties, and covenants should be structured to survive the closing of the sale and to remain effective for the full term of the lease and for the duration of the relationship between the seller-tenant and the buyer-landlord as to the property in question. Under the law of some states, some or all these representations will be deemed to have merged into the deed at closing and not to have survived the closing unless the parties express a contrary intent in the contract or commitment. The contract should also clearly state that these representations, warranties, and covenants are of the essence of the transaction, thus providing a basis for a claim for damages and possible rescission if they are violated.

The contract or commitment should contain appropriate indemnification and hold-harmless agreements by the seller-tenant for the benefit of the buyer-landlord. These provisions should be tailored to fit the agreement of the parties as to what, if any, adverse environmental conditions and enforcement risks are acceptable to the buyer-landlord. If the parties have agreed that the buyer-landlord will not take on the risk of any adverse environmental conditions or enforcement risks, the indemnification and hold-harmless provisions should be drafted accordingly.

The buyer-landlord should be wary of the financial reliability of the party making the representations, warranties, and covenants and providing the indemnification and hold-harmless undertakings. If the contract is a nonrecourse contract for the seller-tenant or if the seller-tenant is an entity without significant assets, the agreements may provide no basis for a meaningful recovery of damages. If the seller-tenant has substantial assets, the buyer-landlord may wish to require an exception to the nonrecourse nature of the contract to provide a meaningful remedy in the case of a breach of the environmental undertakings. If the seller-tenant is without substantial assets, the buyer-landlord may consider asking the seller-tenant to provide a third-party guarantor or other

security to back up the protection to be given the buyer-landlord under the indemnification and hold-harmless provisions. These decisions take on great significance when dealing with environmental undertakings because of the enormity of the liability to which the buyer-landlord in a sale-leaseback transaction may be exposed as the owner of the property after the closing of the purchase.

3. [5.86] Purchaser's Right To Investigate Environmental Facts — Due-Diligence Period

In addition to obligating the seller-tenant to disclose whatever knowledge the seller-tenant has concerning environmental matters pertaining to the property, to the extent the buyer-landlord has not done so during the pre-transaction planning stage, the buyer-landlord should reserve the opportunity to make its own examination of the property as to such matters and then to decide whether to consummate the sale-leaseback transaction. In this effort, the buyer-landlord should have the aid of professional environmental consultants whom the buyer-landlord believes are qualified to give the buyer-landlord independent expert advice as to whether the property presents environmental risks for the buyer-landlord upon its taking title. While the seller-tenant's representations, warranties, covenants, and undertakings provide a basis for a suit by the buyer-landlord for damages or even rescission, the best position for the buyer-landlord to be in is to avoid consummating the transaction if unacceptable environmental risks are discovered before closing. Since the seller-tenant will have difficulty selling the property without an independent environmental inspection, the buyer-landlord should seek to have the seller-tenant pay the costs of the consultant.

The buyer-landlord should insist that the contract or commitment provide for an adequate period of time to conduct a reasonable due-diligence investigation of the environmental condition of the property and that the buyer-landlord and its consultants have access to the property and to the seller-tenant's records in order to do an adequate inspection. While the exact amount of time required for this investigation will depend on the size of the property, its known past uses, and the work schedule of the consultants, at least 45 days, if possible, should be reserved for the preliminary inspection. If the preliminary inspection suggests that a more detailed inspection is necessary, the contract or commitment should allow reasonable additional time for a more detailed inspection to be completed. The buyer-landlord should then have a reasonable additional period after receipt of the report within which to decide whether conditions found by the consultants are acceptable or whether the conditions are unsatisfactory. An additional 15 days may be adequate for this.

The contract or commitment should provide for alternative courses of action if the environmental conditions found show unacceptable risks of cleanup liability or if the buyer-landlord's investigation turns up facts suggesting existing violations of environmental law, the need for reports to be made to governmental authorities, or other environmental enforcement action for which the buyer-landlord could become responsible upon its coming into title. In these circumstances, as an alternative, the buyer-landlord might be able to terminate the contract for a fixed period of time. As another alternative, the seller-tenant might be allowed to make all necessary corrections and to cure those violations that can be quickly cured, with the contract or commitment to remain in effect as long as the seller-tenant performs these obligations promptly. An outside date might be set by which the initial violations are to be cured. For violations that

would take longer to cure, the contract or commitment might entitle the seller-tenant to preserve the contract or commitment by covenanting to take all necessary cleanup or other action after closing that is required to bring the property into environmental compliance. If there is any question about the seller-tenant's reliability to perform its post-closing obligations, the seller-tenant's undertaking should be accompanied by a holdback of a portion of the purchase price or other security (such as a letter of credit) to ensure completion by the seller-tenant of its obligations. Still another alternative might be for the buyer-landlord to be able to require the seller-tenant to take the cleanup steps discussed above, although most seller-tenants will insist, if they are willing to agree to this, that the amount they must spend to cure environmental defects be capped.

D. [5.87] Environmental Provisions of Lease

The contract or commitment will call for a lease of the property back to the seller-tenant as lessee, to become effective when the sale to the purchaser is closed. Preferably, the lease should be attached to the contract or commitment as an exhibit, with the contract or commitment requiring the parties to execute the lease in substantially that form. If this procedure is followed, environmental considerations of special significance to the lessor-lessee relationship will have been addressed in the form of the lease. The seller-tenant and buyer-landlord will have become bound, upon executing the contract, to the use of a lease that properly addresses leasehold environmental matters. If the contract or commitment does not have the lease attached as an exhibit but rather spells out the principal terms of the lease that will be entered into at the closing of the sale, the contract or commitment should set forth certain basic points with respect to environmental matters that will bear on the relationship between the parties during the term of the lease.

Whether the lease is attached as an exhibit or the principal terms of the lease are set out in the contract or commitment, the following environmental considerations should be covered:

1. Note should be made that the seller-tenant, having been in possession of the property at the pre-transaction stage, will remain in possession throughout the lease term. Accordingly, the seller-tenant will have full responsibility for keeping the property free from environmental problems throughout the term of the lease.

2. The seller-tenant should agree to indemnify and hold the buyer-landlord harmless (a) in matters of environmental liability and possible environmental enforcement actions relating to the physical condition of the property up to the date of the closing, (b) in all matters arising with respect to the property at any time during the term of the lease, and (c) for as long thereafter as the seller-tenant retains possession of the property.

3. The lease should contain restrictions on uses of the property that could increase the exposure of the buyer-landlord to the risk of cleanup costs or of other environmental enforcement actions. These limitations should apply to uses both by the seller-tenant and by those holding possession under it. Since the buyer-landlord, as owner of the property, will be exposed to environmental liability that arises from the acts of the seller-tenant or its subtenants, the buyer-landlord must protect itself under the terms of the lease by controlling permissible uses of the property. If the permitted uses of the property could result in environmental contamination of the property, the seller-tenant should be required to deliver periodic environmental audits of the property throughout the terms of the lease so that the buyer-landlord can police the seller-tenant's covenant to keep the property free from environmental contamination.

VII. [5.88] APPENDIX — ADDITIONAL SOURCES

For the attorney interested in pursuing further the subject of sale-leaseback financing, the following are a number of publications on the subject that may be of interest:

Periodicals

Agar, Philip S., *Sales and Leasebacks,* 24 Real Prop.Prob. & Tr.J. 61 (Jan. 1965).

Arnold, Alvin L., *Sale-Leasebacks: Option Violates Rule Against Perpetuities,* 26 Real Est.L.Rep. 3 (1996).

Batson, Martha A., Harris v. Metropolitan Mall: *The Need To Consider Tax Benefits When Awarding Damages in Sale-Leaseback Situation,* 1985 Wis.L.Rev. 375 (1985).

Berman, Bennett I., *The Duty of Repair and Restoration of Leased Premises in Illinois,* 53 Chi.B.Rec. 373 (1972).

Clark, Louis M., *Changing Considerations in Sales and Leaseback Transactions,* 42 Taxes 725 (1964).

Egan, Robert J., *Sale-Leasebacks: Protecting the Institutional Investor Against New Risks,* 6 Real Est.L.J. (1978).

Fink, Joseph H., *Joint Ventures, Limited Partnerships, Sale-Leaseback and Other Devices: The Developer's Approach,* 52 Chi.B.Rec. 323 (Pt. I), 371 (Pt. II) (1971).

Flinn, Irvine D., *Sale and Leaseback Financing,* 283 P.L.I./Real 285 (Oct. 16, 1985).

Fuller, Hoffman F., *Sales and Leaseback and the* Frank Lyon *Case,* 48 Geo.Wash.L.Rev. 60 (1979).

Furner, Joanne F., *Tax Aspects of Sale Leasebacks,* 35 Ala.L.Rev. 202 (1974).

Goldfein, Michael R., *Finding the Key to the Deductibility of Rental Payments Under a Gift and Leaseback,* 10 Loy.U.Chi.L.J. 767 (1979).

Homburger, Thomas C. and Gregory R. Andre, *Real Estate Sale and Leaseback Transactions and the Risk of Recharacterization in Bankruptcy Proceedings,* 24 Real Prop.Prob. & Tr.J. 45 (Spring 1989).

Howard, Norman A., *Essential Elements of a Net Lease,* 8 Prac.Law. 15 (Fall 1962).

Kelley, William A., Jr., *Sales and Leasebacks — Related Parties,* 19 Tul.Tax.Inst. 370 (1970).

Kempner, Paul S., *A Look at Single Tenant Net Leased Properties,* 1 Real Est.Rev., No. 1, p. 50 (Spring 1971).

Kiley, Karen W., *The Evolving Gift-Leaseback Analysis in Light of* May *and* Rosenfeld*,* 59 Notre Dame L.Rev. 921 (1984).

Kratovil, Robert T., *Lease Draftsmanship: Problems of Lessees and Their Lenders,* The Guarantor (Apr. 1970).

Levinson, David, *Basic Principles of Real Estate Leases,* 1952 U.Ill.L.F. 321.

Lucas, Patrick H., *The* Lyon *Dethroned: Federal Income Taxation Characterization of Leases and Leasebacks,* 15 Cumb.L.Rev. 431 (1985).

Morris, Ronald A., *Sale-Leaseback Transactions of Real Property — A Proposal,* 30 Tax Law. 701 (Spring 1977).

Note, *The Expanding Definition of "Security": Sale-Leasebacks and Other Commercial Leasing Arrangements,* 1972 Duke L.J. 1221.

Note, *Leaseback Financing and Owner/Tenant Tax Depreciation Allowances,* 11 Alta.L.Rev. 140 (1973).

Organek, Partyka, and Scott, *Financing Business Activity Through Sale and Leaseback of Real Property — A Comment,* 6 Osgoode Hall L.J. 294 (1968).

Robbins, Valarie C., *Sale and Leaseback of Real Property After* Frank Lyon Co., 11 Tax Adviser 476 (Aug. 1980).

Rosenberg, Alan S. and Herbert T. Weinstein, *Applying the Tax Court's Nontax Benefit Test for Multiple-Party Sale-Leasebacks,* 54 J.Tax'n 366 (1981).

Rubinstein, William S. and Nancy R. London, *Sales and Leasebacks: Some Valuation Problems,* 37 Tax Law. 481 (1984)

Simmons, Frederick L., *Resisting Continuing IRS Attacks on the Use of "Gift and Leaseback" in Tax Planning for the Professional,* 56 Taxes 195 (Apr. 1978).

Strum, Brian J., *Sale-Leasebacks: Protection for Accelerated Depreciation Deduction and Clear Title,* 7 Real Prop.Prob. & Tr.J. 785 (Winter 1972).

Thomas, J. Miles, Jr., *Leasebacks in Commercial and Family Transactions,* 28 Mont.L.Rev. 25 (1966).

Weinstein, Herbert T. and David Silvers, *The Sale and Leaseback Transaction After* Frank Lyon Company, 24 N.Y.L.Sch.L.Rev. 337 (1978).

Wilson, Richard A., *Sales and Leasebacks,* 16 S.Cal.Tax.Inst. 149 (1964).

Young, Christopher N., *Problems of Judicial Interpretation of Real Estate Sale and Leaseback Taxation: Description, Analysis, and Proposed Revision,* 33 Tax Law. 237 (Fall 1979).

Zarrow, Stanton H. and David E. Gordon, *Supreme Court's Sale-Leaseback Decision in* Lyon *Lists Multiple Criteria,* 49 J.Tax'n 42 (1978).

Books

Homburger, Thomas C. et al., STRUCTURING REAL ESTATE SALE-LEASEBACKS: LEGAL AND TAX PLANNING WITH FORMS (1992).

Kane, Howard E., *The Mortgagee's Option To Purchase Mortgaged Property,* FINANCING REAL ESTATE DURING THE INFLATIONARY 80S (1981).

Kratovil, Robert and Raymond J. Werner, MODERN MORTGAGE LAW AND PRACTICE (2d ed. 1981).

SALE AND LEASEBACK FINANCING (PLI, 1973).

6 Assignments and Subleases

JOSEPH B. VANFLEET
Howard & Howard Attorneys PLLC
Managing Attorney, Peoria Office
Co-Chair, Lending Institutions Practice Group

The contribution of Chase M. Hundman to the previous edition of this chapter is gratefully acknowledged.

I. [6.1] INTRODUCTION

This chapter is oriented toward the general practitioner representing either a landlord or a tenant and drafting an assignment or a sublease within the context of a commercial lease. It discusses select residential provisions relevant to the Chicago Municipal Code, Ch. 5-12 (Residential Landlords and Tenants) as well as the risks to the sublessor and the sublessee, but it does not include special problems that may be of interest to a mortgagee, nor does it discuss litigation aspects, except with reference to the provisions of the Bankruptcy Code, 11 U.S.C. §101, *et seq.*

II. DEFINITIONS

A. [6.2] Assignment

An "assignment" is a transfer by a tenant of its entire interest in the leasehold estate without retaining any reversionary interest. *See Dayenian v. American National Bank & Trust Company of Chicago,* 91 Ill.App.3d 622, 414 N.E.2d 1199, 47 Ill.Dec. 83 (1st Dist. 1980). The main feature of such a conveyance is that an assignment is a transfer of the entire term of the lease. Even though the agreement may say that the premises are being sublet for the remaining term, it is an assignment and bears the legal consequences of an assignment. Transfer need not include the tenant's entire interest in the premises; it may be a transfer of only a part thereof, which is known as an "assignment pro tanto." Such an assignment carries all the legal instruments of any other assignment, except that the assignee is liable for only a portion of the rent, in proportion to the amount of the total interest transferred to it. However, drafting such an assignment can be difficult, as much more than the rent is subject to the proportion. As an example, the parties' internal reference in a document that the document is an "assignment" does not control the legal effect of unambiguous language in the document reserving some right to the assignor. *See National Tea Co. v. American National Bank & Trust Company of Chicago,* 100 Ill.App.3d 1046, 427 N.E.2d 806, 56 Ill.Dec. 474 (1st Dist. 1981).

B. [6.3] Sublease

A "sublease" is a conveyance for a period of less than the entire term or a period in which the tenant retains any reversionary interest, however small. *See Orchard Shopping Center, Inc. v. Campo,* 138 Ill.App.3d 656, 485 N.E.2d 1248, 93 Ill.Dec. 38 (5th Dist. 1985) (tenant had option to terminate prime lease, thus sublessor retained interest in prime lease). The reversionary interest may not even be under the control of the sublessor. The sublessor may have retained a reversionary interest if a third party to whom the premises are conveyed has the option to terminate the conveyance. *Id.* Sometimes a document may be a sublease in form but not in substance, so it will not be treated as a sublease. For example, a tenant entered a field warehouse agreement with a third party, under which a portion of the premises was set up for storage of goods pledged as collateral. Although the arrangement was a sublease in form, in substance it was not a sublease but merely an arrangement for the furtherance of the tenant's business. *See Mercury Electronic Laboratories, Inc. v. Krug,* 330 Ill.App. 336, 71 N.E.2d 104 (1st Dist. 1947) (abst.); *Chemical Petroleum Exchange, Inc. v. Metropolitan Sanitary District of Greater Chicago,* 81 Ill.App.3d 1005, 1010, 401 N.E.2d 1203, 37 Ill.Dec. 110 (1st Dist. 1980) ("We believe that the parties properly characterized the

document as an agreement, but it does not possess the attributes of a sublease."). As a matter of interest, *see Jackim v. CC-Lake, Inc.,* 363 Ill.App.3d 759, 842 N.E.2d 1113, 299 Ill.Dec. 761 (1st Dist. 2006), for an introduction to the area of court interpretation of life-care contracts under the Life Care Facilities Act, 210 ILCS 40/1, *et seq.*

III. [6.4] BUSINESS CONSIDERATIONS

Absent provisions in the lease, tenants are free to sublease or assign. However, most leases have provisions setting forth certain restrictions. The landlord, for instance, may want to restrict assignments or subleases because the landlord is relying on the character, creditworthiness, and reputation of the tenant. It may want to preserve the cash flow from the tenant's business, especially if the lease provides for percentage rent. The landlord may also want to be able to take advantage of an upturn in the rental market, and, in addition, it may be concerned with the use represented by the tenant's business. The landlord may have restrictions based on provisions of its mortgage, and, of course, in the event of a shopping area, the landlord may want to preserve the tenant mix. The tenant's desire for permission to sublease or assign will be based on its need for flexibility in providing for changes in its space requirements or location or the nature or character of its business. Each of the parties negotiating the provisions may rely on relative strengths. It is suggested, however, that too onerous a restriction not be insisted on, as it may be stricken from the lease by the court as a violation of public policy or as a contract of adhesion.

IV. [6.5] STATUTORY MATTERS

Illinois statutes do not restrict the right of a tenant to assign or sublease. However, it should be noted that, without specific provisions, the rights of landlords and tenants are specified by statute. The Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* provides that the grantee or assignee shall have the same remedies by action or otherwise for the nonperformance of an agreement in the lease or for the recovery of rent that the grantor or landlord may have had. 735 ILCS 5/9-215. 735 ILCS 5/9-216 provides that the assignees of the tenant shall have the same remedies by action or otherwise against the landlord or the landlord's grantees, assignees, or other representatives for the rent or other agreements included in the tenant's lease. Nothing in the statute requires that these rights and remedies be documented in writing, nor does it require that there be a formal assignment. However, the parties can, by agreement, limit or restrict these rights. Furthermore, 735 ILCS 5/9-317 grants to the landlord, in the event of a sublease or an assignment, the same rights to enforce a lien against the subtenant or assignee that the landlord had against the tenant. Note that in Illinois the landlord does not have a common-law lien, so this section is applicable only to the limited areas in which such a lien does exist, such as a lien for crops or a lien relevant to a distress proceeding.

A statute enacted in 1984 requires that "[a]fter January 1, 1984, a landlord or his or her agent shall take reasonable measures to mitigate the damages recoverable against a defaulting lessee." 735 ILCS 5/9-213.1. It is important to note that the statute protects only a defaulting tenant, not a non-defaulting tenant that wants to be released from its liability. The duty to mitigate applies at least to the situation in which the tenant submits a commercially reasonable transferee who is ready, willing, and able to take over the lease. *Vranas & Associates, Inc. v. Family Pride Finer Foods, Inc.,* 147 Ill.App.3d 995, 498 N.E.2d 333, 101 Ill.Dec. 151 (2d Dist. 1986) (transferor sustained its

burden), *appeal denied,* 113 Ill.2d 586 (1987); *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 60 Ill.Dec. 703 (1st Dist. 1982) (transferor did not sustain its burden); *MBC, Inc. v. Space Center Minnesota, Inc.,* 177 Ill.App.3d 226, 532 N.E.2d 255, 261, 126 Ill.Dec. 570 (1988) (landlord failed to mitigate damages because it attempted to re-rent premises at significantly higher rates than it had been charging previous tenant). *See also Kallman v. Radioshack Corp.,* 315 F.3d 731 (7th Cir. 2002) (landlord delayed in engaging broker; rental rate requested by landlord, combined with condition of property, frustrated landlord's efforts to find replacement tenant; landlord held to have failed to make reasonable efforts under Illinois law to relet property); *American National Bank & Trust Company of Chicago v. Hoyne Industries, Inc.,* 738 F.Supp. 297 (N.D.Ill. 1990) (question whether attempt to relet at higher rent rate constitutes reasonable efforts to mitigate damages is question of fact to be decided by trier of fact). See Anthony J. Aiello, Note, *Illinois Landlords' New Statutory Duty to Mitigate Damages: Ill. Rev. Stat. Ch 110, 9-213.1*, 34 DePaul L.Rev. 1033 (1985), for a more thorough discussion of the ambiguities of the statute, and *Annot.,* 75 A.L.R.5th 1, 16 (2000), for a list of Illinois cases. To avoid uncertainty in the caselaw and in the statute, landlords have tried to incorporate some commercially reasonable standards governing mitigation in lease forms. See the sample forms in §§6.54 and 6.55 below.

There have been several cases since the enactment of the statute that cover the issues raised therein. In *Stein v. Spainhour,* 167 Ill.App.3d 555, 521 N.E.2d 641, 118 Ill.Dec. 359 (4th Dist. 1988), the court determined that in a percentage rental lease, the amount of damages recoverable should include a determination applying the percentage formula to the reasonable expected sales of the tenant. In *Hoyne Industries, supra,* the court noted that there was no specific designation in the statute as to what were reasonable efforts to mitigate, and the court further determined that even if efforts to relet at a higher rental rate were per se unreasonable, there would remain the factual questions of whether and how soon the premises could have been relet at the same rental rate as had been paid by the defaulting tenant.

Of particular interest is *Snyder v. Ambrose,* 266 Ill.App.3d 163, 639 N.E.2d 639, 203 Ill.Dec. 319 (2d Dist. 1994), in which the appellate court held that the landlord has the burden of showing, as a prerequisite for recovering damages for a tenant's default, that it has mitigated its damages and the burden is not on the tenant to prove lack of mitigation. In *Snyder,* the landlord was not excused from a need to present evidence that he had mitigated his damages because the tenant did not plead lack of mitigation as an affirmative defense. Not included in the opinion is the question whether, in filing an action to recover damages for breach of lease, the landlord must specifically plead that it did make reasonable efforts to mitigate damages. Before the enactment of this statute, there was a diversity of opinion on the need for mitigation. There is a possibility, therefore, that a case will come up in which the tenant is not in default, and the landlord may or may not be required to take reasonable efforts to mitigate. In addition, *see St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 230 Ill.Dec. 1013 (1st Dist. 1998), for a further interpretation of *Snyder, supra,* and a discussion of the landlord's obligation to mitigate damages under various fact circumstances. *See Manufacturers Life Insurance Company (U.S.A.) v. Mascon Information Technologies Ltd.,* 270 F.Supp.2d 1009 (N.D.Ill. 2003), in which the court held that the landlord has the burden of proving mitigation of damages. It should be noted that a lease provision that purports to waive a tenant's right to have the landlord mitigate damages has been held to be enforceable. *Takiff Properties Group Ltd. v. GTI Life, Inc.,* 2018 IL App (1st) 171477, 124 N.E.3d 11, 429 Ill.Dec. 242.

Yet there is a split among the Illinois appellate courts regarding whether a landlord's failure to present evidence of mitigation bars the landlord from recovering against the tenant. *Compare Snyder, supra* (establishing burden on landlord to prove mitigation of damages as prerequisite to recovery), *with St. George, supra* (holding that landlord's failure to mitigate damages will not bar recovery but will cause otherwise recoverable damages to be reduced).

See §5-12-120 of the Chicago Municipal Code (Residential Landlords and Tenants), which provides that the landlord (other than in the case of an owner-occupied building of six or fewer units) has to make a good-faith effort to re-rent a tenant's dwelling unit at a fair rental value similar to the rent charged for comparable dwelling units in the premises or in the same neighborhood. It further provides that the landlord must accept a reasonable sublease proposed by the tenant without an assessment of additional fees or charges. However, the landlord still may have a claim against the tenant for the difference between the fair rental and the rental provided in the lease if it is higher.

See the discussion of mitigation in §6.22 below.

V. DRAFTING MATTERS — MORE BUSINESS CONSIDERATIONS

A. [6.6] Incorporation

There is a tendency to simplify subleases by merely incorporating the terms of the prime lease by reference, noting the changes of the word "landlord" to "sublandlord" and the word "tenant" to "subtenant." The tenant-assignor in such a case may feel that because most leases are written in favor of landlords, incorporation will give it adequate protection. Incorporation is also beneficial to the prime tenant because if the tenant is receiving from the subtenant exactly the same performance that it must, in turn, render to the landlord under the prime lease, there is little chance of the tenant ending up in default under the prime lease. However, there are many special problems that may occur with the sublease or assignment that deserve special consideration. Some of these matters are covered in §§6.7 – 6.24 below.

B. [6.7] Over-Incorporation

There may be some language in the prime lease that was modified in favor of the tenant or the landlord for special considerations, or common clauses may have been deleted entirely from the prime lease. For example, the landlord may have agreed to waive the usual clause requiring a security deposit because of the tenant's strong credit. In addition, the length of cure periods may be inapplicable because if they are simply mirrored in the sublease, then there is no time for the tenant to protect itself by a cure before the default period is over. If late performance is not accepted by the landlord, the prime tenant may be exposed to a theoretical loss of its leasehold estate or other damages that could have been avoided. In addition, a right to cure allotted to a prime tenant may not be appropriate for a small subtenant. Holdover clauses are especially dangerous, since a holdover by a partial subtenant may trigger a much larger liability for the prime tenant. Also, the amount of rent on the holdover may be different. Another problem arises with respect to holdovers when the landlord of the prime tenant may be entitled to rent at double the amount of the existing rent as provided by statute. 735 ILCS 5/9-203.

The problem of over-incorporation may be especially relevant if there is a provision in the prime lease for relocating the tenant. This right appears most frequently for smaller tenants and applies to a right of relocation for a prospective new tenant taking a full floor or more. This right may not be applicable for a subtenant or assignee. In addition, the assignment and subleasing clauses in many leases give the landlord a right to terminate the lease and "recapture" the premises. Also, provisions with respect to initial capital improvements, reimbursement of moving costs, lease assumption provisions, rights of first offer, renewal rights, and options to extend or delete all call for special consideration in a sublease. Other provisions that need to be examined are covered in more detail in §§6.8 – 6.24 below.

C. [6.8] Over-Exclusion

Sometimes the tenant's attorney drafts language that provides that the assignee will look solely to the prime landlord for the performance of the landlord's obligations under the lease; however, the assignee will pay all rents to the tenant-assignor. Such language essentially splits performance from payment, leaving the assignee with the obligation for the payment of rent even if it is constructively evicted from the premises. Further, unless the assignee is careful and unless there is a specific consent to the assignment (or sublease) in which the prime landlord agrees to be bound to the assignee in contract, the assignee may not have the right to compel performance of those contract terms that are against the prime landlord within the context of the lease. While, as discussed in §6.5 above, 735 ILCS 5/9-215 does provide protection to the assignee if there is no reference to the issue in the documentation, overly broad documentation could raise the issue of waiver or estoppel, which would interfere with protection otherwise granted in the statute.

D. [6.9] Specific Problems

Several specific problems require inserting additional language into a sublease, rather than merely incorporating the terms of the prime lease. These problems are discussed in §§6.10 – 6.24 below.

1. [6.10] Alterations and Repairs

In most leases, the landlord reserves extensive rights of approval of alterations and has certain requirements with respect to approval of plans and specifications, payments, bonds, etc. Reserving this clause only for the landlord will not necessarily give the prime tenant the protection of the landlord. The tenant in this case must be a go-between between the subtenant and the landlord, which may raise difficult negotiating problems. A better approach is to provide in the lease that the subtenant must obtain the approval of both the prime tenant and the landlord. If the subtenant is taking the entire space, it may be appropriate in this clause to provide only for the consent of the landlord, especially if there is a short lease period at the end of the sublease. Care must be taken by the tenant, however, to ensure that it not be liable for payments for alterations or for lien protection for the landlord if the subtenant defaults in construction matters. Other related matters that require additional language, rather than mere incorporation, are the posting of security for alteration costs, the payment of a supervision fee to the landlord, the requirement to return the premises to the condition they were in at the commencement of the term (rather than at the commencement of the

sublease term), and the obligation of the subtenant to remove or restore leasehold improvements made by the tenant. *See Fan v. Auster Co.,* 389 Ill.App.3d 633, 906 N.E.2d 663, 329 Ill.Dec. 465 (1st Dist. 2009), for a case dealing with the lack of clarity in the drafting of a sublease alteration and repair clause.

2. [6.11] Landlord's Services

Obviously, in most cases the tenant is not able to provide all services required of the landlord, which means that in certain areas the tenant is totally dependent on the landlord for performance and cannot perform independently. For the protection of the subtenant, the sublease should provide merely that the prime tenant is responsible only for using reasonable efforts to enforce the landlord's obligations with respect to services. This provision, too, can cause controversy. How far will the tenant have to go? Can the prime tenant withhold rent? Should the tenant be required to file a complaint seeking damages against the landlord? Are there other matters being negotiated between the landlord and the tenant? What about the obligation of the landlord to repair and maintain the building's common areas or structural components? Again, the tenant cannot repair or maintain these areas; the most that can be required is that the tenant makes reasonable efforts to have the landlord do so. The same problem arises with respect to interruption of services, rent abatement, and rights to cure. The question of rent loss insurance when the premises are not tenantable raises another problem. The tenant would ordinarily have no protection under its insurance policy. Again, the tenant should be required only to use reasonable efforts to enforce the landlord's obligation to provide for abatement of rent or other appropriate relief.

The preceding paragraph approaches the question from the perspective of the tenant. There is also the perspective of the subtenant. While the tenant may have limited control over the delivery of services primarily, if not solely, in the control of the tenant's landlord, the subtenant needs the services and is paying for those services in rent to the tenant as sublandlord. If the subtenant does not receive services, the subtenant wants compensation. The subtenant does not care why the services are not rendered or who is responsible. The issue of landlord services is a focal point of the classic "privity of contract" and "privity of estate" concepts applied to subleases. If the subtenant owes rent to the tenant but must look to the landlord to get those services, what rights or powers does the subtenant have? The answer to that question is that, classically, the subtenant has few or no rights enforceable against the landlord as there is no privity of contract or privity of estate between the subtenant and the landlord. If the lease terms separate the payment of rent from the provision of services (*i.e.,* rent is payable to the tenant but the sublease terms say the subtenant must look only to the landlord to supply landlord services), conceptually, the subtenant owes the tenant rent even if the subtenant never receives services. Careful counsel representing the subtenant will seek to include terms addressing that possible inequity in the sublease and consent to sublease. See the case study in §6.45 below.

Even the issue of basic communication between the parties must be addressed if the sublease documentation is to be complete. The master or prime lease provides that the tenant shall give notice to the landlord to request services and to report problems with services (and any other matters relating to the lease). With no privity of contract or privity of estate between subtenant and landlord, the landlord has no contractual (or other) responsibility to acknowledge communications from the subtenant. All communication to the landlord respecting the lease are to come from the tenant.

What if the tenant no longer exists, is not responsive to requests of the subtenant, or refuses to transmit the subtenant's requests or notices to the landlord? Additionally, even if the tenant is responsive to the requests or notices of the subtenant, the process of the subtenant notifying the tenant and the tenant then notifying the landlord creates a chain of communication inherently inefficient in both the passage of time and the possibility of error. The issue of communication needs to be addressed in the sublease documentation. Again, see the case study in §6.45 below.

In many leases, electricity is separately charged to the tenant, either by allocation or through a separate meter. In these cases, the prime tenant has the responsibility of paying the utility company directly for all electricity used on the premises. In the event of a sublease, the incorporation clause will not satisfy this obligation and either a separate meter should be installed or an engineering survey should be made. In some cases, the subtenant will not have to pay separately for electricity, but a charge will be included in its rent so that this service will be supplied to it by the prime tenant, thus making an incorporation clause inadequate. In some cases, the rent is shared on a pro rata basis, based on the respective square footage each tenant occupies. This lease provision may not be appropriate if the prime tenant and subtenant have different levels of electricity usage. The cost of electricity and the heating, ventilating, and air-conditioning system (HVAC) also must be addressed in the sublease. Often, because of the way the electricity system is designed, a smaller tenant would not be able to have its space separately air-conditioned or heated, so there must be some method arranged for allocating and paying the costs. One method would be to provide that the subtenant request after-hour usage through the prime tenant and pay for the full charge even though the usage would include the entire prime tenant space rather than just the subleased space.

3. [6.12] Insurance, Indemnities, and Waivers

Extra drafting on the insurance indemnity provisions may save the prime tenant both time and expense. The prime tenant's objective is to allocate all the risks and expenses to the parties in interest, including the subtenant and the landlord, to avoid acting as an intermediary for claims. To accomplish this objective, the prime tenant should require the subtenant to carry liability insurance and any required insurance on its furniture, fixtures, and equipment, with the landlord as well as the prime tenant as additional insureds. The obligation of the landlord to carry fire and casualty insurance on the building should not be applicable to the prime tenant as a sublandlord since the prime tenant should not assume nor guarantee this obligation, which is solely that of the landlord. The indemnity and waiver provisions not only should apply to the prime landlord, as would be the case in a mirror sublease, but also should run for the benefit of the prime tenant. In addition, the subtenant's counsel or its insurance counsel should be obligated to provide the initial defense for the landlord and for the prime tenant to avoid payment for extra attorneys.

The landlord may consent to address indemnity and waiver provisions by requiring the subtenant to join in both indemnities and waivers contained in the prime lease. Such a provision is particularly important when the prime lease contains a waiver of subrogation or a waiver of claims for special damages such as loss of profits.

The indemnity section of the typical commercial lease has always included provisions that the tenant indemnifies and holds harmless the landlord. The scope of such indemnities almost universally includes damages to the property or claims against the landlord arising from the actions

or negligence of the tenant and essentially anyone involved with the premises through the tenant. That undertaking is unlimited, although sometimes subject to offset to the extent the damage or claim is covered by insurance. Even then, the offset of the exception for insurance coverage is further limited in scope only to the extent of the insurance proceeds received. One might argue that such provisions reflect history and some kind of morality rather than practical, commercial reality. In "net" lease situations, the landlord typically sets the levels of insurance paid for by the tenant as part of common area expenses. The landlord sets the levels of the tenant's insurance as part of the insurance provisions of the lease. If those levels of insurance are insufficient to cover losses in a commercially reasonable way, whose fault or obligation is that? Even in non-net lease situations, should the tenant bear the responsibility to indemnify the landlord against claims or losses of so wide a scope? If the tenant's employee leaves a coffeemaker on or a computer or vending machine in the tenant's space experiences an electrical short and burns down the entire building of which the tenant's space is a part, can the tenant reasonably be held to either insure or pay for all such damage? While the tenant can buy contractual liability insurance, is it reasonable for the tenant to have to buy such insurance in an amount sufficient to rebuild the entire development of which the tenant's premises is a part? Is it appropriate for the tenant to have to risk going out of business or unlimited personal liability to rent an office or store space? The typical indemnity provisions of standard leases need to be reexamined.

4. [6.13] Fire, Casualty, and Condemnation

Fire, casualty, and condemnation provisions obviously raise special problems for the landlord, the prime tenant, and the subtenant. Someone must decide — if the lease provides for a right of termination for a minor casualty — whether the lease will continue, whether there will be restoration of the premises, and about exercise of termination rights on the part of any one of the three parties. If there is an incorporation clause, then the subtenant may have the right to make a different decision than the prime tenant. The landlord, obviously, will not consent to a termination decision made by a subtenant, and the prime tenant will not want to keep the prime lease in place without a subtenant. One approach to deal with this situation is to provide in the sublease that the prime tenant will make all decisions regarding termination and that, if the prime lease is terminated by the landlord or the prime tenant, then the sublease will be terminated. This approach would also apply to some condemnation provisions. One of the reasons for a sublease is to reduce the tenant's obligations under the lease, and the prime tenant wants to take advantage of any opportunity to cut off its liability. This approach, however, may not be applicable if the prime tenant has made a sublease at a profit.

Another problem concerns the landlord's obligation to repair and restore. A straight incorporation of the lease provisions would impose the liability on the prime tenant, who obviously does not want to undertake this obligation. On the other hand, if the lease clause requires a tenant to restore the leasehold improvements, that obligation could become the subtenant's in a mirror sublease, even for improvements made prior to the sublease term.

From the subtenant's viewpoint, incorporation is inadequate because, in many cases, the sublease may be for a substantially shorter term or for a significantly smaller space than the prime lease, so that the subtenant would want an independent right to terminate but would require the prime tenant to restore. In any event, the time period and circumstances permitting termination or restoration specified in the sublease should be different from those contained in the lease.

5. [6.14] Last Day

A special situation may arise in which a gap occurs between the termination of the sublease and the termination of the prime lease. Frequently, this gap is one day. A special problem arises if the subtenant has made arrangements with the landlord to continue to occupy the space after the termination of the prime lease. Care should be taken to avoid an interpretation that this arrangement is really an assignment, thus exposing the subtenant to all the obligations of the prime tenant, which may include some accrued liabilities the subtenant wishes to avoid. It is possible that an arrangement could be made by a separate agreement to give the subtenant a one-day license with an option to extend, leaving the gap to be measured in hours rather than in days. The parties may agree, however, to consider this problem de minimis and simply ignore it, with the subtenant holding over and waiving the holdover penalty, set forth in 735 ILCS 5/9-202 regarding willful holdover, which calls for double rent upon the landlord's election to treat the occupancy as a holdover upon written notice to the tenant, if the landlord is relying on the terms of the statute rather than on the written terms of the lease relating to holdover and notice. Under the statute, failure of the landlord to give written notice of the landlord's election to treat the tenant's occupancy of the premises after the term of the original lease as a "holdover" may result in the occupancy being treated as a tenancy at sufferance. *Bransky v. Schmidt Motor Sales, Inc.,* 222 Ill.App.3d 1056, 584 N.E.2d 892, 894, 165 Ill.Dec. 458 (2d Dist. 1991). Whether one is treated as a tenant at sufferance or a holdover tenant is significant because a landlord cannot enforce covenants of an original lease against a tenant at sufferance. *Id.* The lease may stipulate the period of notice required for the landlord's declaring the character of the occupancy subsequent to the original term of the lease (holdover, tenancy by sufferance, etc.); however, without contractual terms covering the matter in the original lease, the length of term relating to the occupancy subsequent to the term under the original lease must be determined. The statute stipulates only that the landlord exercise its right to declare the character of the term of the tenant's occupancy, after the end of the term of the occupancy under the original lease, by "written notice" to the tenant.

A question arises as to what period notice is required if one chooses or is required to operate under the provisions of the statute rather than under specific terms in the original lease. In such cases, determining whether the tenant's occupancy after the original term of the lease is a holdover or a tenancy by sufferance depends on the conduct of the parties. If monthly rent has been accepted subsequent to the original term of the lease, it is likely that at least 30 days' prior written notice will be required under 735 ILCS 5/9-202 to create a tenancy at sufferance under terms distinct from the terms provided in the original lease. *Brach v. Amoco Oil Co.,* 570 F.Supp. 1437 (N.D.Ill. 1983). In some instances, rather than having the landlord elect to treat the holdover as an occupancy for an additional term equal to the original term but at double rent (as provided in most "standard" written lease holdover provisions), double rent for a shorter term may be appropriate.

6. [6.15] Renewal and Expansion Rights

Renewal and expansion rights occur in two situations. In the first, the subtenant wants to exercise these rights during the original lease term. In the second, the prime tenant elects to exercise these rights, and then the subtenant has its own independent rights. These problems do not exist under an assignment because the assignee will succeed to these rights; this may prove very important and may be one of the reasons that an assignment form is being used. Obviously, the

subtenant cannot exercise these rights because it has no privity with the landlord and is not a party to the prime lease. The sublease should, therefore, require the prime tenant to exercise the rights under its lease to provide for specific performance. An alternative may be to give the subtenant the power of attorney to exercise these rights in the name of the prime tenant. The third and most preferable method would be to make a direct agreement between the subtenant and the landlord permitting the subtenant to exercise these rights. Drafting these provisions could be particularly difficult if the sublease does not include the entire premises. Warning should be given if the prime lease does not permit assignments or subleasing. The attorney for the subtenant should examine the prime lease to be sure that the provisions are not prohibited.

7. [6.16] Additional Rent

A simple incorporation clause may be completely inappropriate when the prime lease calls for additional rent based on the operating costs and taxes of the building. In this situation, the following issues must be addressed on a sublease:

a. If the additional rent is a percentage of increase over the base year, a determination must be made as to whether the base year is a designated year under the prime lease or a designated year under the sublease.

b. If the sublease is of only a part of the premises, the allocation of the subtenant's share of additional rent must be made.

c. The way problems regarding the right to examine the landlord's books, disputes over charges, and how bearing the expenses are to be handled needs to be determined.

d. The prime tenant may want to restrict the subtenant's right to initiate discovery without first guaranteeing the expenses.

e. When the subtenant will pay its additional rent — monthly, annually, a certain number of days after proof is submitted, after being billed, etc. — must be determined.

8. [6.17] Maintenance of the Lease

The subtenant's main interest is to maintain the validity of its lease as opposed to the fundamental law that upon termination of the prime lease, the subtenant's lease will no longer be in effect, limiting the subtenant to a damage claim against the tenant. There are several things the subtenant can do to protect itself, including delivery of a non-disturbance and attornment agreement with the landlord, providing that the subtenant will receive notices and a right to cure, and providing that notices of default given to the prime tenant will also be served on the subtenant. Language similar to that used to protect a mortgagee is applicable to this situation. An extensive, detailed example of a non-disturbance agreement is included in §6.52 below. From the landlord's viewpoint, the obligations of the subtenant and the rights of the landlord can be expressly contained in the consent of the landlord and should include, for the landlord's benefit, a provision that the landlord does not have to give any notices to the subtenant. However, a provision that termination of the prime lease terminates the sublease ordinarily would not be acceptable to the subtenant if it has a

chance to negotiate. The subtenant should at least ask for the additional phrase "for reasons other than the prime tenant's default" and should include a right to cure. If there are early termination rights in favor of either the prime tenant or the landlord, the subtenant should specifically protect itself to the extent that it is possible to cover its damages or other practical problems it may have because of the lease termination.

There is still another risk with amendments of the prime lease. To the extent that amendments could in any way affect the subtenant, the subtenant should require that it be notified and must consent. This consent may be required either by an agreement with the landlord or by an agreement only with the tenant. Obviously, from the subtenant's viewpoint, its consent should be required by agreement with both the landlord and the tenant.

In the event of default by the prime tenant, the subtenant should reserve the right to undertake performance of the prime tenant's obligations under the prime lease and offset these costs against the rent due under the sublease. This right is not a full answer, except when the rent payable under the sublease is substantially equivalent to the rent under the prime lease and the sublease is for all or substantially all the premises. However, there may be cases in which, even with these restrictions, a right to cure is beneficial to the subtenant because of its need for continued occupancy. *But see Acevedo v. SC Real Estate LLC,* 526 B.R. 761 (N.D.Ill. 2014), in which the court determined that a holdover is a "lease" subject to the automatic stay in bankruptcy.

9. [6.18] Recapture

A common provision in leases permits the landlord to elect to recapture the premises itself in the event of an assignment or sublease, unless the landlord consents to the assignment or sublease. This provision is another example of why the attorney for the subtenant or assignee should examine the prime lease and insert appropriate additional language. If there is an agreement as part of the sublease, or assignment or consent by the landlord, the recapture clause should be specifically considered, including, for example, consideration of the right of the landlord to recapture again if the subtenant or assignee wants to make a further sublease or assignment.

10. [6.19] Environmental Matters

There is a distinct exposure to liability concerning environmental matters that should be carefully considered by all parties to either a sublease or an assignment. To the extent that the premises contain asbestos, the building owner or tenant may be required to disclose these facts under Occupational Safety and Health Administration regulations. The subtenant is obviously exposed to risks with respect to any person employed by the subtenant in the premises, even though the risks result from acts occurring prior to the creation of the sublease, and the tenant may also be exposed to environmental-related liability because of the construction or renovation work performed by the subtenant in its use of the premises. Therefore, in the sublease, consideration should be given to having the tenant make representations and warranties with respect to the freedom of the premises from such risks at the time possession is turned over to the subtenant or assignee. Furthermore, the assignee, on its behalf, should specifically agree to make customary warranties and representations with reference to its use of the premises during the sublease period. Documentation on this matter can be covered in the construction or renovation additions to the lease, if applicable.

11. [6.20] Sharing of Profit

For some years before 1990, it was to the benefit of the landlord to provide in the lease that the landlord would get all or a part of sublease or assignment rent to the extent it exceeded the rent under the prime lease. This provision became moot when leasing became a tenant's market. However, many leases made in the past provide for lower rent than is now being called for, and it is possible that in the future these rents will be bargains so that tenants can again sublease or assign at a profit. Landlords, in this case, will want to again add provisions to the assignment or sublease clause providing for a sharing of this profit. On behalf of the landlord, consideration should be given to providing that if the prime tenant is in default and the assignee's or subtenant's rent is less than the rent payable under the prime lease, the assignee or subtenant is required to pay the full rent as set forth in the prime lease.

12. [6.21] Landlord's Consent

A lessee is free to sublet or assign its lease without the landlord's consent (*Cole v. Ignatius,* 114 Ill.App.3d 66, 448 N.E.2d 538, 69 Ill.Dec. 820 (1st Dist. 1983)), unless the lease expressly requires such consent. *Woods v. North Pier Terminal Co.,* 131 Ill.App.3d 21, 475 N.E.2d 568, 570, 86 Ill.Dec. 354 (1st Dist. 1985). If there is a failure to obtain required consent, the landlord may declare the assignment or sublease void, sue the tenant for breach of covenant, declare the lease terminated, and institute eviction proceedings. However, it is also possible that the landlord will waive the provisions and recognize the assignee or sublessee. The requirement for obtaining the landlord's consent may place a hardship on the tenant if the landlord delays in granting or replying to the tenant's request. A tenant may lose its prospective sublessee or assignee or otherwise default under the lease during this interim period. Accordingly, counsel for tenants should attempt to place a time limit on the landlord, and consent should be deemed to have been given if the landlord does not respond to a request for consent within the time stated.

A tenant should always attempt to obtain some restraint on a landlord's ability to withhold consent. In particular, the tenant should seek a provision prohibiting unreasonableness in the withholding of consent. Such a qualification shifts onto the landlord the burden of justifying a refusal to consent to the assignment or subletting. If consent is then arbitrarily withheld, a tenant may declare a breach. Clearly, if the limitation is intended to be more than just "reasonableness," the landlord should take care that all important considerations are included in the provision. For example, the landlord may consent upon the performance by the tenant of certain acts or obligations. The conditions are supplemental to those contained in the lease but are legally created as incorporated therein.

The rule in *Dumpor's Case,* 76 Eng.Rep. 1110 (1603), that a consent to an assignment waives the necessity of consent to future assignments, has been severely limited, if not extinguished, by Illinois caselaw as far as its applicability to consents relating to subleases is concerned. *Hartford Deposit Co. v. Rosenthal,* 192 Ill.App. 211 (1st Dist. 1915), held that an owner's written consent to a sublease that did not contain any further restrictions against subletting or assigning did not operate as a termination of the conditions in the original lease to render a further sublease valid without the consent of the original landlord. As a result of want of privity of contract, a landlord cannot sue a sublessee on covenants contained in the original lease; however, the sublessee is bound

by any restrictions in the chain of title above, so the landlord has the same equitable remedies to enforce the restrictions contained in the original lease that it would have against a purchaser with notice. *Ford v. Jennings,* 70 Ill.App.3d 219, 387 N.E.2d 1125, 26 Ill.Dec. 295 (3d Dist. 1979). But if the landlord desires to ensure that a covenant is enforceable against the assignee or sublessee, it would be advisable to include a provision in the written consent requiring the assignee or sublessee to obtain the landlord's written consent before making any subsequent transfer. *See Kew v. Trainor,* 150 Ill. 150, 37 N.E. 223 (1894). When the prohibition against further conveyance without the written consent of the landlord was contained in the written consent to the first assignment, it was held to have the same legal effect as if it were incorporated into the original lease. *Springer v. Chicago Real Estate, Loan & Trust Co.,* 202 Ill. 17, 66 N.E. 850 (1903). *Dumpor's Case, supra,* has been limited in many ways. *See Reconstruction Finance Corp. v. Kentucky River Coal Corp.,* 114 F.2d 942, 945 (6th Cir. 1940) ("The trend of recent cases . . . is to limit strictly or even repudiate the rule in *Dumpor's Case*."). As with any other covenant in a lease, this provision may be waived by the landlord. *Compare Wolfram Partnership, Ltd. v. LaSalle National Bank,* 328 Ill.App.3d 207, 765 N.E.2d 1012, 262 Ill.Dec. 404 (1st. Dist. 2001) (tenant was found to have violated terms of its lease by not providing its landlord notice of current sublease even though tenant had provided notice of prior subleases), *appeal denied,* 201 Ill.2d 618 (2002), *with Bolingbrook Equity I Limited Partnership v. Zayre of Illinois, Inc.,* 252 Ill.App.3d 753, 624 N.E.2d 1287, 191 Ill.Dec. 909 (1st Dist. 1993) (when landlord had dealt with and accepted rent from tenant's corporate successor, court held that tenant's actions were not default of lease even though tenant did not comply with explicit terms of lease assignment requirements).

It is appropriate on behalf of all parties (prime tenant, landlord, and assignee or subtenant) that the landlord's consent be evidenced in writing. The subtenant wants the written consent (a) to enable it to retain possession of the premises even if the prime tenant is in default and (b) to act to cure the default. The landlord wants the consent (a) to enable it to proceed with the default provisions by electing its statutory lease remedies without having to make the subtenant a party to any litigation so that notices on a prime tenant would be all that is required — this is especially important if there are numerous subtenants on small portions of the premises — and (b) to clarify the rights of the assignee or the subtenant in the event of default. See the suggested forms of consent provided in §§6.50 and 6.51 below.

13. [6.22] Mitigation — Reasonableness

Although, as discussed in §6.5 above, 735 ILCS 5/9-213.1 provides that the landlord must make reasonable efforts to mitigate damages, there are some special matters that should be considered in defining "reasonable." Two suggested forms are included in §§6.54 and 6.55 below. There may be special situations that would also clarify what is reasonable. When the lease provides that the premises may not be conveyed without the landlord's written consent and such provisions are not modified by local ordinance, reasonable commercial standards for rejection may be implied in the absence of specific lease provisions. *See Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 60 Ill.Dec. 703 (1st Dist. 1982). *See also Golf Management Co. v. Evening Tides Waterbeds, Inc.*, 213 Ill.App.3d 355, 572 N.E.2d 1000, 1003, 157 Ill.Dec. 536 (1st Dist. 1991), for a discussion of *Jack Frost Sales* and other Illinois cases related to providing "a subtenant who was ready, willing, and able to take over the lease."

In *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E. 2d 503, 505 – 506, 230 Ill.Dec. 1013 (1st Dist. 1998) (see reference in §6.5 above), the court upheld a lease clause providing that, in the event of default of the lease, the landlord could recover the current value of the lease rent over the unexpired lease term, less the current fair market rental value over the lease term. However, the court also held that on remand the issue of the fair market value of the lease was to be determined by the court.

A lease, however, may contain some limitation on the landlord's power to withhold consent, and the language commonly used takes the form of "such consent not to be arbitrarily or unreasonably withheld or delayed." Limitations on the right of a landlord to withhold consent are strictly construed against the landlord. *See Edelman v. F.W. Woolworth Co.,* 252 Ill.App. 142 (1st Dist. 1929), in which the court held that the landlord's refusal to consent on the ground that the proposed sublessee was a competitor of the landlord was arbitrary and unwarranted, absent an express prohibition against subletting to a competitor of the landlord. As such limitations are strictly construed against the landlord, the insertion of the above language may have the effect of granting to the tenant a right or rights that were not contemplated by the landlord. In *Chanslor-Western Oil & Development Co. v. Metropolitan Sanitary District of Greater Chicago,* 131 Ill.App.2d 527, 266 N.E.2d 405 (1st Dist. 1970), the court found that withholding consent on the condition of reappraisal and the establishment of a new rent schedule was arbitrary and unreasonable. The *Chanslor-Western* court quoted a decision of the Supreme Court of New Jersey for an explanation of the covenant not to withhold consent unreasonably:

> **Arbitrary considerations of personal taste, sensibility, or convenience do not constitute the criteria of landlord's duty under an agreement such as this . . . the standard is . . . action of a reasonable man in the landlord's position . . . questions of reasonableness of conduct and good faith are ordinarily for the judgment of the trier of facts. Yet, such are questions of law for the court when facts are undisputed and not fairly susceptible of divergent inferences. [**Omissions in original.**]** 266 N.E.2d at 407, quoting *Broad & Branford Place Corp. v. J.J. Hockenjos Co.,* 132 N.J.L. 229, 39 A.2d 80, 82 (N.J. 1944).

The New Jersey Supreme Court expanded on the reason that this standard must be applied to the landlord in its explanation of law, stating:

> **There is a covenant in the words "which consent shall not be unreasonably withheld." The phrase is not merely restrictive of the character and nature of the tenant's covenant, i.e. that it was not to operate at all if the assent of the landlord be arbitrarily withheld. A peremptory duty was thereby laid upon the landlord to act when his consent was invoked, and to be governed therein by the standard of reason. That was his undertaking by language not fairly susceptible of the contrary interpretation; and he is liable in covenant for a breach thereof.** 266 N.E.2d at 407, quoting *Broad & Branford, supra,* 39 A.2d at 84.

Other provisions of the lease may affect the court's determination of reasonableness. Indeed, when the lease contains provisions giving further meaning to the clause granting a person the power to withhold consent, then the standard by which reasonableness is judged is varied accordingly. *See Edelman, supra,* 252 Ill.App. at 145 ("[I]f, in the instant case, plaintiffs had desired to prevent the subletting of the premises to a business competitor they should have so stated in the lease.").

Section 2-403.3 of the Model Residential Landlord-Tenant Code, drafted by the American Law Institute-American Bar Association (ALI-ABA) in 1969, suggests that a written lease may prohibit assignment altogether but can prohibit subletting only on reasonable grounds. Grounds for withholding consent may be based on facts that would reasonably indicate that the proposed subtenant would be less desirable to the landlord than the present tenant.

What constitutes reasonableness for the landlord's consent to an assignment or sublease will depend mostly on the facts of the situation. The forms in §§6.50 and 6.51 below refer to a typical office or store lease, or one with a percentage rent provision. However, other provisions may be applicable depending on the situation. These provisions include:

a. appropriate tenant mix in a shopping center;

b. areas or buildings where other tenants have an exclusive interest;

c. credit standing or financial responsibility;

d. number of persons occupying the premises;

e. commercial activities in residential areas;

f. compliance with the condominium or association rules and regulations;

g. special requirements for heating, air-conditioning, plumbing, or traffic;

h. sale of food or intoxicating beverages; and

i. adverse credit reports.

Considerations of race, creed, sex, political opinions, national origin, or sexual preference should not be included, although *Millers Mutual Casualty Co. v. Insurance Exchange Building Corp.,* 218 Ill.App. 12 (1st Dist. 1920), states that when a lease provides that a proposed sublessee must be satisfactory in all respects to the landlord, the term "satisfactory" does not mean that the proposed sublessee would satisfy a reasonable person. It is suggested that this opinion may not hold up in today's climate.

There have been numerous cases involving the landlord's obligation to mitigate damages since the adoption of the mitigation statute. For example, in *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 178 Ill.Dec. 444 (3d Dist. 1992), the landlord rented the store space vacated by the defendant-tenant within seven months of the defendant's departure. The court found that the plaintiff did mitigate its damages, as shown by the weight of the evidence, and the fact that the new tenant paid less rent did not constitute a failure to mitigate since the property might have remained vacant and would have generated no income if the landlord waited to rent until it found a new tenant who could meet the defendant-tenant's original lease terms.

In *Golf Management, supra,* even though the lease forbade subleasing or assignment without the consent of the landlord, the landlord was held liable for failure to consent to transfer when the tenant repeatedly submitted a subtenant who was ready, willing, and able to assume the lease on reasonable commercial standards. The court rejected the landlord's claim that the tendered subleases were conditional because one prospective new tenant wanted an option to renew the lease and another sublease submitted included the phrase "contingent on my accountant's approval." 572 N.E.2d at 1003.

Furthermore, in *Chicago Title & Trust Co. v. Baskin Clothing Co.,* 219 Ill.App.3d 726, 579 N.E.2d 1045, 162 Ill.Dec. 231 (1st Dist. 1991), summary judgment was given when the court found that the landlord made a substantial effort to rent the space but was unable to interest potential tenants even before considerations of financial terms occurred. The tenant argued that the landlord's failure to attempt to relet at the lease rate constituted a breach of the duty to mitigate, but the court did not accept the argument.

In *MXL Industries, Inc. v. Mulder,* 252 Ill.App.3d 18, 623 N.E.2d 369, 191 Ill.Dec. 124 (2d Dist. 1993), the court reviewed an example of landlord conduct found by the trial court to provide ample support for the trial court's conclusion that the landlord satisfied its obligation to mitigate and found the trial court's view appropriate. In *MXL Industries,* the landlord was (a) able to obtain some partial, short-term rentals (albeit at a reduced rate) and (b) able to relet when, as soon as the tenant vacated the premises, he engaged a building manager, erected a sign, and ran newspaper advertisements. *See also Kallman v. Radioshack Corp.,* 315 F.3d 731 (7th Cir. 2002). Further, in *American National Bank & Trust Company of Chicago v. Hoyne Industries, Inc.,* 738 F.Supp. 297 (N.D.Ill. 1990), the parties to a lease restricted the obligation of the landlord to use reasonable efforts to mitigate damages with respect to the rental rate sought. Therefore, the court determined that "[as] long as the rental rate sought was not in excess of the current market rental rate, the landlord had not breached its duty to mitigate damages by asking for more than the tenant was paying." 738 F.Supp. at 301.

In *MBC, Inc. v. Space Center Minnesota, Inc.,* 177 Ill.App.3d 226, 532 N.E.2d 255, 126 Ill.Dec. 570 (1st Dist. 1988), in which the court held that even prior to the statute requiring mitigation, a landlord's failure to offer a prospective tenant the same terms as the existing tenant was a failure of the landlord's duty to exercise reasonable diligence to mitigate its damages. *See also St. George, supra,* for a discussion of the purpose of the mitigation of damages statute, and *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 332 Ill.Dec. 438 (2d Dist. 2009), in which the court determined that the landlord attempted to undermine the purpose of the mitigation of damages statute by allowing the premises to stand vacant and then attempting to collect the lost rent in the form of damages.

See *Annot.,* 75 A.L.R.5th 1 (2000), for an extended article on mitigation of damages in leases, including references to numerous Illinois cases in the area.

14. [6.23] Indirect Assignment or Sublease by Use of Partnership Interest or Corporate Stock

If the tenant is a partnership or a corporation, the tenant may effect an assignment or sublease, as the case may be, by transferring a partnership interest or corporate stock. The landlord may wish

to cover this possibility by including in the lease's definition of "assignment" or "sublease" a provision prohibiting or restricting such a transaction. A lease provision stating that if corporate stock control is transferred, the lessor may terminate the lease is generally upheld. *See Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 27 Ill.App.2d 467, 170 N.E.2d 35 (1st Dist. 1960). However, in *Peacock v. Feltman,* 243 Ill.App. 236 (1st Dist. 1927), it was held that the incorporation of part of a lessee's business for improved efficiency and cost accounting failed to violate the provision of subletting only with the consent of the lessor. From the tenant's viewpoint, an exception should be made if the corporation results from a merger, consolidation, or reorganization or if control is still maintained by the original partners or shareholders. See also *Annot.,* 12 A.L.R.2d 179 (1950); *Annot.,* 39 A.L.R.4th 879 (1985).

15. [6.24] Practical Considerations of Obligation and Timing of Giving and Receiving of Notices

Most commercial leases provide that a precondition to the exercise of rights or the declaration of a default is the giving of notice. When an assignment or sublease occurs, often the practical effects of the notice provisions under the prime lease are not considered in drafting the documents creating the assignment or sublease.

If the original landlord agrees to consent to the assignment or sublease and be bound to its terms, appropriate adjustments can be made in the provisions regarding timing and delivery of notices — although the issue still must be addressed carefully. If, however, the original landlord refuses to be bound by the terms of the sublease but agrees only to consent that the occupancy of the premises by the assignee or subtenant is not in itself a default of the lease, the issue of notice can become even more of a challenge.

Under a typical commercial lease, the landlord owes a notice and right to cure to the tenant upon the occurrence of an event of default before the landlord can declare a default under the lease. As an example, if that notice is a five-day notice and the landlord's obligation is limited to a notice to its tenant (rather than to the assignee or subtenant), then the original landlord sends a notice to its tenant and the five-day period begins. The original tenant then must send a notice to the assignee or subtenant, and the assignee or subtenant may receive the notice (forwarded from the original tenant's landlord) with insufficient time to respond.

In such circumstances, the attorney representing the assignee or subtenant must take care to protect the interests of the client. If possible, the assignment or sublease documents should be signed by the original landlord and should address a rework of the notice provisions under the lease. Provisions may be made for simultaneous notices to go from the original landlord to the original tenant as well as to the assignee or subtenant. The timing period of the notices may be extended to provide for a practical method of the receipt of notice and to effect a cure. Arrangements may be made for the original tenant to retain the obligation to cure the claimed default if the notice process does not provide for an effective opportunity for the assignee or subtenant to effect a cure.

However, in whatever manner the issue is addressed, the attorney representing the assignee or subtenant should take care not to miss providing a practical solution to give the client an effective notice and right to cure.

The issue of drafting effective provisions for communication addressed in §6.11 above is part of the resolution of the practical considerations in the giving and receiving of notices in subleases.

VI. [6.25] BANKRUPTCY

Although leases used to contain detailed language providing for a default if either of the parties went into bankruptcy, such language is now substantially redundant since the Bankruptcy Code specifically provides that a trustee of either the landlord or the tenant may assume or reject any unexpired lease of the debtor. 11 U.S.C. §365. The matter is relevant to this chapter in that the Bankruptcy Code provides that the trustee can then assign the lease. In this event, however, the trustee must provide for adequate assurance of the assignee's future performance of the lease. 11 U.S.C. §365(b)(1)(C). Also, the Bankruptcy Code states specifically that the nondebtor landlord may require a security deposit. 11 U.S.C. §365(*l*).

The trustee can assume or assign the lease, providing that the lease is for nonresidential real property and has not been terminated under applicable nonbankruptcy law before relief was given. In addition, of course, to assume the lease, the trustee must cure or provide adequate assurance that the trustee will cure defaults and compensate a party other than the debtor for any actual pecuniary loss resulting from that default. The trustee must also provide adequate assurance of future performance under the lease. 11 U.S.C. §365(b)(1)(C).

Adequate assurance regarding the performance of leases of real property in a shopping center requires additional assurance that the financial condition and operating performance of the proposed assignee and its guarantors are substantially equal to those of the debtor and its guarantors; that any percentage rent due under the lease will not decline substantially; that the other provisions of the lease such as exclusivity, radius, use, or location will not be breached; and that the lease will not disrupt any tenant mix or balance. 11 U.S.C. §365(b)(3).

Of interest in this situation is that there may be many parties involved, including the landlord, the tenant, the assignee or subtenant of the tenant, and the subtenant or assignee of the subtenant. The only rights that are determined are those of the debtor itself. Apparently to the extent that the debtor's rights are protected by bankruptcy, the other parties to the transaction would be approximately bound. This matter is discussed in *Waukegan Times Theatre Corp. v. Conrad,* 324 Ill.App. 622, 59 N.E.2d 308 (2d Dist. 1945), which cites a 19th century English case, *Smith v. Gronow,* 2 Q.B. 394 (1891).

A lessee holding a lease to a property sold under the Bankruptcy Code has the right to petition the court for adequate protection of its interest. 11 U.S.C. §363(e). Under such circumstances, the lessee could be compensated for the value of the leasehold from the proceeds of sale of the property. *Precision Industries Inc. v. Qualitech Steel SBQ LLC,* 327 F.3d 537 (7th Cir. 2003).

Nothing in the Bankruptcy Code discusses the right of the trustee to sublease, but it is assumed that such subleasing would be permitted under the general common law permitting such a right.

In *Precision Industries,* there is a discussion of §363(e) of the Bankruptcy Code and the possibility of an entity having an interest in the property being sold being entitled to protection or conditions in the sale to protect that interest. 327 F.3d 547 – 548. Such protection might result in a lessee receiving compensation for the value of its leasehold.

The effect of the Bankruptcy Code on the common or general law cannot be overemphasized. In *Rubloff Development Group, Inc. v. Kmart Corp.,* 389 B.R. 555, 562 (N.D.Ill. 2008), Rubloff claimed that Kmart had, in the context of Kmart's bankruptcy filing, created "anticipatory breach[es]" of its sublease obligations. In denying Rubloff's position, the court said, in part:

> **This is one of the situations where bankruptcy law qualifies and restricts the ability of the nondebtor party to an unexpired lease to invoke general contract law and remedies. Rubloff makes much of the fact that Kmart's statements of its intent to reject the Master Leases in its negotiations with Rubloff pressured Rubloff into taking an assignment of the Leases. We see nothing wrong with this pressure; it is part and parcel of the assume-or-reject scheme.** 389 B.R. at 561.

Section 365 of the Bankruptcy Code deals with leases and the rights of the trustee in bankruptcy to accept or reject a lease. The rights of the trustee (to accept or reject a lease) are dependent on whether a valid lease existed at the time of the filing of the bankruptcy or whether the lease had "expired." To determine whether a lease has expired, the bankruptcy court refers to the applicable nonbankruptcy law, which generally is the law of the state that is the situs of the particular lease involved.

Unfortunately, Illinois cases do not refer to leases as "expired" or "unexpired" but to whether leases are "terminated." The bankruptcy court has determined that a reference to a lease "terminated" under Illinois law is the equivalent of an "expired" leased under §365 of the Bankruptcy Code.

The root cases in Illinois dealing with the issue of when a lease is terminated have arisen within the context of residential leases rather than commercial leases. However, the court's analysis in those cases would seem to apply generally since the eviction statute, 735 ILCS 5/9-101, *et seq.* (formerly referred to as the "forcible entry and detainer statute"), applies to all leases without a distinction between residential and commercial.

The relevant issue is the determination of when a lease is terminated under Illinois law. In *Robinson v. Chicago Housing Authority,* 54 F.3d 316 (7th Cir. 1995), the court determined that there were five steps in the process of having a lease terminated. These steps are (a) default in the lease, (b) notice of default and right to cure, (c) failure to cure the default within the applicable notice period, (d) filing of a lawsuit, and (e) entry of a judgment for possession. The *Robinson* court concluded that, under Illinois law, the rights of the tenant "terminated" at the conclusion of the third step (*i.e.,* failure of the tenant to cure the default within the applicable cure period). A later case, *In re Brown,* No. 95 B 16825, 1995 WL 904913 (N.D.Ill. Dec. 19, 1995), held that, under Illinois law, all five steps needed to be completed to terminate a lease as the tenant could raise equitable or other defenses in state court that could occur only between the fourth step (filing of a lawsuit) and the fifth step (the entry of the judgment). The *Brown* court argued that to hold

otherwise would violate the Fourth and Fifth Amendments and the Due Process Clause of the U.S. Constitution. A later case, *In re Gant,* 201 B.R. 216 (N.D.Ill. 1996), reviewed *Brown* and concluded that the *Brown* analysis was inappropriate. In *Gant,* the court determined that, under Illinois law, there was a distinction between the rights of a tenant under a lease and the right of possession. The *Gant* court held that, under Illinois law, the rights of a tenant under a lease terminated and the lease expired as of the passage of the third step (failure to cure the default within the applicable notice period) detailed in the *Robinson* analysis. Under the court's analysis, the determination of the right to possession of the property was separate from the determination of the termination of the lease. The court argued that to hold otherwise would obviate the concept of a "holdover tenant" or an "occupant" under common law when the issue of possession of the property was independent of the issue of a lease to the property. *See also In re Williams,* 144 F.3d 544, 548 (7th Cir. 1998) ("We agree that before the landlord gets a judgment, the tenant *might* have a 'viable possibility' of reviving her lease. But the mere fact that a landlord has not yet gotten a judgment is not conclusive: whether the tenant can revive the lease depends on whether she has a 'viable' defense.").

The inquiry of the occurrence of the termination of a lease is relevant in bankruptcy. While the method of termination of a residential lease is often governed primarily by the terms of the eviction statute, the issue of termination of a commercial lease is equally relevant in bankruptcy and other areas of the law. In commercial leases, care should be taken to clearly define when the rights of the tenant under a lease terminate as, traditionally, in commercial leases there are special provisions for defaults, cure periods, and waivers of notice. If a bankruptcy occurs, the bankruptcy court will examine whether the tenant's rights under the lease terminated — that is, whether the lease expired — in determining whether the trustee in bankruptcy is to retain authority over the lease or whether the landlord can successfully obtain a lifting of the stay without the trustee in bankruptcy having the power to accept or reject the lease as an asset of the bankruptcy. The same issue of whether a lease is terminated is at the root of cases concerning continuing rights and responsibilities of parties to a lease. See §6.38 below for examples.

VII. REQUISITES

A. [6.26] Parol Assignments and Subleases — Statute of Frauds

An assignment or sublease need not be in writing, except as required under the statute of frauds if it exceeds one year. 740 ILCS 80/2. Occupancy and payment of rent in and of themselves are not necessarily sufficient execution of a parol assignment to charge the assignee with the covenants of its lease, even though this may result in hardship. *See Griffin v. W.L. Pfeffer Lumber Co.,* 285 Ill. 19, 120 N.E. 583, 585 (1918) ("[T]he result of this decision is a hardship on appellants, but we would not be justified in departing from legal principles applied in other cases to avoid such a consequence."). Partial performance may or may not serve to render the statute of frauds inoperative. *See, e.g., Cleveland, C., C. & St.L.Ry. v. Wood,* 189 Ill. 352, 59 N.E. 619 (1901). *See also Johnston v. Messinger,* 226 Ill.App. 397 (1st Dist. 1922), in which it was held that, when an assignee did not sign the assignment but entered into possession, paid rent, and reassigned the lease to another, the assignment was not void under the statute of frauds. The assignment of the lease need not be made as part of the lease itself nor be attached to the lease but may be provided as a separate instrument. There is no requirement that the assignment of the lease be under a seal, even though the lease itself may be under a seal. *See Keeley Brewing Co. v. Mason,* 102 Ill.App. 381 (1st Dist. 1902).

B. [6.27] Recording and Filing

Presumably, 765 ILCS 5/28 encompasses the recordation of leases and their assignments. The phrase therein that supports this position reads: "other instruments relating to or affecting the title to real estate." *Id.* Although never directly ruled on in Illinois, inferences from other cases would indicate that assignments of leases are recordable. In the closest Illinois case construing the quoted phrase, *Kahn v. Deerpark Investment Co.,* 115 Ill.App.2d 121, 253 N.E.2d 121 (1st Dist. 1969), the court, quoting Ill.Rev.Stat. (1967), c. 30, ¶27, stated that a judgment debtor's assignment of rents, in excess of the rents necessary to make his mortgage payments to a judgment creditor, was deemed to be an assignment of an interest "relating to or affecting the title to real estate."

The purpose of recording is to protect bona fide purchasers of property. It provides a medium for constructive notice to the world. However, between the parties to a conveyance, it has no effect. If a lease requires the registration of any assignment thereof and the tenant fails to record, the assignment is not invalid as against an assignee who occupies the premises for a considerable period of time and pays the stipulated rent. *Kewanee Boiler Corp. v. American Laundry Machinery Co.,* 289 Ill.App. 482, 7 N.E.2d 461 (1st Dist. 1937). This case provides a good summary of caselaw applicable to assignments of leases.

Cole v. Ignatius, 114 Ill.App.3d 66, 448 N.E.2d 538, 69 Ill.Dec. 820 (1st Dist. 1983), provides by inference that a lease may provide that an assignment must be recorded to be effective, although the court's holding is stated in the reverse. In that case, the court held that since the lease provided that an assignment could be recorded but did not require that an assignment must be recorded, the failure to record the assignment did not render it invalid.

VIII. WAIVER AND ESTOPPEL

A. [6.28] In General

Although a breach of a provision prohibiting an assignment or subletting may occur, a landlord may be deemed to have waived the breach. *See Sexton v. Chicago Storage Co.,* 129 Ill. 318, 21 N.E. 920 (1889).

B. [6.29] What Constitutes Waiver or Estoppel

A landlord may expressly, or by means of implication, waive a restriction against an assignment or subletting. An implied waiver may occur when the landlord acts in a manner that implies it has waived the condition. For example, if the landlord accepts rent from an assignee, it may be held to have waived the provision requiring its consent to the assignment and, subsequently, may be estopped from asserting a forfeiture of the lease. *Johnson v. Hotel Lawrence Corp.,* 337 Ill. 345, 169 N.E. 240 (1929). A breach may be waived by implication, following the conduct of the aggrieved party. *Hunt v. Shell Oil Co.,* 116 F.2d 598 (10th Cir. 1941). However, for such a waiver to be effective, the landlord must be aware that it is accepting rent from an assignee. Generally, a landlord cannot waive what it does not know.

Again, the policy against prohibiting alienation of property and against forfeiture is strongly in favor of a judicial finding of waiver. In fact, when a landlord accepts rent from a subtenant and subsequently serves the tenant with a notice of eviction for violating a covenant prohibiting subletting without the written consent of the landlord, there has been held to be waiver of the breach. *Krygsman v. Stamatakos,* 175 Ill.App. 583 (1st Dist. 1912). One inconsistent case holds that if the landlord accepts rent from the original tenant, notwithstanding the fact that the landlord has notice of the subletting at the time it receives the rent, a waiver will not be deemed to have occurred. *Meath v. Watson,* 76 Ill.App. 516 (1st Dist. 1897). This case is probably of limited value as precedent because the lease required waivers to be in writing. However, the policy in favor of finding waivers is so strong that anti-waiver clauses may be held to be inoperative. In *Waukegan Times Theatre Corp. v. Conrad,* 324 Ill.App. 622, 59 N.E.2d 308, 312 (2d Dist. 1945), the lease contained the following provision:

> **[**A**]cceptance of rent after it falls due, "or after having knowledge of any breach hereof by lessee, or the giving or making of any notice or demand, whether according to any statutory provision or not, or any act or series of acts except an express written waiver, shall not be construed as a waiver of [**landlord**]'s right to act without notice or demand or of any other right hereby given [**landlord**]."**

In upholding a waiver by the landlord's acceptance of rent from an assignee, the court stated that the clause was for the benefit of the landlord only and did not have any effect on waivers implied by law from conduct of the landlord amounting to estoppel, and, therefore, it did not render an oral waiver inoperative, since the provision itself could be waived.

Whether a waiver has occurred is greatly influenced by the circumstances and intent of the parties. Possession by the assignee and acceptance of rent by the landlord do not necessarily control. In *Wolfram Partnership, Ltd. v. LaSalle National Bank,* 328 Ill.App.3d 207, 765 N.E.2d 1012, 262 Ill.Dec. 404 (1st. Dist. 2001), *appeal denied,* 201 Ill.2d 618 (2002), the appellate court sent the case back to the trial court on issues of whether acceptance of rent waived the tenant's failure to follow the sublease approval procedures in the lease and whether the tenant's failure to follow such procedures was material. *See also Bolingbrook Equity I Limited Partnership v. Zayre of Illinois, Inc.,* 252 Ill.App.3d 753, 624 N.E.2d 1287, 191 Ill.Dec. 909 (1st Dist. 1993) (involving sustaining lease in bankruptcy but also involving landlord's waiver of limitations in lease on subleasing). If a tenant makes a general assignment for the benefit of creditors and the assignee takes possession and tenders rent, the acceptance of the rent by the landlord does not amount to a waiver unless it can be clearly shown that the trustee has elected to accept the old lease. *See also National Distillers & Chemical Corp. v. First National Bank of Highland Park,* 804 F 2d 978 (7th Cir. 1986) (acceptance of two month's rent by landlord was not waiver of default of lease by alleged sublease without consent); *Medinah Temple Co. v. Currey,* 162 Ill. 441, 44 N.E. 839, 840 (1896) ("If the truth of the case is that both parties intended the tenancy should continue, there is an end of the principal title. If not, the landlord is not barred of his remedy by ejectment."). A landlord may be estopped from asserting a breach of a restriction against transfer by acts other than the acceptance of rent. In *Wohl v. Yelen,* 22 Ill.App.2d 455, 161 N.E.2d 339 (1st Dist. 1959), a landlord was estopped to deny the validity of oral consent when he supplied the tenant with a "For Rent" sign and had knowledge that the tenant was advertising for a subtenant. Waiver of the landlord's right to forfeiture on assignment by the acceptance of rent also permits the assignee to exercise an option to renew granted to the tenant. *Kaybill Corp. v. Cherne,* 24 Ill.App.3d 309, 320 N.E.2d 598 (1st Dist. 1974).

One must recognize that the primary objective of a landlord is to generate cash flow from the use of the premises. However, to accept rent from an assignee would generally cause a landlord to risk a waiver of its right to require consent. To that end, the lease may provide that acceptance of rent from an assignee does not constitute an acceptance of the assignment. However, this clause may not be effective if rent is accepted over a material period of time.

IX. CONSTRUCTION AND OPERATION OF ASSIGNMENTS

A. [6.30] In General

An assignment of a lease does not create a new estate but rather transfers the estate held by the assignor to the assignee. It transfers privity of estate but not privity of contract. *See Everett v. John Sexton & Co.,* 280 Ill.App. 350 (1st Dist. 1935). Accordingly, the landlord and assignee have entered into a landlord-tenant relationship. When an assignment is made in breach of a restriction prohibiting assignment, the assignee acquires no enforceable right against the landlord unless the landlord has waived the breach. In fact, if the landlord has declared a forfeiture prior to the assignment, the assignee acquires nothing. *Glanz v. Halperin,* 251 Ill.App. 572 (1st Dist. 1929). Nonetheless, the assignment is generally binding as between the parties thereto.

See American National Trust Company of Chicago v. Kentucky Fried Chicken of Southern California, Inc., 308 Ill.App.3d 106, 719 N.E.2d 201, 241 Ill.Dec. 340 (1st Dist. 1999), in which the court outlined the conduct of a landlord (acceptance of rent, requesting participation in a tax appeal, filing proof of claim in a bankruptcy stating the assignee was a party to the lease, and accepting settlement from the assignee of the lease claim) that equaled an implied acceptance of the assignment.

In drafting an assignment clause, it is desirable to condition the assignment on the assignee's express assumption of the conditions of the lease. This kind of clause will create a privity of contract between the assignee and the landlord, so that the assignee is also bound to the landlord after reassignment.

B. [6.31] Privity of Estate

In any landlord-tenant relationship there is always privity of estate. Privity of estate binds the landlord, the tenant, and the assignee to all covenants that run with the land. For a covenant to run with the land, three elements must coexist: (1) there must be a covenant; (2) there must be an intention that the covenant run with the land; and (3) the covenant must touch and benefit the land.

Covenants that run with the land are incident to the land itself and are not personal to the parties who enter into the agreement. Therefore, any party who subsequently acquires an interest in the estate is bound to the covenants regardless of whether the assignee has explicitly assumed the covenants.

C. [6.32] Privity of Contract

Privity of contract is a relationship between two parties based on a contract, oral or written. However, when real property is involved, compliance with the statute of frauds is required, so a written instrument is necessary to establish such privity. Privity of contract binds individuals to an agreement, regardless of whether the relationship of landlord-tenant still exists — which is to say that it does not run with the land, as is the case with privity of estate. An assignee is not bound by privity of contract unless it expressly assumes the terms of the lease.

D. Rights and Liabilities of Assignees

1. [6.33] Extent of Assignees' Rights

The assignee of a leasehold interest will succeed to the rights of the assignor and no other unless there is an agreement to the contrary. 735 ILCS 5/9-215. Logically, the only estate that the tenant could assign is the term created by the original lease.

The assignee has the right to enforce any covenant running with the land. This right has been held to include the right to renew a lease. *See Infinity Broadcasting Corporation of Illinois v. Prudential Insurance Company of America,* 869 F.2d 1073 (7th Cir. 1989), in which the court held that although the lease required consent to assignment, the tenant's assignee had standing to sue for breach of covenant of quiet enjoyment, constructive eviction, and anticipatory repudiation when the landlord had not objected to the assignment and had accepted rental payments from the assignee. *Cf. Tober v. Collins,* 130 Ill.App. 333, 337 (3d Dist. 1906) ("A covenant against assignment in a lease to two persons is broken by an assignment of the undivided moiety of one lessee to the other. The covenant, though it relates to the estate of the two, necessarily involves the interest of each and neither of them can assign the whole or any part of his interest without consent."). Even though a promise by the landlord to the original tenant was not a covenant running with the land, the promise may be extended to the assignee if the landlord has given written consent to the assignment. The covenant will be extended only if the assignment was valid. *Kleros Bldg. Corp. v. Battaglia,* 348 Ill.App. 445, 109 N.E.2d 221 (1st Dist. 1952). The courts have stretched the common law by interpreting the consent as having the effect of a new lease to the assignee for the unexpired term. *Cleveland, C., C. & St. L. Ry. v. Mitchell,* 74 Ill.App. 602 (4th Dist. 1897). The law does not favor restrictions on the free use of land. As a consequence of this equitable doctrine, consent of the lessor to an assignment is tantamount to consent to any use that was permitted to the tenant. *Bass v. Metropolitan West Side El. R.,* 82 F. 857 (7th Cir. 1897).

2. Extent of Assignees' Liabilities

a. [6.34] In General

An assignee of a leasehold estate is ordinarily liable with respect to covenants running with the land by reason of privity of estate with the landlord. However, an assignee incurs no additional liability unless it assumes the covenants of the lease or specifically agrees to incur additional liability.

b. [6.35] Liability of Assignee When There Is No Express Assumption of Lease

An assignee that does not assume the lease will be liable for the performance of covenants running with the land only, and only for the period of its occupancy. During the period the assignee holds the premises, it is liable to the landlord by privity of estate. Covenants running with the land include covenants for payment of rent reserved and taxes and covenants to yield up in good condition. *Peck v. Christman,* 94 Ill.App. 435 (1st Dist. 1900). The landlord may enforce a covenant to pay rent directly against the assignee even though the rent reserved in the original lease is less than the amount provided for in the assignment. Payment of rent by the assignee to the assignor does not relieve the assignee from its liability to the landlord. *Morrison v. Blackall,* 68 Ill.App. 504 (1st Dist. 1896), *aff'd,* 170 Ill. 152 (1897). An assignee is not relieved from its liability based on privity of estate by yielding possession of the premises. It must make a bona fide transfer of its interest to another party.

During the period an assignee holds a leasehold estate, it is liable to the tenant and any intermediate assignee that, also being liable on the lease by way of privity of contract, has performed any obligation of the lease pursuant to a demand by the landlord on the occurrence of a breach of the obligation. In *Kewanee Boiler Corp. v. American Laundry Machinery Co.,* 289 Ill.App. 482, 7 N.E.2d 461 (1st Dist. 1937), the court based the liability of the ultimate assignee to the intermediate assignee on the principle that if two parties are liable on an obligation and if one party has performed to the benefit of the other, the party receiving the benefit must be liable to the party that performed.

c. [6.36] Liability of Assignee When There Is Express Assumption of Lease

An assignee that assumes the terms of the lease stands in privity of contract as well as privity of estate with the landlord. There are two significant legal consequences incident to privity of contract. The assignee is liable on personal covenants as well as covenants that run with the land, and the assignee is liable on the personal covenants for the duration of the term of the lease or until formally relieved of such liability by the landlord, notwithstanding that it may not be at all times in possession. When an assignee has assumed the obligations of the lease, privity of contract results, and the assignee cannot terminate such liability by assignment or surrender of possession. *Leitch v. New York Cent. R.,* 388 Ill. 236, 58 N.E.2d 16 (1944).

Whether an assignee has assumed contractual obligations for the full term depends on the language of the lease and the circumstances surrounding the assignment. When a lease was assigned for a certain sum "and in consideration of the assumption" by the assignee "of all the obligations and liabilities of the lessee arising under said lease," the court held that the assignee came into privity of contract with the landlord. *Springer v. De Wolf,* 194 Ill. 218, 62 N.E. 542, 543 (1901). Consequently, the assignee was bound as fully as the tenant to perform the obligations of the lease. *Id.* Due to the potential burden on an assignee resulting from the assumption of contractual liability on a lease, the courts are reticent to find personal liability in the absence of a clear and express intent to assume this liability. The phrase "subject to the agreements therein mentioned to be performed by said lessee," contained in an assignment from the tenant to an assignee, was held not to impose contractual liability on the assignee. *Cf. Consolidated Coal Co. of St. Louis v. Peers,* 166 Ill. 361, 46 N.E. 1105, 1109 (1896). The words "subject to the agreements" were interpreted to be words of qualification rather than words of contract. *Id.*

It is not always necessary for the assignee to enter into a written contract to create privity of contract. When the language of the lease between the landlord and the tenant provided that a "assignee or assignees shall expressly accept and assume all the terms and covenants in this lease contained to be kept, observed and performed by the [tenant], and become bound to personally comply therewith," an assignee was deemed to have incurred contractual liability by taking possession and paying rent over a period of time. *Svatik v. Niles,* 293 Ill.App. 465, 13 N.E.2d 101, 103 (1st Dist. 1938). Since the assignee assumed the benefits of the lease, she was held to have incurred the liability. *Id.*

The obligation to assume the terms of the lease may arise from the lease itself, from the terms of the assignment agreement, or in consideration for the landlord's written consent to the assignment when it is required. In all instances, the assignee is bound as fully as the tenant to the covenants and has the same power as the tenant and no more.

Ordinarily, an assignee who assumes the obligations of the lease is liable for breaches that occur subsequent to the assignment. However, the assignee should carefully scrutinize the language of the assumption of liability. If it is framed in terms such as "the assignee shall be bound to the terms of the lease to the full extent of the lessee," the assignee may have assumed retrospective liability and could conceivably be held liable for breaches that occurred prior to the assignment.

The landlord, under certain circumstances, may desire to impose an additional condition that requires the tenant or assignee to deposit security, such as cash or a surety bond, to further assure the landlord that the assignee will perform the covenants and conditions contained in the lease.

3. [6.37] Termination of Relationship and Liability

If an assignee of a lease does not assume the obligations of the lease, the privity of estate that exists between the assignee and the landlord is extinguished upon reassigning the lease and vacating the premises. The assignee is not liable for any breach that occurs after the assignment. It does, however, remain liable for any breach that occurred during its period of tenancy. The assignee may also be liable for any contractual agreements between itself and its assignor even though it did not assume the obligations of the lease. A subsequent assignment will destroy the privity of estate between the landlord and the first assignee, but it will not destroy privity of contract, and the first assignee will remain liable on its covenants under the lease. *Kagan v. Gillett,* 269 Ill.App. 311 (1st Dist. 1933).

To terminate the assignee's liability, the assignment must be actual and not colorable. If an assignee assigns the lease to a corporation that was formed for the sole purpose of relieving the assignee from liability and the assignee remains in possession of the premises, the assignee remains liable. *Cf. Marine Trust Co. of Buffalo v. Reynolds,* 308 Ill.App. 595, 32 N.E.2d 366, 371 (1st Dist. 1941) ("If the transfer of the lease was merely colorable and not bona fide, then there was no transfer.").

The liability of an assignee is not terminated when a subsequent assignment is made in violation of the terms of the lease. If the lease provides that the tenant may not assign without the written consent of the landlord and such consent is not obtained, the assignee is not relieved from liability unless the landlord waives the provision.

If the assignee assumes the obligations of the lease, privity of contract results, and the assignee cannot avoid its contractual liability by making an assignment and going out of possession. *Springer v. Chicago Real Estate, Loan & Trust Co.,* 202 Ill. 17, 66 N.E. 850 (1903). It remains liable for the duration of the term, regardless of subsequent reassignments, even if its assignee may assume the terms of the lease. The subsequent assignee that does not assume the lease, however, comes into only privity of estate with the landlord and, therefore, becomes liable only for covenants running with the land.

E. Rights and Liabilities of Assignors

1. [6.38] With Respect to Landlord

An assignment does not extinguish any privity of contract that exists between the tenant and the landlord unless the landlord releases the tenant from liability. Therefore, the tenant assumes the risk of a breach by any subsequent assignee unless it can obtain a release.

The burden rests on the tenant to demonstrate a clear intent on the part of the landlord to release it. Such an agreement need not be in writing but "may be inferred from facts and circumstances." *Halloran v. Hall,* 165 Ill.App. 440 (4th Dist. 1911). For there to be a release from liability, the landlord must accept the surrender of the lease or demonstrate intent to make a new lease with another party. The receipt of rent from the assignee is not sufficient to discharge the tenant from the covenant to pay rent in the lease. The lease itself may provide that reassignment relieves the tenant from the obligation to pay rent, but few landlords are willing to forgo a potential source of rent should the assignee become insolvent. An alternative available to the tenant is to agree with the landlord to be relieved from liability with respect to some covenants in the lease (*e.g.,* the duty to repair). At a minimum, the tenant should attempt to be released from all nonmonetary covenants or place limits on the amount of liability. Note, though, that even if a release is granted, the tenant may escape only prospective liability but remain liable for any breach committed prior to the agreement releasing the tenant from liability. *See Northbrook PLIC, LLC v. CVS Pharmacy, Inc.,* No. 10 C 0873, 2012 WL 581223 (N.D.Ill. Feb. 17, 2012), for a memorandum opinion in a convoluted case in which the tenant's interest under a lease was assigned and then reassigned or subleased after various workout arrangements were sought, and one of the tenants in the string of tenants was held liable for unpaid rent because the court held that while an assignment relieved the tenant from liability as a tenant under the lease, the assignment did not relieve the tenant as a guarantor under a separate guarantee. The issue of when a lease "terminates" also comes up in what may be unexpected ways. In *Northbrook,* the prime lease was guaranteed by CVS Pharmacy. The prime lease then went through a series of assignments or subleases while the guarantee language was not waived or terminated by subleases or assignments. The landlord entered into a new lease with a tenant rather than continuing the assignment approach. The new tenant defaulted. The court held (a) that the guarantor was responsible for tenant defaults for those tenants under the string of assignments, but (b) that the guarantee did not cover the last "new" lease the landlord entered into with the thereafter defaulting tenant. The court held that the landlord exercised its option "terminating" the original lease and, therefore, terminating the guaranty.

2. [6.39] With Respect to Assignee

Whether the tenant and its assignee stand in the relationship of landlord and tenant or assignor and assignee depends on the intention of the parties. However, if the assignee assumes the covenants of the lease, it is generally liable to the tenant in the same manner that the tenant is liable to the landlord (*i.e.,* the assignee is in privity of estate and contract with the tenant). 52 C.J.S. *Landlord and Tenant* §58 (2003).

Several legal problems arise when there is concurrent liability between the original tenant and one or more subsequent assignees that have assumed liability of the covenants in the lease. Generally, primary liability rests on the ultimate assignee, but a landlord may take action against any assignee that has assumed liability. The difficulty arises when the ultimate assignee breaches a covenant and a former assignee cures the breach by performance of the ultimate assignee's obligations. What action may the intermediate assignee take against the ultimate assignee? Generally, it may not institute an action for foreclosure because the possessory right belongs only to the landlord. The right to possession is an instance of the landlord-tenant relationship, which normally does not exist between the assignor and a subsequent assignee. This fact may prove detrimental to an assignor whose assignee does not have extensive assets or that does not retain any security for the assignment of the lease agreement. While in possession, an assignee that assumes the obligations of the lease is also liable for damages or reimbursement to an intermediate assignor that has performed the conditions of the lease pursuant to demand by the landlord. If it assigns the lease, such an assignee is liable to the landlord and its assignor by contract.

To review, a landlord may take action against its tenant, an assignee in possession, and any assignee that has assumed the obligations of the lease. A tenant may take action against its assignee for the period of the assignee's occupancy and beyond if the assignee assumes the lease. An intermediate assignor may take action against its assignee if the assignee has assumed the obligations of the lease and any subsequent assignee in possession that has assumed the obligations of the lease.

X. OPERATION OF A SUBLEASE

A. [6.40] In General

A sublease creates a new estate between the tenant and the sublessee. The character of the estate depends on the language employed and the circumstances of the transfer. The tenant and the sublessee enter into a landlord-tenant relationship between themselves. The sublessee has no legal relationship to the landlord, there being no privity of estate between the landlord and the sublessee. *Sexton v. Chicago Storage Co.,* 129 Ill. 318, 21 N.E. 920 (1889). Consequently, a sublessee is not liable to the landlord for the terms of the lease even if the sublease is expressly subject to the original lease. The sublessee does, however, have a duty to ascertain the terms of the original lease. See §6.6 above with reference to using the incorporation-by-reference technique.

Many leases, while permitting subleases, contain provisions clearly onerous to a tenant. For example, a lease might state:

Tenant is hereby given the privilege to sublet the demised premises in part or as a whole to a sublessee or sublessees who shall be and remain at all times satisfactory to landlord. This privilege is to be considered as a license only, revocable at the pleasure of landlord.

Under this clause, the landlord remains in complete control over the demise of the premises.

It is questionable whether the license applies solely to prospective subleases or whether the landlord may also terminate the sublease of a current sublessee. If so, a sublessee will be unable to have any security in its occupancy and will, therefore, be reticent to make any material alterations or improvements to the premises. In fact, it is difficult to imagine any party becoming a sublessee without modification of this provision.

A holdover by a sublessee may impose heavy liability on the tenant since it is responsible for the acts of its sublessee. The tenant may be liable for a period of up to a year, depending on the term of the lease and the applicable state law relating to holding over. Although the sublessee may not be held directly liable to the landlord as a holdover, it may be responsible to the tenant by way of an express stipulation. The sublessee is liable to the tenant under such an agreement by the privity of contract, even if it makes a subsequent assignment of its sublease.

B. [6.41] Liability of Original Tenant to Landlord

The creation of a sublease by the tenant does not change the relationship of the tenant to the landlord. The landlord and the tenant continue in privity of contract, with the tenant remaining liable on all conditions and covenants unless there is an agreement to the contrary. The tenant is responsible for the acts or omissions of its sublessee to the same extent as if it had committed the acts itself.

C. Rights and Liabilities of Sublessee

1. [6.42] Rights of Sublessee with Respect to Landlord

The sublessee succeeds to all the rights possessed by the tenant to the extent not limited by the terms of the sublease. The sublessee has neither privity of estate nor privity of contract with the landlord. Privity of contract does not exist absent a direct contract with the landlord. *Third Establishment, Inc. v. 1931 North Park Apartments,* 93 Ill.App.3d 234, 417 N.E.2d 167, 48 Ill.Dec. 765 (1st Dist. 1981). The sublease does not create privity of estate with the landlord since the sublease is subject to the reversionary rights of the tenant. The sublessee, however, holds its estate subject to the terms of the original lease, and anything that defeats the estate of the tenant defeats the estate of the sublessee. The termination of the prime lease, either by way of expiration of the term or forfeiture, terminates the sublease. *See Coleman v. Madison Two Associates,* 307 Ill.App.3d 570, 718 N.E.2d 668, 241 Ill.Dec. 97 (1st Dist. 1999). However, a transfer or devise of the fee by the landlord is subject to the sublease.

It is prudent for a sublessee to request the right to cure any default in the lease occasioned by the tenant to avoid losing the sublessee's leasehold interest. For example, if the original lease required rent at $100 per month but the sublease required only $50, the sublessee should insist on the right to pay the difference, thereby curing what would otherwise be a default in the original lease.

The fact that a sublease is made subject to the terms of an original lease does not put the sublessee in privity of contract with the landlord since the landlord is not a party to the sublease. Therefore, the landlord has no direct right of action against the sublessee.

In addition, the tenant does not necessarily have a right of action against the sublessee for a breach of a covenant in the original lease. Mere knowledge of the original lease will not impose contractual liability on the sublessee without more evidence of intent to assume the conditions and covenants. This principle applies to the situation in which the tenant that is held liable for a breach of the lease perpetrated by the sublessee looks to the sublessee for reimbursement.

A landlord may include a clause making any sublease subject to the terms of the original lease to persuade the tenant to include the material terms of its lease in the sublease so that, in the instance of a breach, the tenant may turn to the sublessee for reimbursement. The theory is that the landlord will have greater assurance of being able to collect a judgment for a breach of a covenant from the tenant if the tenant is able to turn to the sublessee.

Although normally in the event of the tenant's default under the lease the subtenant is unable to remain in possession under its sublease, this is not always the case. If the landlord terminates the tenancy pursuant to a right to terminate provided in the lease, a sublease entered into by the tenant is then terminated. Such a provision, however, may not apply to a voluntary surrender by the tenant of the prime lease other than by default. See Lester G. Britton, *In Illinois, What Happens to Subleases When the Ground Lease Is Surrendered for a New Ground Lease?,* 49 Chi.B.Rec. 148 (1968). *See also Lyon v. Moore,* 259 Ill. 23, 102 N.E. 179 (1913).

2. [6.43] Liabilities of Sublessee with Respect to Landlord

A sublessee is charged with notice of the covenants contained in the original lease. Although a landlord may not sue a sublessee for breach of a covenant due to the lack of privity and may proceed against the tenant only (*Orchard Shopping Center, Inc. v. Campo,* 138 Ill.App.3d 656, 485 N.E.2d 1248, 93 Ill.Dec. 38 (5th Dist. 1985)), the landlord may, in some cases, "distrain" the sublessee's property (735 ILCS 5/9-317) or evict the sublessee. If the landlord retains the right to cancel the lease on the occurrence of an express condition, it may evict the sublessee in the same manner as it could evict the tenant. *Wilson-Broadway Building Corp. v. Northwestern Elevated R.R.,* 225 Ill.App. 306 (1st Dist. 1922).

Although the sublessee and the landlord are not in privity of estate or contract and, consequently, have no right to enforce covenants directly against each other, they are not precluded from entering into an independent agreement. Such an agreement often takes the form of a non-disturbance agreement. Any number of rights may be created by the agreement as long as it complies with the requirements of a binding contract. The agreement, however, may not affect the relationship between the landlord and the tenant or the tenant and the sublessee unless the tenant is a party.

Further, a non-disturbance agreement will not protect a sublessee from the right of a paramount mortgage or the holder of a paramount title, absent a provision to the contrary contained in the mortgage or execution and delivery of a subordination, non-disturbance, and attornment agreement between the sublessee and the mortgagee.

Illustrative forms of non-disturbance agreements between a landlord and a sublessee as well as between a lender and a tenant (which can be adapted for a sublessee) are included in §§6.52 and 6.53 below.

3. [6.44] Rights and Liabilities of Sublessee with Respect to Tenant

The sublease creates a relationship similar to that of the landlord and the tenant between the tenant and the sublessee. The sublessee is bound to the covenants of the sublease in the same manner in which the tenant is bound to the covenants of the original lease. There is both privity of estate and privity of contract between the tenant and the sublessee. Consequently, if the sublessee has assigned its estate with the consent of the tenant, its assignee comes into privity of estate with the tenant. If the assignee assumes the obligations of the sublease, it also comes into privity of contract. *Kagan v. Gillett,* 269 Ill.App. 311 (1st Dist. 1933). If the subtenant has assumed the obligations of the covenants contained in the prime lease or has specifically agreed to perform a certain covenant contained in the prime lease, it is liable only to the tenant.

XI. [6.45] CASE STUDY

DISCLAIMER: What follows is a case study involving the negotiation of a sublease on behalf of the local office of a national firm. Included are the original, "standard form" documents submitted by the subtenant's broker and a set of final documents as executed after multiple drafts and negotiation and review by two separate attorneys on behalf of the tenant (in two states) and the attorneys for the landlord and for the landlord's real estate broker in addition to the attorney for the subtenant. Each document went through a minimum of five separate drafts. Further, as such documents are based on the actual documents involved in the transactions (with names and identifying business terms, references to addresses, space, rental amounts, etc., excised), which were created under the time pressure and multiple inputs described, such documents should not be used as templates or form documents but as teaching illustrations for consideration and review by members of the bar for educational purposes only.

Client: The local main office of a national firm.

Engagement: Negotiate and document a sublease on behalf of the client.

Subtenant: The tenant in a large suburban office tower. The tenant is involved in drastic downsizing in anticipation of the loss of its prime customer.

Landlord: The developer of the large suburban office tower.

Referral source: The "tenant broker" of the client.

Status of the matter at time of engagement: The subtenant's broker has submitted a standard form sublease and a separate standard form landlord consent to sublease form.

The standard form landlord consent to sublease:

CONSENT TO SUBLEASE

This Consent To Sublease is made and effective this _____ day of _____, 20__, by and between Prime Landlord, LLC, an Illinois limited liability company (Landlord), whose address is _____, Prime Tenant, LLC, an Illinois limited liability company (Tenant), whose address is _____, and Subtenant, Inc., an Illinois corporation (Subtenant), whose address is _____.

RECITALS

A. Landlord and Tenant executed a lease dated _____, 20__ (Master Lease), covering approximately _____ rentable square feet premises located at _____ (Premises) and described as: _____.

B. Tenant has requested that Landlord consent to Tenant subleasing that certain portion of the Premises consisting of approximately _____ square feet located on the _____ floor and described above as the _____ Suite (Subleased Premises) to Subtenant on the terms contained in a sublease dated _____, 20__, a copy of which is attached hereto and incorporated herein (Sublease).

C. Landlord is willing to consent to such Sublease on the express conditions stated below.

THEREFORE, in consideration of the mutual covenants and agreements stated below, and for good and valuable consideration received and acknowledged by each party, Landlord hereby consents to the Sublease pursuant to the conditions stated below.

1. *Tenant Responsible.* Notwithstanding the Sublease and Landlord's consent thereto, Tenant expressly acknowledges and confirms that the Lease will remain in full force and effect in accordance with its terms and that Tenant will remain fully and directly responsible and obligated to Landlord for all Tenant's covenants, agreements, obligations, and other undertakings under the Lease, including, without limitation, the full and timely payment (payable directly to Landlord) of all Base Rental, all additional rent, and all other sums or other charges due or that hereafter may become due thereunder.

2. *Relationship Among the Parties.* With respect to the Lease and the Sublease, Tenant and Subtenant each expressly acknowledges and confirms the following:

2.1. The Sublease is and reflects an agreement and contract between Tenant and Subtenant only, and Landlord is not and will not become responsible, obligated, or liable to Tenant or to Subtenant for or with respect to any covenants, agreements, obligations, or other undertakings of either Tenant or Subtenant thereunder, except as expressly provided herein.

2.2. The Lease is and reflects an agreement and contract between Landlord and Tenant only, and Landlord is not to become responsible, obligated, or liable to Subtenant (whether as a third-party beneficiary or otherwise) for or with respect to any covenants, agreements, obligations, or other undertakings of either Landlord or Tenant thereunder, except as expressly provided herein.

2.3. If for any reason the Lease shall terminate or Tenant's right to occupy the Premises shall terminate (without a termination of the Lease), whether such shall occur by expiration of the stated Term thereof or by default by Tenant thereunder (Lease Default), then in any such case the Sublease and Subtenant's right to occupy the Subleased Premises shall each terminate absolutely, without the requirement of notice being given to Subtenant and without Subtenant having any right to cure the same. Subtenant forthwith shall surrender the Subleased Premises to Landlord, subject to the provisions of Paragraph 3 below.

2.4. The Sublease shall not be amended, modified, extended, or renewed without in each case the prior written consent thereto by Landlord.

2.5. The consent to the Sublease and to Subtenant set forth herein is limited and conditioned as herein set forth and shall not extend or be deemed to extend to any other subletting or sub-subletting of all or any portion of the Premises or to any assignment of the Lease, any of which will require the prior written consent of Landlord as required by the Lease.

3. *Election To Recognize Sublease.* Upon the occurrence of a Lease Default, and subject to written agreement by Subtenant, Landlord shall have the election (but shall not be obligated) to assume Tenant's obligations under the Sublease, in which event the Sublease shall continue in full force and effect in accordance with its terms. In order to exercise the election granted Landlord herein, Landlord shall be obligated to give Subtenant written notice of its election within ten business days following the Lease Default, and upon the timely giving of such notice the sublease shall be reinstated and shall continue in full force and effect in accordance with its terms. In such event, Landlord will succeed Tenant as "Sublandlord" under the Sublease, and each of Landlord and Subtenant will execute and deliver to the other counterparts of an instrument prepared by Landlord (and reasonably satisfactory to both Landlord and Subtenant) confirming the continuation of the Sublease and the respective obligations of Landlord and Subtenant thereunder. The exercise or failure to exercise by Landlord of the election granted it hereunder will in no case affect in any way Landlord's

rights, powers, and remedies under the Master Lease in respect of such a Lease Default, and Landlord shall be permitted to pursue its rights and remedies against Tenant as is provided for in the Lease. Notwithstanding the foregoing, in the event Landlord elects not to assume Tenant's obligations under the Sublease as provided above, then Subtenant shall have the right, but not the obligation, to remain in possession of the Subleased Premises for up to one year after the date Subtenant receives written notice from Landlord that a Lease Default has occurred on the same terms and conditions contained in the Sublease, except that Landlord shall succeed Tenant as "Sublandlord" and the rent required to be paid by Subtenant under the Sublease shall be adjusted to the average rent per square foot paid by all other tenants in the Building.

4. ***Indemnification of Landlord.*** **Tenant and Subtenant each hereby jointly and severally indemnifies and agrees to defend and hold harmless Landlord from and against all liability and claims for any injury to person or damage to property caused by any act, omission, or neglect of Subtenant, its agents, servants, employees, or licensees, or any other person entering the Building under the invitation of Subtenant, or otherwise arising out of the use of the Subleased Premises by Subtenant, except for any such loss, injury, or damage that is caused by or results from the negligence or willful misconduct of Landlord, its employees, or its agents.**

5. ***Brokerage Commissions.*** **Landlord shall not be liable for any brokerage commission or other charges levied or incurred relating to this Sublease.**

6. ***Alterations.*** **Subtenant shall make no alterations or improvements to the Subleased Premises without Tenant's and Landlord's written approval.**

7. ***Improvements.*** **Subtenant and Tenant acknowledge that any changes, modifications, or improvements to signage, keys, card access systems, etc., shall be paid for by Subtenant and require the prior written approval of Landlord.**

AFFIRMING THE ABOVE, the parties have executed this Consent To Sublease as of the date first identified.

LANDLORD
Prime Landlord, LLC, an Illinois limited liability company
BY: _____

TENANT
Prime Tenant, LLC, an Illinois limited liability company
BY: _____

SUBTENANT:
Subtenant, Inc., an Illinois corporation
BY: _____

Legal effect of the terms of the standard form landlord consent to sublease:

a. The only effect of the document is that the landlord agrees that the subtenant's occupancy of the premises under the sublease will not in itself be a violation of the prime lease.

b. The document fails to meet the needs of the subtenant in that

1. it does not establish any privity of contract between the landlord and the subtenant; and

2. it does not establish any privity of estate between the landlord and the subtenant.

Accordingly, the execution of the standard form landlord consent to sublease provides the subtenant with limited if any practical benefit.

The standard form sublease:

SUBLEASE AGREEMENT

THIS SUBLEASE AGREEMENT ("Sublease" or "Sublease Agreement") is entered into this _____ day of _____, 20__, between Prime Tenant, LLC, a Illinois Limited Liability Company with its principal business address being _____ (Sublandlord) and Subtenant, Inc. (Subtenant), with an office located at _____.

WITNESSETH:

WHEREAS, Sublandlord and Prime Landlord, LLC, an Illinois limited liability company (Landlord), as Landlord, entered into that certain Office Lease dated _____, 20__ (Original Lease), whereby Sublandlord leased from Landlord approximately _____ rentable square feet of space (Original Premises) in the building known as _____ and located at _____, _____, Illinois (Building);

WHEREAS, the Original Lease is hereinafter referred to as the Master Lease, a copy of which is attached hereto as Exhibit A and incorporated herein by this reference; and

WHEREAS, Sublandlord desires to sublease to Subtenant, and Subtenant desires to sublease from Sublandlord, that certain portion of the Original Premises consisting of the _____ floor suite, containing approximately _____ rentable square feet (Premises) on the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the mutual promises herein provided, the parties agree as follows:

1. ***Premises and Term.*** **All capitalized terms used herein shall have the meanings ascribed to them in the Master Lease unless otherwise defined herein. Sublandlord hereby subleases to Subtenant and Subtenant hereby subleases from Sublandlord the Premises (which Premises are located and configured as shown on Exhibit B attached hereto and incorporated**

herein by this reference), upon and subject to the covenants, representations, warranties, agreements, terms, and conditions herein provided, for the term commencing on _____, 20__ (Sublease Commencement Date), and terminating on _____, 20__ (Sublease Expiration Date). Sublandlord shall deliver possession of the Premises to Subtenant on or before the Sublease Commencement Date. Notwithstanding the foregoing, upon execution of this Sublease Agreement and receipt of Landlord's consent, Subtenant shall be permitted access to the Premises to install its furnishings and equipment.

2. ***Rent.*** **Subtenant covenants and agrees to pay a monthly gross rental to Sublandlord for the Premises due and payable in advance on the first day of each month as follows: _____.**

All payments shall be made to: _____.

3. ***Security Deposit.*** **Upon the execution and delivery of this Sublease, Subtenant shall deliver to Sublandlord a check in the amount of $_____ as security for the full and faithful performance of every provision of this Sublease to be performed by Subtenant. If Subtenant defaults in the performance of any of its obligations under this Sublease, and such default continues after notice and expiration of any applicable period of grace, Sublandlord may use all or any part of this Security Deposit for the payment of rent or any other amount that Sublandlord is obligated to spend by reason of Subtenant's default. Subtenant shall not be entitled to interest on the Security Deposit, and Sublandlord may commingle the Security Deposit with other funds; provided, however, that the Security Deposit shall be considered to be held in trust for Subtenant's benefit in accordance with the terms of this Sublease. In the event Sublandlord becomes a debtor under the Bankruptcy Code, Subtenant shall have priority and the right to a return of the Security Deposit. In the event Landlord's consent to this transaction is not obtained, the Security Deposit will be promptly returned to Subtenant. If Subtenant shall fully and faithfully perform every provision of this Sublease to be performed by it prior to the expiration or earlier termination of the Sublease, then Sublandlord shall return the Security Deposit to Subtenant within 30 days after the expiration or earlier termination of the Sublease. In the event Sublandlord defaults under this Sublease or the Master Lease or Subtenant is prevented from operating in the Premises for any reason (unless caused by Subtenant's action or failure to act), then Landlord shall immediately refund the Security Deposit to Subtenant.**

4. ***Use.*** **The Premises shall be used for offices and uses accessory thereto, but in no event for any uses not permitted under the Master Lease.**

5. ***Incorporation of Master Lease.*** **Except as otherwise provided herein, all the covenants, agreements, terms, and conditions of the Master Lease relating to or applicable to Tenant under the Master Lease are incorporated herein to the extent that they apply to the Premises and are made a part hereof with the same force and effect as if set forth at length herein, except to the extent the same are modified or amended by this Sublease, it being understood and agreed that said provisions shall fix the obligations (other than monetary obligations, which shall be governed by Paragraph 2 hereof) of Subtenant to Sublandlord with the same effect as if Subtenant was Tenant named in the Master Lease and Sublandlord was Landlord**

named in the Master Lease; provided, however, that Subtenant is only assuming such obligations as they relate to the Premises (which is only a portion of the Original Premises governed by the Master Lease). Except as otherwise provided herein, Subtenant agrees that Sublandlord shall have all the rights and remedies of Landlord under the Master Lease relating to the Premises with respect to Subtenant as if such rights and remedies were fully set forth herein. Sublandlord represents that the Master Lease is in full force and effect and that neither Landlord nor Sublandlord is in default as of the date of this Sublease Agreement. In the event of any inconsistency between the Sublease and the Master Lease, the Sublease shall govern. Sublandlord agrees to promptly provide Subtenant with copies of all notices received from Landlord with respect to the Premises and all notices of default received from Landlord under the Master Lease.

6. ***Takings.*** **If any substantial part of the Premises, or the temporary use or occupancy thereof, shall be taken for any public or quasi-public use or purpose by condemnation or exercise of the power of eminent domain, including any sale or transfer in lieu thereof, or in any other lawful manner, this Sublease shall terminate as of the effective date of the taking and the rent and other periodic charges payable hereunder shall be apportioned as of such date. As between Sublandlord and Subtenant, Subtenant shall be entitled to receive _____ percent of the award given to Sublandlord in connection with such taking, if any award is given, subject to the provisions of the Master Lease. This provision shall include any award made for the value of the estate vested by this Sublease in Subtenant, and Subtenant hereby expressly assigns to Sublandlord _____ percent of its right, title, and interest in and to any part of such award or awards.**

7. ***Condition of Premises.*** **Subtenant represents that it has inspected the Premises and agrees to accept possession of the Premises in their present condition without any obligation on the part of Sublandlord to make any alterations, decorations, installations, or improvements except as provided in Paragraph 8 below. Subtenant may make alterations and improvements to the Premises in accordance with the applicable provisions of the Master Lease. Notwithstanding the foregoing, Sublandlord represents and warrants to Subtenant that the Premises has been separately demised and all improvements made by Sublandlord to the Original Premises (including the Premises) have been made in compliance with the Master Lease and all laws. It is Subtenant's obligation under this Sublease to obtain receipt of all permits, approvals, and licenses from the local governmental authorities required for Subtenant to operate its business in the Premises. Sublandlord agrees, at Subtenant's request but at no cost or expense to Sublandlord, to cooperate with Subtenant to obtain the Permits from the local governmental authorities.**

8. ***Adherence to Master Lease.*** **Subtenant and Sublandlord covenant and agree (a) to perform and observe all the agreements, covenants, terms, and conditions of the Master Lease with respect to the Premises (and the Building and Common Areas, to the extent applicable) arising after the date hereof and relating to the periods after the date hereof to the extent that the same are not modified or amended by this Sublease; (b) that they shall not do or suffer or permit anything to be done that would constitute a default under the Master Lease with respect to the Premises; and (c) that notwithstanding any other provision of this Sublease to the contrary, any act or omission by Subtenant or Sublandlord that constitutes a default under the Master Lease with respect to the Premises also constitutes a default hereunder.**

9. *Default.* If any default, as defined in Section 19A of the Master Lease, by Subtenant continues, in the case of payment of rent or any other sum owned by Subtenant, for more than ten days after written notice from Sublandlord, or, in the case of any of Subtenant's other covenants, agreements, or obligations under this Sublease or the Master Lease, for more than thirty days after written notice by Sublandlord, Sublandlord may immediately or at any time thereafter and without further notice terminate this Sublease and take any and all actions permitted to be taken by Landlord under the Master Lease in respect of a default by Tenant thereunder or any termination as a result thereof.

10. *Indemnity.* From and after the Sublease Commencement Date, each party shall indemnify and hold harmless the other from and against any and all cost, expense, or liability (including reasonable attorneys' fees) incurred as a result of the other's or its employees' acts or omissions or misconduct in the Premises or on account of any breach or violation of this Sublease, or the Master Lease, unless and except to the extent the same is due to the negligence or willful misconduct of either the party or its employees, agents, licensees, or contractors. Each party hereby releases and waives any right or claim against the other for loss of business, loss of profits, or inconvenience, or for any other incidental or consequential damages.

11. *Assignment.* Subtenant shall not assign this Sublease or further sublet the Premises, in whole or in part, and shall not permit Subtenant's interest in this Sublease Agreement to be vested in any third party by operation of law or otherwise without Sublandlord's written consent, which will not be unreasonably withheld, conditioned, or delayed. Notwithstanding the above, and subject to the provisions of the Master Lease, Sublandlord hereby consents to an assignment of this Lease or a sublease of the Premises to a wholly owned subsidiary of Subtenant, or to any corporation into or with which Subtenant may be merged; provided that Subtenant is not released from liability under this Sublease.

12. *Authority.* Subtenant represents and warrants that it has read and is familiar with the terms of the Master Lease. Sublandlord and Subtenant each warrant and represent that the parties executing this Sublease have the full authority to enter into this Sublease, that this Sublease constitutes a binding obligation on behalf of Sublandlord and Subtenant, and that the individual(s) signing on behalf of each party is/are duly authorized to bind Sublandlord and Subtenant hereto.

13. *Late Charges.* Other remedies for nonpayment of rent notwithstanding, any rental payment not received within ten days of the date it was due shall be subject to a late payment fee in the amount of five percent of such overdue payment, which fee is a service charge intended to compensate Sublandlord for the additional administrative and other costs and expenses it incurs by reason of such late payment.

14. *Insurance.* During the term of this Sublease Agreement, Subtenant shall maintain public liability and property damage insurance for the Premises in accordance with the provisions of the Master Lease. Sublandlord shall maintain or cause to be maintained insurance for the remainder of the original Premises in accordance with the Master Lease. Subtenant shall maintain fire and extended coverage insurance on its fixtures, equipment,

and leasehold improvements in amounts equal to the full insurable value thereof. Sublandlord and Subtenant each release the other from any liability for loss or damage sustained by it to the extent the same would be or is covered by insurance as herein provided, by waiver of subrogation, or otherwise. Subtenant shall name Sublandlord and Landlord under the Master Lease as an additional insured on its comprehensive liability insurance policy and, upon request, shall provide Sublandlord and Landlord under the Master Lease with a certificate of insurance certifying said coverage.

15. ***Services and Repairs.*** **It is understood that all work, services, repairs, restorations, equipment, and access that are required to be provided and made by Sublandlord hereunder or by Landlord under the Master Lease will, in fact, be provided by Landlord under and subject to the Master Lease, and Sublandlord shall have no obligation during the term of this Sublease Agreement to do any such work, to provide any such services, equipment, or access, or to make any such repairs or restorations or otherwise perform any obligations or observe any conditions required to be observed or performed by Landlord under the Master Lease, and Subtenant agrees to look solely to Landlord under the Master Lease for the performance and observance of the same. Sublandlord shall in no event be liable to Subtenant nor shall Subtenant's obligations hereunder be impaired or the performance thereof excused because of any failure or delay on the part of Landlord under the Master Lease in performing or observing the obligations of Landlord under the Master Lease, provided, however, that if a failure by Landlord under the Master Lease materially interferes with Subtenant's use and occupancy of the Premises, and Subtenant so notifies Sublandlord in writing thereof, Sublandlord shall use its good-faith efforts to cause Landlord under the Master Lease to promptly correct the failure, provided that Sublandlord shall not be required to incur any expense or liability, as determined by Sublandlord, with respect thereto.**

16. ***Access.*** **Subtenant agrees to allow Sublandlord and its agents reasonable access to the Premises outside of Subtenant's normal business hours, with reasonable advance written notice, to inspect Subtenant's compliance with the terms of this Sublease and subject to Subtenant's security requirements.**

17. ***Time of Essence.*** **Subtenant and Sublandlord agree that time shall be of the essence with respect to their respective obligations hereunder.**

18. ***Notices.*** **Any notice required or permitted under this Sublease shall be in writing and shall be deemed to have been received (a) if given by overnight delivery service or by personal delivery, when actually received, or (b) if given by certified mail, return receipt requested, postage prepared, three business days after posting with the United States Postal Service, to the other party at the addresses set forth in the first paragraph of this Sublease. Either party may, by notice as aforesaid, direct that future notices be sent to a different address.**

19. ***Sublandlord's Additional Representations, Warranties, and Covenants.*** **Sublandlord represents, warrants, and covenants to Subtenant the following: (a) the Master Lease is in full force and effect, and Sublandlord is in good standing with Landlord and otherwise permitted to occupy and possess the Premises; (b) a true copy of the Master Lease and any**

amendments or modifications thereto is attached hereto as Exhibit A and, except as modified by this Sublease Agreement, the Master Lease has not been modified, supplemented, or amended in any way; (c) all work required by Landlord under the Master Lease has been completed in accordance with the provisions of the Master Lease; (d) there are no Defaults or Events of Default under the Master Lease and no event has occurred that with the passage of time or the giving of notice, or both, will constitute a Default under the terms of the Master Lease; (e) there are no disputes presently pending between Landlord and Sublandlord with respect to the Master Lease; (f) Sublandlord has not received written notice of any current violations of any legal requirements or insurance requirements affecting the Premises, the Building, or any of the Building Systems that have not been remedied, nor, to the knowledge of Sublandlord, does the Premises, the Building, or any of the Building Systems violate any legal and/or insurance requirements; and (g) all rental and other amounts to be paid by Sublandlord under the Master Lease have been or will be paid through the Effective Date; Sublandlord shall pay for its pro rata share of Common Area maintenance operating expense pass-through as required in the Master Lease, which amounts shall be paid in full by Sublandlord as and when they become due and payable; and as long as there is no Event of Default on the part of the Subtenant under this sublease, Sublandlord shall (i) not take any action or fail to take any action that would cause the Master Lease or this Sublease to terminate sooner than _____, 20__; (ii) pay all sums due to Landlord under the Master Lease; (iii) not modify or amend the Master Lease without the written consent of Subtenant; and (iv) not cause, permit, or suffer any Event of Default under the Master Lease.

20. ***Entire Agreement.*** **All prior understandings and agreements between the parties with respect to the subject matter hereof are merged within this Sublease. The covenants, representations, warranties, and agreements herein contained shall bind and inure to the benefit of Sublandlord, Subtenant, and their respective successors and permitted assigns.**

21. ***Effectiveness.*** **This Sublease shall be effective only when executed by Sublandlord and Subtenant and approved by Landlord under the Master Lease, subject to the terms and conditions of this Sublease (Effective Date).**

22. ***Brokers.*** **Sublandlord and Subtenant each represents to the other that it has not retained or dealt with any broker or agent in connection with this Sublease Agreement other than _____, as Sublandlord's representative, and _____, as Subtenant's representative (collectively, "the Brokers"). Each party agrees to indemnify and hold harmless the other from and against any breach of the foregoing representation. Sublandlord shall pay the Brokers pursuant to a separate written agreement between Sublandlord and the Brokers.**

23. ***Miscellaneous.*** **(a) If any dispute should arise between Sublandlord and Subtenant with respect to interpretation or performance of this Sublease, the non-prevailing party shall pay the prevailing party's reasonable attorneys' fees and costs. (b) This Sublease shall be governed by, interpreted under, and construed and enforced in accordance with the laws of the State of Illinois. (c) No modification, change, or amendment of this Sublease shall be binding on either party unless such modification, change, or amendment is in writing, duly authorized and signed by Sublandlord and Subtenant, and consented to in writing by Landlord.**

24. *Quiet Enjoyment.* Sublandlord covenants that Subtenant, on the paying of Rent, charges for services, and other payments herein reserved and on the keeping, observing, and performing of all other terms, covenants, conditions, provisions, and agreements herein contained on the part of Subtenant to be kept, observed, and performed, shall, during the term of this Sublease, peaceably and quietly have, hold, and enjoy the Premises subject to the terms, covenants, conditions, and provisions hereof free from hindrance.

25. *Common Areas.* Subtenant shall have rights to use the Common Areas and facilities of the Building as provided under the Master Lease, as well as the Common Areas located on the _____ floor of the Building including, without limitation, the elevator lobby, stairwell, and restrooms. Each party agrees that its use of the Common Areas shall be in a manner that shall minimize interference with the other party's use of such Common Areas.

26. *Special Stipulations.* Special Stipulations shall control if in conflict with any of the foregoing provisions of this Sublease:

a. Subtenant has no expansion or renewal options.

b. Except as expressly specified herein, the Premises shall be taken by Subtenant in an as-is condition.

c. Subtenant shall be allowed to use Sublandlord's furniture and appliances at no charge to Subtenant throughout the Term of this Sublease, including without limitation the furniture described on Exhibit C attached hereto and made a part hereof. Sublandlord represents and warrants that the Premises shall be in substantially the same condition on the Sublease Commencement Date with all furniture, supplies, and equipment in place.

d. Subtenant shall have the right to place its signage on the Premises and the Building provided the plans for such signage have been approved by Landlord if required by the Master Lease. Subtenant shall repair any damage caused to the Premises by the installation of the signage. Subtenant shall remove all signage installed by Subtenant upon the termination or expiration of this Sublease and repair any damage caused by such removal.

e. Subtenant shall, at its own expense, upon termination or expiration of this agreement, leave the Premises in a condition substantially the same as when it took possession.

f. Subtenant shall be provided with adequate parking for its employees, customers, and invitees in a parking area located adjacent to the Building where the Premises are located.

27. *Automatic Termination.* This Sublease shall automatically terminate and become null and void in the event this Sublease has not been executed on behalf of the Subtenant and returned to the Sublandlord no later than _____, 20__, TIME BEING OF THE ESSENCE.

IN WITNESS WHEREOF, the parties hereto have caused this Sublease Agreement to be executed under seal by an officer duly authorized, as of the day and year first above written.

LANDLORD
Prime Landlord, LLC, an Illinois limited liability company
BY: _____

TENANT
Prime Tenant, LLC, an Illinois limited liability company
BY: _____

SUBTENANT:
Subtenant, Inc., an Illinois corporation
BY: _____

EXHIBIT A

[master lease**]**

EXHIBIT B

[floor plan showing premises**]**

EXHIBIT C

[furniture inventory**]**

Limitations of the standard form sublease:

a. The document is essentially a copy of the prime lease with the word "Sublandlord" substituted for the word "Landlord" and the word "Subtenant" substituted for the word "Tenant."

b. The document provides that the subtenant acknowledges that

1. the sublease is subject to the prime lease and that the subtenant agrees to be bound by the terms of the prime lease;

2. the subtenant will look only to the landlord under the prime lease to provide all services due under the sublease; and

3. the subtenant agrees to pay the tenant ("Sublandlord") the rent due under the sublease.

c. The sublease terms delete certain specific rights granted the tenant under the prime lease as rights of the subtenant under the sublease (*i.e.,* options to extend the term of the lease, options to expand the premises under the lease, etc.).

Legal effect of the terms of the standard form sublease:

a. The subtenant owes rent to the tenant ("Sublandlord") whether or not the tenant retains possession of the premises under the prime lease.

b. The subtenant owes rent to the tenant ("Sublandlord") whether or not the landlord provides the subtenant with the services due under the sublease to the subtenant.

c. The subtenant has no legal relationship to the landlord, neither privity of contract nor privity of estate.

d. All communication and notices under the prime lease are to be provided to and between the landlord and the tenant:

1. The subtenant has no right to communicate with the landlord. The only communication right (or pathway) the subtenant has is to communicate with or provide notices (or requests for services) to the tenant while under the sublease. The subtenant has agreed to look only to the landlord for the provision of services.

2. The subtenant has no right to receive notices under the prime lease from the landlord. All notices under the prime lease go to the tenant.

3. There is no protection for the subtenant in the event the tenant is unavailable, no longer exists, or simply fails or refuses to forward subtenant communications to the landlord or to forward landlord notices to the subtenant.

e. The tenant has no right to cure a default of the prime lease by the tenant as the subtenant has no legal relationship to the landlord.

f. The sublease is subordinate to the prime lease. If the prime lease falls, the sublease falls.

Dynamics of the negotiation:

a. The standard form documents, the landlord's consent to the sublease and the sublease document itself, have been supplied by the subtenant's real estate broker.

b. The documents have been submitted to the landlord for approval before submission to the subtenant for review.

c. Neither the landlord nor the tenant appears to be represented by counsel as of the submission of the standard form documents to the subtenant for review.

d. The client desires a "flat fee" quote for the attorney's fee to be involved in the engagement.

e. The client wants the sublease completed so as to allow the commencement of the lease term by the beginning of the following month (approximately ten days from the inception of the engagement).

f. Although the client does not actually know all the facts, the client is concerned that the tenant may not be financially stable, and accordingly the client wants the right to continue under the sublease even if the tenant defaults the prime lease.

The landlord's consent to sublease as finally negotiated:

CONSENT TO SUBLEASE

This Consent to Sublease is made and effective this _____ day of _____, 20__, by and between Prime Landlord, LLC, an Illinois limited liability company (Landlord), whose address is _____, Prime Tenant, LLC, an Illinois limited liability company (Tenant), whose address is _____, and Subtenant, Inc., an Illinois corporation (Subtenant), whose address is _____.

RECITALS

A. Landlord and Tenant executed a certain lease dated _____, 20__ (Master Lease), covering approximately _____ rentable square feet premises located at _____ (Premises) and described as: _____.

B. Tenant has requested that Landlord consent to Tenant subleasing that certain portion of the Premises consisting of approximately _____ square feet located on the _____ floor and described above as the _____ Suite (Subleased Premises) to Subtenant on the terms contained in a sublease dated _____, 20__, a copy of which is attached hereto and incorporated herein as if set out in full where referenced (Sublease).

C. Landlord is willing to consent to such Sublease on the express conditions stated below.

THEREFORE, in consideration of the mutual covenants and agreements stated below, and for sufficient consideration received and acknowledged by each party, Landlord hereby consents to the Sublease pursuant to the conditions stated below.

1. *Tenant Responsible.* Notwithstanding the Sublease and Landlord's consent thereto, Tenant expressly acknowledges and confirms that the Master Lease will continue in full force and effect in accordance with its terms and that Tenant is and will remain fully and directly responsible and obligated to Landlord for all Tenant's covenants, agreements, obligations, and other undertakings under the Master Lease, including, without limitation, the full and timely payment (payable directly to Landlord) of all Base Rental, all additional rent, and all other sums or other charges due or that hereafter may become due thereunder.

2. *Relationship Among the Parties.* With respect to the Master Lease and the Sublease, Tenant and Subtenant each expressly acknowledges and confirms the following:

2.1. The Sublease is and reflects an agreement and contract between Tenant and Subtenant only, and Landlord is not and will not become responsible, obligated, or liable to Tenant or to Subtenant for or with respect to any covenants, agreements, obligations, or other undertakings of either Tenant or Subtenant thereunder, except as expressly provided herein.

2.2. The Master Lease is and reflects an agreement and contract between Landlord and Tenant only, and Landlord is not and will not become responsible, obligated, or liable to Subtenant (whether as a third-party beneficiary or otherwise) for or with respect to any covenants, agreements, obligations, or other undertakings of either Landlord or Tenant thereunder, except as expressly provided herein.

2.3. If for any reason the Master Lease shall terminate or Tenant's right to occupy the Premises shall terminate (without a termination of the Master Lease), whether such shall occur by expiration of the stated Term thereof or by a default by Tenant thereunder (a "Lease Default"), then, except as provided in Paragraph 3 below, the Sublease and Subtenant's right to occupy the Subleased Premises shall each terminate absolutely, with the requirement of notice being given to Subtenant and with Subtenant having any right to cure the same granted hereunder. In the event of the termination of the Master Lease, subject to the provisions of Paragraph 3 below, Subtenant forthwith shall surrender the Subleased Premises to Landlord.

2.4. The Sublease shall not be amended, modified, extended, or renewed without in each case the prior written consent thereto by Landlord.

2.5. The consent to the Sublease and to Subtenant set forth herein is limited and conditioned as herein set forth and shall not extend or be deemed to extend to any other subletting or sub-subletting of all or any portion of the Premises or to any assignment of the Sublease except to a subsidiary or affiliate of Subtenant, any of which subletting or assignment other than to a subsidiary or affiliate of Subtenant will require the prior written consent of Landlord as required by the Master Lease.

3. ***Election To Recognize Sublease.*** **If for any reason the Master Lease shall terminate or Tenant's right to occupy the Premises shall terminate (without a termination of the Master Lease) or upon the occurrence of a Lease Default by Tenant, Landlord shall provide notice to Subtenant of such occurrence, and Landlord shall assume Tenant's obligations under the Sublease until _____, 20__, in which event the Sublease shall continue in full force and effect in accordance with its terms but with a reduction in its term to a term ending _____, 20__ (but not in respect of any amendment to such Sublease not previously approved in writing by Lessor). Such assumption of Tenant's obligations under the Sublease by Landlord will thereby establish direct privity of estate and contract between Landlord and Subtenant. In such event, Landlord will succeed Tenant as "Sublandlord" under the Sublease, and each of Landlord and Subtenant will execute and deliver to the other counterparts of an instrument prepared by Landlord (and reasonably satisfactory to both Landlord and Subtenant) confirming the continuation of the Sublease and the respective obligations of Landlord and Subtenant thereunder. The continuation of the Sublease as provided herein will in no case affect in any way Landlord's rights, powers, and remedies under the Master Lease in respect of such a Lease Default, and Landlord shall be permitted to pursue all rights and remedies against Tenant as provided for in the Master Lease.**

4. ***Indemnification of Landlord.*** **Tenant and Subtenant each hereby jointly and severally indemnifies and agrees to defend and hold harmless Landlord from and against all liability**

and claims for any injury to person or damage to property caused by any act, omission, or neglect of Subtenant, its agents, servants, employees, invitees, or licensees, or any other person entering the Building under the invitation of Subtenant, or otherwise arising out of the use of the Subleased Premises by Subtenant, except for any such loss, injury, or damage that is caused by or results from the negligence or willful misconduct of Landlord, its employees, or its agents.

5. ***Brokerage Commissions.*** **Landlord shall not be liable for any brokerage commission or other charges levied or incurred relating to this Sublease.**

6. ***Alterations.*** **Subtenant shall make no alterations or improvements to the Subleased Premises without Tenant's and Landlord's written approval.**

7. ***Improvements.*** **Subtenant and Tenant acknowledge that any changes, modifications, or improvements to signage, keys, card access systems, etc., shall be paid for by Subtenant and shall require the prior written approval of Landlord.**

8. ***Services.*** **Landlord agrees that as long as the Master Lease is in effect and as long as Subtenant fully and faithfully performs its obligations as Subtenant under the Sublease, Landlord will provide to Subtenant those services, rights, and privileges due Tenant under the Master Lease relating to Tenant's use and occupancy of the space subleased to Subtenant under the Sublease and those rights appurtenant thereto relating to access to the Building and the use of the Common Areas.**

9. ***Communication.*** **Landlord agrees that as long as the Master Lease is in effect and as long as Subtenant fully and faithfully performs its obligations as Subtenant under the Sublease, Landlord will accept correspondence and requests required or permitted under the Master Lease relating to the Subleased Premises from Subtenant directly as the authorized agent of Tenant as to matters dealing with Subtenant's use and occupancy of the Subleased Premises and Landlord will respond to such correspondence and requests as if such matters were submitted to Landlord by Tenant. Landlord agrees to provide Subtenant with a notice of Lease Default by Tenant that could result in a termination of the Sublease and provide Subtenant with a five-business-day right to cure any such Lease Default as it relates to the Sublease Premises. Landlord further agrees not to invoke any of its remedies, either expressed or implied, under the Master Lease with respect to the Subleased Premises (except in case of emergency repairs) until said five business days have elapsed and during any period Subtenant is proceeding to cure a Lease Default (other than a nonpayment of rent default) with due diligence.**

10. ***Limitation.*** **The parties intend and agree that unless and until a Lease Default by Tenant, or Tenant's right to occupy the Premises shall terminate (without a termination of the Master Lease), or a termination of the Master Lease under any circumstances, this Consent To Sublease does not constitute any privity of estate between Landlord and Subtenant. Further, the parties acknowledge and agree that while this agreement does create privity of contract between Landlord and Subtenant as parties to this agreement according to its terms, the execution of this agreement does not create privity of contract between**

Landlord and Subtenant under the Master Lease unless and until a termination of the Master Lease under any circumstances, until Tenant's right to occupy the Premises shall terminate (without a termination of the Master Lease), or until a Lease Default by Tenant or until Landlord succeeds Tenant as Sublandlord under the Sublease as described in Paragraph 3 hereof.

AFFIRMING THE ABOVE, the parties have executed this Consent To Sublease as of the date first identified.

Witness: **BY: _____** **Name: _____** **BY: _____** **Name: _____** **BY: _____** **Name: _____**	**TENANT** **Prime Tenant, LLC, an Illinois limited liability company** **BY: _____** **Name: _____** **Title: _____**
LANDLORD **Prime Landlord, LLC, an Illinois limited liability company** **BY: _____** **Name: _____** **Title: _____**	**SUBTENANT:** **Subtenant, Inc., an Illinois corporation** **BY: _____** **Name: _____** **Title: _____**

Fundamental issues addressed by the landlord's consent to sublease as finally negotiated:

a. The landlord agrees to provide services to the subtenant, establishing privity of contract between the landlord and the subtenant.

b. The landlord agrees to accept communications from the subtenant in the name of the tenant.

c. In the event of a tenant default of the prime lease, the landlord agrees (for a limited term) to recognize the sublease as to the subtenant to allow the subtenant reasonable transition time (one or two years, for example) to negotiate a new arrangement with the landlord or to arrange to move to new space. In such event there will be privity of estate between the landlord and the subtenant.

The sublease as finally negotiated:

SUBLEASE AGREEMENT

THIS SUBLEASE AGREEMENT ("Sublease" or "Sublease Agreement") is entered into this _____ day of _____, 20__, between Prime Tenant, LLC, a Illinois Limited Liability Company with its principal business address being _____ as sublandlord under the Sublease (Sublandlord) and Subtenant, Inc., an Illinois corporation (Subtenant), with an office located at _____. In addition to being Sublandlord under the Sublease,

Prime Tenant, LLC, also is the tenant (Tenant) under the Master Lease. Accordingly, Prime Tenant, LLC, is sometimes referred to herein as "Sublandlord" and sometimes as "Tenant" in reference to the particular capacities of Prime Tenant, LLC, being referred to in particular instances in this document.

WITNESSETH:

WHEREAS, Sublandlord and Prime Landlord, LLC, an Illinois limited liability company (Landlord), as Landlord, entered into that certain Office Lease dated _____, 20__ (Original Lease), whereby Sublandlord leased from Landlord approximately _____ rentable square feet of space (Original Premises) in the building known as _____ and located at _____, _____, Illinois (Building);

WHEREAS, the Original Lease is hereinafter referred to as the Master Lease, a copy of which is attached hereto as Exhibit A and incorporated herein by this reference; and

WHEREAS, Sublandlord desires to sublease to Subtenant, and Subtenant desires to sublease from Sublandlord, that certain portion of the Original Premises consisting of the _____ floor suite, containing approximately _____ rentable square feet (Subleased Premises) on the terms and conditions hereinafter provided.

NOW, THEREFORE, in consideration of the mutual promises herein provided, the parties agree as follows:

1. ***Premises and Term.*** **All capitalized terms used herein shall have the meanings ascribed to them in the Master Lease unless otherwise defined herein. Sublandlord hereby subleases to Subtenant and Subtenant hereby subleases from Sublandlord the Subleased Premises (which Subleased Premises are located and configured as shown on Exhibit B attached hereto and incorporated herein by this reference), upon and subject to the covenants, representations, warranties, agreements, terms, and conditions herein provided, for the term commencing on _____, 20__ (Sublease Commencement Date), and terminating on _____, 20__ (Sublease Expiration Date). Sublandlord shall deliver possession of the Premises to Subtenant on or before the Sublease Commencement Date. Notwithstanding the foregoing, upon execution of this Sublease Agreement and receipt of Landlord's consent, Subtenant shall be permitted access to the Premises to install its furnishings and equipment.**

2. ***Rent.*** **Subtenant covenants and agrees to pay a monthly gross rental to Sublandlord for the Subleased Premises due and payable in advance on the first day of each month as follows: _____.**

Though Sublandlord as Tenant pays additional rent to the Landlord under the Master Lease, Subtenant shall not be responsible for the payment of additional rent under the Sublease as rent under the Sublease is limited to the gross rent described above.

All payments shall be made to:

Prime Tenant, LLC
c/o _____

3. *Use.* The Subleased Premises shall be used for offices and uses accessory thereto, but in no event for any uses not permitted under the Master Lease.

4. *Incorporation of Master Lease.* Except as otherwise provided herein, all the covenants, agreements, terms, and conditions of the Master Lease relating to or applicable to Tenant under the Master Lease are incorporated herein to the extent that they apply to the Subleased Premises and are made a part hereof with the same force and effect as if set forth at length herein, except to the extent the same are modified or amended by this Sublease, it being understood and agreed that said provisions shall fix the obligations (other than monetary obligations, which shall be governed by Paragraph 2 hereof) of Subtenant to Sublandlord with the same effect for the Sublease as if Subtenant as Tenant under this Sublease was Tenant named in the Master Lease and Sublandlord was Landlord named in the Master Lease; provided, however, that Subtenant is assuming such obligations only as they relate to the Subleased Premises (which is only a portion of the Original Premises governed by the Master Lease) and provided further that Subtenant's performance of any obligation tendered to Landlord under the Master Lease shall satisfy Subtenant's obligation to tender performance of that obligation to Sublandlord under the Sublease. Except as otherwise provided herein, Subtenant agrees that Sublandlord shall have all the rights and remedies of Landlord under the Master Lease relating to the Subleased Premises with respect to Subtenant as if such rights and remedies were fully set forth herein. Sublandlord represents that the Master Lease is in full force and effect and that neither Landlord nor Sublandlord is in default as of the date of this Sublease Agreement. In the event of any inconsistency between the Sublease and the Master Lease, the Sublease shall govern. Sublandlord agrees to promptly provide Subtenant with copies of all notices received from Landlord with respect to the Subleased Premises and all notices of default received from Landlord under the Master Lease.

5. *Takings.* If any substantial part of the Subleased Premises, or the temporary use or occupancy thereof, shall be taken for any public or quasi-public use or purpose by condemnation or exercise of the power of eminent domain, including any sale or transfer in lieu thereof, or in any other lawful manner, this Sublease shall terminate as of the effective date of the taking and the rent and other periodic charges payable hereunder shall be apportioned as of such date. As between Sublandlord and Subtenant, Subtenant shall be entitled to receive _____ percent of the award given to Sublandlord in connection with such taking, if any award is given, subject to the provisions of the Master Lease. This provision shall include any award made for the value of the estate vested by this Sublease in Subtenant, and Subtenant hereby expressly assigns to Sublandlord _____ percent of its right, title, and interest in and to any part of such award or awards related to the Premises under the Master Lease.

6. *Condition of Subleased Premises.* Subtenant represents that it has inspected the Subleased Premises and agrees to accept possession of the Subleased Premises in their present condition without any obligation on the part of Sublandlord to make any alterations, decorations, installations, or improvements except as provided in Paragraph 25 below. Subtenant may make alterations and improvements to the Subleased Premises in accordance with the applicable provisions of the Master Lease. Notwithstanding the foregoing, Sublandlord represents and warrants to Subtenant that the Subleased Premises has been separately demised and all improvements made by Sublandlord to the Original Premises (including the Subleased Premises) have been made in compliance with the Master Lease and all laws. It is Subtenant's obligation under this Sublease to obtain receipt of all permits, approvals, and licenses from the local governmental authorities required for the Subtenant to operate its business in the Subleased Premises. Sublandlord agrees, at Subtenant's request but at no cost or expense to Sublandlord, to cooperate with Subtenant to obtain the Permits from the local governmental authorities.

7. *Adherence to Master Lease.* Subtenant and Sublandlord covenant and agree (a) to perform and observe all the agreements, covenants, terms, and conditions of the Master Lease with respect to the Subleased Premises (and the Building and Common Areas, to the extent applicable) arising after the date hereof and relating to the periods after the date hereof to the extent that the same are not modified or amended by this Sublease; (b) that they shall not do or suffer or permit anything to be done that would constitute a default under the Master Lease with respect to the Premises; and (c) that notwithstanding any other provision of this Sublease to the contrary, any act or omission by Subtenant or Sublandlord that constitutes a default under the Master Lease with respect to the Premises also constitutes a default hereunder.

8. *Default.* If any default, as defined in Section 19A of the Master Lease, by Subtenant continues, in the case of payment of rent or any other sum owned by Subtenant, for more than ten days after written notice from Sublandlord, or, in the case of any of Subtenant's other covenants, agreements, or obligations under this Sublease or the Master Lease, for more than thirty days after written notice by Sublandlord, Sublandlord may immediately or at any time thereafter and without further notice terminate this Sublease and take any and all actions permitted to be taken by Landlord under the Master Lease in respect of a default by the tenant thereunder or any termination as a result thereof.

9. *Indemnity.* From and after the Sublease Commencement Date, each party shall indemnify and hold harmless the other from and against any and all cost, expense, or liability (including reasonable attorneys' fees) incurred as a result of the other's or its employees' acts or omissions or misconduct in the Subleased Premises or on account of any breach or violation of this Sublease, or the Master Lease, unless and except to the extent the same is due to the negligence or willful misconduct of the party claiming to have incurred such a cost, expense, or liability or its employees, agents, licensees, or contractors. Each party hereby releases and waives any right or claim against the other for loss of business, loss of profits, or inconvenience, or for any other incidental or consequential damages. A party suffering a default of the terms of this Sublease shall be entitled to collect the reasonable attorneys' fees, costs, and expenses it incurs in enforcing the terms of this Sublease or in the collection or enforcement of any judgment obtained with respect to any matter relating to this Sublease.

10. *Assignment.* Subtenant shall not assign this Sublease or further sublet the Subleased Premises, in whole or in part, and shall not permit Subtenant's interest in this Sublease Agreement to be vested in any third party by operation of law or otherwise without Sublandlord's written consent, which will not be unreasonably withheld, conditioned, or delayed. Notwithstanding the above, and subject to the provisions of the Master Lease, Sublandlord hereby consents to an assignment of this Lease or a sublease of the Subleased Premises to a wholly owned subsidiary of Subtenant, or to any corporation into or with which Subtenant may be merged; provided that Subtenant is not released from liability under this Sublease.

11. *Authority.* Subtenant represents and warrants that it has read and is familiar with the terms of the Master Lease. Sublandlord and Subtenant each warrant and represent that the parties executing this Sublease have the full authority to enter into this Sublease, that this Sublease constitutes a binding obligation on behalf of Sublandlord and Subtenant, and that the individual(s) signing on behalf of each party is/are duly authorized to bind Sublandlord and Subtenant hereto.

12. *Late Charges.* Other remedies for nonpayment of rent notwithstanding, any rental payment not received within ten days of the date it was due shall be subject to a late payment fee in the amount of five percent of such overdue payment, which fee is a service charge intended to compensate Sublandlord for the additional administrative and other costs and expenses it incurs by reason of such late payment.

13. *Insurance.* During the term of this Sublease Agreement, Subtenant shall maintain public liability and property damage insurance for the Subleased Premises in accordance with the provisions of the Master Lease. Sublandlord shall maintain or cause to be maintained insurance for the remainder of the Original Premises in accordance with the Master Lease. Subtenant shall maintain fire and extended coverage insurance on its fixtures, equipment, and leasehold improvements in amounts equal to the full insurable value thereof. Sublandlord and Subtenant each release the other from any liability for loss or damage sustained by it to the extent the same would be or is covered by insurance as herein provided, by waiver of subrogation, or otherwise. Subtenant shall name Sublandlord and Landlord under the Master Lease as an additional insured on its comprehensive liability insurance policy and, upon request, shall provide Sublandlord and Landlord under the Master Lease with a certificate of insurance certifying said coverage.

14. *Services and Repairs.*

A. It is understood that all work, services, repairs, restorations, equipment, and access that are required to be provided and made by Sublandlord hereunder or by Landlord under the Master Lease (Subtenant Services) will, in fact, be provided by Landlord under and subject to the Master Lease, and Sublandlord shall have no obligation during the term of this Sublease Agreement to do any such work, to provide any such services, equipment, or access, or to make any such repairs or restorations or otherwise perform any obligations or observe any conditions required to be observed or performed by Landlord under the Master Lease,

and Subtenant agrees to look solely to Landlord under the Master Lease for the performance and observance of the same. Subtenant agrees that Sublandlord shall not be liable to Subtenant for the consequential effects of Landlord's failure to provide such services, privileges, and rights to Subtenant.

B. Notwithstanding any other provision of this Agreement, the parties acknowledge that the structure of this Agreement could be interpreted to create an illogical circumstance that is not the intent of the parties. Since the Agreement provides that Subtenant shall pay rent to Sublandlord but that Subtenant agrees to look only to Landlord under the Master Lease for the provision of the Subtenant Services, if Landlord under the Master Lease fails to provide any or all the Subtenant Services, Subtenant might still be held by the other terms of this Agreement to owe rent to Sublandlord even though Subtenant was not receiving any or all the Subtenant Services. Such a result is not the intention of the parties hereto. Accordingly, the parties agree as follows:

(i) Tenant hereby grants Subtenant the right, in Subtenant's own name, and in the name of Prime Tenant, LLC, as Tenant under the Master Lease, to request Master Landlord's performance of the Subtenant Services.

(ii) In the event Landlord under the Master Lease fails to provide any or all the Subtenant Services to Subtenant otherwise due Prime Tenant, LLC, as Tenant (Master Landlord Default), Subtenant shall provide reasonable notice to Prime Tenant, LLC, of the basis of Subtenant's claim of such default. Upon such notice, Sublandlord shall use reasonable efforts in good faith to cause Landlord under the Master Lease to promptly correct the alleged Master Landlord Default, provided that Sublandlord shall not be required to incur any unreimbursed expense with respect thereto.

(iii) Tenant shall have the right to conduct such proceedings as may be required to obtain performance of the Subtenant Services. Sublandlord agrees to cooperate with Subtenant in such proceedings and to execute such documents as may be required in connection therewith, and Subtenant agrees to reimburse Sublandlord for any reasonable legal expenses incurred by Sublandlord in connection with any legal proceedings in which Sublandlord is required to join.

(iv) If by virtue of the efforts of Sublandlord or Subtenant it is determined by agreement of Landlord, Tenant, and Subtenant or by judgment of a court of competent jurisdiction that Sublandlord as Tenant under the Master Lease is entitled to a rent abatement or rent adjustment under the Master Lease as a result of such Master Landlord Default, Subtenant shall be entitled to an "equivalent" rent abatement or rent adjustment under the Sublease.

[NOTE: The standard referred to as "equivalent" is used in the sentence above because the rent to be paid by the sublandlord to the landlord under the master lease for the subleased premises exceeds the rent to be paid by the subtenant to the sublandlord under the sublease. Accordingly, as one example of a possible adjustment scenario, if it were determined that by virtue of a master landlord default the sublandlord as tenant under the master lease was entitled to an abatement of one half of

the base rent due for the subleased premises under the master lease, then the subtenant would be entitled to an abatement of one half of the rent due under the sublease (even though the amount of the dollars involved in one half of the base rent under the master lease for the subleased space might be more than the amount of dollars involved in one half of the rent under the sublease).**]**

15. ***Access.*** **Subtenant agrees to allow Sublandlord and its agents reasonable access to the Subleased Premises outside of Subtenant's normal business hours, with reasonable advance written notice, to inspect Subtenant's compliance with the terms of this Sublease and subject to Subtenant's security requirements.**

16. ***Time of Essence.*** **Subtenant and Sublandlord agree that time shall be of the essence with respect to their respective obligations hereunder.**

17. ***Notices.*** **Any notice required or permitted under this Sublease shall be in writing and shall be deemed to have been received (a) if given by overnight delivery service or by personal delivery, when actually received, or (b) if given by certified mail, return receipt requested, postage prepared, three business days after posting with the United States Postal Service, to the other party at the addresses set forth in the first paragraph of this Sublease. Either party may, by notice as aforesaid, direct that future notices be sent to a different address.**

18. ***Sublandlord's Additional Representations, Warranties, and Covenants.*** **Sublandlord represents, warrants, and covenants to Subtenant the following: (a) the Master Lease is in full force and effect and Sublandlord is in good standing with Landlord and otherwise permitted to occupy and possess the Original Premises; (b) a true copy of the Master Lease and any amendments or modifications thereto is attached hereto as Exhibit A and, except as modified by this Sublease Agreement, the Master Lease has not been modified, supplemented, or amended in any way; (c) all work required by Landlord under the Master Lease has been completed in accordance with the provisions of the Master Lease; (d) there are no Defaults or Events of Default under the Master Lease and no event has occurred that with the passage of time or the giving of notice, or both, will constitute a Default under the terms of the Master Lease; (e) there are no disputes presently pending between Landlord and Sublandlord with respect to the Master Lease; (f) Sublandlord has not received written notice of any current violations of any legal requirements or insurance requirements affecting the Original Premises, the Building, or any of the Building Systems that have not been remedied, nor, to the knowledge of Sublandlord, does the Original Premises, the Building, or any of the Building Systems violate any legal and/or insurance requirements; (g) Subtenant shall have the right to available parking spaces at the ratio defined in the Master Lease; and (h) all rental and other amounts to be paid by Sublandlord under the Master Lease have been or will be paid through the Effective Date; Sublandlord shall pay for its pro rata share of Common Area maintenance operating expense pass-through as required in the Master Lease, which amounts shall be paid in full by Sublandlord as and when they become due and payable; and as long as there is no Event of Default on the part of Subtenant under the Sublease, Sublandlord (i) shall not take any action or fail to take any action that would cause the Master Lease or this Sublease to terminate sooner than _____, 20__, (ii) shall pay all sums due to Landlord under the Master Lease, (iii) shall not modify or amend the Master Lease without the written consent of Subtenant, (iv) shall not cause, permit, or suffer any**

Event of Default under the Master Lease, (v) shall not enter into any assignment of the Master Lease or the Sublease that includes any part of the Subleased Premises without the prior written consent of Subtenant, and (vi) agrees that as long as Subtenant shall pay the rent due under the Sublease and perform all other obligations of Subtenant herein contained (1) Tenant shall keep, observe, and perform all its obligations under the Master Lease, (2) Subtenant shall be entitled to the use, occupancy, and quiet enjoyment of the Subleased Premises and all rights, privileges, and appurtenances granted thereto to Tenant under the Master Lease, and (3) Tenant will not amend, modify, or supplement any of the terms or conditions of the Master Lease that would operate to amend or abrogate the terms and conditions of the Master Lease and that would adversely affect Subtenant's use and occupancy of the Subleased Premises or rights under this Sublease without, in each instance, obtaining Subtenant's prior written consent thereto.

19. ***Entire Agreement.*** **All prior understandings and agreements between the parties with respect to the subject matter hereof are merged within this Sublease. The covenants, representations, warranties, and agreements herein contained shall bind and inure to the benefit of Sublandlord, Subtenant, and their respective successors and permitted assigns.**

20. ***Effectiveness.*** **This Sublease shall be effective only when executed by Sublandlord and Subtenant and approved by Landlord under the Master Lease, subject to the terms and conditions of this Sublease (Effective Date).**

21. ***Brokers.*** **Sublandlord and Subtenant each represents to the other that it has not retained or dealt with any broker or agent in connection with this Sublease Agreement other than _____, as Sublandlord's representative, and _____, as Subtenant's representative (collectively, "the Brokers"). Each party agrees to indemnify and hold harmless the other from and against any breach of the foregoing representation. Sublandlord shall pay the Brokers pursuant to a separate written agreement between Sublandlord and the Brokers.**

22. ***Miscellaneous.*** **(a) If any dispute should arise between Sublandlord and Subtenant with respect to interpretation or performance of this Sublease, the non-prevailing party shall pay the prevailing party's reasonable attorneys' fees and costs. (b) This Sublease shall be governed by, interpreted under, and construed and enforced in accordance with the laws of the State of Illinois. (c) No modification, change, or amendment of this Sublease shall be binding on either party unless such modification, change, or amendment is in writing, duly authorized and signed by Sublandlord and Subtenant, and consented to in writing by Landlord.**

23. ***Quiet Enjoyment.*** **Sublandlord covenants that Subtenant, on the paying of Rent, charges for services, and other payments herein reserved and on the keeping, observing, and performing of all other terms, covenants, conditions, provisions, and agreements herein contained on the part of Subtenant to be kept, observed, and performed, shall, during the term of this Sublease, peaceably and quietly have, hold, and enjoy the Subleased Premises subject to the terms, covenants, conditions, and provisions hereof free from hindrance.**

24. *Common Areas.* Subtenant shall have rights to use the Common Areas and facilities of the Building as provided under the Master Lease, as well as the Common Areas located on the _____ floor of the Building including, without limitation, the elevator lobby, stairwell, and restrooms. Each party agrees that its use of the Common Areas shall be in a manner that shall minimize interference with the other party's use of such Common Areas.

25. *Special Stipulations.* Special Stipulations shall control if in conflict with any of the foregoing provisions of this Sublease:

a. Subtenant has no expansion or renewal options.

b. Except as expressly specified herein, the Subleased Premises shall be taken by Subtenant in an as-is condition.

c. Subtenant shall be allowed to use Sublandlord's furniture and appliances at no charge to Subtenant throughout the Term of this Sublease, including without limitation the furniture described on Exhibit C attached hereto and made a part hereof. Sublandlord represents and warrants that the Subleased Premises shall be in substantially the same condition on the Sublease Commencement Date with all furniture, supplies, and equipment in place. In the event of the cancellation or termination of the Master Lease by Landlord, whether voluntary or involuntary, or by operation of law, Subtenant shall be allowed to continue to use Sublandlord's furniture and appliances at no charge to Subtenant throughout the occupancy of the space constituting the Subleased Premises by Subtenant whether under the Sublease or otherwise, and if Tenant defaults the Master Lease, if the Master Lease is terminated by default or otherwise, or if Tenant's possession of the Original Premises under the Master Lease or the Subleased Premises is terminated or abandoned and Subtenant is otherwise in compliance with the terms of this Sublease, title to such furniture and appliances shall as of such described event transfer to Subtenant.

d. Subtenant shall have the right to place its signage on the Subleased Premises and the Building provided the plans for such signage have been approved by Landlord if required by the Master Lease. Subtenant shall repair any damage caused to the Subleased Premises by the installation of the signage. Subtenant shall remove all signage installed by Subtenant upon the termination or expiration of this Sublease and repair any damage caused by such removal.

e. Subtenant shall, at its own expense, upon termination or expiration of this agreement, leave the Subleased Premises in a condition substantially the same as when it took possession, ordinary wear and tear excepted.

f. Subtenant shall be provided with adequate parking for its employees, customers, and invitees in a parking area located adjacent to the Building where the Premises are located.

26. ***Automatic Termination.*** **This Sublease shall automatically terminate and become null and void in the event this Sublease has not been executed on behalf of Subtenant and returned to Sublandlord no later than _____, 20__, TIME BEING OF THE ESSENCE.**

IN WITNESS WHEREOF, the parties hereto have caused this Sublease Agreement to be executed under seal by an officer duly authorized, as of the day and year first above written.

SUBLANDLORD: **Prime Tenant, LLC**	**SUBLANDLORD'S BROKER**
BY: _____	**BY: _____**
Its: _____	**Its: _____**
SUBTENANT: **Subtenant, Inc.**	**SUBTENANT'S BROKER**
BY: _____	**BY: _____**
Its: _____	**Its: _____**

EXHIBIT A

[master lease**]**

EXHIBIT B

[floor plan showing premises**]**

EXHIBIT C

[furniture inventory**]**

Fundamental issues addressed by the sublease as finally negotiated:

a. A more complete explanation of the relationship of the parties to each other and the relationship of the prime lease and sublease to each other.

b. A clarification of the insurance obligations of the parties under the prime lease and the sublease.

c. Specific provisions relating to the provision of services to the subtenant by the landlord.

d. A clarification of the process and right of the subtenant to obtain services and a right of offset against rent in the subtenant if such services are not provided to the subtenant.

e. A signage right granted the subtenant for listing on the building occupants list.

f. A parking lot usage right granted to the subtenant for its employees, clients, customers, and business invitees.

XII. APPENDIX — FORMS

A. [6.46] Agreements and Representations of Tenant with Reference to Status of Prime Lease

1. Tenant represents and warrants to Subtenant as follows:

(a) The Lease is in full force and effect; Tenant has delivered to Subtenant a true copy of the Lease complete with all amendments and changes; no default by Tenant under the Lease now exists; Tenant has full right and power to execute this Sublease and to lease the sublet space to Subtenant subject only to the consent of Landlord under the Lease; and no agreement or understanding exists between Tenant and Landlord except as disclosed in the Lease.

(b) There is no existing default under the Lease on the part of Landlord, and Tenant has no claims against, or disputes with, Landlord currently existing with respect to Tenant improvements, rent, security, or other deposits; duties and obligations of Landlord or Tenant; or any other matters arising under the terms of the Lease.

(c) Tenant will not enter into any assignment of the Lease or the Sublease that includes any part of the sublet space without the prior written consent of Subtenant.

2. Tenant agrees that as long as Subtenant shall pay the rent due under this Sublease and shall perform all other obligations of Subtenant herein contained:

(a) Tenant shall keep, observe, and perform all its obligations under the Lease.

(b) Tenant will not amend, modify, or supplement any of the terms or conditions of the Lease that would operate to amend or abrogate the terms and conditions of the Lease and that would adversely affect Subtenant's use and occupancy of the sublet space or rights under this Sublease without, in each instance, obtaining Subtenant's prior written consent thereto.

(c) Tenant agrees to send to Subtenant a copy of all notices of default received by Tenant under the Lease within three business days after Tenant's receipt thereof.

B. [6.47] Right To Assign

Subject to the following enumerated conditions precedent, Lessee shall have the right at any time to assign all or any part of its interest in this Lease, provided, however, that all the following conditions precedent to such right to assign are fully performed by Lessee before any such assignment may be made:

1. Lessee must secure Lessor's express prior written consent to such assignment.

2. At the time of such assignment, the building now standing on the Demised Premises shall be in a safe, tenantable, and good condition, order, and repair and shall otherwise conform to the requirements and covenants in respect thereof contained in this Lease.

3. At the time of such assignment, Lessee shall not be in arrears of rent nor in default in the performance or observance of any other covenant, provision, or condition in this Lease.

4. Such assignment shall be made only to a reputable and financially responsible person or persons, or a corporation legally, properly, and in good faith organized, existing, and doing business under the laws of the state where the premises are located or of some other state of the United States and duly authorized and licensed to do business in the state where the premises are located; duly authorized and empowered to assume all the provisions, obligations, and conditions of this Lease; and solvent and having a capital stock fully paid up and wholly unimpaired of not less than $_____.

5. Assignee shall at the time of the assignment properly make, execute, and acknowledge a valid and binding instrument of assignment, directly enforceable by Lessor, wherein such Assignee shall assume and agree personally to pay all the rent herein reserved and expressly assumes and agrees to perform, keep, observe, and be bound by all the covenants and conditions of this Lease, including those set out in this provision.

6. Such instrument, properly executed and in recordable form, shall immediately be filed for record in the proper office of the county where the premises are located.

7. An authentic copy thereof, together with a written statement of the Assignee's or Purchaser's residence and place of business, shall be delivered to Lessor.

8. Such assignment shall be made only to effect and carry out an absolute bona fide sale of Lessee's leasehold interest to the intended Assignee, and for no other purpose shall any such assignment be permitted.

The conditions of this provision shall be continuing conditions and shall apply to every successive assignment under this Lease, and Lessor's failure to insist on or Lessor's waiver of such conditions or any of them in any one case shall not be taken to be a waiver in any other case, nor shall consent given in any one case be held to extend to any subsequent case. If all such conditions precedent to the right of Lessee to assign shall have been performed and observed, Lessee on so assigning shall then be released from all liability thereafter arising or accruing under this Lease; but under no circumstances shall Lessee be otherwise released, nor shall the acceptance of rent from any Assignee or Purchaser in any case operate or be taken to effect such release. Every Assignee shall be subject to and be bound by all the provisions, covenants, and conditions of this provision with respect to any future or further assignment.

C. [6.48] Right To Assign or Sublease

Tenant shall not assign, mortgage, or otherwise encumber this Lease, or sublet or permit all or part of the Premises to be used by others, without the prior written consent of Landlord in each instance. If Tenant requests an assignment or subleasing for all or substantially all the remaining term of this Lease other than to a wholly owned subsidiary of Tenant or to a company into which Tenant may be merged or consolidated, Landlord shall have the right to cancel this Lease of the Premises or portion thereof sought to be so assigned or sublet without thereby relieving Tenant from its obligations or liabilities accruing prior thereto. If without Landlord's written consent this Lease is assigned, or the Premises are sublet or occupied by anyone other than Tenant, Landlord may accept and retain the rent from such Assignee, Subtenant, or Occupant without being deemed to have accepted or consented to such purported assignment, but no such assignment, subletting, occupancy, or acceptance of rent shall be deemed a waiver of this covenant. Consent by Landlord to an assignment or subletting shall not relieve Tenant from the obligation to obtain Landlord's written consent to any further assignment or subletting. Any rent payable or received by Tenant as result of an assignment or sublease that is in excess of the rent payable under the provisions of Paragraphs _____ of this Lease shall be due and payable to Landlord as additional rent hereunder, except as Landlord may otherwise specifically agree in writing.

D. [6.49] Sharing of Excess Rental

1. If Lessee shall at any time assign or sublet its interest under this Lease and receive thereby a rental in excess of the rental herein specified, Lessee shall divide the excess rent so received equally with Lessor.

2. Notwithstanding any of the foregoing provisions of this paragraph to the contrary, it is agreed that if Landlord approves a proposed subletting by Tenant and such subletting will be profitable for Tenant (*i.e.,* the sub-rents received by Tenant with respect to the subleased space will be in excess of the rentals then currently paid by Tenant with respect to such sublease), Landlord shall participate in such excess amount (Excess Rental) as set forth, and the following terms and conditions shall be applicable thereto:

(a) As to any Excess Rental received by or payable to Tenant during the first [three**] years of the term of this Lease Agreement, Landlord shall be entitled to and shall be paid by Tenant _____ percent thereof;**

(b) As to any Excess Rental received by or payable to Tenant for any period subsequent to the first [three**] years of the term of this Lease Agreement, the following shall be applicable:**

(i) If the subleased space is less than _____ percent of the total net rentable area covered by this Lease Agreement, Landlord shall be entitled to receive and shall be paid by Tenant _____ percent of such excess rental.

(ii) If the subleased space is at least _____ percent but not more than _____ percent of the total net rentable area covered by this Lease Agreement, Landlord shall be entitled to receive and shall be paid by Tenant _____ percent of such Excess Rental.

(iii) If the subleased space is more than _____ percent of the total net rentable area covered by this Lease Agreement, Landlord shall have the option of either receiving all such excess rental or terminating such sublease and this Lease Agreement insofar as the space covered by such sublease is concerned, in which latter event Tenant will be relieved of all further obligations under this Lease Agreement as to such space, and the Subtenant will be relieved of all obligations with respect to such space under the sublease.

E. Consent To Sublease

1. [6.50] Long Form

AGREEMENT made as of this _____ day of _____, 20__, by and among _____, a _____ corporation, having its principal office at _____ (Landlord), and _____, a _____ corporation, having an office at _____ (Tenant), Tenant under a lease dated as of _____, 20__ (which lease as heretofore or hereafter amended is hereinafter called the "Master Lease"), under which Landlord demised to Tenant a portion of the floor in the building known as _____ (Demised Premises), and _____, a _____ corporation, having an office at _____ (Subtenant).

Landlord hereby consents to the subletting by Tenant to Subtenant, pursuant to a sublease (Sublease) dated as of _____, 20__, of a portion of the Demised Premises as shown and marked on the floor plan attached hereto (which space is hereinafter referred to as the "Sublet Space"), such consent being subject to and on the following terms and conditions, to each of which Tenant and Subtenant expressly agree:

1. Nothing contained in this agreement shall

(a) operate as a consent to or approval or ratification by Landlord of any of the provisions of the Sublease or as a representation or warranty by Landlord, and Landlord shall not be bound or estopped in any way by the provisions of the Sublease;

(b) be construed to modify, waive, or affect (i) any of the provisions, covenants, or conditions in the Master Lease; (ii) any of Tenant's obligations under the Master Lease; or (iii) any rights or remedies of Landlord under the Master Lease or otherwise or to enlarge or increase Landlord's obligations or Tenant's rights under the Master Lease or otherwise; or

(c) be construed to waive any present or future breach or default on the part of Tenant under the Master Lease; in case of any conflict between the provisions of this agreement and the provisions of the Sublease, the provisions of this agreement shall govern.

2. The Sublease shall be subject and subordinate at all times to the Master Lease and all its provisions, covenants, and conditions. In case of any conflict between the provisions of the Master Lease and the provisions of the Sublease, the provisions of the Master Lease shall govern.

3. Neither the Sublease nor this consent thereto shall release or discharge Tenant from any liability under the Master Lease, and Tenant shall remain liable and responsible for the full performance and observance of all the provisions, covenants, and conditions set forth in the Master Lease on the part of Tenant to be performed and observed. Any breach or violation of any provisions of the Master Lease by Subtenant shall be deemed to be and shall constitute a default by Tenant thereunder.

4. This consent is not assignable and shall not be construed as a consent by Landlord to any further subletting either by Tenant or Subtenant. The Sublease may not be assigned, renewed, or extended, nor shall the Demised Premises or Sublet Space, or any part thereof, be further sublet without the prior written consent of Landlord thereto in each instance.

5. Upon the expiration or any earlier termination of the term of the Master Lease, or in case of the surrender of the Master Lease by Tenant to Landlord, except as provided in the next succeeding sentence, the Sublease and its term shall expire and come to an end as of the effective date of such expiration, termination, or surrender and Subtenant shall vacate the Sublet Space on or before that date. If the Master Lease shall expire or terminate during the term of the Sublease for any reason other than condemnation or destruction by fire or other cause, or if Tenant shall surrender the Master Lease to Landlord during the term of the Sublease, Landlord, in its sole discretion, upon written notice given to Tenant and Subtenant not more than [30**] days after the effective date of such expiration, termination, or surrender, without any additional or further agreement of any kind on the part of Subtenant, may elect to continue the Sublease with the same force and effect as if Landlord as Lessor and Subtenant as Lessee had entered into a lease as of such effective date for a term equal to the unexpired term of the Sublease and containing the same provisions as those contained in the Sublease, and Subtenant shall attorn to Landlord, and Landlord and Subtenant shall have the same rights, obligations, and remedies thereunder as were had by Tenant and Subtenant thereunder prior to such effective date, respectively, except that in no event shall Landlord be (a) liable for any act or omission by Tenant, (b) subject to any offsets or defenses that Subtenant had or might have against Tenant, or (c) bound by any rent or additional rent or other payment paid by Subtenant to Tenant in advance. Upon an expiration of the term of the Sublease pursuant to the provisions of the first sentence of this paragraph, if Subtenant fails to vacate the Sublet Space as therein provided, Landlord shall be entitled to all the rights and remedies available to a landlord against a tenant holding over after the expiration of a term.**

6. Both Tenant and Subtenant shall be liable for all bills rendered by Landlord for charges incurred by or imposed on Subtenant for services rendered and materials supplied to the Sublet Space.

7. Any notice or communication that any party hereto may desire or be required to give any other party under or with respect to this agreement shall be given by prepaid certified or

registered mail addressed to such other party, in the case of Landlord at its address first hereinabove set forth, and in the case of Tenant or Subtenant at the building in which the Demised Premises are located, or in any case at such other address as such other party may have designated by notice given in accordance with the provisions of this paragraph. The time when such notice or communication shall be deemed to have been given shall be the time it shall be so mailed.

8. This agreement shall be construed in accordance with the laws of the State of _____, contains the entire agreement of the parties hereto with respect to the subject matter hereof, and may not be changed or terminated orally or by course of conduct.

IN WITNESS WHEREOF, the parties hereto have duly executed this agreement as of the day and year first above written.

_____, as
Agent for Landlord

By: _____

_____

By: _____
(Tenant)

_____

By: _____
(Subtenant)

2. [6.51] Short Form

On behalf of _____ (Landlord), you are advised that permission is given to sublease part of your Suite _____ at _____ as requested by you subject and subordinate to all the terms of the lease agreement (Lease Agreement). All such Subtenants should understand, of course, that they have no rights against us to remain in possession or to exercise any of their rights except through you.

It is requested that each of your Subtenants sign and return a counter-copy of this consent so that we know they have received our consent and that all their rights flow through you.

_____
Landlord

Approved:

_____
Subtenant

F. [6.52] Non-Disturbance Agreement Among Lessor, Lessee, and Sublessee

THIS AGREEMENT, made this _____ day of _____, 20__, by and between _____ (Lessor), _____ (Lessee), and _____ (Sublessee).

WITNESSETH:

WHEREAS, Lessor is the owner of certain premises in the City of _____, County of _____, and State of _____, as described in Exhibit _____, which is attached hereto and incorporated herein by reference as if fully set forth at this point; and

WHEREAS, under the terms of a certain lease dated _____, 20__ (Lease), Lessor did lease, let, and demise said premises to Lessee for a term of _____ years on the terms and conditions therein stated; and

WHEREAS, the parties hereto desire to establish additional rights acquired in peaceful possession for the benefit of the Sublessee under the terms of a Sublease dated _____, 20__ (Sublease), by and between Lessee and Sublessee, and to further define the terms, covenants, and conditions precedent for such additional rights.

NOW, THEREFORE, in consideration of the respective sums and for the sum of [ten dollars**], and for good and valuable consideration, each to the other in hand paid, the receipt whereof by the respective parties is acknowledged, it is hereby mutually covenanted and agreed by the parties hereto as follows:**

1. That in the event of cancellation or termination of the Lease by Lessor, whether voluntary or involuntary or by operation of law, including any extensions or renewals of the Lease whether now provided or agreed to hereafter, and subject to the observance and performance by Sublessee of all the terms, covenants, and conditions of the Sublease on the part of Sublessee to be observed and performed, Lessor hereby covenants the following:

(a) the quiet and peaceful possession of Sublessee under the Sublease; and

(b) that the Sublease will continue in full force and effect and Lessor shall recognize the Sublease and Sublessee's rights thereunder and will thereby establish direct privity of estate and contract between Lessor and Sublessee, with the same force and effect and with the same relative priority in time and right as though the Sublease were directly made from Lessor in favor of Sublessee, but not in respect of any amendment to such Sublease not previously approved in writing by Lessor.

2. Notwithstanding anything to the contrary in the Lease, that Lessee shall not be in default under the provisions of the Lease unless written notice specifying such default is mailed to Sublessee. Lessee agrees that Sublessee shall have the right to cure such default on behalf of Lessee within _____ calendar days after receipt of such notice. Lessor further agrees not to invoke any of its remedies, either express or implied, under the Lease (except in the case of emergency repairs) until said _____ days have elapsed and during any period that Sublessee is proceeding to cure such default with due diligence.

3. That in the event of any cancellation, termination, or default of the Lease or surrender thereof, whether voluntary or involuntary or by operation of law, Sublessee hereby covenants and agrees to make full and complete attornment to Lessor on the same terms, covenants, and conditions as provided in the Lease, except as otherwise herein or in the Sublease provided, to establish direct privity of estate and contract between Lessor and Sublessee with the same force and effect as if the Lease were originally made directly from Lessor to Sublessee, and Sublessee will thereafter make all payments directly to Lessor and will waive any defaults of Lessee under the Sublease (whether curable or noncurable) that occurred prior to the termination of the Lease.

4. That the terms, covenants, and conditions hereof shall inure to the benefit of and be binding on the respective parties hereto and their heirs, executors, administrators, successors, and assigns.

IN WITNESS WHEREOF, the parties hereto have caused this writing to be signed, sealed, and delivered in their respective names and behalf, and, if a corporation, by its officers duly authorized, the day and year first above written.

Lessor: **Lessee:**

_____ _____

Sublessee:

_____

G. [6.53] Agreement of Subordination, Non-Disturbance, and Attornment Among Lender, Lessor, and Tenant

THIS AGREEMENT, made this _____ day of _____, 20__, by and between _____ (Lessor), _____, a _____ company organized under the laws of the State of _____, and having its principal office at _____, City of _____, County of _____, and State of _____ (Lender), and _____, a corporation duly organized and existing under the laws of the State of _____ (Tenant).

WITNESSETH:

WHEREAS, Lessor is the owner in fee simple of certain premises in the City of _____, County of _____, and State of _____, as described in Exhibit _____, which is attached hereto and incorporated herein by reference as if fully set forth at this point; and

WHEREAS, under the terms of a certain lease dated _____, 20__ (Lease), Lessor did lease, let, and demise said premises to Tenant for a term of _____ years on the terms and conditions therein stated; and

WHEREAS, Lender is the owner and holder of one certain note in the principal sum of _____ dollars, secured by a mortgage dated _____, 20__, and recorded in Volume _____, page _____, of the Office of the Recorder of _____ County, Illinois; and

WHEREAS, the parties hereto desire to establish additional rights acquired in peaceful possession for the benefit of Tenant under the terms of the Lease and to further define the terms, covenants, and conditions precedent for such additional rights.

NOW, THEREFORE, IN CONSIDERATION of the respective sums and for the sum of [ten dollars**], and for good and valuable consideration, each to the other in hand paid, the receipt whereof by the respective parties is acknowledged, it is hereby mutually covenanted and agreed by the parties hereto as follows:**

1. Lender, Lessor, and Tenant do hereby covenant and agree that the said mortgage shall be and is hereby made subordinate to the Lease with the same force and effect as if the Lease had been executed, delivered, and recorded prior to the execution and recording of the said mortgage.

EXCEPT, HOWEVER, that this subordination shall not affect nor be applicable to and does hereby expressly exclude, and Lessor and Tenant acknowledge and agree to

(a) the priority of all rights and claims under the lien of the said mortgage in, to, and on any award or other compensation heretofore or hereafter to be made for any taking by eminent domain of any part of the demised premises and as to the right of disposition thereof in accordance with the provisions of the said mortgage;

(b) the priority of all rights and claims under and the priority of lien of the said mortgage in, to, and on any proceeds payable under all policies of fire, extended coverage, and rent insurance on the demised premises and as to the right of disposition thereof in accordance with the terms of the said mortgage; and

(c) any lien, right, power, or interest of Lender, if any, that may have arisen or intervened in the period between the recording of the said mortgage and the execution, amendment, or recording of the Lease.

2. In the event of cancellation or termination of the Lease by Lessor, whether voluntary, involuntary, or by operation of law, including any extensions or renewals of the Lease whether now provided or agreed to hereafter and subject to the observance and performance by Tenant of all the terms, covenants, and conditions of the Lease on the part of Tenant to be observed and performed, Lender hereby covenants upon its obtaining title the following:

(a) the quiet and peaceful possession of Tenant under the Lease; and

(b) that the Lease will continue in full force and effect and Lender shall recognize the Lease and Tenant's rights thereunder and will thereby establish direct privity of estate and contract between Lender and Tenant, with the same force and effect and

with the same relative priority in time and right as if the Lease were directly made from Lender in favor of Tenant, but not in respect of any amendment to the Lease not previously approved in writing by Lender.

3. Notwithstanding anything to the contrary in the Lease, Lessor shall not be in default under the provisions of the Lease unless written notice specifying such default is mailed to Lender. Lessee agrees that Lender shall have the right to cure such default on behalf of Lessor within [30**] calendar days after receipt of such notice. Lessee further agrees not to invoke any of its remedies, either expressed or implied, under the Lease (except in the case of emergency repairs) until said [**30**] days have elapsed and during any period that Lender is proceeding to cure such default with due diligence or is taking steps with due diligence to obtain title of the leased premises and cure said default.**

4. In the event of any cancellation, termination, or default of the Lease or surrender thereof, whether voluntary, involuntary, or by operation of law, prior to the repayment in full of the mortgage, Tenant hereby covenants and agrees to make full and complete attornment to Lender as Substitute Lessor on the same terms, covenants, and conditions as provided in the Lease, so as to establish direct privity of estate and contract between Lender and Tenant with the same force and effect and relative priority in time and right as if the Lease were originally made directly from Lender to Tenant, and Tenant will thereafter make all payments directly to Lender and will waive any defaults of Lessor (whether curable or noncurable) that occurred prior to Lender's becoming Substitute Lessor by obtaining title to the premises, and Tenant waives all notices, joinder, and/or service of any and all foreclosure actions by Lender under the note and mortgage on the premises.

5. The terms, covenants, and conditions hereof shall inure to the benefit of and be binding on the respective parties hereto and their heirs, executors, administrators, successors, and assigns.

IN WITNESS WHEREOF, the parties hereto have caused this writing to be signed, sealed, and delivered in their respective names and behalf, and, if a corporation, by its officers duly authorized, the day and year first above written.

Lender: **Lessor:**

_____ _____

Tenant:

_____

H. Agreement on Reasonable Acts in Mitigation

1. [6.54] Form 1

Tenant agrees that it is reasonable for Landlord to refuse to accept an assignment, sublease, or new lease to mitigate any damages recoverable from Tenant, including, for example, refusal if

(a) Landlord has other vacant space in the [building**] [**shopping center**] available to any proposed assignee or tenant;**

(b) the proposed assignee or tenant is not commercially responsible;

(c) the use of the premises by such proposed assignee or tenant would be in conflict with or inconsistent with the use of the [building**] [**shopping center**] by other tenants;**

(d) the proposed use of the premises by the proposed assignee or tenant would cause additional expenses for insurance or cleaning or excessive use of elevators, public facilities, or common areas;

(e) use of the premises by such tenant or assignee would breach an obligation that Landlord has to other tenants in the [building**] [**shopping center**];**

(f) the proposed assignee or subtenant's business is not consistent with the tenant mix of other tenants in the [building**] [**shopping center**]; or**

(g) the premises are for retail sales with percentage rent being payable by Tenant and the use of the premises by the proposed assignee or tenant would in normal course reflect a lower percentage rent income payable to Landlord.

2. [6.55] Form 2

With respect to the provisions of the laws of the State of Illinois, if any, that require that a landlord take reasonable measures to mitigate the damage recoverable against a defaulting lessee, Tenant agrees that Landlord shall have no obligation to relet the premises to a potential substitute tenant (a) before Landlord rents other vacant space in the building; (b) if the potential tenant is tendered to Landlord for its consent to a sublease or an assignment of the space by other tenants in the building who are not in default; (c) for store tenants, if there is a risk or probability that the substitute tenant will make fewer sales on which Landlord is entitled to collect percentage rent; (d) if the nature of the substitute tenant's business is not consistent with the tenant mix of the building or with any other tenant leases containing provisions against Landlord leasing space in the building for certain uses; or (e) if the nature of the potential substitute tenant's business may have an adverse impact on the first-class, high-grade manner in which the building is operated or with the high reputation of the building, even though in each of these circumstances the potential substitute tenant may have a good credit rating.

I. [6.56] Sublease

THIS AGREEMENT, made this _____ day of _____, 20__, by and between _____ (Sublessor) and _____ (Sublessee):

WITNESSETH:

WHEREAS, Sublessee desires to lease a portion of the premises commonly known as _____ (Premises), legally described as:

[legal description]

WHEREAS, the Premises are presently leased by Sublessor under a certain lease dated _____, 20__, by and between _____ as Lessor and Sublessor as Lessee (Lease), a copy of which is attached hereto as Exhibit _____ and made a part hereof by reference; and

WHEREAS, the parties are agreeable to entering into a Sublease of the Premises on the following terms and conditions.

NOW, THEREFORE, in consideration of the premises and the covenants contained herein, the parties agree as follows:

1. Sublessor hereby sublets to Sublessee the Premises for a term of _____ years commencing _____, 20__, and terminating _____, 20__.

2. The rental for the Premises subleased shall be $_____ per year; on or before the first day of each month of the term of this Sublease, Sublessee shall pay to Sublessor the sum of $_____, which payment shall be made to Sublessor at _____, or at such other place as Sublessor may from time to time designate. Sublessee has paid to Sublessor the sum of $_____ as a security deposit for the faithful performance by Sublessee of the terms and conditions of this Sublease. This sum, less any amounts due Sublessor for breach of such terms and conditions, shall be returned to Sublessee within [30**] days after the termination of this Sublease.**

3. Sublessor shall pay all taxes and assessments, general and special, maintain fire and extended coverage insurance on the building, and provide exterior maintenance and heat for the subleased Premises. Sublessee shall provide such utilities as are required.

4. Sublessee agrees to indemnify and hold Sublessor harmless from all claims, loss, damage, liability, cost, and expenses, including reasonable attorneys' fees, that may arise out of a violation of any term of the Lease resulting from Sublessee's act or omission.

5. Sublessee shall not re-sublet or assign this Sublease, in whole or in part, without the prior written consent of Sublessor.

6. Sublessee shall not alter, remodel, or change the subleased Premises without the prior written consent of Sublessor. All such alterations shall, at the option of Sublessor, remain at the end of the term hereof or be removed at Sublessee's expense to restore the demised Premises to their original condition.

7. Sublessor shall not be liable to Sublessee for any damage or injury to it or its property occasioned by the failure of Sublessor to keep the Premises in repair and shall not be liable for any injury done or occasioned by wind or by or from any defect of plumbing, electric wiring or insulation thereof, gas pipes, water pipes, steam pipes, or air compressor, or from the backing up of any sewer pipe or downspout, or from the bursting, leaking, or running of any tank, tube, washstand, water closet, or water pipe, drain, or any other pipe or tank, in, on, or about the Premises, nor from the escape of steam or hot water from any radiator, nor for any such damage or injury occasioned by water, snow, or ice being on or coming through the roof, stairs, walks, or any other place on or near the Premises, nor for any such damage or injury done or occasioned by the falling of any fixture, plaster, or stucco, nor for any damage or injury arising from any act, omission, or negligence of other persons, or of Sublessor's agents, all claims for any such damage or injury being hereby expressly waived by Sublessee but only to the extent that Sublessee is indemnified by its insurance policies for said claims.

8. At the termination of this Sublease, by lapse of time or otherwise, Sublessee shall yield up immediate possession to Sublessor and, failing to do so, shall pay as liquidated damages, for the whole time such possession is withheld, a sum equal to twice the amount of the rent herein reserved, prorated per day of such withholding. But the provisions of this clause and the acceptance of any such liquidated damages by Sublessor shall not constitute a waiver by Lessor of any other rights Sublessor might have against Sublessee for Sublessee's failure to yield up possession.

9. In the event the insurance rates on the Premises increase as a result of the use of the subleased Premises by Sublessee, Sublessee shall pay such increased costs to Sublessor within [10**] days after being notified of such increase. If any insurance policy shall be canceled or the coverage reduced in any way by reason of the use of the subleased Premises by Sublessee, Sublessee will, within [**10**] days after being notified of such cancellation or reduction in coverage, remedy the condition giving rise to such cancellation or reduction of coverage. In the event Sublessee fails to remedy the condition within [**10**] days, Sublessor may, at its option, cancel the Sublease effective immediately, and the term of this Sublease shall thereupon terminate.**

10. The following provisions of the Lease are hereby incorporated in this Sublease as if set forth herein in full with the term "Sublessor" replacing the term "Lessor" and the term "Sublessee" replacing the term "Lessee":

Sections _____
_____
_____

11. Any notice to be given hereunder shall be deemed given when mailed in a properly addressed envelope, postage prepaid, by United States certified mail. Until changed as hereinafter provided, notices and communications to Lessor and Lessee shall be properly addressed as follows:

IF TO LESSOR:

[address**]**

IF TO LESSEE:

[address**]**

Each party shall have the right to specify as its proper address any other address in the United States of America by giving to the other party at least [10**] days' written notice thereof.**

12. Sublessor represents that Exhibit _____ is a true, correct, and complete copy of the Lease, and Sublessor and Sublessee understand and agree that the provisions of the Lease that are by reference incorporated in this Sublease pertain to the subleased Premises as specified in this Sublease.

13. Sublessor covenants and warrants to Sublessee and its successors and assigns that it is presently in full compliance with all the terms and conditions of the Lease and will not default in any of its obligations under the terms of the Lease during the term hereof. Sublessor further covenants and warrants to Sublessee and its successors and assigns that it will not voluntarily enter into any agreement with Lessor that would result in the termination of the Lease prior to the termination of this Sublease or any extensions or renewals thereof.

IN WITNESS WHEREOF, the parties hereto have caused this Sublease to be executed by their respective officers thereunto duly authorized and their corporate seals to be hereto affixed this _____ day of _____, 20__.

Sublessor: **Sublessee:**

_____ _____

7 Landlord's Duties and Liabilities

JOSEPH B. VANFLEET
Howard & Howard Attorneys PLLC
Managing Attorney, Peoria Office
Co-Chair, Lending Institutions Practice Group

The contribution of Noah A. Menold to previous editions of this chapter is gratefully acknowledged.

VI. Tenant Protection Against Criminal Acts

A. [7.27] General Rule
B. Exceptions
   1. [7.28] Foreseeable Injuries
   2. [7.29] Knowledge of Criminal Activity
   3. [7.30] Voluntary Assumption of Control

VII. [7.31] Property Damage

A. [7.32] Fire
B. [7.33] Third Party
C. [7.34] Other Losses
D. [7.35] Waiver

VIII. [7.36] Security Deposits

A. [7.37] Duty To Return
B. [7.38] Assignment

IX. Options

A. [7.39] Renew, Extend, or Expand
   1. [7.40] Excusable Neglect
   2. [7.41] When Lease Is Silent
   3. [7.42] Assignments
B. [7.43] Purchase
C. [7.44] Commentary

X. Enforcement

A. [7.45] Landlord's Failure To Enforce
   1. [7.46] Waiver by Acceptance
   2. [7.47] Required Notice of Strict Compliance
   3. [7.48] Tenant's Obligation To Pay Rent
B. [7.49] Nonwaiver Provisions
C. [7.50] Assignment and Subletting
   1. [7.51] Assignment Prohibition
   2. [7.52] Failure To Object

I. [7.1] SCOPE OF CHAPTER

The duties and liabilities facing landlords have evolved over time and continue to evolve. Traditionally, courts have applied common law throughout most of America's history to determine the landlord and tenant duties and liabilities. This common law often favored landlords, leaving tenants to bear responsibility for issues related to real estate. However, as American society evolved and as the American economy became more and more industrial, courts became less willing to apply strict common law. Many duties and liabilities of landlords are defined either by statute or by contract. While this is more evident in the realm of residential leases, commercial landlords also must be aware of their statutory duties, as well as their contractual duties, to ensure they minimize liability exposure.

This chapter examines the state of landlord duties and liabilities under Illinois law. These duties and liabilities arise from common law and statute, as well as provisions in commercial leases. Having a keen understanding of these principles will assist landlords in drafting their commercial leases and will provide them with insight on the circumstances under which they can and cannot be found liable for damages.

II. ESSENTIAL LEASE REQUIREMENTS

A. [7.2] Habitability

Under traditional common law, no duty as to the condition of the demised premises was generally implied in either residential or commercial lease agreements. However, as American society developed, so too did a landlord's duties to its tenants. The doctrine of implied warranty of habitability is a judicially created doctrine designed to eliminate the unjust results from caveat emptor and the doctrine of merger. *Board of Directors of Bloomfield Club Recreation Ass'n v. Hoffman Group, Inc.,* 295 Ill.App.3d 279, 692 N.E.2d 825, 827, 229 Ill.Dec. 836 (2d Dist. 1998); *1400 Museum Park Condominium Association by Board Managers v. Kenny Construction Co.,* 2021 IL App (1st) 192167, 200 N.E.3d 798, 460 Ill.Dec. 250. In essence, the implied warranty of habitability imposes a duty on the landlord to maintain the property in a habitable condition and free from latent defects. *Jack Spring, Inc. v. Little,* 50 Ill.2d 351, 280 N.E.2d 208 (1972). Illinois courts, traditionally, have limited the doctrine of implied warranty of habitability to the sale of residential property and stated that the purpose of the doctrine is to protect innocent and unsophisticated purchasers who may not possess the ability to determine whether the property they have purchased is free from latent defects. *Bloomfield Club, supra,* 692 N.E.2d at 827.

Due in part to the doctrine's purpose of protecting unsophisticated purchasers, Illinois courts have explicitly determined that the implied warranty of habitability does not extend to commercial leases. *Id*; *J.B. Stein & Co. v. Sandberg,* 95 Ill.App.3d 19, 419 N.E.2d 652, 658, 50 Ill.Dec. 544 (2d Dist. 1981) (holding that commercial tenant could not recover for damages to property under implied warranty of habitability); *Hopkins v. Hartman,* 101 Ill.App.3d 260, 427 N.E.2d 1337, 56 Ill.Dec. 791 (4th Dist. 1981) (providing that purchasers of duplex residence that was never occupied by purchasers but was used as rental property were not within class of purchasers protected by implied warranty of habitability). Therefore, there generally is no cause of action available for a commercial tenant against its landlord for breach of the implied warranty of habitability.

B. [7.3] Possession

An essential requirement of any lease is that the lease transfer exclusive possession of the demised premises to the tenant. *Baumgardner v. Consolidated Copying Co.,* 44 Ill.App. 74, 75 (1st Dist. 1891). The Illinois Supreme Court has stated, "[a] leasehold consists of the right to the use and possession of the demised premises for the full term of the lease." *People ex rel. Korzen v. American Airlines, Inc.,* 39 Ill.2d 11, 233 N.E.2d 568, 572 (1967). As a result, assuming the tenant has not breached the lease, a landlord, generally, should refrain from disturbing the tenant's use and possession of the demised premises during the lease term.

For the effect of a landlord's breach on a tenant's obligations and the rights of a tenant if the landlord breaches certain covenants in the lease, see §7.58 below. See also §§7.5 – 7.9 below addressing a landlord's constructive eviction of a tenant, which may release the tenant from future obligations under the lease.

C. [7.4] Quiet Enjoyment

A corollary to the rule that a lease grants to a tenant exclusive possession of the demised premises is the landlord's covenant of quiet enjoyment. Illinois law implies a covenant of quiet enjoyment in all lease agreements. *Chapman v. Brokaw,* 225 Ill.App.3d 662, 588 N.E.2d 462, 467, 167 Ill.Dec. 821 (3d Dist. 1992). A landlord's conduct breaches the covenant of quiet enjoyment when it substantially interferes with the tenant's use and enjoyment of the premises. *Blue Cross Ass'n v. 666 North Lake Shore Drive Associates,* 100 Ill.App.3d 647, 427 N.E.2d 270, 273, 56 Ill.Dec. 190 (1st Dist. 1981); *Infinity Broadcasting Corporation of Illinois v. Prudential Insurance Company of America,* 869 F.2d 1073, 1075 (7th Cir. 1989). When determining whether a landlord has breached the covenant of quiet enjoyment, a landlord's intent will not be considered by the court. *Blue Cross, supra,* 427 N.E.2d at 273. Therefore, a landlord can breach this covenant — and be subject to liability — without ever having any intention of doing so.

In *Blue Cross,* the lessee brought suit for injunctive relief against its landlord, seeking a preliminary injunction preventing the landlord from penetrating the premises for the purpose of installing plumbing, ventilation, and electrical system risers. After moving into the premises, the lessee had installed a valuable telecommunications system. The defendant-landlord thereafter purchased the building and notified the lessee that it would need to physically penetrate some of the lessee's space for planned renovations. The lessee refused to allow any penetrations and refused to relinquish any of its leased space. The lessee argued that the landlord's penetration into the premises breached the covenant of quiet enjoyment. The trial court disagreed and found for the landlord. On appeal, the court reversed. The court did not accept the landlord's argument that the covenant of quiet enjoyment was not breached because the plaintiff was not actually or constructively evicted. The court held that a landlord can breach a covenant of quiet enjoyment even without a finding that the landlord intended to deprive the lessee of possession. The court found that (1) the covenant of quiet enjoyment is implied in all lease agreements, and (2) the lease in question expressly granted the plaintiff the right of quiet and peaceful possession and enjoyment. As a result, the court reversed the trial court and remanded with instructions for entry of a preliminary injunction. 427 N.E.2d at 272 – 273.

If a landlord is found to have breached the covenant of quiet enjoyment, a tenant can remain in possession and, thus, be liable for rent but still maintain an action for damages. *64 East Walton, Inc. v. Chicago Title & Trust Co.,* 69 Ill.App.3d 635, 387 N.E.2d 751, 755 – 756, 25 Ill.Dec. 875 (1st Dist. 1979). The appropriate measure of damages for a breach of quiet enjoyment is the difference between the rental value of the demised premises and the rent the tenant has agreed to pay, together with such special damages as may have been directly and necessarily occasioned to the tenant by the landlord's wrongful act. *Id. See also Madison Associates v. Bass,* 158 Ill.App.3d 526, 511 N.E.2d 690, 110 Ill.Dec. 513 (1st Dist. 1987).

D. [7.5] Constructive Eviction

Illinois has long distinguished between the standards for breach of the covenant of quiet enjoyment and for constructive eviction. *See Blue Cross Ass'n v. 666 North Lake Shore Drive Associates,* 100 Ill.App.3d 647, 427 N.E.2d 270, 56 Ill.Dec. 190 (1st Dist. 1981). Illinois law no longer requires that the tenant be physically dispossessed of the property by the landlord prior to establishing an eviction. Illinois law affords a tenant rights when a landlord's actions, which are in violation of lease covenants or common law, create circumstances that establish a constructive eviction. In Illinois, a constructive eviction has been defined by the courts as "something of a serious and substantial character done by the landlord with the intention of depriving the tenant of the beneficial enjoyment of the premises in accordance with the terms of the lease." *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 411, 122 Ill.Dec. 150 (1st Dist. 1988). "There need not be an express intention on the part of the landlord to so deprive the tenant, for "persons are presumed to intend the natural and probable consequence of their acts.' " *Shaker & Associates, Inc. v. Medical Technologies Group, Ltd.,* 315 Ill.App.3d 126, 733 N.E.2d 865, 872, 248 Ill.Dec. 190 (1st. Dist. 2000), quoting *John Munic Meat Co. v. H. Gartenberg & Co.,* 51 Ill.App.3d 413, 366 N.E.2d 617, 122 Ill.Dec. 150 (1st Dist. 1977). Upon being constructively evicted, the tenant has rights and will be able to pursue damages from the landlord. *Id.* A landlord is not entitled to accelerate rents after a constructive eviction of tenants. *Ivanhoe Shoppers, LLC v. Bauspies,* 2021 IL App (2d) 200582, 192 N.E.3d 886, 456 Ill.Dec. 26.

1. [7.6] Tenant's Rights

A tenant is permitted to claim constructive eviction if as a result of a breach of the landlord's covenant to repair, the leased premises becomes unfit for the purpose for which it was leased. *American National Bank & Trust Company of Chicago v. Sound City, U.S.A., Inc.,* 67 Ill.App.3d 599, 385 N.E.2d 144, 145, 24 Ill.Dec. 377 (2d Dist. 1979). *See Shaker & Associates, Inc. v. Medical Technologies Group, Ltd.,* 315 Ill.App.3d 126, 733 N.E.2d 865, 248 Ill.Dec. 190 (1st Dist. 2000) (tenant is justified in abandoning the premises if landlord's breach of covenant to repair makes them unfit for purpose for which they were leased). The question of whether a tenant has been constructively evicted is one of fact, and the reviewing court will not disturb the trial court's finding unless it is against the manifest weight of evidence. *John Munic Meat Co. v. H. Gartenberg & Co.,* 51 Ill.App.3d 413, 366 N.E.2d 617, 620, 9 Ill.Dec. 360 (1st Dist. 1977).

A constructive eviction discharges the tenant's obligation to pay rent and comply with the other terms of the lease. *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 122 Ill.Dec. 150 (1st Dist. 1988). Upon being constructively evicted, the tenant may abandon the

premises. 526 N.E.2d at 411. Abandonment is crucial because there can be no constructive eviction with the tenant vacating the premises. 526 N.E.2d at 412. That being said, before abandonment of the property, the tenant must give notice to the landlord and allow the landlord a reasonable opportunity to cure the defect. *Id.*

Dell'Armi put forth the following:

a. When a constructive eviction has occurred, the tenant is not required to vacate the premises immediately but is given a reasonable time to do so.

b. The question of whether a tenant has vacated in a reasonable time is one of fact.

c. Courts have held that a delay in vacating the premises might be excusable if the tenant can establish that the delay in vacating was a result of reliance on a landlord's promise to correct the defects.

d. Another factor that courts consider in whether a delay in abandoning the premises is reasonable is the time required for the tenant to find a new location. *Id.*

The failure of a tenant to vacate the premises in a reasonable time after being constructively evicted could result in the tenant being liable for rent while it remains in the premises. *City of Chicago v. American National Bank,* 86 Ill.App.3d 960, 408 N.E.2d 379, 42 Ill.Dec. 1 (1st Dist. 1980).

2. [7.7] Foreseeability

If the actions of the landlord that provide the basis for a tenant's claim of constructive eviction were foreseeable at the time the lease was executed, those actions cannot sustain a claim for constructive eviction. *Infinity Broadcasting Corporation of Illinois v. Prudential Insurance Company of America,* 869 F.2d 1073, 1078 (7th Cir. 1989).

Several older cases from Illinois courts suggest that when a tenant is unaware of another tenant's noise or nuisance activities before entering into a lease, the other tenant's conduct could result in a claim for constructive eviction. See generally *Annot.,* 1 A.L.R.4th 849, 868 (1980), citing *Halligan v. Wade,* 21 Ill. 470 (1859) (tenant operating hotel was constructively evicted due to noise from other tenants in mixed-use building); *Kesner v. Consumers Co.,* 255 Ill.App. 216 (1st Dist. 1929) (constructive eviction of tenant found when landlord failed to abate activities of another tenant which amounted to fire hazard and nuisance). *But see A.H. Woods Theatre v. North American Union,* 246 Ill.App. 521 (1st Dist. 1927) (constructive eviction not found when actions complained of amounted to employees being distracted by noise and there was no showing of loss of business).

3. [7.8] Waiver

Constructive eviction results from a landlord's failure to keep the premises in tenantable condition. *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 969 – 970, 178 Ill.Dec. 444 (3d Dist. 1992). Following constructive eviction, the tenant must vacate the premises in a reasonable time. *Id.* Abandoning the premises in a reasonable time is crucial. Even if

the tenant has grounds to vacate the premises on a claim of constructive eviction, the tenant may be deemed to have waived the landlord's breach of the covenant of habitability if it does not vacate in a reasonable time. *Id.,* citing *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 412, 122 Ill.Dec. 150 (1st Dist. 1988). The tenant bears the burden of establishing that the abandonment took place within a reasonable time after the untenantable condition occurred. *Automobile Supply Co. v. Scene-in-Action Corp.,* 340 Ill. 196, 172 N.E. 35, 38 (1930) (although failure to provide heat could be grounds for constructive eviction, tenant still must establish it provided notice and vacated within reasonable time). *See also Shaker & Associates, Inc. v. Medical Technologies Group, Ltd.,* 315 Ill.App.3d 126, 733 N.E.2d 865, 248 Ill.Dec. 190 (1st Dist. 2000) (tenant's failure to establish reasonableness of time before it vacated premises precluded finding of constructive eviction). The reasonableness of any delay in abandoning the premises is generally a question of fact. *Paolucci, supra.*

4. [7.9] Caselaw

In *RNR Realty, Inc. v. Burlington Coat Factory Warehouse of Cicero, Inc.,* 168 Ill.App.3d 210, 522 N.E.2d 679, 119 Ill.Dec. 17 (1st Dist. 1988), the landlord brought suit against the tenant for breach of a commercial lease. The tenant counterclaimed, alleging that it was constructively evicted due to the landlord's failure to provide sufficient parking spaces as required by the lease. The trial court found for the landlord, and the appellate court affirmed. The court noted that the tenant had not complained to the landlord of the breach for nearly 13 months and had failed to vacate the premises for an additional 4 months. In addition, evidence was presented that the tenant vacated the building not because of the lack of parking spaces but because of financial problems it was experiencing. Based on these factors, the court ruled that the tenant had intentionally and unreasonably delayed abandoning the premises, that abandonment was not due to the actions of the landlord, and that no constructive eviction occurred. 522 N.E.2d at 686 – 687.

Similarly, in *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 122 Ill.Dec. 150 (1st Dist. 1988), the appellate court affirmed the trial court's ruling that the tenant was not constructively evicted. The landlord brought suit against the tenant for rent and other damages. The tenant counterclaimed, alleging constructive eviction by arguing that it had vacated the premises in a reasonable time after the landlord breached its duty by failing to repair a leak in the roof. The trial court ruled in favor of the landlord, and the appellate court affirmed. It found that after the tenant provided notice of the leaky roof, the landlord took measures to repair the leak and made arrangements for installation of a new roof. The court also held that no constructive eviction occurred because the tenant remained in possession and had been aware of the issues with the roof at the time the lease was executed. As a result, the landlord was released from liability for damage resulting from water seepage through the roof, and no constructive eviction occurred. 526 N.E.2d at 411 – 412.

In *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 178 Ill.Dec. 444 (3d Dist. 1992), the landlord brought suit against a commercial tenant for unpaid rent, resulting from the tenant's breach of lease. The tenant claimed that it was constructively evicted due to the landlord's failure to remedy excessive noise emanating from a neighboring shop that shared a common wall with the tenant. The tenant, over a five-year span, lodged more than 500 complaints about the noise with the landlord. The trial court found that the tenant had been constructively

evicted, but the appellate court reversed. The appellate court did not address the question of whether the noise rendered the property untenantable. Rather, it found that because the tenant remained in the property for over five years after the condition arose, as well as entered into a new lease during that period of time, the tenant had waived any claim of constructive eviction. 604 N.E.2d at 971.

Conversely, in *American National Bank & Trust Company of Chicago v. Sound City, U.S.A., Inc.,* 67 Ill.App.3d 599, 385 N.E.2d 144, 24 Ill.Dec. 377 (2d Dist. 1979), the appellate court affirmed the trial court's ruling that the tenant had been constructively evicted. The plaintiff (the new landlord) brought suit against the tenant for nine months of rent remaining on a one-year lease. At the time of execution of the lease in question, the original landlord executed an addendum that required that it repair certain defects in the building. After execution of the lease, the original landlord failed to make the repairs and, subsequently, notified the tenant that there was a new landlord. Due to non-repair, the tenant vacated the premises about four months after moving in. The appellate court, in affirming the trial court, found that the tenant had been constructively evicted and was not liable for the remainder of the rent under the lease. The court found that the tenant had provided adequate notice of the defects and that the tenant's four-month delay in vacating the premises was reasonable due to reliance on the landlord's representation that the defects would be fixed. Additionally, the court found that notice of the defects to the previous landlord was sufficient and that the tenant did not have a duty to notify the new landlord of the defects before vacating the premises. 385 N.E.2d at 146.

Likewise, the court in *Home Rentals Corp. v. Curtis,* 236 Ill.App.3d 994, 602 N.E.2d 859, 176 Ill.Dec. 913 (5th Dist. 1992), a case involving a residential apartment lease, found that the tenants had been constructively evicted. The landlord brought suit against the tenants for breach of lease, and the tenants counterclaimed on the basis of constructive eviction. The tenants claimed that when they arrived at the apartment, it was overrun with roaches, did not contain a working toilet, had holes in the walls, and was in an untenantable condition. Accordingly, they provided the landlord notice of the defects, as well as notified the city's code enforcement division. The city's code enforcement division timely inspected the apartment and found that, due to the severe nature of the violations, the apartment was unfit for habitation in its then condition. Four days later, the problems had not been fixed, and the tenants moved out. The landlord claimed the tenants were liable for rent and had wrongfully vacated the premises because the problems were fixed shortly after the tenants vacated. The court found for the tenants and held that, given the gravity of the problems, four days' notice was sufficient opportunity to cure. As a result, the trial court's finding of constructive eviction was affirmed. 602 N.E.2d at 862 – 863.

III. PAYMENT OF REAL ESTATE OR LEASEHOLD TAXES

A. [7.10] General Rule

In Illinois, the general rule is that in the absence of an agreement on the parties to the lease, it is the duty of the owner of land to pay all taxes and special assessments. *Metropolitan Airport Authority of Rock Island County v. Farliza Corp.,* 50 Ill.App.3d 994, 366 N.E.2d 112, 113, 8 Ill.Dec. 950 (3d Dist. 1977) (affirming trial court's finding that landlord, not tenant, was responsible for paying taxes on real estate even though lease bound tenant to pay taxes on leasehold improvements). *See also Ceres Terminals, Inc. v. Chicago City Bank & Trust Co.,* 259 Ill.App.3d 836, 635 N.E.2d 485, 504, 200 Ill.Dec. 146 (1st Dist. 1994).

Because of the general rule, if the parties wish to alter the responsibility for taxes, the parties should ensure the lease clearly and unambiguously expresses the parties' intentions. In *First National Bank of Highland Park v. Mid-Central Food Sales, Inc.,* 129 Ill.App.3d 1002, 473 N.E.2d 372, 85 Ill.Dec. 4 (1st Dist. 1984), the plaintiff-landlord brought suit against the tenant for payment of real estate taxes due after the termination of a lease with the defendant. The lease at issue terminated on July 1, 1982. A provision of the lease provided that "throughout the term of this Lease, Lessee shall pay when due all taxes, . . . together with any interest and penalties thereon, which are imposed or levied upon or assessed against the premises or any part thereof." [Omission in original.] 473 N.E.2d at 374. Based on this language, the defendant refused to pay its share of the real estate taxes during 1982, arguing that even though taxes for 1982 had been incurred, they were not due and payable prior to termination of the lease. The plaintiff, in order to avoid allowing the taxes to become delinquent, paid the amount owed and commenced suit for the amount paid. The trial court ruled for the defendant, but the appellate court reversed. The court concluded that the language of the lease was not ambiguous and clearly required the lessee to pay its pro rata share of the real estate taxes for the duration of the lease even though the taxes did not become due and payable until after termination of the lease. 473 N.E.2d at 377. *See also Ceres Terminals, supra* (upholding trial court's ruling that increase in tenant's rent did not constitute shifting of landlord's tax liability to tenant because landlord retained its obligation to pay all real estate taxes on land); *Transcraft Corp. v. Anna Industrial Development Corp.,* 223 Ill.App.3d 100, 584 N.E.2d 1033, 165 Ill.Dec. 599 (5th Dist. 1991) (providing that tenant's failure to deduct excess real estate taxes it had paid from rent payments did not amount to waiver of right to enforce landlord's obligation to pay real taxes under lease).

B. [7.11] Tenant's Obligation

Landlords should note that while a lease may not require a tenant to pay for real estate taxes on the underlying property, the tenant still is responsible for taxes on all improvements that the tenant places on the land. *See Lannon v. Lamps,* 53 Ill.App.3d 145, 368 N.E.2d 196, 199 – 200, 10 Ill.Dec. 710 (3d Dist. 1977) (in absence of covenant by lessee to pay taxes, amount of taxes levied on account of improvements placed on land by lessee are chargeable to lessee). See also 86 A.L.R.2d 670 (1962) (stating that "on the basis, doubtless, that one should not be taxed for what he neither owns nor will be benefited by, the lessee has been held to bear the burden of increased taxes resulting from his improvements . . . which . . . will be of little or no benefit to the lessor"); *Metropolitan Airport Authority of Rock Island County v. Farliza Corp.,* 50 Ill.App.3d 994, 366 N.E.2d 112, 8 Ill.Dec. 950 (3d Dist. 1977) (holding that landlord was responsible for real estate taxes, but that tenant remained responsible for taxes on improvements).

C. [7.12] Tenant's Bankruptcy: Effect

Generally, when a tenant under a commercial lease files for bankruptcy, any unpaid amounts due and owing under the lease prior to the date of filing of a petition for bankruptcy become unsecured debt. Therefore, the general rules applicable to unsecured debt likely will apply to any unpaid amounts owed prior to filing.

This chapter is not intended to provide an in-depth discussion of the effect of a tenant's bankruptcy on landlords. Those issues are addressed in Chapter 11 of this handbook. However, it should be noted that when a tenant petitions for bankruptcy, the Bankruptcy Code, 11 U.S.C. § 101, *et seq.,* does provide some protection for commercial landlords after the petition is filed.

IV. REPAIRS AND MAINTENANCE

A. [7.13] General Rule

In 1921, the Illinois Supreme Court set forth the obligations of a landlord in making repairs to the leased premises. *Gibbons v. Hoefeld,* 299 Ill. 455, 132 N.E. 425 (1921). In short, it is the obligation of a landlord to make the premises tenantable for the use for which it is leased. Once this obligation has been satisfied, the landlord has no further duty to make repairs during the term of the lease unless he or she is otherwise contractually obligated to do so. 132 N.E. at 427.

The rule of law set forth in *Gibbons* is still applied by Illinois courts. *Forshey v. Johnston,* 132 Ill.App.2d 1106, 271 N.E.2d 81, 82 – 83 (4th Dist. 1971) (providing that ordinarily mere relationship of landlord and tenant creates no obligation on landlord to make repairs, absent express covenant or stipulation binding it to make repairs or to keep property in repair); *McDaniel v. Silvernail,* 37 Ill.App.3d 884, 346 N.E.2d 382, 386 (4th Dist. 1976) (stating that traditionally landlord is not bound to make repairs unless it has expressly agreed to do so); *Baxter v. Illinois Police Federation,* 63 Ill.App.3d 819, 380 N.E.2d 832, 835, 20 Ill.Dec. 623 (1st Dist. 1978) (holding that absent covenant in lease obligating landlord to make repairs, landlord has no obligation to repair leased premises). The general rule that a landlord has no duty to repair also has been applied to the relationship between a sublandlord and a subtenant. *Mandelke v. International House of Pancakes, Inc.,* 131 Ill.App.3d 1076, 477 N.E.2d 9, 12, 87 Ill.Dec. 408 (1st Dist. 1985). *See also Uresil Corp. v. Becton, Dickinson & Co.,* No. 89 C 6130, 1990 WL 51379 (N.D.Ill. Apr. 11, 1990).

B. [7.14] Exceptions

Notwithstanding the general rule that a landlord has no duty to repair, circumstances do exist in which a landlord is obligated to make repairs. The circumstances include (1) when a landlord expressly covenants to repair (*Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 614, 5 Ill.Dec. 282 (2d Dist. 1977); (2) structural repairs (when not delegated to the tenant) (*Sandelman v. Buckeye Realty, Inc.,* 216 Ill.App.3d 226, 576 N.E.2d 1038, 1040, 160 Ill.Dec. 84 (1st Dist. 1991)); and (3) existence of a latent defect known by the landlord and concealed from the tenant (*Dapkunas v. Cagle,* 42 Ill.App.3d 644, 356 N.E.2d 575, 577, 1 Ill.Dec. 387 (5th Dist. 1976)). The third exception is discussed in §7.20 below in the context of a landlord's tort liability to third parties.

1. [7.15] Covenants

A well-known exception to the general rule occurs when a landlord covenants to make certain repairs in the lease. If such covenants have been made, these covenants generally supersede common law, and the landlord is bound by these obligations. *McGann v. Murry,* 75 Ill.App.3d 697, 393 N.E.2d 1339, 1342, 31 Ill.Dec. 32 (3d Dist. 1979). As stated by the court in *McGann,* "[t]he law in our State is that when parties to a lease have expressly entered into covenants as to repairs and maintenance of leased property these covenants super[s]ede any implied or common law covenants and become the measure of liability and duty for the respective parties." 393 N.E.2d at 1342. Likewise, in *Intaglio Service Corp. v. J.L. Williams & Co.,* 95 Ill.App.3d 708, 420 N.E.2d

634, 51 Ill.Dec. 220 (1st Dist. 1981), the court held that the landlord would be held to obligations in lease documents in which he agreed to make repairs or complete work. The court ruled that the lessee's acceptance of the demised premises did not act as a waiver of objected-to defects that allegedly resulted from the lessor's failure to comply with the guarantees made in the parties' contract. 420 N.E.2d at 639. The court also held that the "existence in the contract of a provision imposing a duty to repair . . . for one year in no way bars plaintiff after that one year from claiming damages as a result of faulty or insufficient work or material." *Id.*

In Illinois, it appears that for a landlord's covenant to repair to be enforceable it must (a) be made either at or around the time the lease is executed or (b) be later assumed with consideration received. *Forshey v. Johnston,* 132 Ill.App.2d 1106, 271 N.E.2d 81 (4th Dist. 1971); *Moldenhauer v. Krynski,* 62 Ill.App.2d 382, 210 N.E.2d 809 (1st Dist. 1965). In *Forshey,* the court held that the landlord's promise to make repairs — a promise made after execution of the lease — is a mere naked promise and creates no liability against the landlord for failure on its part to make such repairs. As stated by the court, in order to be enforceable, the covenant must be "created at the time the original lease was incubated or assumed for a consideration thereafter." 271 N.E.2d at 84.

Landlords also often covenant to make repairs or provide rights in common to multiple tenants, such as when a landlord leases space to multiple tenants in a shopping mall. Under these circumstances, the landlord has a continuing obligation to maintain these rights equally with all interested tenants. Under Illinois law, a landlord is liable for any encroachment or interference with the tenant's rights. *See The Fair v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 4 Ill.App.2d 454, 124 N.E.2d 649 (1st Dist. 1954) (finding for tenant and against landlord on tenant's claim that window installed by landlord provided greater benefit to new tenant at expense of existing tenants); *Madigan Brothers, Inc. v. Melrose Shopping Center Co.,* 123 Ill.App.3d 851, 463 N.E.2d 824, 79 Ill.Dec. 270 (1st Dist. 1984) (tenant successfully enjoined landlord from erecting building in shopping center's parking lot due to interference with tenant's easement).

2. [7.16] Structural vs. Nonstructural Repairs

Another exception to the general rule that a landlord is not obligated to make repairs involves structural repairs to the demised premises. In Illinois, despite the existence of a lease provision making a lessee generally responsible for repairs, if the required repairs are of a structural nature, they likely will be deemed obligations of the landlord. *Expert Corp. v. LaSalle National Bank,* 145 Ill.App.3d 665, 496 N.E.2d 3, 5, 99 Ill.Dec. 657 (1st Dist. 1986). *See also Hardy v. Montgomery Ward & Co.,* 131 Ill.App.2d 1038, 267 N.E.2d 748 (5th Dist. 1971) (holding that general covenant of tenant to repair, or to keep premises in repair, merely binds it to make ordinary repairs reasonably required to keep premises in proper condition; it does not require it to make repairs involving structural changes).

That being said, it has been held that the landlord can be relieved of its obligation to make structural repairs if the tenant assumes that obligation in an expenses covenant in the lease. *Chicago Title Land Trust Co. v. Fifth Third Bank,* No. 11 C 1914, 2011 WL 6029565 (N.D.Ill. Dec. 5, 2011); *See also Kallman v. Radioshack Corp.,* 315 F.3d 731, 738 (7th Cir. 2002) (tenant had duty to repair and replace roof and HVAC units when lease provided that "[l]*essee shall be liable for repair to the roof and for any structural failure of the building*" [emphasis added by *Kallman* court]).

It is often difficult to predict what will be deemed a structural repair or an ordinary nonstructural repair. In *Kaufman v. Shoe Corporation of America,* 24 Ill.App.2d 431, 164 N.E.2d 617 (3d Dist. 1960), the court held that installation of a heating system was a structural repair. In *Mandelke v. International House of Pancakes, Inc.,* 131 Ill.App.3d 1076, 477 N.E.2d 9, 87 Ill.Dec. 408 (1st Dist. 1985), the court determined that the lease language required that the tenant was responsible for the repair of an underground water main. In *Expert Corp., supra,* the court held that the lease did not obligate the tenant to repair or replace a structurally defective wall on the verge of collapse. 496 N.E.2d at 5. As a result of the difficulties in determining what will constitute a structural or nonstructural repair, landlords may want to expressly define in the lease what is considered — and what is not considered — a structural repair.

Also, landlords should note that even when a tenant assumes the duty to make structural repairs, the landlord still may have a replacement obligation. *Quincy Mall, Inc. v. Kerasotes Showplace Theatres, LLC,* 388 Ill.App.3d 820, 903 N.E.2d 887, 328 Ill.Dec. 227 (4th Dist. 2009). In *Quincy Mall,* a dispute arose between the landlord and the tenant regarding the roof of the leased premises. It appears from the court's opinion that there was no dispute the roof could not be repaired and that both parties agreed that the roof needed to be replaced. The pertinent provision of the lease provided:

> **Tenant agrees during the term hereof to keep and maintain in good condition and repair, the demised premises and every part thereof [**including**] without limitation the . . . roof . . . . The [t]enant further agrees to keep the demised premises at all times in good order, condition and repair, and agrees that the demised premises shall be kept in a clean, sanitary, and safe condition, in accordance with the laws and regulations of any governmental authority having jurisdiction over the same.** 903 N.E.2d at 891.

The landlord argued that the above provision obligated the tenant to replace the roof. The court disagreed. The court held that that in order to shift the burden from the landlord to the tenant in making structural repairs, the warrant for the change must be "plainly discoverable" in the lease. *Id.* The court determined the lease did not shift the burden to replace the roof and was only a general repair clause "falling short of the 'plainly discoverable' provision, which requires clear and unambiguous language." *Id. See also Nida v. Spurgeon,* 2013 IL App (4th) 130136, ¶46, 998 N.E.2d 938, 376 Ill.Dec. 228 (covenant to keep premises in repair covers ordinary repairs and not "renewals and replacements which would last a lifetime"), quoting *Quincy Mall, supra,* 903 N.E.2d at 890.

The *Quincy Mall* court found that while the lease clearly obligated the tenant to repair the roof, it was ambiguous as to which party had the burden of replacing it. Accordingly, the landlord was found to be responsible for replacing the roof. 903 N.E.2d at 892. *See also Sandelman v. Buckeye Realty, Inc.,* 216 Ill.App.3d 226, 576 N.E.2d 1038, 160 Ill.Dec. 84 (1st Dist. 1991) (holding that general repair clause in lease did not obligate tenant to replace roof).

C. [7.17] Tenant's Options for Breached Covenant

Illinois law affords tenants several options if a landlord breaches its express covenant to repair. These options include, but may not be limited to, (1) abandoning the premises if they become

untenantable by reason of breach, (2) remaining in possession and recouping damages in an action for rent, (3) making repairs and deducting the costs from the rent or suing the landlord for the costs, or (4) suing the landlord for damages. *American National Bank & Trust Company of Chicago v. K-Mart Corp.,* 717 F.2d 394, 398 (7th Cir. 1983), citing *Book Products Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881, 885 (2d Dist. 1961). If a tenant sues for damages, the proper calculation for damages is the difference between the value of the premises if kept in a condition of repair as required by the landlord's covenant and the rental value of the premises in their actual condition. *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 613, 5 Ill.Dec. 282 (2d Dist. 1977).

Another option may be for the tenant to make repairs and offset the cost of repair against rent owed under the lease. In *Quincy Mall, Inc. v. Kerasotes Showplace Theatres, LLC,* 388 Ill.App.3d 820, 903 N.E.2d 887, 328 Ill.Dec. 227 (4th Dist. 2009), the tenant replaced the damaged roof and attempted to offset its costs against rent owed to the landlord. The court set forth three factors that a tenant must satisfy in order to offset rent against the costs of repair or replacement when a landlord fails to replace a critical component of the leased premises in violation of its duty to do so:

1. The tenant must inform the landlord of the need to replace the necessary component.

2. The landlord must have failed to replace the component in a timely manner.

3. The tenant must inform the landlord of its intention to offset the costs of the necessary replacement.

The court determined the tenant had satisfied all three requirements and, therefore, allowed for the offset of rent. 903 N.E.2d at 892.

Notwithstanding the remedies generally available to a commercial tenant, these remedies can be limited by contract. If landlords are concerned about tenant remedies in the event of a breach, the lease should be drafted accordingly. Under Illinois law, commercial leases may contain language that obligates a tenant to pay rent "without any set-off, abatement, counterclaim, or deduction whatsoever." If these provisions are included in a lease agreement, the court may determine that the contractual language limits the remedies available to the tenant when seeking relief as a result of a landlord's breach of its covenant to repair. *Id.*

D. Tort Liability

1. [7.18] General Rule

In Illinois, the basic rule is that a landlord that has relinquished full control and possession of the demised premises to a tenant ordinarily is not liable for injuries to the tenant or a third party caused by the tenant's negligence or because of a defective condition of the premises arising after the beginning of the lease. *Watts v. Bacon & Van Buskirk Glass Co.,* 20 Ill.App.2d 164, 155 N.E.2d 333, 336 – 337 (3d Dist. 1958), *aff'd* 18 Ill.2d. 226, 163 N.E.2d 425 (1959). *See also Gilley v. Kiddel,* 372 Ill.App.3d 271, 865 N.E.2d 262, 309 Ill.Dec. 899 (2d Dist. 2007); *Bourgonje v. Machev,* 362 Ill.App.3d 984, 841 N.E.2d 96, 298 Ill.Dec. 953 (1st Dist. 2005); *Bennett v. Northlake*

Associates Limited Partnership, 442 F.Supp.2d 569 (N.D.Ill. 2006) (holding that when landlord relinquishes control of property to tenant, landlord owes no duty to third parties and tenant). The rationale for the rule, as set forth in *Watts, supra,* is that because the landlord's right of entry and possession of the premises is suspended during the term, if during the term — through the fault of the tenant — the premises become unsafe, then the tenant, not the landlord, should bear liability for the defective condition. 155 N.E.2d at 336.

Applying the general rule, Illinois courts have precluded landlord liability in cases involving third-party injury caused by a tenant's tort. *Klitzka v. Hellios,* 348 Ill.App.3d 594, 810 N.E.2d 252, 284 Ill.Dec. 599 (2d Dist. 2004) (landlord not liable for tenant's dog attack of third person after relinquishing control of premises to tenant). Likewise, courts have applied the general rule to preclude landlord liability under a residential lease for injury to a tenant arising out of defects in the premises. *Lamkin v. Towner,* 138 Ill.2d 510, 563 N.E.2d 449, 150 Ill.Dec. 562 (1990) (landlord found not liable for injuries sustained when tenant's child fell through window screen).

Landlords should note that while relinquishing full control and possession of premises appears to shield them from liability from injuries or damage to a tenant or third person, if full control and possession is not transferred, landlords can still be subject to liability. *See Bennett, supra*. Under Illinois law, when a lessor retains control and ownership of part of the premises, the lessor can be liable for injuries sustained on the part of the premises within its control. 442 F.Supp.2d at 570 – 571.

2. Exceptions

a. [7.19] Control and/or Possession Retained by Landlord

Like most rules, exceptions to the general rule regarding tort liability do exist. In Illinois, if the landlord does not relinquish full control and possession of the premises, the landlord can still be subject to liability for injuries sustained on the premises. *See Bennett v. Northlake Associates Limited Partnership,* 442 F.Supp.2d 569 (N.D.Ill. 2006). Under Illinois law, when a lessor retains control and ownership of part of the premises, the lessor can be liable for injuries sustained on the part of the premises within his or her control. 442 F.Supp.2d at 570 – 571. *See also Demos v. Ferris-Shell Oil Co.,* 317 Ill.App.3d 41, 740 N.E.2d 9, 251 Ill.Dec. 179 (1st Dist. 2000); *Guerino v. Depot Place Partnership,* 273 Ill.App.3d 27, 652 N.E.2d 410, 209 Ill.Dec. 870 (2d Dist. 1995); *Fan v. Auster Co.,* 389 Ill.App.3d 633, 906 N.E.2d 663, 329 Ill.Dec. 465 (1st Dist. 2009); *Flores v. Westmont Engineering Co.,* 2021 IL App (1st) 190379, 183 N.E.3d 188, 451 Ill.Dec. 142.

In *Guerino, supra,* a worker who was injured when attempting to open an entrance gate to property leased to his employer brought suit against the partnership that leased the premises. The lease at issue placed the duty of repair and maintenance on the tenant. During the lease term, the landlord made improvements to the premises, reimbursed the tenant for some repairs, and kept and maintained records on the premises. On appeal, the tenant argued that these facts established that the landlord did not relinquish possession of the premises to the tenant, and that the trial court erred in granting the landlord's motion for summary judgment. The appellate court agreed. The court found that the landlord's use and maintenance of the premises created a genuine question of fact as to whether the landlord retained control and possession of the premises. 652 N.E.2d at 413.

Likewise, in *Fan, supra,* the decedent employee's estate brought suit against the sublessor and sublessee of a commercial building. The employee was killed when he fell into an elevator shaft on the premises. The court cited *Guerino* in its decision to deny summary judgment in the tenant's favor as sublandlord on the basis that questions of material fact existed as to who had control of the premises at the time of the accident. 906 N.E.2d. at 680.

Nevertheless, even though a landlord may be deemed to have not relinquished control of the premises, liability for an injury does not automatically attach. In *Demos, supra,* a customer sued the owner and tenant of a service station for injuries sustained when the tire he was attempting to inflate with the station's free air hose exploded. The plaintiff argued that while the tenant assumed control over the day-to-day operations at the station, the owner assumed the duty of safety with regard to the station. Based on the facts of the case, the court agreed. The court found that, based on the owner's involvement with the premises, it had, in fact, assumed the duty of safety with regard to the station. However, the court did not find the owner liable because there was not sufficient evidence that it breached its duty of care. The court determined that actions of the owner did not proximately cause the customer's injury. Rather, the injury was caused by the improper mounting of the tire that exploded. 740 N.E.2d at 21.

b. [7.20] Latent and/or Concealed Defects; Negligent and/or Unaddressed Repairs

Merely relinquishing control and possession of the premises to the tenant does not completely shield a landlord from liability. Illinois courts have held that even when a landlord relinquishes control and possession of the premises, the landlord may still be subject to liability for injury to the tenant or a third person if

> **(1) . . . a latent defect exists at the time of the leasing, which defect is known or should have been known to the landlord in the exercise of reasonable care and which could not have been discovered upon a reasonable examination of the premises by the tenant; (2) . . . the landlord fraudulently conceals from the tenant a known, dangerous condition; (3) . . . the defect causing the harm, in the law, amounts to nuisance; and (4) . . . the landlord promises the tenant to repair the premises at the time of leasing.** *Thorson v. Aronson,* 122 Ill.App.2d 156, 258 N.E.2d 33, 34 – 35 (2d Dist. 1970).

See also Cuthbert v. Stempin, 78 Ill.App.3d 562, 396 N.E.2d 1197, 33 Ill.Dec. 473 (1st Dist. 1979); *Seago v. Roy,* 97 Ill.App.3d 6, 424 N.E.2d 640, 53 Ill.Dec. 849 (3d Dist. 1981); *Gilbreath v. Greenwalt,* 88 Ill.App.3d 308, 410 N.E.2d 539, 43 Ill.Dec. 539 (3d Dist. 1980); *Watts v. Bacon & Van Buskirk Glass Co.,* 20 Ill.App.2d 164, 155 N.E.2d 333 (3d Dist. 1958), *aff'd* 18 Ill.2d. 226, 163 N.E.2d 425 (1959).

In *Watts, supra,* the plaintiff brought suit based on injuries she sustained when a drugstore door made of untempered glass shattered when she opened it. The door, installed by the landlord, had already been replaced once due to someone striking it. The court held that the plaintiff was entitled to a new trial on the issue of whether the landlord had knowledge that the door was not suitable for the intended use. The court also found that because the landlord had voluntarily installed and repaired the door, it became responsible to perform the work in a manner that would prevent reasonably foreseeable or probable injuries. As a result, the trial court erred in directing a verdict for the landlord. 155 N.E.2d at 337.

In *O'Rourke v. Oehler,* 187 Ill.App.3d 572, 543 N.E.2d 546, 135 Ill.Dec. 163 (4th Dist. 1989), a painter was electrocuted when the ladder he was using to paint farm property came into contact with electrical wires. The painter's estate brought suit against the owner-lessor and the lessee. Testimony established that the owner had previously maintained and repaired the farm property, that it had contracted with a painting company to paint some of the property, and that it had authorized the tenant to replace bare exterior electrical wires. As a result, the court held that material questions of fact existed as to whether the owner had knowledge of the condition that led to the painter's electrocution and found that the trial court erred in granting summary judgment to the landlord. 543 N.E.2d at 552.

c. [7.21] Code Violations

Another exception to the general rule regarding tort liability exists when injuries are suffered as a result of code violations by the landlord of a statute or ordinance that prescribes a duty for protection and safety of persons or property. 24 I.L.P. *Landlord and Tenant* §194 (2009); *Chem-Pac, Inc. v. Simborg,* 145 Ill.App.3d 520, 495 N.E.2d 1124, 99 Ill.Dec. 389 (1st Dist. 1986); *Lombardo v. Reliance Elevator Co.,* 315 Ill.App.3d 111, 733 N.E.2d 874, 248 Ill.Dec. 199 (1st Dist. 2000).

In *Lombardo, supra,* a bank's maintenance worker suffered injuries when a lift on which he was riding suddenly fell. He brought an action against several parties, including the owner of the premises, for violating its duty to maintain the lift in a safe condition. The elevator and lift in question had been examined by inspectors prior to the plaintiff's injury. The inspection report indicated that the lift was rusty, dry, and needed to be replaced. 733 N.E.2d at 877. However, the inspection report was provided only to the bank, not to the owner, and it did not appear that the owner had notice of the defective condition. Nevertheless, the court found the owner liable. The court found that an owner "may be liable for violation of an ordinance, even if the owner has surrendered possession and control of the premises to a tenant." 733 N.E.2d at 881. The court stated that the ordinance relating to the injury imposed a nondelegable duty on the owner to maintain the lift in safe operating condition. *Id.* The court did not accept the owner's argument that liability should not be imposed because it had neither actual nor constructive notice. The court stated that an "owner has constructive notice of all conditions discoverable by reasonable inspection of the premises" and that a "principle also has constructive notice of all material facts known to its agent." 733 N.E.2d at 881 – 882. The court found that the owner had constructive notice of the defective condition as a result of the bank having notice of the defective condition and that owner liability should be imposed. *Id.*

Likewise, in *Jones v. Polish Falcons of City of Chicago Heights,* 244 Ill.App.3d 348, 614 N.E.2d 397, 185 Ill.Dec. 263 (1st Dist. 1993), the landlord was sued for negligence by the building residents who were injured in a fire and the survivors of residents who were killed. The trial court entered judgment for the plaintiffs, and the landlord appealed. On appeal, the court affirmed. The building at issue had previously been inspected by the city and was subject to a report that indicated that there were various violations of building code ordinances and that it was unfit for human habitation. Nevertheless, and without correcting the violations, the landlord permitted a woman to live in the building along with her friend and her friend's five children; the friend and three of her children died in the fire. In ruling for the plaintiffs, the court stated that

> **violation of a statute or ordinance designed for the protection of human life or property is *prima facie* evidence of negligence, and that the party injured thereby has a cause of action, provided that he comes within the purview of the particular ordinance or statute, and the injury has a direct and proximate connection with the violation.** 614 N.E.2d at 400.

The court found that the city's ordinance prohibiting anyone to occupy a building with an uncorrected dangerous condition was designed for the protection of human life. The court also found that the plaintiffs fell within the class of persons intended to be protected by the ordinance and that the plaintiffs' injuries were the kind the ordinance was intended to prevent. As a result, the court stated that "[w]hen an owner violates an ordinance, it is not a defense that the owner was not in possession and control of the premises." 614 N.E.2d at 401.

d. [7.22] Common Areas

Another exception to the general rule regarding tort liability exists under circumstances in which the landlord retains control and possession over common areas in buildings with multiple tenants. *Williams v. Alfred N. Koplin & Co.,* 114 Ill.App.3d 482, 448 N.E.2d 1042, 70 Ill.Dec. 164 (2d Dist. 1983). In *Williams,* the plaintiff, an employee of the building tenant, brought suit against the landlord for injuries she sustained while walking down an outside staircase covered with snow. The landlord had shoveled a narrow strip in the middle of the stairs but had failed to shovel the entire stairs. The plaintiff claimed that the handrails on the stairs were inaccessible while walking in the strip of the stairs that was shoveled. 448 N.E.2d at 1044 – 1045.

The trial court granted the defendant's motion for summary judgment, but the appellate court reversed. The appellate court first stated the general principle that absent a special agreement, a landlord owes no duty to its tenants to remove natural accumulations of snow and ice from common areas that remain under its control. However, the court found that a separate basis of liability could exist under circumstances in which the landlord took measures to clear the snow and did so in an unreasonable manner. The court held that questions of material fact existed as to the landlord's liability under this theory. The court stated, "[b]y voluntarily shoveling a path on the stairway the defendants then obligated themselves to perform the undertaking with reasonable care." 448 N.E.2d at 1047. As a result, in Illinois, when a landlord rents the premises to several tenants and retains control over a part of the premises for the common use of the several tenants, "he has the duty of exercising reasonable care to keep the premises in a reasonably safe condition and is liable for an injury from the failure to perform such duty." 448 N.E.2d at 1045.

Similarly, in *Hiller v. Harsh,* 100 Ill.App.3d 332, 426 N.E.2d 960, 55 Ill.Dec. 635 (1st Dist. 1981), an action was brought against the manager and the owner of an apartment building to recover for personal injuries claimed to have been sustained by the plaintiff in a fall on the stairs of the building. The trial court entered judgment for the plaintiff on a jury verdict, and the appellate court affirmed. The court stated that in Illinois it is well settled that a landlord has the duty to exercise reasonable care to keep common areas in a reasonably safe condition and that the landlord is liable for injuries to persons lawfully on the premises due to the failure to perform this duty. 426 N.E.2d at 964. The facts established that the defendants were aware of the condition that proximately caused the plaintiff's injury and failed to repair the defect in a reasonable time. As a result, the

court found that liability on the defendants was proper. *Id. See also Evans v. United Bank of Illinois, N.A., Trust No. 1233,* 226 Ill.App.3d 526, 589 N.E.2d 933, 168 Ill.Dec. 533 (2d Dist. 1992) (finding questions of material fact existed as to landlord's liability for injuries sustained in parking lot of shopping center); *Sears, Roebuck & Co. v. Charwil Associates Limited Partnership,* 371 Ill.App.3d 1071, 864 N.E.2d 869, 309 Ill.Dec. 628 (1st Dist. 2007) (interpreting language in lease at issue as providing for landlord liability when customer of tenant was injured by employee of tenant in common area of shopping mall).

3. [7.23] Commentary

The discussion on landlord liability in §§7.19 – 7.22 above illustrates the importance for a landlord to clearly and unambiguously spell out its duties and responsibilities in the lease. By expressly providing what a landlord is and is not responsible for in the lease (to the extent permissible by law), the landlord can minimize its exposure to both the tenant and third parties. Similarly, landlords should take effective measures to ensure that they have adequate liability insurance in the event they are sued. Even when landlords ultimately are found not liable, they frequently find themselves as defendants in lawsuits and need to have their defense costs covered. Finally, landlords should make sure the lease they enter into does not include a broad indemnification clause for the benefit of the tenant or third parties. Rather, the landlord is better served by insisting that its tenants indemnify the landlord for their own negligence and that of their employees, agents, and contractors, even when the negligent conduct occurs outside the premises in the common areas of the building, shopping center, or apartment complex.

V. LANDLORD EXONERATION

A. [7.24] Illinois Law Overview

Under Illinois law, any lease provision that absolves a landlord from liability for injuries sustained to persons or property as a result of the negligence of the landlord, its agents, servants, or employees is unenforceable. See the Landlord and Tenant Act, 765 ILCS 705/0.01, *et seq.* Specifically, §1 of the Act provides:

> **(a) Except as otherwise provided in subsection (b), every covenant, agreement, or understanding in or in connection with or collateral to any lease of real property, exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his or her agents, servants or employees, in the operation or maintenance of the demised premises or the real property containing the demised premises shall be deemed to be void as against public policy and wholly unenforceable.**
>
> **(b) Subsection (a) does not apply to a provision in a non-residential lease that exempts the lessor from liability for property damage.** 765 ILCS 705/1.

The purpose of the Act is to prevent landlords from avoiding liability for their own negligence. *Whitledge v. Klein,* 348 Ill.App.3d 1059, 810 N.E.2d 303, 284 Ill.Dec. 650 (4th Dist. 2004).

In *Whitledge,* the tenants of an apartment complex brought a negligence suit against the apartment complex following an apartment fire. The tenants' leases contained provisions stating that "[t]he owner is not responsible for Resident's property in case of accident." 810 N.E.2d at 304. One tenant's lease contained an additional provision stating that "IT WILL BE YOUR RESPONSIBILITY TO CARRY RENTERS['] INSURANCE. THE INSURANCE IS TO PROVIDE PROTECTION FOR YOUR PERSONAL POSSESSIONS. [THE LANDLORD] IS NOT RESPONSIBLE FOR YOUR PROPERTY IN CASE OF AN ACCIDENT." 810 N.E.2d at 305.

Despite the language of the Act, the landlord argued the lease provisions exonerated it from any liability due to the fire. It was the landlord's position that the leases merely compelled tenant indemnification of the landlord and, therefore, were permissible and did not violate the Act. The trial court denied the landlord's motion to dismiss and certified the question for appeal. *Id.*

On the questions posed, the court found that the Act applied. The court held that the Act precludes enforcement of lease provisions, providing that the landlord is not responsible for damage to the tenant's personal property in the case of an accident in a situation in which the damage was caused by the negligence of the owner, even when the tenant purchased rental insurance and recovered its loss under the insurance policy. 810 N.E.2d at 307. According to the court's opinion, a tenant's insurers must be given the same protections as the tenant under the Act, as they stood in the place of the tenant. Any contrary ruling would allow a landlord to shield itself of liability for its own negligence. *Id.*

Similarly, in *McMinn v. Cavanaugh,* 177 Ill.App.3d 353, 532 N.E.2d 343, 126 Ill.Dec. 658 (1st Dist. 1988), a plaintiff who fell on pavement at a service station brought suit against the lessor and the lessee of the service station. The lessor counterclaimed and sought indemnity from the lessee based on provisions in the lease. The trial court dismissed the counterclaim, and the appellate court affirmed. The court rejected the landlord's argument that the Act did not apply because the clause at issue was an indemnity agreement and not an exculpation. 532 N.E.2d at 344. While the court agreed that there was a difference between an indemnification clause and an exculpatory clause, the court found that the Act applied because an indemnity clause in the lease had the same effect and an exculpatory clause; the landlord did not pay. 532 N.E.2d at 345. As a result, the court affirmed the trial court's dismissal of the counterclaim and ruled that the Act precludes indemnification clauses in leases, as well as exculpatory clauses that are designed to shield the landlord from injuries or damages suffered as a result of the landlord's negligence. *Id.*

For a decision relating to a landlord's potential liability for damage to personal property, *see Dubey v. Public Storage, Inc.,* 395 Ill.App.3d 342, 918 N.E.2d 265, 335 Ill.Dec. 181 (1st Dist. 2009). However, the lease agreement at issue in *Dubey* was issued prior to the adoption of subsection §1(b) of the Act. It is uncertain whether the landlord in *Dubey* would have been found liable had the lease agreement been entered into after the addition of §1(b). *See Midway Park Saver v. Sarco Putty Co.,* 2012 Ill. App (1st) 110849, ¶32, 976 N.E.2d 1063, 364 Ill.Dec. 500 ("because the parties executed the lease agreement in 1993, and the amendment to the Act was enacted in 2005, the lease agreement is governed by the Act as it was 1993").

B. [7.25] Caselaw

When adopted, the Landlord and Tenant Act provided that it applied prospectively only, and not retroactively. Therefore, exculpatory clauses in leases entered into prior to the Act's September 17, 1971, effective date remain valid and enforceable. *See Midway Park Saver v. Sarco Putty Co.,* 2012 Ill. App (1st) 110849, ¶32, 976 N.E.2d 1063, 364 Ill.Dec. 500. As a result, when courts encounter leases that predate the Act, the rulings generally uphold lease provisions that permitted a landlord to exculpate itself from its own negligence. *See Bruno v. Gabhauer,* 9 Ill.App.3d 345, 292 N.E.2d 238 (1st Dist. 1972) (landlord held not liable by virtue of exculpatory clause in lease when tenant was injured from fall on iron gate due to alleged lack of repair to gate); *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 5 Ill.Dec. 282 (2d Dist. 1977) (Act did not render unenforceable lease entered into in 1966 that contained clause that exculpated landlord from damages caused by water on roof); *J.B. Stein & Co. v. Sandberg,* 95 Ill.App.3d 19, 419 N.E.2d 652, 50 Ill.Dec. 544 (2d Dist. 1981) (upholding validity of exculpatory clause in lease entered into in 1964 and renewed in 1973 that shielded landlord from liability from fire on premises).

C. [7.26] Limitation

Although Illinois law does not permit a landlord to shield itself from liability due to its own negligence, there are ways a landlord can limit its exposure in the event of a breach of its obligations under the lease. In *Guitar Center Stores, Inc. v. 7250 South Cicero Equities, LLC,* No. 07 C 4227, 2007 WL 3374592 (N.D.Ill. Nov. 8, 2007), the plaintiff-tenant sued the landlord for damages it allegedly sustained by the landlord's breach of lease. Under the parties' lease agreement, the landlord was to make certain improvements to the premises prior to providing access and possession to the plaintiff. It is undisputed that the improvements were not made on the date possession was supposed to be awarded. The plaintiff sought damages in the form of abatement of rent provided for in the lease as well as consequential damages caused by the delay. 2007 WL 3374592 at *1.

The lease at issue provided that in the event the landlord did not deliver possession of the premises to the tenant, the tenant's remedy would be the abatement of rent. 2007 WL 3374592 at *4. Despite the fact that the lease did not expressly provide this was the tenant's "exclusive" remedy, the court found that rent abatement was the tenant's only remedy for delay. 2007 WL 3374592 at **4 – 5. As a result, the court found that the tenant was not entitled to consequential damages and was limited to the relief available in the lease. 2007 WL 3374592 at *7.

Guitar Center is illustrative of measures a landlord can take to limit its exposure under the terms of a lease. When entering into lease agreements, landlords should examine the terms of the lease to determine their potential liability in the event certain timing requirements are not met. If the landlord is subject to exposure in addition to the abatement of rent, *Guitar Center* suggests the landlord should take the appropriate step to limit potential liability by inserting an exclusive remedy clause in the lease.

VI. TENANT PROTECTION AGAINST CRIMINAL ACTS

A. [7.27] General Rule

In Illinois, generally, there is no duty requiring a landowner to protect others from criminal activity by third persons on its property absent a special relationship between the parties. The Illinois Supreme Court has held that the simple relationship between a landlord and tenant, or a landlord and those on the premises with the tenant's consent, is not a "special" one imposing a duty to protect them against the criminal acts of others. *Rowe v. State Bank of Lombard,* 125 Ill.2d 203, 531 N.E.2d 1358, 126 Ill.Dec. 519 (1988). *See also Whalen v. Lang,* 71 Ill.App.3d 83, 389 N.E.2d 10, 12, 27 Ill.Dec. 324 (3d Dist. 1979) (finding that landlord did not have duty to repair and maintain exterior lighting for safety of its tenants absent finding of special relationship, which did not exist); *Bourgonje v. Machev,* 362 Ill.App.3d 984, 841 N.E.2d 96, 121, 298 Ill.Dec. 953 (1st Dist. 2005) (landlord does not owe any special duty to tenant to protect tenant from criminal acts of third party); *Sanchez v. Wilmette Real Estate & Management Co.,* 404 Ill.App.3d 54, 934 N.E.2d 1029, 1034 – 1035, 343 Ill.Dec. 426 (1st Dist. 2010) (general relationship between landlord and tenant does not impose duty on landlord to protect against criminal acts of others); *N.W. v. Amalgamated Trust & Savings Bank, Trust No. 4015,* 196 Ill.App.3d 1066, 554 N.E.2d 629, 633, 143 Ill.Dec. 694 (1st Dist. 1990) (finding landlord not liable for criminal act directed at tenant on basis that generally there is no duty imposed on landlords to protect tenants from criminal activity); *Ohio Casualty Group v. Dietrich,* 285 F.Supp.2d 1128, 1131 (N.D.Ill. 2003) (commercial landlord did not owe duty to tenant to protect it from criminal acts of third persons).

In *Whalen,* a tenant, who was attacked by a trespasser in a parking lot, brought suit against his commercial landlord. The trial court dismissed the tenant's complaint for failure to state a cause of action, and the appellate court affirmed. In his complaint, the tenant alleged that the landlord had knowledge of similar acts occurring in the past and had failed to exercise ordinary care by (1) failing to provide adequate lighting in the parking lot, (2) failing to physically guard the lot by a physical structure, (3) failing to request police patrols in the area, and (4) failing to provide private security personnel. 389 N.E.2d at 10.

The court began its analysis by restating the general rule that absent a special relationship, Illinois courts have refused to impose a duty on one party to protect a second party from the intentional or criminally reckless acts of a third party. The court noted that a special relationship is not found in the usual landlord-tenant relationship. The court recognized that exceptions to the rule exist but found that none applied to the set of facts involved. In order for the tenant to sustain the cause of action, allegations must include a special relationship between the parties, a dangerous condition that caused the injury, or an affirmative act of the landlord that caused the injury. There was no special relationship alleged. Similarly, there were no allegations regarding an affirmative act of the landlord that caused the injury. As a result, the court affirmed dismissal of the cause of action. 389 N.E.2d at 11.

B. Exceptions

1. [7.28] Foreseeable Injuries

An exception to the general rule that a landlord has no duty to protect others from criminal activity by third persons on its property absent a special relationship between the parties occurs when the landlord has an affirmative duty to perform some act to prevent reasonably foreseeable injuries and either fails to perform that act or performs the act negligently, thereby causing the criminal activities or harm to the tenant on the demised premises. Under these circumstances, a landlord can be held liable for criminal acts that harm a tenant. In *Mims v. New York Life Insurance Co.,* 133 Ill.App.2d 283, 273 N.E.2d 186 (1st Dist. 1971), the tenant brought suit against the landlord for negligence for loss of her fur coat and cash taken from her residence. The tenant was a resident in an apartment owned by the landlord and was terminating the lease at the end of the lease term. Prior to termination, the landlord's employee inspected the apartment to determine whether the interior of the apartment had been damaged. During the inspection, the employee left the door unlocked, and the tenant's fur coat and cash were taken. The court found the landlord liable and held that the theft was reasonably foreseeable from the employee's actions of leaving the door unlocked and unguarded. The court held that the general rule, precluding landlord liability for criminal acts of a third party, did not apply as the landlord still had a duty to protect against the reasonably foreseeable consequences of its agent's negligent acts. 273 N.E.2d at 187.

2. [7.29] Knowledge of Criminal Activity

Another exception to the general rule that a landlord has no duty to protect others from criminal activity by third persons on its property absent a special relationship between the parties exists when the landlord has knowledge of the criminal activity and fails to take reasonable measures to prevent such criminal activity in the future, with such failure causing injuries to the tenant. *Duncavage v. Allen,* 147 Ill.App.3d 88, 497 N.E.2d 433, 100 Ill.Dec. 455 (1st Dist. 1986).

In *Duncavage,* the deceased tenant had been killed after a criminal hid in high weeds on the property and used the landlord's ladder, which was stored in the yard, to climb up to the tenant's window (a window which was incapable of being locked). Once inside, the criminal raped and murdered the tenant. The tenant's estate sued the landlord, arguing that the landlord had notice of the dangerous condition of the property because, inter alia, an intruder had burglarized the premises before by entering it in the same fashion. The trial court granted the landlord's motion to dismiss, but the appellate court reversed. The court found that prior criminal acts on the property imposed a duty of reasonable care on the landlord to the tenants, that the plaintiff had adequately alleged that duty was breached, and that the breach proximately caused the tenant's death. 497 N.E.2d at 438.

Likewise, in *Stribling v. Chicago Housing Authority,* 34 Ill.App.3d 551, 340 N.E.2d 47 (1st Dist. 1975), the tenants brought suit against the landlord under the theory that their injuries were foreseeable due to prior criminal conduct. The tenants were the victims of three separate break-ins by criminals who gained access to their residence by entering adjacent vacant apartments and then breaking through the common walls. The tenants notified the landlord of the unauthorized persons in the vacant apartments and asked that the landlord secure the apartments. The landlord failed to act. The landlord was found liable for injuries resulting from the two subsequent burglaries, but not

the first. The court reasoned that after the landlord was notified of the dangerous condition and failed to act, the subsequent burglaries became foreseeable. In other words, after the first crime, a duty to prevent the same crime from occurring in the same manner arose; when the landlord failed to act, it became liable. 340 N.E.2d at 47.

Notwithstanding the above cases, simply because a landlord has knowledge of previous similar criminal activity does not automatically impose a duty on it to protect in all cases. *Shea v. Pres. Chicago, Inc.,* 206 Ill.App.3d 657, 565 N.E.2d 20, 24 – 25, 151 Ill.Dec. 749 (1st Dist. 1990) (prior incidents of same criminal activity are not per se requirements for finding that landlord voluntarily assumed duty to protect tenants from third-party criminal attacks); *Taylor v. Hocker,* 101 Ill.App.3d 639, 428 N.E.2d 662, 57 Ill.Dec. 112 (5th Dist. 1981) (prior knowledge of criminal acts not enough to impose duty on part of shopping mall store owner to protect customer from assault in shopping mall parking lot). In order for a duty to arise, the facts of the case must indicate that the landlord had a duty to act to prevent reasonably foreseeable injuries based on its prior knowledge of criminal acts. *See Shea, supra,* 565 N.E.2d at 22.

3. [7.30] Voluntary Assumption of Control

Another exception to the general rule that a landlord has no duty to protect others from criminal activity by third persons on its property absent a special relationship between the parties exists mainly under circumstances in which a landlord or owner has decided to provide security on the premises to ensure against criminal acts of third parties. *Regions Bank v. Joyce Meyer Ministries, Inc.,* 2014 IL App (5th) 130193, ¶9, 15 N.E.3d 545, 383 Ill.Dec. 767 (5th Dist. 2014) ("this exception has been narrowly construed and the duty imposed is limited by the extent of the undertaking"). Under these circumstances, courts often are asked to decide (a) whether the landlord's actions created a voluntary assumption of control of the premises and (b) whether the landlord acted negligently in providing the security. Illinois courts have held that when a landlord undertakes to provide security, it may be retaining control over or access to a portion of the property under circumstances that demonstrate the landlord assumed a duty to protect tenants against reasonably foreseeable third-party criminal attacks. *See Comastro v. Village of Rosemont,* 122 Ill.App.3d 405, 461 N.E.2d 616, 621, 78 Ill.Dec. 32 (1st Dist. 1984) (once landlord elects to keep premises safe from criminal activities, it owes duty to tenants to perform services with skill and is liable for breach if services are not provided with due care); *Pippin v. Chicago Housing Authority,* 78 Ill.2d 204, 399 N.E.2d 596, 599, 35 Ill.Dec. 530 (1979) (stating that when landlord contracted to provide security services to premises, it had duty to use reasonable care in engaging services and could be liable for negligent hiring); *Bourgonje v. Machev,* 362 Ill.App.3d 984, 841 N.E.2d 96, 298 Ill.Dec. 953 (1st Dist. 2005) (landlord's provision of door buzzers and intercom system for building did not constitute voluntary undertaking to provide security for tenant).

In *Cross v. Wells Fargo Alarm Services,* 82 Ill.2d 313, 412 N.E.2d 472, 475, 45 Ill.Dec. 121 (1980), the landlord hired part-time security personnel to ensure against criminal acts of third persons. The part-time security personnel stopped work about 1:00 a.m. The defendant was injured when he was beaten by unnamed assailants about 1:15 a.m. The trial court dismissed the defendant's cause of action against the landlord, but the appellate court reversed, and the Illinois Supreme Court affirmed the reversal. The Supreme Court found that by contracting with a third party to provide protection services, the landlord assumed certain duties and that duties voluntarily

assumed had to be performed with due care. The court found that the plaintiff adequately pleaded its cause of action by alleging that the landlord's providing of part-time security guards substantially increased the risk of crime after 1:00 a.m., when the guards were removed. As a result, the court ruled that the plaintiff's complaint against the landlord should not have been dismissed. 412 N.E.2d at 475.

However, by contracting to provide security devices or services to property, the landlord does not become per se liable for injuries occurring thereon. If the court determines the duty to use reasonable care was satisfied, the landlord will be relieved from liability. *Taylor v. Hocker,* 101 Ill.App.3d 639, 428 N.E.2d 662, 665, 57 Ill.Dec. 112 (5th Dist. 1981) (shopping mall owners found not liable for injuries sustained by customers assaulted in shopping mall parking lot because customers did not establish landlord breached duty of care); *Kolodziejzak v. Melvin Simon & Assocs.,* 292 Ill.App.3d 490, 685 N.E.2d 985, 988, 226 Ill.Dec. 530 (1st Dist. 1997) (defendant property management company not liable for death on shopping mall grounds when plaintiffs did not prove defendant breached its duty of care after hiring security service).

Finally, practitioners can review the Illinois Supreme Court's decision in *Rowe v. State Bank of Lombard,* 125 Ill.2d 203, 531 N.E.2d 1358, 126 Ill.Dec. 519 (1988) (discussion of general principles outlined in this section). In *Rowe,* personal injury and wrongful-death actions were brought against various parties, including the owners and operators of an office park and the owner's managing agent. The court discussed the general rule that absent a special relationship between the landlord and tenant there is no duty on the landlord to protect the tenant from criminal acts of a third party on the premises. 531 N.E.2d at 1364. The court found that, even though the landlord took measures to ensure the safety of its tenants, those actions did not create a special relationship that imposed a duty to protect the tenants from criminal acts. However, because the landlord failed to adequately protect the master keys, which enabled the violent crimes committed on the premises, questions of fact existed as to whether the landlord's failures facilitated the criminal acts of a third person and whether the criminal activity was reasonably foreseeable. 531 N.E.2d at 1368.

VII. [7.31] PROPERTY DAMAGE

Most commercial leases provide for each party's duties and responsibilities in the event of an occurrence that renders the property temporarily or permanently untenantable. Nevertheless, litigation often arises regarding the proper interpretation of these provisions. *Cerny-Pickas & Co. v. C.R. Jahn Co.,* 7 Ill.2d 393, 131 N.E.2d 100 (1955); *Nationwide Mutual Fire Insurance Co. v. T & N Master Builder & Renovators,* 2011 IL App (2d) 101143, 959 N.E.2d 201, 355 Ill.Dec. 173. In regard to commercial leases, absent an express covenant in the lease to the contrary, common-law principles apply. *First National Bank of Elgin v. G.M.P,* 148 Ill.App.3d 826, 499 N.E.2d 1039, 1040, 102 Ill.Dec. 259 (2d Dist. 1986).

A. [7.32] Fire

One of the most frequently litigated issues between landlords and tenants with respect to property damage is which party bears responsibility for losses due to fire. At common law, in the

absence of a contrary provision in a lease, there is no duty on either the landlord or the tenant to restore or replace the leased premises when destroyed by fire, and the tenant under such circumstances is still required to pay rent. *Lewis v. Real Estate Corp.,* 6 Ill.App.2d 240, 127 N.E.2d 272, 275 (1st Dist. 1955). The lessor, at common law, has the option of making the repairs and could compel the lessee to either surrender the premises or retain them, making such repairs as it desires. *Id.* Common law also provides that when the lease contains a provision requiring the lessee to make repairs, together with a provision that the lessee must deliver the premises back to the landlord in the same condition as at the time of the lease, the lessee is required to restore the premises if they are damaged by fire. *Id.*

These obligations can be modified by agreement of the parties. If the parties provide that the tenant is required to return the demised premises in good condition, ordinary wear and tear and loss by fire excepted, the tenant likely will not be required to restore the premises if damaged by fire and will be released from liability for property damage regardless of whether the fire was caused by the tenant's negligence. *Cerny-Pickas & Co. v. C.R. Jahn Co.,* 7 Ill.2d 393, 131 N.E.2d 100, 102 – 103 (1955); *Ford v. Jennings,* 70 Ill.App.3d 219, 387 N.E.2d 1125, 1128, 26 Ill.Dec. 295 (3d Dist. 1979) (upholding summary judgment in favor of tenant on landlord's claim for damages from fire as exculpatory clause exempting tenant from damages was valid and enforceable).

However, if the lease provides that the tenant will bear the loss from fire that is a result of the tenant's negligence, the tenant likely will be liable. *First National Bank of Elgin v. G.M.P.,* 148 Ill.App.3d 826, 499 N.E.2d 1039, 1040, 102 Ill.Dec. 259 (2d Dist. 1986). Also, if the lease does not expressly provide that the tenant is to be free from liability for fires resulting from its own negligence, the intent of the parties regarding the tenant's liability will "be gleaned from considering the instrument as a whole." 499 N.E.2d at 1041.

Landlords should be keenly aware of lease provisions relating to loss by fire. If the lease allows the tenant to surrender the premises, upon termination of the lease, in the same condition as it was on the date the lease was executed, ordinary wear and tear and loss by fire excepted, the landlord may be assuming the risk in the event of loss by fire. As a result, if landlords wish to minimize their exposure in the event of a fire, they may want to negotiate with tenants to ensure that such a surrender provision is not contained in the lease.

The following are examples of cases that have applied the above law and determined the landlord bears the risk of loss: *Cerny-Pickas, supra; Stein v. Yarnall-Todd Chevrolet, Inc.,* 41 Ill.2d 32, 241 N.E.2d 439 (1968) (surrender clause in lease exempting tenant from liability due to fire damage upheld); *American National Bank & Trust Co. v. Edgeworth,* 249 Ill.App.3d 52, 618 N.E.2d 899, 188 Ill.Dec. 329 (1st Dist. 1993) (tenant could not be held liable for negligence in causing fire when landlord obtained fire insurance and tenant paid for insurance out of its rent); *Sheridan v. Comp-U-Motive, Inc.,* 168 Ill.App.3d 451, 522 N.E.2d 800, 119 Ill.Dec. 138 (2d Dist. 1988) (surrender clause with unconditioned fire loss exception was complete affirmative defense to claim for damages); *Nationwide Mutual Fire Insurance Co. v. T & N Master Builder & Renovators,* 2011 IL App (2d) 101143, 959 N.E.2d 201, 355 Ill.Dec. 173 (lease language providing that holdover tenants were liable for all damages except for losses caused by fire was enforceable and precluded tenant liability for damages from fire); *Midwest Drilled Foundations & Engineering v. Republic Services, Inc.,* No. 10 C 5446, 2012 WL 2565830 (N.D.Ill. June 28, 2012); *Auto Owners*

Insurance Co. v. Callaghan, 2011 IL App (3d) 100530, 952 N.E.2d 119, 351 Ill.Dec. 746 (landlord could not recover damages as result of fire from tenant when lease did not make tenant liable in event of fire); *Dix Mutual Insurance Co. v. LaFramboise,* 149 Ill.2d 314, 597 N.E.2d 622, 625, 173 Ill.Dec. 648 (1992) (construing lease "as a whole," parties intended landlord, not tenant, to be liable for any fire damage to premises).

The following are cases that have applied the above law and determined that the tenant bears the risk of loss for damage by fire: *G.M.P., supra* (court construed lease at issue as requiring tenant to be liable for damages resulting from fire caused by tenant's negligence); *Fire Insurance Exchange v. Geekie,* 179 Ill.App.3d 679, 534 N.E.2d 1061, 128 Ill.Dec. 616 (3d Dist. 1989) (reaffirmed common law that in absence of express agreement to contrary, tenant is liable for damages to leased premises resulting from its own negligence); *Troccoli v. L & B Products of Illinois, Inc.,* 189 Ill.App.3d 319, 545 N.E.2d 219, 136 Ill.Dec. 695 (1st Dist. 1989) (finding that tenant was liable to landlord for property damage resulting from fire).

B. [7.33] Third Party

Issues can also arise when damage occurs to property of third parties or when injuries occur to third parties while on the premises. *ESL Delivery Services Co. v. Delivery Network, Inc.,* 384 Ill.App.3d 451, 893 N.E.2d 289, 323 Ill.Dec. 275 (5th Dist. 2008); *Hacker v. Shelter Insurance Co.,* 388 Ill.App.3d 386, 902 N.E.2d 188, 327 Ill.Dec. 433 (5th Dist. 2009).

In *ESL Delivery,* suit was filed by the tenant and a third party against the owner of a warehouse for damages sustained to property in the warehouse when it was destroyed by fire. The owner filed a counterclaim of contribution, alleging the tenant's negligence proximately caused the losses. In ruling, the court reviewed the principles set forth in *Dix Mutual Insurance Co. v. LaFramboise,* 149 Ill.2d 314, 597 N.E.2d 622, 173 Ill.Dec. 648 (1992), which held that an exculpatory clause in a lease relieving the landlord from liability for damage to the tenant's personal property while remaining silent on the landlord's liability for damage to the leased premises in case of a fire nonetheless meant that the landlord's property-insurance carrier was liable for remedying fire damage to the leased premises, even if the fire was caused by the tenant. 893 N.E.2d at 293. The court distinguished *Dix,* which involved the responsibility for fixing damage to the premises itself, from the facts in its case, which involved claims for damage to third-party property, and held there was nothing in the tenant's lease that would exculpate the tenant from its own negligence. The court also found that there was nothing in the lease establishing that "the parties intended the landlord to bear the burden of losses suffered by third parties as a result of the tenant's negligence." 893 N.E.2d at 294. As a result, the owner's claim of contribution was allowed.

In *Hacker, supra,* the issue involved liability for injuries relating to a third party. The court ruled that an apartment tenant was not considered a coinsured under the landlord's liability insurance policy and, therefore, was not entitled to a defense by the landlord's insurance company to a third-party complaint by the landlord against the tenant, claiming her negligence caused or contributed to the injuries suffered by her mother who fell on the stairs of the apartment. 902 N.E.2d at 194. The tenant's mother had brought suit against the landlord first and claimed that the landlord's negligence in maintaining the stairway caused her fall and the resulting injuries. 902 N.E.2d 189 – 190.

The *Hacker* court also distinguished *Dix, supra,* and made note that the type of insurance policy at issue in *Dix* (property damage covering fire losses or other damage to the premises) as compared to the type of policy at issue in *Hacker* (liability that covered liability of the insured to third parties) was significant. With property damage insurance, if the tenant does not receive the benefit of the landlord's fire insurance, then both parties would be required to insure against the loss. The same analysis does not apply to liability insurance, which covers losses from an individual's liability to third parties arising out of the tenant's negligence. 902 N.E.2d at 193. As a result, the court held that the tenant could not reasonably expect to be deemed an insured under the landlord's liability insurance policy as there was no evidence the parties intended this in the lease or the policy itself. *Id.* Finally, the court made mention that it was common business practice for tenants to obtain their own renters insurance policy to cover their liability for losses they caused to third parties. 902 N.E.2d at 194. The court declined to expand the *Dix* ruling to hold that a tenant gains the status of a coinsured under the landlord's liability policy merely by the payment of rent. *Id. See also Combs v. Schmidt,* 2012 IL App (2d) 110517, ¶19, 976 N.E.2d 659, 364 Ill.Dec. 381, receded from in part on appeal after remand, 2015 IL App (2d) 131053, ¶18, 48 N.E.3d 1174 (distinguishing *Hacker* from *Dix*).

ESL Delivery and *Hacker* set forth the existing law in Illinois for when a landlord will not be held liable for damage to property of third parties or injury to third parties occurring on the premises. Practitioners should be aware of the law set forth in these cases and should advise landlords to make sure their lease agreements clearly and unambiguously provide for which losses or damages will be insured or borne by the landlord and which losses or damages will be insured or borne by the tenant.

C. [7.34] Other Losses

Although cases involving property damage resulting from loss by fire appear to be the most litigated, other types of property damage cases also have been reported.

In *Arling v. Zeitz,* 269 Ill.App. 562 (1st Dist. 1933), the tenant brought suit against the landlord for damage sustained when water pipes on the premises burst due to freezing. The lease at issue provided that the landlord would not be held liable for damages resulting from the tenant's failure to keep the premises in repair and absolved the landlord of liability for injury caused by defective plumbing and water pipes. The court enforced the lease provisions and allowed the landlord to raise the lease provisions as a defense. The court noted, though, that the lease provisions did not shield the landlord from liability for injuries resulting from its own negligence or from liability if it knew a defective condition existed. 269 Ill.App. at 566 – 568. *See also Nylint Corp. v. Ingram,* 11 Ill.App.3d 122, 296 N.E.2d 392 (2d Dist. 1973) (denying tenant's suit against landlord and upholding provision in lease that required tenant to obtain insurance to cover loss due to water damage); *Wanland v. Beavers,* 130 Ill.App.3d 731, 474 N.E.2d 1327, 86 Ill.Dec. 130 (1st Dist. 1985) (tenant allowed recovery from landlord from loss resulting from water damage due to finding that landlord knew of defective condition and failed to disclose latent defects to tenants).

In short, when dealing with damage other than property damage, the general rules and exceptions still apply. Courts look to the express terms of the lease to see if the parties have

provided for who should bear the loss under the specific circumstances of the case. If no provision applies, courts look to common law and the intent of the parties to aid in their analysis. As stated above, many uncertainties regarding potential liability can be minimized by careful and unambiguous drafting of lease provisions relating to property damage losses.

D. [7.35] Waiver

Due to issues related to which party bears the loss when property damage or injuries occur to or on the premises, many commercial leases include "waiver of subrogation" provisions. These provisions are intended to place the burden of loss on the party obligated to insure such loss and its insurer.

Notwithstanding the increased popularity of waiver of subrogation provisions in commercial lease agreements, it does not appear there has been any Illinois caselaw specifically addressing the enforceability of such provisions. Although there have been cases relating to subrogation claims, the authors have uncovered no caselaw specifically addressing the enforceability of a waiver of subrogation provision in the context of a commercial or residential lease. For cases that discuss subrogation issues in connection with leases, *see Whitledge v. Klein,* 348 Ill.App.3d 1059, 810 N.E.2d 303, 284 Ill.Dec. 650 (4th Dist. 2004) (subrogation claim by insurers of tenants, but no indication that lease contained waiver of subrogation clause), and *Ohio Casualty Group v. Dietrich,* 285 F.Supp.2d 1128 (N.D.Ill. 2003) (subrogation claim by tenant, but focus of court was on cause of fire, not on insurance company's subrogation rights).

That being said, it does appear that the amendments to the Landlord and Tenant Act quoted in §7.24 above provide that waiver of subrogation clauses could be enforceable in the context of commercial leases. Had this statutory provision been in effect at the time of *Whitledge, supra,* it likely would not have changed the court's decision in that case, because §1(b) of the Landlord and Tenant Act does not apply to non-residential leases. See 765 ILCS 705/1(b).

For additional information and discussion on issue of subrogation in commercial leases, see Milton R. Friedman and Patrick A. Randolph, Jr., FRIEDMAN ON LEASES, Practicing Law Institute, ch. 38 (5th ed. 2014). See also Myles Hannan, *Using Property Insurance, Mutual Waiver, and Waiver of Subrogation Clauses in Commercial leases (with Model Clauses),* 17 Prac. Real Est.Law., No. 2, 23 (Mar. 2001), and Alan M. Di Sciullo, *A Guide to Subrogation in Commercial Leases,* 20 Real Est. L.J. 299 (1992); PROPERTY INSURANCE SUBROGATION FROM A TO Z (ABA National Institute, Section of Tort and Insurance Practice, 1991).

VIII. [7.36] SECURITY DEPOSITS

Illinois has no statutory provision governing a commercial landlord's duties and liabilities with respect to the security deposits of its tenants. While Illinois has codified a landlord's obligations with respect to security deposits in residential leases (see the Security Deposit Interest Act, 765 ILCS 715/0.01, *et seq.*), no corresponding act has been adopted for commercial landlords. Similarly, there is little caselaw dealing with this topic. The absence of any specific law on the issue suggests that the parties, generally, are entitled to provide for the obligations of the landlord with respect to the security deposit in the lease, and that courts will apply general principles of contract law if disputes arise.

Issues that may arise include, but are not limited to, (a) the landlord's right to use the deposit; (b) the conditions under which the deposit must be returned to the tenant; (c) whether — and under what conditions — the landlord is permitted to deduct from the security deposit; and (d) assignment of the security deposit. A commercial lease likely should take into account all these issues. A sample provision for security deposits in commercial leases appears below:

Tenant shall deposit with Landlord, prior to possession of the Property, for Landlord's general account, an additional $_____ (Security Deposit) as security for the performance of each and every term, covenant, agreement, and condition of the Agreement on Tenant's part to be performed. Landlord may use or apply on Tenant's behalf or retain, without liability for interest, the whole or any part of the Security Deposit to the extent required for the payment of sums as to which Tenant may be in default hereunder, or for any sum that Landlord may expend to cure any default of Tenant or by reason of Tenant's default, including, but not limited to, any deficiency or damage incurred in reletting the Property but excluding Rent. After each application from the Security Deposit, Tenant shall, within [10**] days from written notice and itemization of what funds have been used from the Security Deposit, replenish and restore such Security Deposit to the initial amount. The use, application, or retention of the Security Deposit by Landlord shall not be deemed a limitation on Landlord's recovery in any case, be deemed a waiver by Landlord of any default, nor prevent Landlord from exercising any other right or remedy for default by Tenant. Provided that Tenant has fully complied with all terms and obligations of this Agreement required of Tenant, the Security Deposit, less any amount applied as herein provided, or for any damages, key replacement and lock change charges, cleaning costs or deficiencies with respect to the Improvement, or attorneys' fees, costs, and collection expenses incurred in enforcement of any terms of this Agreement, shall be returned to Tenant within [**30**] days of the termination of the Initial Term. Tenant may not apply all or any part of such Security Deposit to Rent or any other amounts otherwise due Landlord.**

In the event of a sale of the Property or assignment of this Agreement by Landlord, Landlord shall have the right to transfer the Security Deposit to its vendee or assignee and thereupon Landlord shall be released from liability with respect to the return of such Security Deposit to Tenant. After such sale or assignment, Tenant shall look solely to the new Landlord for return of the Security Deposit. In no event will any mortgagee or any purchaser at a foreclosure sale or a sale in lieu of foreclosure be liable to Tenant for the return of the Security Deposit, unless such mortgagee or purchaser actually receives the Security Deposit from Landlord. Tenant shall not assign or encumber the Security Deposit or its interest therein, and Landlord shall not be bound by any attempted assignment or attempted encumbrance.

A. [7.37] Duty To Return

As stated in §7.36 above, little caselaw exists in Illinois related to a commercial landlord's obligations with respect to a security deposit. That being said, some general principles for commercial landlords were established in *Auker v. Gerold,* 67 Ill.App.2d 425, 214 N.E.2d 618 (5th Dist. 1966). In *Auker,* the lease at issue provided that the tenant's security deposit was to be credited to the tenant during the final two years of the lease. However, the premises were destroyed by fire prior to the last two years of the lease, and the lease was terminated. The landlord refused to return

the deposit under the theory that the deposit was an advance rent payment that it was entitled to retain. The court disagreed and found for the tenant. The court held that when the lease provision is ambiguous, a tenant's money paid in advance of the lease term will be construed as security for the tenant's performance under the lease. 214 N.E.2d at 624. In dictum, the court also noted that a tenant's right to return of its deposit should be determined by "whether the money was paid to secure performance or was the contracting parties' determination of liquidated damages." 214 N.E.2d at 620.

Also discussed in *Aucker* were cases that established the following principles:

1. Unless parties provide otherwise, payments to secure performance are adjusted on the basis of actual damages resulting from nonperformance. 214 N.E.2d at 620 – 621, citing *Advance Amusement Co. v. Franke,* 268 Ill. 579, 109 N.E. 471 (1915).

2. Tenants are entitled to a refund of unearned advance rent payments absent a compelling consideration to the contrary. 214 N.E.2d at 622, citing *Virginia Amusement Co. v. Mid-City Trust & Savings Bank,* 220 Ill.App. 147 (1st Dist. 1920). *See also Cauley v. Northern Trust Co.,* 315 Ill.App. 307, 43 N.E.2d 147 (1st Dist. 1942) (tenant not entitled to refund of security deposit when tenant had been evicted for breach of covenant to construct new building).

The principles in *Auker, supra,* were interpreted by the Bankruptcy Court for the Northern District of Illinois in *New World Institute, Inc. v. American National Bank & Trust Company of Chicago (In re New World Institute, Inc.),* No. 89 B 19535, 1990 WL 16933 (Bankr. N.D.Ill. Feb. 23, 1990). The *New World* court read *Auker* as standing for the following principles:

1. A security deposit may be held for the purpose of either prepaid rent or security for the performance of obligations under the lease.

2. A non-defaulting tenant is more likely to recover a security deposit than a defaulting tenant.

3. A tenant does not have an absolute right to a refund of a security deposit if it is in the nature of an advance prepaid rent.

4. A security deposit will be construed as being security for a tenant's obligations under the lease, rather than advance payment, unless a contrary intent is clearly expressed.

5. A security deposit to secure a tenant's obligations under the lease is recoverable upon lease termination.

6. The landlord can deduct actual damages, evidenced by appropriate documentation, from a deposit held as security for the tenant's performance. 1990 WL 16933 at *2.

Based on the above principles, it appears that, unless a lease clearly specifies the purpose of the deposit and under what conditions the tenant is not entitled to its return, the tenant likely will be entitled to a refund of its security deposit upon the termination of the lease, less the landlord's actual damages, if any, for nonperformance. Advance rent payments may be refundable unless the lease provides that such payments will be forfeited if the lease is terminated early as a result of a default by the tenant.

B. [7.38] Assignment

Landlords should also remember that if their interest in the lease is assigned, it must also transfer the tenant's security deposit to the assignee in order to be relieved of liability to the tenant for the return of the deposit. *McDonald's Corp v. Blotnik,* 28 Ill.App.3d 732, 328 N.E.2d 897 (3d Dist. 1975). In *McDonald's,* a landlord assigned its rights under the lease but did not transfer the security deposit to the assignee. The court found that the landlord's assignment did not release it from the obligation to return the security deposit, which was a personal obligation of the landlord as a pledgee, not as a landlord. The court concluded that the security deposit was given to the landlord as a pledgee for the landlord's conditional benefit. 328 N.E.2d at 900.

IX. OPTIONS

A. [7.39] Renew, Extend, or Expand

In Illinois, commercial leases frequently provide the tenant with the option to either extend or renew the lease upon expiration of the original term. Absent a lease provision granting the tenant the ability to extend or renew the lease, the tenant, generally, would have no ability to do so. Illinois caselaw differentiates between an extension and a renewal of a lease. A lease renewal has been deemed "a covenant to grant an additional term upon the condition specified." *J.B. Stein & Co. v. Sandberg,* 95 Ill.App.3d 19, 419 N.E.2d 652, 656, 50 Ill.Dec. 544 (2d Dist. 1981). A lease extension has been deemed "not a mere right to an additional enjoyment of the term, but . . . a present demise for a future term." *Id.* The court in *Sanni, Inc. v. Fiocchi,* 111 Ill.App.3d 234, 443 N.E.2d 1108, 66 Ill.Dec. 945 (2d Dist. 1982), described the difference in another way. The *Sanni* court stated that a lease extension is considered a privilege that, when exercised, creates a present demise through the end of the extended term, while a lease renewal is a present demise for the initial term with a privilege to obtain a new lease for an additional period of time. 443 N.E.2d at 1114.

The difference between an option to renew and an option to extend has been litigated in Illinois courts. *See J.B. Stein, supra* (whether tenant had exercised option to extend or option to renew was crucial to determining whether lease provision exculpating landlord from liability was enforceable); *Chicago Title & Trust Co. v. GTE Directories Corp.,* No. 94 C 5003, 1995 WL 584434 (N.D.Ill. Oct. 12, 1995) (court rejected theory of original tenant that agreement between landlord and assignee was renewal and not extension). Landlords should know the difference between a renewal and an extension to ensure that they do not grant the tenant an option that is not intended.

1. [7.40] Excusable Neglect

The most litigated issues regarding provisions granting an option to renew or expand involve situations in which a landlord does not recognize the tenant's exercise of the option. Most commercial leases that include an option to renew or expand provide that the tenant must exercise the option by a specified time before expiration of the initial lease, according to certain conditions. In Illinois, if the tenant fails to exercise the option within the allowed time and according to the express conditions, the exercise of the option may not be recognized by the landlord. *Michigan Wacker Associates, L.L.C. v. Casdan, Inc.,* 2018 IL App (1st) 171222, 100 N.E.3d 596, 421 Ill.Dec.

579; *Dikeman v. Sunday Creek Coal Co.,* 184 Ill. 546, 56 N.E. 864 (1900). In *Dikeman,* the tenant-coal mining company neglected to renew a ten-year lease until six days after the option expired. Then the landlord attempted to terminate the lease and brought an ejectment action against the tenant. The court determined that the tenant failed to exercise its option within the express time frame provided in the lease, and its "forgetfulness" prevented the landlord from exercising its rights. 56 N.E. at 865. It should be noted that although the court did not accept the tenant's "forgetfulness" as a defense to failure to timely exercise an option to renew, it did suggest that some excuses for noncompliance, such as fraud, accident, or mistake, might be found to be valid defenses. *Id.*

Caselaw since has elaborated on *Dikeman* and provided that circumstances may exist that justify enforcement of a renewal option even though the tenant failed to strictly comply with the terms of the renewal provision in the lease. *Linn Corp. v. LaSalle National Bank,* 98 Ill.App.3d 480, 424 N.E.2d 676, 53 Ill.Dec. 885 (1st Dist. 1981). In *Linn,* the tenant under a commercial lease made nearly $200,000 worth of improvements to the premises. The tenant also orally notified the landlord of its intent to renew the lease but failed to strictly comply with the renewal provision by providing the landlord with written notice to renew. The landlord notified the tenant that the lease would not be renewed, based on the failure to comply with the renewal provision, and the tenant filed a strict performance action against the landlord. Although the court noted the rule set forth in *Dikeman, supra,* for strict compliance of renewal provisions, the court determined that an exception should apply to the tenant, due to the amount of the improvements made by the tenant and the landlord's right to keep the improvements if the lease was terminated. 424 N.E.2d at 679. As a result, the court excused the tenant's noncompliance, based on improvements and the fact that oral notice was given, and held that the parties could not have intended that such vast improvements would be made if the tenant did not intend to renew the lease. *Id.*

Rexam Beverage Can Co. v. Bolger, No. 06 C 2234, 2007 WL 2156674 (N.D.Ill. July 24, 2007), is another interesting case dealing with renewal options. The holding in *Rexam* is consistent with the general rule that, absent special circumstances, strict compliance with a renewal provision is required. Much of the analysis in *Rexam*, however, was on whether the landlord waived its right to require strict compliance. The landlord in *Rexam* acknowledged receipt of the tenant's letter purporting to renew the lease, even though it was sent late. The landlord's acknowledgment came in the form of a response letter to the tenant, notifying it that the notice was subject to the tenant being in full compliance with its obligations under the lease. 2007 WL 2156674 at *1.

The court ultimately found for the landlord on the basis that the tenant was not in full compliance with its repair obligations under the lease. Although the court found for the landlord, *Rexam* should be instructive to landlords who receive a notice to renew after expiration of the renewal period in the lease. Landlords should make sure their subsequent actions and correspondence with the tenant cannot be construed as waiving the right to demand strict compliance with the renewal option. 2007 WL 2156674 at *6.

For additional caselaw on enforcement of renewal or extension provisions, *see Ceres Terminals, Inc. v. Chicago City Bank & Trust Co.,* 117 Ill.App.3d 399, 453 N.E.2d 735, 72 Ill.Dec. 860 (1st Dist. 1983) (court stated that strict compliance with renewal provisions could be excused

by showing of undue hardship); *Gold Standard Enterprises, Inc. v. United Investors Management Co.,* 182 Ill.App.3d 840, 538 N.E.2d 636, 131 Ill.Dec. 261 (1st Dist. 1989) (equity relieved tenant from strictly complying with renewal provision since its failure to comply resulted from uncontemplated accident).

2. [7.41] When Lease Is Silent

It is clear that a tenant's strict compliance with an option to renew provision in a lease will be deemed a valid exercise of that option. Commercial leases, however, often provide for a renewal option, but fail to specify the manner in which the tenant is to exercise the option.

For instance, in *Kaybill Corp v. Cherne,* 24 Ill.App.3d 309, 320 N.E.2d 598 (1st Dist. 1974), the commercial lease at issue gave the tenant the option of renewing but failed to specify the manner in which the tenant was required to exercise the option. The court found that when the lease was silent on the manner in which exercise of the option was required, the tenant was allowed to provide notice orally, but only during the original lease term. 320 N.E.2d at 608.

Similarly, in *Oliva v. Amtech Reliable Elevator Co.,* 366 Ill.App.3d 148, 851 N.E.2d 256, 303 Ill.Dec. 358 (1st Dist. 2006), at issue was whether the tenant's continued possession of the premises equated to an effective exercise of an option to extend when it provided no written or oral notice. The lease that granted the extension option was silent on the manner in which the tenant was to exercise the option. The lease provided only that "any notices required or permitted to be given . . . shall be effective only if given in writing." 851 N.E.2d at 260. The question then became whether the law requires some type of written or verbal notice to effectively exercise an option to extend when the lease is silent on the issue. The court found no notice necessary, holding that when "a tenant has the privilege of extending the term of a lease, as distinguished from renewing a lease, no notice of the tenant's election is required in the absence of a stipulation requiring such notice, 'merely remaining in possession being sufficient notice.'" 851 N.E.2d at 260 – 261, quoting *Vincent v. Laurent,* 165 Ill.App. 397, 403 (4th Dist. 1911). The court went on to hold that any provisions in a lease requiring a tenant to give notice is for the benefit of the landlord and that the requirement can be waived by the landlord accepting increased rent if required for the additional period, absent some evidence to the contrary. 851 N.E.2d at 261.

The message landlords should take from *Kaybill* and *Olivia* is that if the landlord wishes to receive notice of a renewal or extension option, the procedure for the tenant exercising that option should be clearly and unambiguously outlined in the commercial lease.

3. [7.42] Assignments

Illinois law has long held that an option to renew found in a lease passes to the assignee upon a tenant's assignment of the lease. *Sutherland v. Goodnow,* 108 Ill. 528 (1884). However, in order for there to be an effective assignment, the assignor must transfer its entire interest under the lease to the assignee. *Danaj v. Anest,* 77 Ill.App.3d 533, 396 N.E.2d 95, 97, 33 Ill.Dec. 19 (2d Dist. 1979). If any interest or reversion in the leased premises is retained or reserved, no matter how small, there is no privity of estate between the assignee and the original lessor, and an assignment will not be established. *Id.*

In *Danaj,* the plaintiff (assumed to be an assignee) brought a declaratory judgment action to determine his rights under the lease. The plaintiff had a written lease agreement with the tenant on the property. The lease agreement incorporated the terms of the original lease. The plaintiff installed a car wash on the property and informed the landlord that he wished to exercise the renewal option in the lease. The tenant would not consent to the plaintiff exercising the renewal option, and the landlord refused to allow the extension without the tenant's consent. Based on the language in the lease, the trial court found that the plaintiff was not an assignee but a sublessee and, therefore, he could not exercise the option to renew found in the original lease. The plaintiff appealed, and the appellate court reversed. The court determined that the lease language, providing that the plaintiff "shall remain in possession of the premises So long as he operates a gas station," did not create a reversionary interest, but rather created a determinable fee. 396 N.E.2d at 96. As a result, the court found that the tenant had assigned all its rights and interest in the property to the plaintiff and, therefore, the plaintiff could exercise the extension option.

B. [7.43] Purchase

In addition to options to renew or extend, many commercial leases also grant the tenant the option to purchase the demised premises. In Illinois, a lease that grants the lessee the option of purchasing the premises is a continuing and irrevocable offer that binds the lessor to convey to the lessee the subject premises upon compliance with the terms of the option. *See Okey, Inc. v. American National Bank & Trust Company Under Trust Dated November 30, 1964, Known as Trust No. 20912,* 96 Ill.App.3d 987, 422 N.E.2d 221, 223, 52 Ill.Dec. 540 (1st Dist. 1981). The contract that arises out of an option to purchase is an executed unilateral contract that becomes bilateral and executory upon the exercise of the option. 422 N.E.2d at 223. In order to avail itself of the option to purchase, the lessee must comply with the terms and conditions of the option, unless they are waived. *Lake Shore Country Club v. Brand,* 339 Ill. 504, 171 N.E.494, 501 (1930). If the conditions precedent to the right to convert the unilateral contract to a bilateral contract are not met, the unilateral contract does not become bilateral, and the option to purchase is not satisfied. *Id.* An option to purchase also is transferable. *Keogh v. Peck,* 316 Ill. 318, 147 N.E.2d 266, 269 – 270 (1925). In addition, a landlord's duty to convey pursuant to an option to purchase is conditioned on the existence of a valid lease. *Okey, supra,* 422 N.E.2d at 224.

In *Sandra Frocks, Inc. v. Ziff,* 397 Ill. 497, 74 N.E.2d 699 (1947), a tenant sued the landlord for specific performance of an option to purchase provision in the lease agreement. The landlord had terminated the lease due to the tenant's failure to make timely rent payments. After termination of the lease, the tenant attempted to exercise an option to purchase that was contained in a rider to the lease. Although the lease at issue was determined to be valid, the court refused to require specific performance from the landlord. The court held that the option to purchase was an integral part of the lease and that when the lease was terminated for failure of the tenant to perform its obligations thereunder, the option to purchase also was terminated. The court rejected the tenant's theory that the option to purchase was an independent undertaking apart from the terms of the lease and that it could still be enforced notwithstanding termination of the lease. 74 N.E.2d at 703 – 704. *See also Bond v. Long,* 338 Ill.App. 1, 86 N.E.2d 585 (4th Dist. 1949) (refusing to allow tenant to exercise option to purchase after lease was terminated due to tenant's breach of covenant); *Penn-Daniels, LLC v. Daniels,* No. 07-1282, 2010 WL 431888 (C.D.Ill. Jan. 28, 2010) (finding that

questions of fact existed as to whether tenant's breach allowed it to exercise option to purchase); *Wolfram Partnership, Ltd. v. LaSalle National Bank,* 328 Ill.App.3d 207, 765 N.E.2d 1012, 262 Ill.Dec. 404 (1st Dist. 2001) (questions of fact existed as to whether landlord could terminate lease and option to purchase due to tenant's breach).

Based on the above law, it is clear that Illinois common law provides that a tenant cannot exercise an option to purchase contained in a lease after expiration, termination, or forfeiture of the lease since the contractual right to the option no longer exists. However, a landlord "may not, by a breach of a covenant to convey, compel the continuance of the relation of landlord and tenant for the purpose of creating a breach of covenant to pay rent so as to enable him to declare the option forfeited." *Cities Service Oil Co. v. Viering,* 404 Ill. 538, 89 N.E.2d 392, 403 (1949). Therefore, once a tenant validly exercises an option to purchase, a landlord cannot declare forfeiture of the lease. *Cole v. Ignatius,* 114 Ill.App.3d 66, 448 N.E.2d 538, 544, 69 Ill.Dec. 820 (1st Dist. 1983).

At least one Illinois court also has held that in the absence of lease language requiring a tenant to continue to pay rent from the time the option to purchase is exercised, a tenant's obligation to pay rent ceased once it became an equitable owner in the property. *Industrial Steel Construction, Inc. v. Mooncotch,* 264 Ill.App.3d 507, 637 N.E.2d 663, 202 Ill.Dec. 124 (1st Dist. 1994). The importance of *Industrial Steel* to landlords is clear: landlords should expressly provide in the lease that in the event a tenant exercises an option to purchase, it still remains obligated to perform all its obligations under the lease until closing, including payment of rent. *See also Napleton v. Ray Buick, Inc.,* 302 Ill.App.3d 191, 704 N.E.2d 864, 235 Ill.Dec. 291 (1st Dist. 1998) (finding that specific language of lease created exemption to general rule that lease terminates after tenant exercises option to purchase). By including such a provision in the lease, landlords should be entitled to rent until closing, rather than only until the tenant exercises the option to purchase.

C. [7.44] Commentary

If a commercial landlord grants a tenant an option to purchase, the landlord must give serious consideration to the circumstances under which it would convey the property and must craft the lease accordingly. Because economic circumstances can and often do change, landlords in a long-term commercial lease may be willing to sell the property in the initial lease term but may want to retain the property if the lease is renewed or extended. As a result, landlords should carefully draft the lease to reflect the circumstances under which they would agree to sell the property. In addition, in any option to purchase, landlords should ensure that in the event a tenant exercises the option, the tenant remains liable for all obligations under the lease, including payment of rent until closing and not just until equitable title has transferred.

X. ENFORCEMENT

A. [7.45] Landlord's Failure To Enforce

The covenants contained in a commercial lease form the basis of the relationship between the landlord and tenant. The tenant can expect to maintain possession of the premises as long as its obligations thereunder are performed. Likewise, the landlord generally can expect the tenant to

remain in the property as long as the landlord performs its obligations under the lease. However, landlords must be aware that if a tenant fails to abide by one of its obligations under the lease, it should take action, in some form, so as not to waive the ability of the landlord to enforce that action on the tenant in the future. In Illinois, strict compliance with contractual provisions, including a tenant's performance of obligations under a lease, can be waived by the conduct of the parties. *Jung v. Zemel,* 189 Ill.App.3d 191, 545 N.E.2d 242, 245, 136 Ill.Dec. 718 (1st Dist. 1989). The general rule is that once a landlord has waived the tenant's breach of an obligation in a lease, the landlord cannot later assert that breach as the basis for forfeiture, termination, or eviction. *Garbaczewski v. Vanucci,* 342 Ill.App. 367, 96 N.E.2d 653, 654 (1st Dist. 1950).

In *Jung, supra,* a landlord brought an eviction action against the tenant and the alleged subtenant, arguing that the tenant failed to obtain the landlord's prior written consent to subtenancy as required in the lease. The trial court found for the landlord, and the tenant appealed. On appeal, the court reversed. The court found that the landlord waived strict compliance with the contractual provision requiring its consent to the subtenancy when it had no commercially reasonable basis to object to the subtenancy and when it continued to treat the lease as effective even after becoming aware of the subtenancy. 545 N.E.2d at 246.

1. [7.46] Waiver by Acceptance

A landlord's act of granting a tenant leniency under its obligations in a lease may backfire against the landlord. *See Okey, Inc. v. American National Bank & Trust Company Under Trust Dated November 30, 1964, Known as Trust No. 20912,* 96 Ill.App.3d 987, 422 N.E.2d 221, 223, 52 Ill.Dec. 540 (1st Dist. 1981). In *Okey,* the tenant attempted to exercise a lease provision granting it an option to purchase. The landlord refused to recognize the exercise of the option, alleging that the tenant had breached the lease by previously filing bankruptcy and making late rent payments. Notwithstanding the landlord's allegations, the facts established that the landlord had accepted the tenant's late rent payments and had continued the lease after the tenant had filed bankruptcy. As a result, the appellate court found that genuine issues of material fact existed as to whether the landlord's action constituted a waiver under the lease, which waiver would allow the tenant to exercise the option to purchase. 422 N.E.2d at 225.

Similarly, in *Sixeas v. Fogel,* 253 Ill.App. 579 (1st Dist. 1929), a landlord brought an eviction claim against its tenant based on the tenant's late payment of rent. The landlord separately gave the tenant notice of its intention to terminate the lease. Prior to suit by the landlord, the tenant had routinely paid rent late and the landlord had routinely accepted it. Under these circumstances, the court found that it would be inequitable to provide for forfeiture in favor of the landlord when the landlord, through its previous actions, had induced the tenant into believing that strict compliance with the lease was not required. The court noted that before declaring forfeiture, the landlord was required "to give notice of his intention to insist upon a strict compliance with the terms of the lease with reference to the time rent should be paid." 253 Ill.App. at 581 – 582.

2. [7.47] Required Notice of Strict Compliance

As a general rule, even under circumstances in which a landlord has allowed leniency in enforcing a lease provision, strict performance may still be required if the landlord subsequently

notifies the tenant that leniency will no longer be tolerated and demands strict performance thereafter. *Sixeas v. Fogel,* 253 Ill.App. 579, 581 – 582 (1st Dist. 1929). *See also LaSalle National Bank v. Khan,* 191 Ill.App.3d 41, 547 N.E.2d 472, 138 Ill.Dec. 305 (1st Dist. 1989) (finding that judgment of possession was proper, and landlord did not waive right to timely rent, when landlord notified tenant that late payments would no longer be accepted and demanded strict compliance with lease); *Fox v. Commercial Coin Laundry Systems,* 325 Ill.App.3d 473, 757 N.E.2d 529, 258 Ill.Dec. 840 (1st Dist. 2001) (holding that landlord was entitled to summary judgment as matter of law when it had notified tenant that it would not accept future late rent payments); *Rubloff CB Machesney, LLC v. World Novelties, Inc.,* 363 Ill.App.3d 558, 844 N.E.2d 462, 300 Ill.Dec. 464 (2d Dist. 2006) (upholding judgment in favor of lessor when lessor demanded strict compliance with rent provision in lease and tenant failed to thereafter comply).

Therefore, under Illinois law, even if a landlord has waived its right to enforce a tenant's performance of certain duties and obligations in a lease, all is not lost. A landlord still can require that the tenant timely perform those duties and obligations in the future, but only after notifying the tenant that strict compliance with the lease provisions is required. After notice is provided, a landlord will be able to use any future defaults as a basis for a claim for termination of the lease.

3. [7.48] Tenant's Obligation To Pay Rent

It is important to note that by allowing leniency to the tenant in the performance of lease obligations, a landlord is not waiving the tenant's obligations of performance altogether. *Pros Corporate Management Services, Inc. v. Ashley S. Rose, Ltd.,* 228 Ill.App.3d 573, 592 N.E.2d 609, 170 Ill.Dec. 173 (2d Dist. 1992). In *Pros Corporate,* the court held that a landlord did not waive its right to collect past due rents when its agent had previously accepted rental payments for less than the full amount of past-due rent. The court distinguished its holding from *Okey, Inc. v. American National Bank & Trust Company Under Trust Dated November 30, 1964, Known as Trust No. 20912,* 96 Ill.App.3d 987, 422 N.E.2d 221, 223, 52 Ill.Dec. 540 (1st Dist. 1981), discussed in §7.46 above, noting that in *Okey* the issue was whether a landlord could declare a forfeiture for late rent under circumstances in which late rent had previously been accepted. The court noted that *Okey* did not stand for the proposition that a landlord waives the right to collect past-due rent by accepting late payments or payments for less than the full amount of past-due rent. *Pros Corporate, supra,* 592 N.E.2d at 614 – 615. As a result, even when a landlord has been lenient in the performance of a tenant's lease obligations, the tenant still is required to perform those obligations. The landlord just cannot terminate the lease without first requiring that strict performance be made in the future.

B. [7.49] Nonwaiver Provisions

Illinois law recognizes the enforceability of nonwaiver provisions in commercial leases. *Justine Realty Co. v. American Can Co.,* 119 Ill.App.3d 582, 456 N.E.2d 871, 876, 75 Ill.Dec. 50 (1st Dist. 1983); *Baird & Warner, Inc. v. Al-Par, Inc.,* 183 Ill.App.3d 467, 539 N.E.2d 192, 131 Ill.Dec. 839 (1st Dist. 1989) (landlord entitled to terminate lease after written demand that tenant comply with use, signage, and maintenance of premises provisions of lease, even after tenant's violations had existed without complaint by landlord for nearly five years because tenant made no effort to comply by date specified in landlord's notice). The following are examples of nonwaiver provisions found in commercial leases:

The waiver by any Party of any breach of this Agreement, whether in a single instance or repeatedly, shall not be construed as a waiver of rights under this Agreement. Any waiver shall not constitute a waiver by such Party to strictly adhere to this Agreement nor as a waiver of any claim for damages or other remedy by reason of any such breach.

[or**]**

The Landlord's waiver of or consent to any default or breach of any term, condition, or covenant of this Lease shall not be deemed a waiver of or consent to any subsequent default or breach of any term, condition, or covenant of this Lease.

Landlords should note, however, that even if a lease includes a nonwaiver clause, a landlord's action can result in a waiver of the nonwaiver clause. *See, e.g., Waukegan Times Theatre Corp. v. Conrad,* 324 Ill.App. 622, 59 N.E.2d 308 (2d Dist. 1945) (landlord's waiver of provision requiring written consent to assignments could be inferred from both its conduct and its agent's oral statements, as could waiver of lease's nonwaiver clause); *Fuchs v. Peterson,* 315 Ill. 370, 146 N.E.556 (1925) (landlord can orally waive leave provision requiring written notice of lease renewal).

Not only must a landlord be careful not to waive a nonwaiver provision, but it also must ensure that it strictly adheres to the lease provision that it is attempting to enforce. Illinois law recognizes lease provisions that waive the statutory requirement that a landlord provide notice to a tenant of default and termination of the lease. *Sandra Frocks, Inc. v. Ziff,* 397 Ill. 497, 74 N.E.2d 699, 702 (1947). However, a landlord must comply with the strict terms of the lease provisions, or its noncompliance could be deemed a waiver of the right to enforce them.

In *Sixeas v. Fogel,* 253 Ill.App. 579 (1st Dist. 1929), a tenant entered into a commercial lease with a landlord that provided (1) that the tenant waived service of demand for rent and notice of the landlord's intention to terminate the lease and to reenter the premises upon the tenant's default and (2) that any breach of the tenant's covenants was a forcible detainer for purposes of Illinois statutory law. Nonetheless, these provisions were found unenforceable as a result of the landlord's voluntary service of notice to the tenant of its intention to terminate the lease upon the tenant's breach. Because the landlord did not strictly adhere to the lease's termination provision, the landlord was required to observe Illinois statutory law, which provided the tenant a right to tender back-due rent to the landlord within a specified number of days after service of the notice. As a result, after the rent was tendered to the landlord, the landlord had no right to proceed with an eviction action. 253 Ill.App. at 583.

Sixeas illustrates the importance of landlords strictly enforcing lease obligations and complying with lease provisions that give them a right to declare a forfeiture of the lease in a manner different from Illinois statutory law. If landlords deviate from the procedures set forth in the lease, they likely will be deemed to waive the provisions that were intended for their benefit, and they will be required to comply with the procedures set forth in the eviction statute, Article IX of the Code of Civil Procedure, 735 ILCS 5/9-101, *et seq*.

A landlord's rights and duties with respect to tenant breaches are covered more thoroughly in Chapter 8 of this handbook.

C. [7.50] Assignment and Subletting

Illinois common law recognizes a tenant's right to assign or sublease at will in the absence of a restriction in the lease providing otherwise. *Cole v. Ignatius,* 114 Ill.App.3d 66, 448 N.E.2d 538, 69 Ill.Dec. 820 (1st Dist. 1983) (finding assignment in commercial lease valid and enforceable in absence of express restriction precluding assignment).

As a result, if a landlord wishes to control the manner and extent of the tenant's ability to assign or sublease, a provision to that effect should be inserted in the lease. Such provisions are enforceable under Illinois law absent a finding that the landlord unreasonably withheld consent to the assignment or sublease. *Edelman v. F.W. Woolworth Co.,* 252 Ill.App. 142, 145 (1st Dist. 1929). Litigation often arises over what does or does not amount to unreasonably withholding consent. Because the rules of law governing a landlord's duties and liabilities in the enforcement of lease provisions pertaining to whether a landlord has the right to withhold its consent to an assignment or a subletting are virtually identical, the rules applicable to assignments and those applicable to subleases are considered interchangeable for purposes of the discussion in §§7.51 – 7.55 below.

1. [7.51] Assignment Prohibition

Under Illinois law, an outright prohibition against assignment of a commercial lease is not considered an invalid restraint on alienation. *Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 27 Ill.App.2d 467, 170 N.E.2d 35, 39 (1st Dist. 1960) (clause allowing landlord to terminate lease upon transfer of shares of corporate tenant valid and enforceable, and not invalid restraint on alienation). Lease prohibitions against assigning and subletting vary widely in scope. Prohibition clauses in commercial leases can be against (a) assignment, conveyance, mortgage, pledge, hypothecation, encumbrance, or other transfer of the lease, in whole or part, or any interest therein; (b) any assignment by operation of law; (c) subleasing the premises in whole or in part; (d) the use or occupancy of the premises by any party other than the tenant, its agent, and its employees; or (e) any combination of the other four prohibitions.

Although enforceable, such clauses are not favored and, if litigation ensues, the clause will be construed most strongly against the landlord. *Edelman v. F.W. Woolworth Co.,* 252 Ill.App. 142, 145 (1st Dist. 1929). In *Edelman,* the plaintiff-landlord brought an action against the tenant for eviction. The lease at issue prohibited the tenant from assigning or subletting the premises without the landlord's written consent, which could not be unreasonably withheld. The tenant notified the landlord of its intention to vacate and sublet the premises, but the landlord would not consent to the sublease. The trial court awarded judgment in favor of the defendant, and the appellate court affirmed. The appellate court construed the lease most strongly against the landlord and found that no good cause was shown by the landlord for withholding consent to the sublease. 252 Ill.App. at 145.

However, before a landlord can be found to be liable for unreasonably withholding consent for an assignment or sublease, the tenant has the burden of proving that it tendered a subtenant who was ready, willing, and able to take over the lease and who met reasonable commercial standards. *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 950, 60 Ill.Dec. 703 (1st Dist. 1982) (finding that to show landlord unreasonably withheld consent, tenant must prove proposed transferee met reasonable commercial standards).

In order to ensure their interests are protected, landlords should include express language in lease agreements outlining each party's obligations and rights with respect to subletting and assigning. To protect specific interests, landlords could condition approval of an assignment on the tender of a substitute tenant meeting the same standards as the original tenant with respect to such matters as type of business, trade or industry name recognition, cost of merchandise, character, reputation, or financial capability. After determining which conditions should be in included in the lease, landlords should take measures to strictly adhere to any procedures for consenting to the assignment or sublease to ensure these requirements are not deemed to have been waived.

2. [7.52] Failure To Object

As noted in §7.51 above, landlords should take measures to ensure they are aware of the obligations of each party under any lease provision requiring consent to a transfer or assignment. If a tenant takes actions in contravention of that provision, and the landlord fails to object or takes action inconsistent with refusal of the assignment, the landlord could be deemed to have waived its rights, and it will be unable to contest the assignment. *Kaybill Corp. v. Cherne,* 24 Ill.App.3d 309, 320 N.E.598, 607 (1st Dist. 1974).

In *Kaybill,* a provision in the commercial lease provided that the landlord must consent in writing to any assignment of the lease. The tenant assigned its interest in the lease to a corporate tenant it had found, and the landlord fought the assignment, arguing that it never provided its written consent. Evidence at trial established the landlord had seen the name of the new tenant on display at the premises, had discussed the new corporate tenant with the original tenant, and had accepted rent payments from the assignee. As a result, the court determined that the landlord had waived its right to forfeit the lease for breach of the non-assignment provision. The landlord was estopped from denying the validity of the assignment due to its inconsistent conduct. 320 N.E.2d at 607.

Likewise, in *Woods v. North Pier Terminal Co.,* 131 Ill.App.3d 21, 475 N.E.2d 568, 86 Ill.Dec. 354 (1st Dist. 1985), the lease at issue required the landlord's consent to an assignment. Despite arguing that it did not consent to an assignment of the lease, the court found the assignment valid and enforceable. Evidence established that the landlord had sent correspondence to the tenant intending to consent to the assignment and that it did not object to the assignment once it had notice. Because the landlord did not treat the leasehold as void or otherwise object to the assignment, the court determined the landlord had waived its right to consent. 475 N.E.2d at 570. *See also American National Trust Company of Chicago v. Kentucky Fried Chicken of Southern California, Inc.,* 308 Ill.App.3d 106, 719 N.E.2d 201, 241 Ill.Dec. 340 (1st Dist. 1999) (no consent of assignment necessary when landlord accepted rent from assignee); *Waukegan Times Theatre Corp. v. Conrad,* 324 Ill.App. 622, 59 N.E.2d 308 (2d Dist. 1945) (landlord waived consent provision in lease when its agent consented to assignment); *Peacock v. Feltman,* 243 Ill.App. 236 (1st Dist. 1927) (landlord waived consent provision in lease by accepting rent after notice of violation of non-assignment provision).

3. Withholding Consent

a. [7.53] Unreasonable

Although provisions can be inserted into leases that require that the landlord provide consent for an assignment, Illinois law does not permit a landlord to unreasonably withhold its consent. *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 60 Ill.Dec. 703 (1st Dist. 1982); *Vranas & Associates, Inc. v. Family Pride Finer Foods, Inc.,* 147 Ill.App.3d 995, 498 N.E.2d 333, 101 Ill.Dec. 151 (2d Dist. 1986). Disputes often arise as to what does and does not constitute the unreasonable withholding of consent. Illinois common law provides some guidance on this issue.

If a tenant does not tender a suitable assignee or sublessee, a landlord's refusal to consent to the assignment or sublease will not be deemed unreasonable. *Jack Frost, supra,* 433 N.E.2d at 951. Whether the assignee or sublessee is suitable is determined by commercially reasonable standards; whether those standards are met is determined by the specific facts of each case. 433 N.E.2d at 950; *Arrington v. Walter E. Heller International Corp.,* 30 Ill.App.3d 631, 333 N.E.2d 50 (1st Dist. 1975).

In *Jack Frost, supra,* the tenant brought an action against the landlord for wrongful refusal to accept an assignment of the commercial lease. The circuit court entered judgment in favor of the tenant, and the landlord appealed. On appeal, the court reversed. The court held that the tenant had the burden of proving that the tendered assignee was "ready, willing and able" to accept the lease and meet standards of commercial reasonableness. 433 N.E.2d at 949. In this case, the assignee tendered by the tenant did not meet a reasonable standard of financial responsibility, being a corporation with stated capital of only $1,000. The tenant also failed to provide the landlord with other pertinent financial information of the assignee. There was also discussion as to the assignee's request for extension of terms, which may not have been available, thus raising a question as to whether the proposed assignee was actually ready, willing, and able to accept the assignment. As a result, the court determined the landlord's refusal to consent was not unreasonable. 433 N.E.2d at 951.

Conversely, in *Vranas, supra,* the landlord's refusal to consent to the proposed assignee was determined by the court to be unreasonable. The court set forth several factors used by courts in determining whether the proposed tenant is commercially reasonable:

1. the tenant's financial resources and responsibility;

2. the tenant's proposed business;

3. the potential competitive impact of the tenant's business on the landlord and/or other tenants;

4. the tenant's impact on the commercial environment or the surroundings;

5. the tenant's willingness to comply with the lease terms; and

6. the contemplation of the sale of the tenant's business as reflected in the lease. 498 N.E.2d at 339 – 340.

In this case, the court determined that the landlord's refusal to consent to the assignment was not based on a legitimate business concern with the proposed assignee's acceptability as a tenant and was found to be unreasonable. 498 N.E.2d at 343.

See also Shreeji Krupa, Inc. v. Leonardi Enterprises, No. 04 C 7809, 2007 WL 2386655 (N.D.Ill. Aug. 15, 2007) (landlord did not unreasonably withhold consent when tenant did not tender purchaser of its business that was ready, willing, and able to accept all tenant's lease terms); *Losurdo Bros. v. Arkin Distributing Co.,* 125 Ill.App.3d 267, 465 N.E.2d 139, 80 Ill.Dec. 348 (2d Dist. 1984) (landlord's failure to respond to tenant's request for consent to sublease not unreasonable because of tenant's default under lease and minimal time provided to landlord to either consent or refuse).

b. [7.54] In Exchange for Concessions

Illinois law suggests that a landlord cannot withhold consent of an assignment in exchange for concessions from the tenant. *Chanslor-Western Oil & Development Co. v. Metropolitan Sanitary District of Greater Chicago,* 131 Ill.App.2d 527, 266 N.E.2d 405, 408 (1st Dist. 1970) (landlord found to have unreasonably withheld consent when it attempted to condition consent on reappraisal of property and renegotiation of rent schedule in original lease).

The suggestion that landlords cannot condition consent to an assignment on concessions by a tenant is furthered by the holding in *Toys "R" Us, Inc. v. NBD Trust Company of Illinois,* No. 88 C 10349, 1995 WL 591459 (N.D.Ill. Oct. 4, 1995). In *Toys "R" Us,* the court stated that the tenant has the burden of proving that the landlord acted unreasonably by withholding consent in order to obtain a benefit not reflected in the terms of the original lease. In determining whether consent was unreasonably withheld, the court must determine the true motivations of the landlord, discarding any pretextual motivations. The court found that the landlord acted unreasonably by refusing to give its consent to the tenant's sublease in order to have a portion of the leased building returned to it, so that it could improve its status under the lease and rent directly to the subtenant. It was noted by the court that the landlord originally refused to consent to the sublease even without any knowledge of or inquiry into the subtenant's finances or plans to use the space. *Id.*

The *Toys "R" Us* opinion supports the notion that a landlord could expose itself by attempting to condition consent of an assignment provision to a concession not found in the original lease. The tenant in *Toys "R" Us* was awarded damages on the basis that its subtenant would have occupied the space and exercised its lease options had it not been for the landlord's actions. In awarding damages, the court noted that when there is uncertainty in provisions relating to renewals or extensions, the tenant — not the landlord — is favored. The court also awarded attorneys' fees to the tenant and agreed to accept further evidence to determine whether the tenant could prove its claimed damages for projected increases in common area maintenance and real estate taxes. *Id.*

4. [7.55] Tenant's Bankruptcy

While the broad effect of a tenant's bankruptcy is beyond the scope of this chapter, the issue of a landlord's ability to object to a tenant's assignment of the lease in bankruptcy should briefly be discussed here.

Section 365(f) of the Bankruptcy Code generally allows a tenant under a commercial lease to assign the lease without regard to any restrictions. The Code provides:

> **(f)(1) Except as provided in subsections (b) and (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.**
>
> **(2) The trustee may assign an executory contract or unexpired lease of the debtor only if —**
>
> > **(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and**
> >
> > **(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.**
>
> **(3) Notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law that terminates or modifies, or permits a party other than the debtor to terminate or modify, such contract or lease or a right or obligation under such contract or lease on account of an assignment of such contract or lease, such contract, lease, right, or obligation may not be terminated or modified under such provision because of the assumption or assignment of such contract or lease by the trustee.** 11 U.S.C. § 365(f).

The Bankruptcy Code provides more protection for landlords of a tenant of a bankrupt shopping center, providing:

> **(3) For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance —**
>
> > **(A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;**
> >
> > **(B) that any percentage rent due under such lease will not decline substantially;**

> **(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and**
>
> **(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.** 11 U.S.C. § 365(b)(3).

Application of the above two Code sections was at issue in *In re Trak Auto Corp.,* 367 F.3d 237 (4th Cir. 2004). In *Trak Auto,* the landlord objected to the bankrupt debtor's plan to assign its lease in an auto parts store to a discount apparel merchandiser. The lease at issue contained a restriction that required the tenant to use the premises only as a Trak Auto store. Based on the restriction, the Fourth Circuit held that the lower court erred in allowing the debtor to assign its lease to an apparel merchandiser. The court determined that the more specific provisions of §365 (b)(3)(C) controlled over the more general provisions in §365(f)(1).

The lesson to landlords is clear: object to any attempt by a bankruptcy tenant or its trustee in bankruptcy to assume its lease if, as part of its plan, it intends to assign the lease to another tenant that is objectionable under any one of the §365(b)(3) requirements. Chapter 11 of this handbook contains a more in-depth discussion of the assumption and assignment of bankrupt tenant leases generally.

D. [7.56] Tenant's Assignment or Subletting

Although the rules governing a landlord's right to withhold consent for an assignment and sublease are nearly identical, the legal effect of an assignment and a sublease are different. Under Illinois law, an assignment of a lease differs from a sublease in that an assignment occurs "where the lessee transfers the entire unexpired remainder of the term created by his lease." *Dayenian v. American National Bank & Trust Company of Chicago,* 91 Ill.App.3d 622, 414 N.E.2d 1199, 1201, 47 Ill.Dec. 83 (1st Dist. 1980), quoting *Urban Investment & Dev. Co. v. Maurice L. Rothchild & Co.,* 25 Ill.App.3d 546, 323 N.E.2d 588, 592 (1st Dist. 1975). However, if the transferor retains a reversionary interest, so as to leave the transferee in the landlord-tenant relationship with the transferor, privity of estate between the transferee and the original landlord is not created, and the result is a sublease. *Id. See also Builders Square, Inc. v. Illgross Partners & Co.,* No. 94 C 4632, 1995 WL 66277 (N.D.Ill. Feb. 8, 1995) (finding that agreement between plaintiff and original tenant was assignment and not sublease when language in agreement indicated it was assignment and original tenant reserved no reversionary interest).

Once a landlord-tenant relationship is established, the landlord and tenant have privity of contract and estate. Although a tenant can sever its privity of estate by assigning its lease, its contractual liability to the landlord remains unless the landlord releases the tenant. *Consolidated Coal Co. of St. Louis v. Peers,* 166 Ill. 361, 46 N.E. 1105, 1107 (1896). Privity of estate, as between the landlord and the assignee, arises upon assignment; but unless the assignee assumes the tenant's obligations under the lease, there is no privity of contract between the landlord and the assignee.

By acquiring privity of estate with the landlord, liability is imposed on the assignee for breach of any tenant's lease covenants that run with the land. *Id.* If an assignee assumes the lease, it will also be liable for the performance of all conditions and covenants of the lease through privity of contract. *Springer v. De Wolf,* 194 Ill. 218, 62 N.E.2d 542 (1901).

Courts in Illinois analyze several factors to determine if a covenant runs with the land to impose liability on an assignee. *Streams Sports Club, Ltd. v. Richmond,* 99 Ill.2d 182, 457 N.E.2d 1226, 1230, 75 Ill.Dec. 667 (1983). These factors are whether

1. the covenantor and covenantee intend that the covenant run with the land;

2. the covenant itself touches and concerns the land; and

3. privity of estate exists. *Id.*

In *American National Bank & Trust Company of Chicago v. Hoyne Industries, Inc.,* 738 F.Supp. 297 (N.D.Ill. 1990), the landlord and the successor to the original tenant disputed whether privity of contract existed between them. If privity of contract existed, the obligation to perform under the lease, including payment of rent, would be imposed on the successor tenant, which had vacated the premises 18 months before expiration of the lease. Under Illinois law, when the assignee of a lease does not assume the obligations of the lease, only privity of estate results between the landlord and the assignee. The assignee, therefore, is liable for rent only as long as privity of estate exists, and the assignee remains in possession. Privity of contract exists when the lease obligations are assumed by the assignee. In contrast to privity of estate, the assignee cannot abrogate those obligations by a further assignment of the lease and the termination of its right to possession. 738 F.Supp. at 299. Based on these legal principles, the court determined that privity of contract existed between the landlord and the tenant's successor. This was the case — even though the tenant and its successor had failed to obtain the landlord's consent to the assignment — because the successor had assumed the tenant's lease obligations under the terms of the purchase agreement. 738 F.Supp. at 300 – 301.

E. [7.57] Landlord's Assignment

In Illinois, a lease's obligations and benefits inure to the benefit of the landlord's assignee. *Bruno v. Gabhauer,* 9 Ill.App.3d 345, 292 N.E.2d 238, 239 (1st Dist. 1972). As a result, if the landlord assigns its interest in a lease to an assignee, the assignee (1) owes the tenant all of the landlord's duties under the lease and (2) receives all the benefits from the tenant under the lease. The tenant's obligations are unaffected by a landlord's assignment of the lease. *Montgomery Ward & Co. v. Wetzel,* 98 Ill.App.3d 243, 423 N.E.2d 1170, 1175, 53 Ill.Dec. 366 (1st Dist. 1981) ("the right of the lessee is unaffected by the lessor's assignment of the lease and alienation of the premises; and the alienee is subject to all the rights and equities of the lessee against the lessor").

The assignee under a lease succeeds to the landlord's rights subsequent to the assignment but is also subject to all the rights and equities of the lessee against the lessor. *Charles Mulvey Manufacturing Co. v. McKinney,* 184 Ill.App. 476, 480 (1st Dist. 1914). An assignee must be aware that if it acquires an assignment when the lessee is in actual, open, and visible possession and occupancy, the assignee will be charged with constructive notice of the lessee's rights and takes the property subject to those rights. 184 Ill.App. at 481.

Also, under the Code of Civil Procedure, all remedies available to the original landlord are also available to a successor landlord. Illinois law provides:

> **The grantees of any leased lands, tenements, rents or other hereditaments, or of the reversion thereof, the assignees of the lessor of any lease, and the heirs, legatees and personal representatives of the lessor, grantee or assignee, shall have the same remedies by action or otherwise, for the non-performance of any agreement in the lease, or for the recovery of any rent, or for the doing of any waste or other cause of forfeiture, as their grantor or lessor might have had if such reversion had remained in such lessor or grantor.** 735 ILCS 5/9-215.

F. [7.58] Landlord's Breach

Under long-standing Illinois law, a tenant's obligation to pay rent is a continuing obligation that is generally deemed to be independent of the landlord's duty to fulfill its obligations under the lease. *City of Chicago v. American National Bank,* 86 Ill.App.3d 960, 408 N.E.2d 379, 381, 42 Ill.Dec. 1 (1st Dist. 1980); *Village of Palatine v. Palatine Associates, LLC,* 2012 IL App (1st) 102707, 966 N.E.2d 1174, 359 Ill.Dec. 486 (finding that lessee's duty to pay rent is independent of landlord's covenants in lease); *Lipkin v. Burnstine,* 18 Ill.App.2d 509, 152 N.E.2d 745, 750, (1st Dist. 1958) (lessee's obligation to pay rent and lessor's covenants are independent, and breach by lessor does not relieve lessee of liability for rent).

Notwithstanding a tenant's continuing obligation to pay rent, at least one Illinois court has held that a material breach of lease by the landlord, while not affecting a lessee's obligation to pay rent, can excuse the tenant from any obligation to pay real estate taxes after vacating the premises. *U.S. Fidelity & Guaranty Co. v. Old Orchard Plaza Limited Partnership,* 284 Ill.App.3d 765, 672 N.E.2d 876, 220 Ill.Dec. 59 (1st Dist. 1996). Nevertheless, the best practice is to assume that the failure to satisfy the covenant to pay rent is not circumscribed by the landlord's separate breach under the lease. *Greggs USA, Inc. v. 400 East Professional Associates, LP,* 2021 IL App (1st) 200959, 198 N.E.3d 1062, 459 Ill.Dec. 685.

XI. [7.59] MITIGATION OF DAMAGES

When a lease is terminated before its established expiration date as a result of a tenant's default or the tenant's abandonment of the demised premises, a landlord must consider to what extent it might have an obligation to mitigate its damages.

A. [7.60] Statutory Duty

Under Illinois law, a landlord has a duty to mitigate its damages upon termination of a lease. The Code of Civil Procedure provides:

> **After January 1, 1984, a landlord or his or her agent shall take reasonable measures to mitigate the damages recoverable against a defaulting lessee.** 735 ILCS 5/9-213.1.

As a result, landlords in Illinois have a statutory duty to take "reasonable measures" to mitigate damages upon termination of a lease. This duty to mitigate arises when the tenant abandons or vacates the premises. *Block 418, LLC v. Uni-Tel Communications Group, Inc.,* 398 Ill.App.3d 586, 925 N.E.2d 253, 338 Ill.Dec. 756 (2d Dist. 2010).

The statute obligating a landlord to mitigate is silent, however, on whether it applies retroactively or only prospectively. In Illinois, unless otherwise stated, a statute applies only prospectively. *Allegis Realty Investors v. Novak,* 223 Ill.2d 318, 860 N.E.2d 246, 252 – 253, 307 Ill.Dec. 592 (2006). Therefore, it appears the landlord's duty to mitigate damages applies only prospectively. That being said, it remains uncertain whether the statute applies only to leases entered into after January 1, 1984, or whether it also applies to breaches committed after January 1, 1984, regardless of when the lease was executed. At least one Illinois court has suggested that the duty to mitigate may be applicable to breaches occurring after January 1, 1984, even if the lease was entered into prior to the date the statute was enacted. *See Stein v. Spainhour,* 167 Ill.App.3d 555, 521 N.E.2d 641, 118 Ill.Dec. 359 (4th Dist. 1988).

The statute also fails to define what constitutes "reasonable measures." In Illinois, the question of whether a landlord has met its statutory duty to mitigate its damages generally is a question of fact. *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 40 – 41, 332 Ill.Dec. 438 (2d Dist. 2009). As a result, whether a landlord has satisfied its statutory duty to mitigate its damages likely will depend on the specific facts of each individual case.

In *Danada,* the landlord brought an action against its former tenant for damages that arose out of the default by the former tenant's assignee of its obligations under the lease. The landlord consented to the tenant's assignment of lease provided that the tenant remain the guarantor of the lease obligations. The assignee then extended the lease, but filed for bankruptcy shortly thereafter and rejected the lease in the bankruptcy proceedings. The landlord and tenant then entered into negotiations for either (1) a new lease for the remainder of the extended term or (2) new terms under which the tenant could satisfy its obligations. The negotiations fell apart on the landlord's requirement of a "60-day out" clause, and the tenant stopped paying rent. 913 N.E.2d at 35. Nine months later, the landlord rented the premises to a new tenant at a reduced rate and sought damages from the original tenant.

The appellate court reversed judgment in favor of the landlord, finding that the landlord's insistence on a 60-day out clause breached its duty to mitigate. The tenant was held to be ready, willing, and able to rent the premises, a position that would have lessened the landlord's damages. However, because the landlord insisted on a 60-day out clause, negotiations fell apart. The court determined that all the landlord's requested damages were the result of its failure to make suitable arrangements with the tenant and would not allow the landlord to recover for those damages based on its failure to mitigate. 913 N.E.2d at 43.

In *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 230 Ill.Dec. 1013 (1st Dist. 1998), a commercial landlord sued the tenant for damages under a lease that was guaranteed by the individual members of the tenant for damages incurred when the tenant vacated the premises and terminated the lease. The tenant argued the landlord's failure to mitigate precluded it from recovery. The lease at issue provided that upon termination the

landlord was entitled to a variety of damages, including any "rent differential," which was to be calculated on an assumption that the premises would be immediately relet and based damages on the difference between the original lease rate and the market rate for the remainder of the term. 695 N.E.2d at 506 – 507. The court found that this provision satisfied the landlord's statutory duty to mitigate and noted that it gave the best possible outcome by limiting the landlord's damages to a claim for lost rent, if any, based on the market rate at the time of termination.

In *MXL Industries, Inc. v. Mulder,* 252 Ill.App.3d 18, 623 N.E.2d 369, 191 Ill.Dec. 124 (2d Dist. 1993), under a commercial lease, the tenant filed a declaratory judgment action seeking a determination that it had satisfied its termination obligations. The trial court ruled against the tenant and in favor of the landlord, awarding the landlord damages and attorneys' fees. The appellate court affirmed. The court found that the tenant had breached the lease, resulting in termination. After termination, the landlord obtained some short-term rentals at a reduced rate; marketed the property for rent; erected a sign; placed calls to developers, brokers, and bankers; and ran ads in newspapers. The appellate court concluded that based on the landlord's actions, it had taken reasonable measures to mitigate its damages, and the damage award was upheld. 623 N.E.2d at 369.

Finally, it should be noted that a landlord's actions to mitigate damages do not have to be successful in order to be deemed reasonable. In *Chicago Title & Trust Co. v. Baskin Clothing Co.,* 219 Ill.App.3d 726, 579 N.E.2d 1045, 1053, 162 Ill.Dec. 231 (1st Dist. 1991), the court found that the landlord satisfied its duty to mitigate even though its actions did not result in a replacement tenant.

Other cases that have examined the issue of whether a landlord has taken reasonable measures to mitigate damages include *Block 418, supra* (finding landlord's duty to mitigate is triggered after defaulting tenant abandons premises), *St. Louis North Joint Venture v. P&L Enterprises, Inc.,* 116 F.3d 262 (7th Cir. 1997) (landlord found to have taken reasonable measures to mitigate damages after tenant vacated premises), and *Becknell Development, L.L.C. v. Linamar Corp.,* No. 07 C 5455, 2008 WL 576334 (N.D.Ill. Feb. 28, 2008) (finding that landlord took reasonable measures to mitigate damages after tenant's breach of lease).

B. [7.61] Burden of Proof

When a landlord attempts to obtain damages against the tenant upon termination of a lease, the landlord bears the burden of proving that it complied with its statutory duty to mitigate damages. *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 41, 332 Ill.Dec. 438 (2d Dist. 2009). If a landlord cannot establish that it took reasonable steps to mitigate damages, the damages that it could otherwise recover will be reduced and any losses that could have been avoided will not be recoverable. *See id.; St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 230 Ill.Dec. 1013 (1st Dist. 1998).

Prior to *Danada, supra,* it appeared there was a split of authority in Illinois courts regarding damages recoverable absent proof of mitigation of damages. In *Snyder v. Ambrose,* 266 Ill.App.3d 163, 639 N.E.2d 639, 641, 203 Ill.Dec. 319 (2d Dist. 1994), the Second District held that if a landlord does not establish that it took measures to reasonably mitigate its damages, it would be precluded from recovery against the tenant.

Conversely, the First District in *St. George, supra,* and the Northern District of Illinois in *Manufactures Life Insurance Company (U.S.A.) v. Mascon Information Techs. Ltd.,* 270 F.Supp.2d 1009, 1013 – 1014 (N.D.Ill. 2003), both found that the failure to satisfy the burden of proof on mitigation of damages did not preclude a landlord from recovery. Rather, if the landlord did not satisfy its burden of proof, the damages would be reduced and the landlord could not recover for losses that reasonably could have been avoided. *St. George, supra,* 695 N.E.2d at 509.

However, with *Danada,* it appears that Illinois courts are now in agreement that if a landlord fails to establish that it took reasonable measures to mitigate its damages, it will not be precluded from recovering, although its damages will be reduced by any damages that could have been avoided.

C. [7.62] Contractual Obligations

In addition to a statutory duty to mitigate damages, many commercial leases also include express provisions obligating the landlord to take certain measures in order to mitigate its damages. If litigation arises as to what constitutes "reasonable measures" to litigate damages, courts may look to the parties' lease agreement for guidance.

In *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 230 Ill.Dec. 1013 (1st Dist. 1998), discussed in §§7.60 and 7.61 above, the parties agreed that in the event of a breach by the tenant, the landlord should attempt to relet the premises, and damages would be awarded based on the lease value and the market value for the remainder of the term. The court analyzed the lease and determined that the parties had agreed on what measures would be considered reasonable in the event of a breach. The court found the landlord acted in conformity with the lease provisions and awarded the landlord damages based on the procedure for calculating damages in the lease. 695 N.E.2d at 507.

The lesson landlords should take from *St. George* is that they should be aware of any provisions in a commercial lease that require certain action in order to mitigate damages. If disputes arise, the court may look to the lease as evidence for what the parties considered reasonable in the event of a breach. If procedures are set forth in the lease requiring the landlord to take certain actions to relet the premises in the event of a breach, the landlord should ensure that it strictly adheres to those procedures.

D. [7.63] Expiration or Termination

In Illinois, a landlord has no obligation to demand possession of the premises or to provide a tenant with a notice to quit upon the expiration of the lease. Under the Illinois eviction statute, expiration of the lease term, as defined in the lease, is sufficient notice to the tenant to vacate the premises. 735 ILCS 5/9-213. The provisions of the statute apply to both commercial and residential leases. If a commercial tenant fails to vacate the premises upon expiration or termination of the lease, the landlord may commence eviction procedures.

In addition to eviction, landlords may also have other remedies against tenants upon termination. Many commercial leases give the landlord the right to terminate a defaulting tenant's

right to possession of the premises without terminating either the lease or the tenant's obligation to pay rent. Upon termination of the tenant's right to possession, the landlord would be obligated to mitigate its damages, but the tenant would still remain liable for rent due under the lease until the premises are relet. See 735 ILCS 5/9-213.1.

In *Elliott v. LRSL Enterprises, Inc.,* 226 Ill.App.3d 724, 589 N.E.2d 1074, 168 Ill.Dec. 674 (2d Dist. 1992), a landlord filed a breach-of-contract action against its tenant for failing to pay rent until the end of the lease term. The parties had previously agreed to an order terminating the tenancy, but providing that the tenant continued to be liable for rent through the agreed termination date. Upon the tenant's failure to continue paying rent, the landlord commenced its suit. The court held that the prior order stated, "that the tenancy, not the lease, was terminated" and ruled that the "parties incorporated the language 'termination of tenancy' into the order because they understood that the lease would remain in effect." 589 N.E.2d at 1079. Because the lease was not terminated, the tenant remained in privity of contract and the landlord was not precluded from bringing suit for nonpayment of rent. *Id.*

Finally, landlords should ensure that strict compliance is made with any termination option granted in a lease. Failure of a tenant to strictly abide by a lease's termination option could result in a finding that termination is improper. *See MXL Industies, Inc. v. Mulder,* 252 Ill.App.3d 18, 623 N.E.2d 369, 191 Ill.Dec. 124 (2d Dist. 1993) (tenant had not complied with termination provisions in lease, so its efforts to terminate lease were invalid); *Thomson Learning, Inc. v. Olympia Properties, LLC,* 365 Ill.App.3d 621, 850 N.E.2d 314, 302 Ill.Dec. 877 (2d Dist. 2006) (denying tenant summary judgment because questions of fact existed as to strict compliance with termination provision in lease). As a result, once a landlord receives a termination notice from its tenant, it should review the lease to see if the tenant has strictly complied with all requirements for terminating the lease.

XII. [7.64] COMMERCIAL REAL ESTATE BROKER LIEN ACT

Due to the Commercial Real Estate Broker Lien Act, 770 ILCS 15/1, *et seq.,* commercial landlords should inquire with prospective tenants as to whether a broker was used in locating the premises. If a broker was used, the landlord must take measures to ensure that the tenant has paid the broker the agreed compensation or will be paying the broker the agreed compensation throughout the term of the lease. Failure of the tenant to compensate the broker could result in the broker filing a lien against the property, an action now permitted under Illinois law.

A. [7.65] Scope

The Commercial Real Estate Broker Lien Act applies only to commercial real estate. See 770 ILCS 15/5. The Act gives brokers of commercial real estate the general right to assert a lien against commercial real estate for payment of the agreed compensation for the brokers' services. The Act defines "commercial real estate" as

> **real estate located in Illinois other than (i) real estate containing one to 6 residential units, (ii) real estate on which no buildings or structures are located, or (iii) real estate classified as farmland for assessment purposes under the Property Tax Code [**35 ILCS 200/1-1, *et seq.***].** 770 ILCS 15/5.

The Act specifically excludes from its purview

> **single family residential units such as condominiums, townhouses, or homes in a subdivision when sold, leased, or otherwise conveyed on a unit by unit basis even though these units may be part of a larger building . . . containing more than 6 residential units.** *Id.*

B. [7.66] Caselaw

Despite having been enacted effective January 1, 1992, there is little caselaw interpreting the Commercial Real Estate Broker Lien Act. In *West Suburban Bank v. Attorneys' Title Insurance Fund, Inc.,* 326 Ill.App.3d 502, 761 N.E.2d 346, 260 Ill.Dec. 502 (2d Dist. 2001), the owner of commercial real estate hired a broker to sell the property. The broker found a purchaser for the real estate, but the total amount of the sale was insufficient to cover the two mortgages on the property as well as the broker's commission.

The bank's attorney notified the broker that any lien claimed by the broker was junior to the bank's mortgages. The bank also notified the broker that if the broker claimed a lien, the bank would place funds in escrow pursuant to the Act and the broker would be required to execute a release at closing. The broker refused to release its lien at closing; the lender filed a declaratory judgment action asking that the escrow funds be paid to the bank and that the broker release its lien. The trial court granted summary judgment to the bank and extinguished the broker's lien. 761 N.E.2d at 349.

On appeal, the Second District held that the escrow provisions of the Act did not require that the parties establish the escrow because the proceeds from the sale were insufficient to extinguish all liens against the property and the broker's commission. As a result, the broker was excluded from compliance with the Act's requirements relating to escrow. The court further determined that the bank had released its prior mortgages in order to obtain title insurance for its new mortgages, which the court stated would not have been given without the escrowed funds and prior mortgage releases. 761 N.E.2d at 351. Therefore, the court determined that the bank no longer had an interest in the escrowed funds, that the trial court erred in extinguishing the broker's lien, and that the broker was the only party with an interest in the funds. 761 N.E.2d at 350 – 351.

The decision in *West Suburban Bank* illustrates the importance of understanding the Act's requirements whenever a broker's lien has been filed. If a landlord is not aware of these requirements or does not understand them, it could find itself subject to a broker's lien that otherwise could have been avoided by due diligence at the time the lease was executed.

For other decisions related to the Act, *see Brian Properties, Inc. v. Burley,* 278 Ill.App.3d 272, 662 N.E.2d 522, 214 Ill.Dec. 956 (1st Dist. 1996), and *Grubb & Ellis Co. v. First Colonial Trust Co.,* No. 94 C 3706, 1995 WL 549131 (N.D.Ill. Sept. 8, 1995).

8 Tenant Defaults and Landlord Remedies

WILLIAM J. DORSEY
Blank Rome LLP
Chicago

The contribution of Timothy J. Patenode to previous editions of this chapter, and the contribution of Amanda M. Noonan to the current edition, are gratefully acknowledged.

I. [8.1] INTRODUCTION

This chapter is intended to provide a primer for landlord's counsel on the common issues and basic procedures pertaining to tenant defaults on office, retail, and industrial leases. This chapter does not address residential or agricultural leases or hotel occupancy. It also does not address certain related issues, such as insurance and waivers of rights of subrogation, easements, condominium evictions, or forfeiture of installment real estate sale contracts. The comments in this chapter are general in nature, and there are exceptions to every case. The author is a practicing litigator and expects that, at times, he may have to take positions at variance with those expressed herein, based on the facts of a particular case.

The two most common situations facing landlord's counsel are

a. a default by a tenant during the term of a lease; and

b. a holdover by a tenant after expiration of the lease term.

Because the rights of the landlord differ in these situations, they are addressed separately in §§8.2 – 8.29 and 8.30 – 8.32 below.

II. DEFAULT BY TENANT DURING THE LEASE TERM

A. [8.2] Determination of Default

The starting point for landlord's counsel must be the written lease. Prudent counsel will obtain a copy of the written lease together with all amendments and addenda. Counsel should also obtain a copy of the correspondence file, as letters occasionally will be used to amend important rights.

The practitioner should then thoroughly review the documents, giving special attention to the possibility of ambiguities. Ambiguities in the lease can increase the cost, expense, and uncertainty of litigation. If an ambiguity exists in an important provision, one can expect the tenant to argue that the ambiguity should be construed against the landlord as the drafter of the lease. *Housing Authority of Joliet v. Keys,* 326 Ill.App.3d 577, 761 N.E.2d 338, 343, 260 Ill.Dec. 494 (3d Dist. 2001) ("Since we find the lease ambiguous, its terms must be construed against the Housing Authority as the drafter of the lease."); *Kimball Hill Management Co. v. Roper,* 314 Ill.App.3d 975, 733 N.E.2d 458, 463, 248 Ill.Dec. 11 (2d Dist. 2000) (same, interpreting same provision as *Keys*); *NutraSweet Co. v. American National Bank & Trust Company of Chicago,* 262 Ill.App.3d 688, 635 N.E.2d 440, 445, 200 Ill.Dec. 101 (1st Dist. 1994) ("After reviewing the Lease, we conclude that this language of the defendants must be construed against them, as they are the drafters of the Lease, as well as the lessors of the property."). Of course, in commercial leases, tenants regularly participate in the drafting of the lease, and the lease may even include a provision that prohibits it from being construed against the landlord. Furthermore, even if the lease was wholly drafted by the landlord, the landlord may seek to argue that construction against the drafter is a secondary rule of contract construction to be used only when the intent of the parties cannot otherwise be ascertained from extrinsic evidence. A lease, like any other contract, is to be construed so as to give

effect to the intent of the parties, and when the contract is ambiguous, the court should first consider extrinsic evidence of the parties' intent, including their negotiations and the practices of the industry. *Fox v. Commercial Coin Laundry Systems,* 325 Ill.App.3d 473, 757 N.E.2d 529, 531, 258 Ill.Dec. 840 (1st Dist. 2001); *Farwell Construction Co. v. Ticktin,* 84 Ill.App.3d 791, 405 N.E.2d 1051, 1057, 39 Ill.Dec. 916 (1st Dist. 1980). Contracting parties may also choose to include an integration clause to preclude consideration of precontractual negotiations and related extrinsic evidence, as long as the lease is clear and unambiguous. *Greggs USA, Inc. v. 400 East Professional Associates, LP,* 2021 IL App (1st) 200959, 198 N.E.3d 1062, 459 Ill.Dec. 685.

In the course of analyzing the lease, the practitioner should track the default through three kinds of provisions of the lease, including

1. the covenants and conditions of the lease (see §§8.3 – 8.9 below);

2. the event of default provision (see §8.10 below); and

3. the remedies provision (see §8.11 below).

1. [8.3] The Covenants and Conditions of the Lease

Covenants and conditions make up the majority of the lease. These are the provisions that state when and how much rent is to be paid, how insurance is to be maintained, how landlord access is to be provided, and so on. See §§8.4 – 8.9 below.

a. [8.4] Rent Clause

The most fundamental provision of any lease is the rent clause. In commercial leases, however, "rent" may have several components, as noted in §§8.5 – 8.7 below.

(1) [8.5] Base rent

"Base rent" is the fixed sum to be paid each month. A failure to pay base rent can best be proved through an accounting record maintained by the landlord that is admissible under the business records exception to the hearsay rule. Illinois Rule of Evidence 803(6); Illinois Supreme Court Rule 236.

A common problem that arises with respect to payment of base rent is the landlord's waiver of strict compliance with the due date. Many commercial leases require rent to be paid by the first, fifth, or tenth day of the month, but if a tenant has regularly tendered the rent after the due date and the landlord has accepted the late payment, the landlord may have waived its right to insist on strict compliance with the lease.

The landlord can reestablish its right to require strict compliance with the lease through a definite and specific notice to the tenant. *E.g., Fox v. Commercial Coin Laundry Systems,* 325 Ill.App.3d 473, 757 N.E.2d 529, 258 Ill.Dec. 840 (1st Dist. 2001); *Famous Permanent Wave Shops, Inc. v. Smith,* 302 Ill.App. 178, 23 N.E.2d 767 (1st Dist. 1939); *Sixeas v. Fogel,* 253 Ill.App. 579

(1st Dist. 1929). If the practitioner is placed in a situation in which a pattern and practice defense may be asserted, it may be prudent for the practitioner to have the client reestablish the strict terms of the lease before asserting a default. *LaSalle National Bank v. Khan,* 191 Ill.App.3d 41, 547 N.E.2d 472, 138 Ill.Dec. 305 (1st Dist. 1989). An additional measure that practitioners should consider when drafting a commercial lease is including a nonwaiver clause, which can provide that a landlord's failure to demand strict performance shall not be construed as a waiver or relinquishment of any rights thereunder. *Transcraft Corp. v. Anna Industrial Development Corp.,* 223 Ill.App.3d 100, 584 N.E.2d 1033, 165 Ill.Dec. 599 (5th Dist. 1991) (enforcing nonwaiver clause relating to tenant's tax payment obligations under lease).

Another common problem is whether security deposits must be applied before declaring default for failure to pay rent. If the written lease explicitly provides that the landlord has no obligation to apply security deposits on unpaid rent, that provision should be enforced. *Elizondo v. Perez,* 42 Ill.App.3d 313, 356 N.E.2d 112, 113 – 114, 1 Ill.Dec. 112 (1st Dist. 1976). *See also Pyramid Enterprises, Inc. v. Amadeo*, 10 Ill.App.3d 575, 294 N.E.2d 713 (1st Dist. 1973).

(2) [8.6] Percentage rent

"Percentage rent" is common in retail leases. It is often calculated as a percentage of gross sales made or net revenues received by the tenant at the leased premises. Usually, the tenant's obligation to pay percentage rent is supported by its obligation to regularly submit financial statements or certifications. The tenant's failure to provide those financial reports may itself be a separate breach of covenant, but that breach will probably be treated differently than a failure to pay rent under the event of default provision. See §8.10 below. The lease may also authorize the landlord to conduct an audit. Although audits can be expensive, the landlord may wish to exercise audit rights if it suspects the tenant of misrepresenting financial information. A thoughtful practitioner will be careful in communications with the auditor so that the auditor's credibility will not be impaired if he or she has to testify as a witness.

(3) [8.7] Additional rent

"Additional rent" can encompass many kinds of financial obligations, but two common ones are the tenant's share of common area maintenance (CAM) expenses and real estate taxes (RET) for the property. CAM and RET are generally charged on an estimated basis during each lease year, with one twelfth of the estimated annual charge being payable each month. The CAM and RET charges are then reconciled after year's end once the actual CAM and RET expenses are known. Additional rent may include other expenses, such as contributions to merchant associations, costs to remedy tenant default, and attorneys' fees and expenses.

b. [8.8] Use Clauses and Covenants To Operate

Most leases contain clauses stating what use the tenant can make of the leased premises. These provisions are especially significant in multi-tenant properties, particularly shopping centers, where tenants may potentially have overlapping lines of business. To avoid competition between tenants in the same building, a tenant may insist, as a condition of its lease, that the landlord prohibit other tenants from conducting certain businesses within their premises. The landlord will thus include provisions in these other leases that restrict or prohibit certain uses.

Related to the use clause is the covenant to operate. Leases may explicitly require a tenant to be open for business at certain times and/or on certain days. The landlord's purpose for this provision, particularly in a multi-tenant retail property, is to make the building more attractive to potential customers. Indeed, anchor or chain tenants may require the landlord to include operating covenants in in-line store leases.

Several Illinois appellate opinions address the question whether a covenant to operate may be implied. For instance, in two cases, *Fox v. Fox Valley Trotting Club,* 8 Ill.2d 571, 134 N.E.2d 806 (1956), and *Simhawk Corp. v. Egler,* 52 Ill.App.2d 449, 202 N.E.2d 49 (2d Dist. 1964), the court found that a use provision in a lease created an express covenant obligating the tenant to continue to do business at the leased premises. In those cases, the use provision in the lease severely limited the tenant's use of the premises, stating that the tenant was to use the premises "solely" or "only for the purpose of" the stated activity (*see Fox, supra,* 134 N.E.2d at 808; *Simhawk, supra,* 202 N.E.2d at 50) and did not permit, as leases often do, the broad use of the premises for "any lawful purpose." Also significant in both cases was that the lease required payment of percentage rent in addition to base rent and that the amount of the base rent was relatively insignificant compared to the percentage rent or was to be applied as a credit to the percentage rent. Without operating a business in the leased premises, the tenant would thus be able to avoid most of its rent obligation. A similar provision for percentage rent was sufficient to imply an operating covenant in *Stein v. Spainhour,* 167 Ill.App.3d 555, 521 N.E.2d 641, 118 Ill.Dec. 359 (4th Dist. 1988).

Use clauses, however, were found not to constitute operating covenants in *Gerardi v. Vaal,* 169 Ill.App.3d 818, 523 N.E.2d 1327, 120 Ill.Dec. 416 (3d Dist. 1988), and *Fay v. Montgomery Ward & Co.,* 19 Ill.App.2d 302, 153 N.E.2d 421 (2d Dist. 1958) (abst.). In *Gerardi,* the use clause was broadly drawn and percentage rent was not a principal component of the rent. An implied covenant to operate was also ruled out on the authority of *Chicago Title & Trust Co. v. Southland Corp.,* 111 Ill.App.3d 67, 443 N.E.2d 294, 297, 66 Ill.Dec. 611 (1st Dist. 1982), and *Marquette National Bank v. Walgreen Co.,* 126 Ill.App.3d 680, 467 N.E.2d 954, 957, 81 Ill.Dec. 832 (1st Dist. 1984). The court found that the abandonment and assignment provisions of the lease were inconsistent with an implied obligation to continue operating.

c. [8.9] Assignment Provision

Landlords are often concerned about the identity, character, and creditworthiness of the tenants with which they deal. Indeed, when a landlord attempts to finance its property, the credit rating or creditworthiness of its tenants may be a crucial consideration in determining the rate of financing that the landlord will be able to achieve. Accordingly, landlords regularly place provisions in their leases restricting the tenant's ability to sublet or assign the leased premises.

Generally, Illinois courts have rejected arguments that anti-assignment provisions in leases are contrary to public policy. *E.g., Mott v. Patten Co.,* 119 Ill.App.2d 237, 255 N.E.2d 483 (2d Dist. 1970) (abst.); *Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 27 Ill.App.2d 467, 170 N.E.2d 35 (1st Dist. 1960). Because restraints on alienation are disfavored, however, courts tend to strictly construe such restrictions. Thus, when an assignment provision is ambiguous, there is some possibility that it will not be enforced in favor of the landlord.

One issue that may arise with corporate tenants is the transfer of control or ownership by sale of the corporate shares. Well-drafted commercial leases will explicitly prohibit a transfer of control or ownership by a sale of shares, and those provisions will be enforced. *Associated Cotton Shops, supra*. If the provision does not explicitly forbid the transfer of corporate stock, however, enforcement of an anti-assignment provision will be more problematic.

Some anti-assignment provisions prohibit assignment without the landlord's consent. When the landlord's consent is required, the landlord cannot unreasonably withhold consent. *Golf Management Co. v. Evening Tides Waterbeds, Inc.,* 213 Ill.App.3d 355, 572 N.E.2d 1000, 1003, 157 Ill.Dec. 536 (1st Dist. 1991); *Vranas & Associates, Inc. v. Family Pride Finer Foods, Inc.,* 147 Ill.App.3d 995, 498 N.E.2d 333, 339, 101 Ill.Dec. 151 (2d Dist. 1986); *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 949, 60 Ill.Dec. 703 (1st Dist. 1982); *Shreeji Krupa, Inc. v. Leonardi Enterprises,* 299 Fed.Appx. 573, 576 (7th Cir. 2008) (applying Illinois law). The tenant, however, has the burden of proving that it has tendered a subtenant who is ready, willing, and able to take over the lease; who meets reasonable commercial standards, including the requisite level of financial responsibility; and who will not compete with the business of the lessor and its other tenants. *Golf Management, supra; Vranas, supra; Jack Frost, supra; Shreeji Krupa, supra.* Moreover, courts have been reluctant to expand this rule beyond the assignment context. *See LaSalle Bank National Ass'n v. Moran Foods, Inc.,* 477 F.Supp.2d 932, 938 (N.D.Ill. 2007) (refusing to apply reasonableness requirement to prohibition of tenant construction).

2. [8.10] The Event of Default Provision

The law does not require an event of default provision in the lease, but this type of provision is often used as a way of bringing together all the different breaches of covenant that could lead to termination. The event of default provision may state additional conditions that must be met before exercising remedies. For instance, although a rent covenant may require rent to be paid by the tenth of the month, the event of default provision may require written notice of the failure and the expiration of a cure period before remedies can be exercised. Accordingly, the practitioner should be prepared to meet both conditions.

Event of default provisions usually treat different kinds of defaults differently. For example, failures to pay rent or to cure hazardous conditions or abandonment of the leased premises may be immediate events of default or may require only short notice.

By contrast, failures to comply with other terms, provisions, or covenants of the lease may require written notice and lapse of a cure period. The tenant may also be able to extend the cure period if the default is capable of cure and the tenant has commenced to cure before the end of the initial period.

Furthermore, bankruptcy, insolvency, or appointment of a receiver generally results in an immediate default without notice, but because of the automatic stay in bankruptcy, the landlord's remedies are temporarily stayed and the lease may be rejected under §365 of the Bankruptcy Code, 11 U.S.C. §365.

3. [8.11] The Remedies Provision

As a matter of common law, it is necessary that the lease contain an explicit remedy for the tenant's breach of covenant.

> **There was no doctrine at common law that a material breach of the lease would give rise to a cause of action for breach of the entire lease, and there was, a fortiori, no doctrine of anticipatory breach of a lease. . . . [**C**]ourts have generally declined to apply the doctrine of anticipatory damages to contracts for the use of land. In order to have it appl[**y**] to such contracts resort has been had to the introduction into leases of provisions having that effect.** *People ex rel. Nelson v. West Town State Bank,* 373 Ill. 106, 25 N.E.2d 509, 512 (1940).

This is rarely a problem in commercial leases. Nearly every commercial lease contains explicit termination provisions, an explicit right of reentry for breach of covenant, or both. Either sort of provision is sufficient. *Id.; White v. Naerup,* 57 Ill.App. 114 (1st Dist. 1894).

The termination provision in commercial leases almost always gives the landlord an option either to terminate the lease altogether or to terminate possession alone while keeping the lease in full force and effect. Termination of the lease may terminate the tenant's obligation to pay future rent, whereas termination of mere possession is intended to maintain the tenant's obligations to pay rent and to observe the other covenants of the lease. Accordingly, prudent landlords generally terminate only possession, although there may be creative reasons or unusual circumstances under which termination of the lease is preferable. The practitioner should be certain which option is being exercised and draft notices and court documents accordingly. If, however, a notice terminating a lease is sent when only termination of possession was intended, the practitioner may find that the lease explicitly preserves the tenant's obligations to pay rent, even after termination of the lease. Such provisions are enforceable. *See Lake Shore Management Co. v. Blum,* 92 Ill.App.2d 47, 235 N.E.2d 366, 369 (1st Dist. 1968).

The practitioner should also be aware that there is some Illinois law suggesting that when the tenant has an option to purchase the leased premises, a court of equity may intervene, under certain circumstances, to prevent a default and forfeiture of the lease. Generally, however, those circumstances arise when (a) the lease is part of a transaction for the installment sale of real estate, (b) the lease is intended to give the purchaser possession of the premises during tenancy of the installment sale contract, and (c) the separate consideration for the installment sale contract is clearly stated. Under such circumstances, the special procedures for forfeiture of an installment sale contract should be followed. A discussion of those procedures is beyond the scope of this chapter.

Many commercial leases will also expressly reserve "other remedies at law or in equity." The landlord has such remedies whether or not the lease reserves them, and such remedies, to the extent that they are not inconsistent, are cumulative and may be exercised in any order. *Stave v. Great Atlantic & Pacific Tea Co.,* 262 Ill.App. 221 (1st Dist. 1931).

B. Remedies for Default

1. [8.12] Self-Help Prohibited

Occasionally, clients are confused by lease provisions that state that upon a breach of covenant, the landlord has the right to reenter and take possession of the premises. "If the lease says it and the tenant agreed to it," they ask, "why can't I just do it?"

Experienced practitioners know the answer: the Illinois eviction statute prohibits forcible entry. Section 9-101 of the Code of Civil Procedure, 735 ILCS 5/9-101, states: "No person shall make an entry into lands or tenements except in cases where entry is allowed by law, and in such cases he or she shall not enter with force, but in a peaceable manner." This is a departure from common law, which "permitted an individual who was rightfully entitled to enter upon land to do so with force and arms and retain possession by force." *Fortech, L.L.C. v. R.W. Dunteman Co.,* 366 Ill.App.3d 804, 852 N.E.2d 451, 459, 304 Ill.Dec. 201 (1st Dist. 2006), quoting *Heritage Pullman Bank v. American National Bank & Trust Company of Chicago,* 164 Ill.App.3d 680, 518 N.E.2d 231, 236, 115 Ill.Dec. 706 (1st Dist. 1987). *See City of Chicago v. Chicago S.S. Lines, Inc.,* 328 Ill. 309, 159 N.E. 301 (1927). "[T]he Forcible Entry and Detainer Act [since renamed the Eviction Act] put an end to the practice of self-help and provides the sole means for settling a dispute over possession rights to real property." *Fortech, supra,* 852 N.E.2d at 459. *See Heritage Pullman, supra,* 518 N.E.2d at 236, citing *Ross v. Youngman,* 125 Ill.App. 494, 496 (3d Dist. 1906).

"The statute prohibits any actual or constructive self-help through force, including changing locks or locking someone out of his land." *Fortech, supra,* 852 N.E.2d at 460, quoting *Yale Tavern, Inc. v. Cosmopolitan National Bank,* 259 Ill.App.3d 965, 632 N.E.2d 80, 85, 198 Ill.Dec. 21 (1st Dist. 1994). *See People v. Evans,* 163 Ill.App.3d 561, 516 N.E.2d 817, 819, 114 Ill.Dec. 662 (1st Dist. 1987); *Phelps v. Randolph,* 147 Ill. 335, 35 N.E. 243, 245 (1893); *Faubel v. Michigan Boulevard Building Co.,* 278 Ill.App. 159 (1st Dist. 1934); *Brooks v. LaSalle National Bank,* 11 Ill.App.3d 791, 298 N.E.2d 262, 268 (1st Dist. 1973).

Thus, even if no breach of the peace occurs, entry into the leased premises in the absence of the tenant could still constitute forcible entry if the tenant is still in actual possession, the entry is against the tenant's will, and the entry has the effect of excluding the tenant from possession. *Harper v. Sallee,* 376 Ill. 540, 34 N.E.2d 860, 864 (1940); *Bugner v. Chicago Title & Trust Co.*, 280 Ill. 620, 117 N.E. 711, 718 (1917); *Hammond v. Doty,* 184 Ill. 246, 56 N.E. 371, 372 (1900); *Phelps, supra.*

NOTE: P.A. 100-173, §30 (eff. Jan. 1, 2017), amended the Illinois statutes to replace references to "forcible entry and detainer" with "eviction," but many peripheral statutes and courts still refer to "forcible entry and detainer actions." *E.g.,* Cook County Circuit Court General Order No. 1.2,2.3(b)(1) (municipal courts have jurisdiction over "forcible entry and detainer actions"); *Goodwin v. Matthews,* 2018 IL App (1st) 172141, ¶20, 123 N.E.3d 460, 428 Ill.Dec. 731 (ruling on "forcible entry and detainer" complaint).

2. [8.13] Abandonment by the Tenant

What if the notice of default is given and the tenant appears to have abandoned the premises? In those circumstances, the practitioner has two goals. First, he or she must make sure not to run afoul of the prohibitions against self-help under the eviction statute. The landlord has the right to reenter as long as it does not constitute forcible entry. *Perry v. Evanston Young Men's Christian Ass'n,* 92 Ill.App.3d 820, 416 N.E.2d 340, 346, 48 Ill.Dec. 309 (1st Dist. 1981). In that case, the landlord gave notice to the tenants that their lease was terminated. The tenants then took their personal property and left the leased premises. After the time given by the landlord for termination of the lease elapsed, the landlord reentered and took possession of the premises. In an action brought by the tenants to recover for forcible entry, the court held for the landlord. The tenants claimed that forcible entry occurred because the landlord had verbally threatened to lock at least one tenant out of his room. The appellate court affirmed denial of that claim, however, because the landlord took no action to lock out the tenant. *See Parnass v. Ryerson,* 128 Ill.App. 489 (1st Dist. 1906), and *Ebersol v. Trainor,* 81 Ill.App. 645 (2d Dist. 1898), for cases upholding the landlord's right to reenter after abandonment. When a five-day notice is issued and the tenant abandons the property prior to the end of the notice period, the safer practice is to wait until the notice period is up before reentering. *See Arcada Bldg, LLC v. Data Net Systems, LLC,* 2015 IL App (2d) 140646-U, ¶34.

Second, the practitioner should make sure that the leasehold is not surrendered in such a way that the tenant can claim that the lease has been terminated. "Surrender is the yielding up of an estate so that the leasehold interest becomes extinct by mutual agreement." *Peirce v. Conant,* 47 Ill.App.2d 294, 198 N.E.2d 555, 559 (1st Dist. 1964). *See Solomon v. Geller,* 48 Ill.App.2d 15, 198 N.E.2d 210 (1st Dist. 1964) (surrender occurs when both lessor and lessee intend to terminate lease and cancel all covenants and obligations thereunder).

Whether a surrender has actually occurred depends on the intention of the parties. *Peirce, supra; Alschuler v. Schiff,* 164 Ill. 298, 45 N.E. 424, 425 (1896); *Langendorf v. Ritter,* 225 Ill.App. 466 (1st Dist. 1922). Although fact patterns vary, the courts have rejected surrender defenses even in situations in which the lessee turned over the keys to the lessor and the lessor took possession and either put up signs offering to lease the premises or began operating the existing business located on the premises. *Solomon, supra; United Cigar Stores Company of America v. Friend,* 257 Ill.App. 359, 367 (3d Dist. 1930) ("It has always[s] been the law that when a tenant abandons leased premises, without fault of the landlord, the landlord may re-enter and re-rent the premises, crediting the former tenant with the proceeds, and the landlord so taking possession does not relieve the tenant from liability for the stipulated rent."). Generally, it appears that the intent to surrender has to be established by some express written or oral agreement before the tenant is relieved of further liability under the lease. *Alschuler, supra; Solomon, supra*. Prudent landlords often issue notices of abandonment to tenants confirming a tenant's intent to abandon and reaffirming the tenant's remaining lease obligations.

3. Eviction Action

a. [8.14] Nature of Action

If the tenant does not abandon the premises after the notice of default, landlord's counsel will then find it necessary to obtain possession by filing an action under the eviction statute. An action

under this statute is "a special statutory proceeding, summary in its nature, in derogation of the common law, and a party seeking this remedy must comply with the requirements of the statute, especially with respect to jurisdiction." *Avdich v. Kleinert,* 69 Ill.2d 1, 370 N.E.2d 504, 507, 12 Ill.Dec. 700 (1977), quoting *West Side Trust & Savings Bank v. Lopoten,* 358 Ill. 631, 193 N.E.2d 462, 464 (1934). *See Avenaim v. Lubecke,* 347 Ill.App.3d 855, 807 N.E.2d 1068, 1074, 283 Ill.Dec. 227 (1st Dist. 2004); *Wells Fargo Bank, N.A. v. Watson,* 2012 IL App (3d) 110930, ¶14, 972 N.E.2d 1234, 362 Ill.Dec. 201. Note that the First District Appellate Court held in 2018 that a failure to comply with the statutory requirements of the eviction statute did not deprive the court of subject-matter jurisdiction. *Goodwin v. Matthews,* 2018 IL App (1st) 172141, ¶20, 123 N.E.3d 460, 428 Ill.Dec. 731. *See also 2460-68 Clark, LLC v. Chopo Chicken, LLC,* 2022 IL App (1st) 210119, ¶27, 198 N.E.3d 655, 459 Ill.Dec. 628.

The provision of the eviction statute principally operative for a commercial lease is 735 ILCS 5/9-102(a)(4): "[A] person entitled to the possession of lands or tenements may be restored thereto under any of the following circumstances: . . . (4) [w]hen any lessee of the lands or tenements, or any person holding under such lessee, holds possession without right after the termination of the lease or tenancy by its own limitation, condition or terms, or by notice to quit or otherwise."

The practitioner should note that there are special procedures available for obtaining possession of leased premises that the tenant uses for the commission of any felony or Class A misdemeanor under Illinois law. 735 ILCS 5/9-120(a). There are similar procedures available for obtaining possession of leased premises used for possessing, serving, storing, cultivating, delivering, using, selling, or giving away controlled substances. 740 ILCS 40/11.

b. [8.15] Preparation of the Notice of Default

Under 735 ILCS 5/9-102(a)(4), the first requirement of an eviction action is that the lease, or possession under the lease, be terminated. The practitioner must follow the provisions of the lease for termination, including any notice and demand requirement contained in the event of default provisions. The notice should typically state the grounds for default and, in the case of rent default, state the amount of unpaid rent, make a demand for payment of that rent, and have the landlord sign the notice. *Westerman v. Gilmore,* 17 Ill.App.2d 455, 150 N.E.2d 660, 662 (3d Dist. 1958).

In determining the amount of unpaid rent, the practitioner should cover with the client all of the components of "rent" under the lease. If some components cannot be determined at the time of the notice, the practitioner may wish to make an express reservation of the right to demand payment of the undetermined component at a later date. An overstatement of the amount of unpaid rent should not invalidate the notice if the tenant fails to tender the proper amount of rent. *Village of Palatine v. Palatine Associates, LLC,* 2012 IL App (1st) 102707, ¶26, 966 N.E.2d 1174, 359 Ill.Dec. 486; *Elizondo v. Medina,* 100 Ill.App.3d 718, 427 N.E.2d 381, 382 – 383, 56 Ill.Dec. 301 (1st Dist. 1981); *Lehndorff USA (Central) Ltd. v. Cousins Club, Inc.,* 40 Ill.App.3d 875, 353 N.E.2d 171 (1st Dist. 1976). The practitioner will also want to describe the leased premises adequately, although the description need only be sufficiently certain so that the tenant cannot reasonably misunderstand it. *Killian v. Welfare Engineering Co.,* 328 Ill.App. 375, 66 N.E.2d 305, 311 (2d Dist. 1946).

If the lease does not contain specific notice and demand periods, the practitioner will have to follow the statutory provisions. For defaults in rent, the practitioner should follow 735 ILCS 5/9-209, which states:

> **A landlord or his or her agent may, any time after rent is due, demand payment thereof and notify the tenant, in writing, that unless payment is made within a time mentioned in such notice, not less than 5 days after service thereof, the lease will be terminated. If the tenant does not pay the rent due within the time stated in the notice under this Section, the landlord may consider the lease ended and commence an eviction or ejectment action without further notice or demand.**

735 ILCS 5/9-209 also contains form language protecting the landlord against partial or late payments.

For breaches of lease other than a failure to pay rent, 735 ILCS 5/9-210 should be followed:

> **When default is made in any of the terms of a lease, it is not necessary to give more than 10 days' notice to quit, or of the termination of such tenancy, and the same may be terminated on giving such notice to quit at any time after such default in any of the terms of such lease.**

735 ILCS 5/9-210 specifies a form that may be used to give the notice to quit.

The lease may provide different time limits than those stated in §§9-209 and 9-210. For instance, the lease may require no notice or demand prior to termination for a failure to pay rent. If the lease allows the landlord to terminate without giving a §9-209 five-day notice, the caselaw supports the landlord's contractual right. *Avdich v. Kleinert,* 69 Ill.2d 1, 370 N.E.2d 504, 12 Ill.Dec. 700 (1977); *Sandra Frocks, Inc. v. Ziff,* 397 Ill. 497, 74 N.E.2d 699 (1947); *LaSalle National Bank v. Khan,* 191 Ill.App.3d 41, 547 N.E.2d 472, 138 Ill.Dec. 305 (1st Dist. 1989); *Balaban & Katz Corp. v. Channel Amusement Co.,* 336 Ill.App. 113, 83 N.E.2d 27 (1st Dist. 1948).

However, the landlord may inadvertently waive the provision by recognizing the existence of the tenancy subsequent to the time that the lessor might have declared termination of the lease. *Avdich, supra.* Issuing a statutory five-day notice under §9-209 itself may constitute a recognition of the existence of the tenancy. *Id.; Sixeas v. Fogel,* 253 Ill.App. 579 (1st Dist. 1929); *Hopkins v. Levandowski,* 250 Ill. 372, 95 N.E. 496 (1911). Furthermore, there is a prudential consideration. The concept of the five-day notice for failure to pay rent has become so ingrained in the judicial consciousness that practitioners should think twice before embarking on an eviction action without giving such notice. It is a rare situation in which the landlord cannot afford to wait the extra five days to serve a notice under 735 ILCS 5/9-209, and the prove-up or trial will go more smoothly as a result.

Conversely, if the lease requires more than the statutory notice period for a default, the landlord should follow the terms of the lease. *See Dasenbrock v. Interstate Restaurant Corp.,* 7 Ill.App.3d 295, 287 N.E.2d 151 (5th Dist. 1972).

Practitioners should also note that §9-102(a)(4) does not require a demand for possession. When a demand is not required by statute, it cannot be added by judicial construction. *See North American Old Roman Catholic Church v. Bernadette,* 253 Ill.App.3d 278, 627 N.E.2d 1094, 194 Ill.Dec. 452 (1st Dist. 1992) (addressing §9-102(a)(2)). Nevertheless, the practitioner may consider sending a separate demand for possession after the period of time given in the notice has expired. *See Shelby County Housing Authority v. Thornell,* 144 Ill.App.3d 71, 493 N.E.2d 1109, 1111, 98 Ill.Dec. 88 (5th Dist. 1986); *Slowik v. Larson,* 333 Ill.App. 153, 76 N.E.2d 830 (1st Dist. 1947) (abst.). The landlord should not demand possession until the notice period has expired. *Korte v. National Super Markets, Inc.,* 173 Ill.App.3d 1066, 528 N.E.2d 10, 13, 123 Ill.Dec. 626 (5th Dist. 1988) (demand that tenant deliver possession within 15 days of demand did not comply with lease requirement for 10 days' written notice of default prior to termination).

c. [8.16] Service of the Notice of Default

The operative statutory provision for service of the notice of default is 735 ILCS 5/9-211, which states:

> **Any demand may be made or notice served by delivering a written or printed, or partly written and printed, copy thereof to the tenant, or by leaving the same with some person of the age of 13 years or upwards, residing on or in possession of the premises; or by sending a copy of the notice to the tenant by certified or registered mail, with a returned receipt from the addressee; and in case no one is in the actual possession of the premises, then by posting the same on the premises.**

The cases have held that the use of the word "may" in this provision means that other methods of service are acceptable. *Prairie Management Corp. v. Bell,* 289 Ill.App.3d 746, 682 N.E.2d 141, 224 Ill.Dec. 580 (1st Dist. 1997); *Ziff v. Sandra Frocks, Inc.,* 331 Ill.App. 353, 73 N.E.2d 327 (1st Dist. 1947). With respect to the provision allowing service by the posting of the notice, the landlord should confirm the tenant is not in possession of the premises. *American Management Consultant, LLC. v. Carter,* 392 Ill.App.3d 39, 915 N.E.2d 411, 427 – 428, 333 Ill.Dec. 605 (3d Dist. 2009); *Figueroa v. Deacon,* 404 Ill.App.3d 48, 935 N.E.2d 1080, 1084, 343 Ill.Dec. 852 (1st Dist. 2010).

735 ILCS 5/9-212 provides that if the demand is made and notice is served by an officer authorized to serve process, the officer's return is prima facie evidence of the service. If demand is made or notice is served by a person not an authorized officer, the return should be sworn to by the server and the affidavit becomes prima facie evidence. *Id.*

The practitioner should note that under 735 ILCS 5/9-212, the notice period commences on the day that the tenant receives the notice. *Avdich v. Kleinert,* 69 Ill.2d 1, 370 N.E.2d 504, 12 Ill.Dec. 700 (1977). If the notice is served by certified or registered mail with return receipt requested, the notice commences from the date of delivery shown on the receipt. *Id.* However, if the lease provides that service is effective upon mailing, that provision is enforceable. *Sjostrom & Sons, Inc. v. D. & E. Mall Restaurant, Inc.,* 29 Ill.App.3d 1082, 332 N.E.2d 62 (2d Dist. 1975). Also, a tenant who refuses to accept delivery of a certified letter is held to be in constructive receipt of the letter for purposes of the statutory notice. *Helland v. Larson,* 138 Ill.App.3d 1, 485 N.E.2d 457, 92 Ill.Dec. 646 (3d Dist. 1985).

The practitioner should be careful not to commence suit until the notice period has elapsed; otherwise, the case could be deemed premature and be dismissed. *Avdich, supra. See Fifth Third Mortgage Co. v. Foster,* 2013 IL App (1st) 121361, ¶13, 994 N.E.2d 101, 373 Ill.Dec. 616 (forcible suit filed few days before termination of lease was dismissed). Conversely, if the notice inadvertently states a termination date that is too early, there is caselaw holding that the notice is nevertheless effective to terminate the lease at the earliest possible date after the date stated. *Wendy & William Spatz Charitable Foundation v. 2263 North Lincoln Corp.,* 2013 IL App (1st) 122076, ¶¶35 – 36, 998 N.E.2d 909, 376 Ill.Dec. 199, citing *Steffen v. Paulus,* 125 Ill.App.3d 356, 465 N.E.2d 1021, 80 Ill.Dec. 675 (4th Dist. 1984), and *Meyer v. Cohen,* 260 Ill.App.3d 351, 632 N.E.2d 22, 197 Ill.Dec. 953 (1st Dist. 1993).

If the landlord becomes concerned about the deficiency of a notice, it should be able to send a second notice without waiver of the first, provided that the landlord makes it clear that no waiver is intended and that the second notice is purely precautionary. *See Chicago Housing Authority v. Taylor,* 207 Ill.App.3d 821, 566 N.E.2d 417, 152 Ill.Dec. 730 (1st Dist. 1990); *Mitchell v. Tyler,* 335 Ill.App. 117, 80 N.E.2d 449 (1st Dist. 1948). *See also Shelby County Housing Authority v. Thornell,* 144 Ill.App.3d 71, 493 N.E.2d 1109, 1111, 98 Ill.Dec. 88 (5th Dist. 1986).

d. [8.17] Preparation, Filing, and Service of the Complaint

Assuming that the notice period has expired, the practitioner may then turn to preparation of the eviction complaint. The statutory requirements are few and are contained in 735 ILCS 5/9-106. Under that section, the complaint requires only

1. a statement that the plaintiff is entitled to the possession of the premises;

2. a description of the premises with reasonable certainty;

3. the identification of the defendant; and

4. a statement that the defendant unlawfully withholds possession from the plaintiff. *Id.*

Caselaw has confirmed that the lessor's complaint need only comply with the minimum statutory requirements. *Chicago Housing Authority v. Walker,* 131 Ill.App.2d 299, 266 N.E.2d 785 (1st Dist. 1970).

The complaint should be brought in the name of the party entitled to possession of the premises. 735 ILCS 5/9-106. Generally, the lessor under the lease will be the named plaintiff. Two special cases to consider are land trusts and beneficiaries. Generally under a land trust agreement, the beneficiary, not the land trustee, has the right to possession. *Mamolella v. Mamolella,* 73 Ill.App.3d 398, 401, 392 N.E.2d 99, 29 Ill.Dec. 542 (1st Dist. 1979). If the land trustee executed the lease, however, the trustee can properly be named as the plaintiff. *Central Nat. Bank v. Paset,* 347 Ill.App. 179, 106 N.E.2d 159 (1st Dist. 1952) (abst.). Conversely, the beneficiary is a proper plaintiff even if the beneficiary is not named in the lease if the lease documents indicate that the trustee has no authority to enforce the lease. *LaSalle National Bank v. Khan,* 191 Ill.App.3d 41, 547 N.E.2d 472, 138 Ill.Dec. 305 (1st Dist. 1989).

Note that the party entitled to possession has the right to enforce the lease regardless of whether that party executed the lease as the landlord. In *Zirp-Burnham, LLC v. E. Terrell Associates, Inc.,* 356 Ill.App.3d 590, 826 N.E.2d 430, 292 Ill.Dec. 289 (1st Dist. 2005), the tenant's president claimed that the lease he signed named a different landlord than the one that sued. The verdict against the tenant was affirmed on appeal on the grounds that there was evidence of the tenant's affirmance or ratification of the lease with the other landlord and there was evidence from which the jury could conclude that the identity of the landlord was unimportant. The court said, "Thousands of contracts are made in which one party neither knows nor cares to know who the other party is." 826 N.E.2d at 441, quoting 7 Joseph M. Perillo, CORBIN ON CONTRACTS §28.32, pp. 156 – 157 (rev. ed. 2002). *See Pennymac Corp. v. Jenkins,* 2018 IL App (1st) 171191 ¶32, 105 N.E.3d 962, 423 Ill.Dec. 554 (holding that amendment to substitute current landowner for previous landowner was proper, even though demand for possession was erroneously in name of previous landowner).

When the property has been conveyed by deed, the grantee is the proper plaintiff. *Pros Corporate Management Services, Inc. v. Ashley S. Rose, Ltd.,* 228 Ill.App.3d 573, 592 N.E.2d 609, 613 – 614, 170 Ill.Dec. 173 (2d Dist. 1992); *Lipschultz v. Robertson,* 407 Ill. 470, 95 N.E.2d 357, 359 (1950); *Jordan v. Weston,* 26 Ill.App.2d 498, 168 N.E.2d 809 (1st Dist. 1960) (abst.); *Goldblatt Bros. v. Hoefeld, Inc.,* 284 Ill.App. 31, 1 N.E.2d 573 (1st Dist. 1936); 735 ILCS 5/9-215. The grantee also has the same remedy for recovery of rent due under the lease as the original grantor might have had if the assignment had not been made. 735 ILCS 5/9-215. *See Telegraph Savings & Loan Ass'n v. Guaranty Bank & Trust Co.,* 67 Ill.App.3d 790, 385 N.E.2d 97, 102 – 103, 24 Ill.Dec. 330 (1st Dist. 1978), citing *Bellows v. Ziv,* 38 Ill.App.2d 342, 187 N.E.2d 265, 268 – 269 (1st Dist. 1962).

In Cook County, all eviction actions are filed in the Municipal Department no matter how much rent is due. See Cook County Circuit Court General Order Nos. 1.2,2.1(a)(1)(v), 1.2,2.3(b)(1).

S.Ct. Rule 101(b)(2) prescribes the form of summons. The summons will specify a return date for the defendant to appear for trial, which will be not more than 40 days or less than 7 days after issuance of the summons. (Note that Cook County Circuit Court Rule 10.5(a)(5) requires service not less than 14 days after issuance.) The summons cannot be served later than 7 days before the trial date. Although it is relatively rare that a commercial tenant cannot be found for service of process, the eviction statute does provide for constructive service in those situations by posting or publication. 735 ILCS 5/9-107. A judgment based on constructive service must be limited to possession and cannot include an award of rent. *Id.*

e. [8.18] Trial Considerations

S.Ct. Rule 181(b)(2) requires the tenant to appear on the return date. If the tenant appears, no answer will be required, unless ordered, and the case will proceed as though the allegations of the complaint were denied; any defense may be proved, provided it is germane, as though it were specially pleaded. Accord 735 ILCS 5/9-106. In a complicated case, the plaintiff may thus want to explore through discovery the presence of any affirmative defense so that it can be better prepared for the trial.

If the tenant does not appear, the case may be proved up on that date. If the tenant does appear and asks for a continuance, generally one continuance will be allowed.

Although the plaintiff is entitled to move for summary judgment in an eviction (*Wells Fargo Bank, N.A. v. Watson,* 2012 IL App (3d) 110930, ¶13, 972 N.E.2d 1234, 362 Ill.Dec. 201; *First Illinois Bank & Trust v. Galuska,* 255 Ill.App.3d 86, 627 N.E.2d 325, 327, 194 Ill.Dec. 209 (1st Dist. 1993)), almost every case is decided at trial. At the trial of the case, the practitioner should be ready with the original lease, a business record of the rent payments made, and a witness who can authenticate and explain both documents. The burden of proof is mere preponderance. 735 ILCS 5/9-109.5.

Even though there is a statute prohibiting waiver of a jury trial in residential leases (735 ILCS 5/9-108), waivers of jury trials in commercial leases are enforceable. The landlord, however, should guard against procedural waiver of the jury waiver by asserting the jury waiver promptly. *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 510, 230 Ill.Dec. 1013 (1st Dist. 1998). As a practical matter, most courts often consider a right to jury waived if not raised at the first appearance.

735 ILCS 5/9-109 provides for trial ex parte and without a jury if the tenant does not appear after having been duly summoned.

f. [8.19] The Judgment of Possession and Eviction

If the court finds that the landlord is entitled to possession, the landlord's counsel will prepare the judgment for possession. 735 ILCS 5/9-110. Trial courts regularly stay the judgment for possession for a period of 30 days or more so that the tenant has the opportunity to vacate the premises in an orderly fashion. Note that any action by the landlord or its agents or contractors that disturbs the possession or appropriates property of the tenant prior to the termination of the stay will violate the self-help prohibition and possibly lead to tort claims. *Fortech, L.L.C. v. R.W. Dunteman Co.,* 366 Ill.App.3d 804, 852 N.E.2d 451, 304 Ill.Dec. 201 (1st Dist. 2006).

A tenant who continues in possession of the premises pursuant to a stay order is a tenant at sufferance, holding only naked possession, and has no privity with the landlord. *Nationwide Mutual Fire Insurance Co. v. T & N Master Builder & Renovators,* 2011 IL App (2d) 101143, ¶¶20 – 28, 959 N.E.2d 201, 355 Ill.Dec. 173; *Troccoli v. L & B Products of Illinois, Inc.,* 189 Ill.App.3d 319, 545 N.E.2d 219, 221, 136 Ill.Dec. 695 (1st Dist. 1989); *Bradley v. Gallagher,* 14 Ill.App.3d 652, 303 N.E.2d 251, 254 (1st Dist. 1973).

The practitioner should note that there is a short statute of limitations for enforcement of an eviction order. 735 ILCS 5/9-117 states that "[n]o eviction order obtained in an action brought under this Article may be enforced more than 120 days after the order is entered, unless upon motion by the plaintiff the court grants an extension of the period of enforcement of the order." The statute requires that the notice for the motion extend the judgment to be served on the tenant. The court is required to grant the motion unless the tenant establishes that (1) its lease has been reinstated, (2) the breach has been cured or waived, (3) some postjudgment agreement has been entered into with the landlord, or (4) some other legal or equitable ground exists to avoid

enforcement. *Id.* The careful practitioner, of course, will want to diligently enforce the judgment so as to avoid providing the tenant an opportunity to raise new issues. The statute does not explicitly say that the motion must be brought before the expiration of the 120 days, but a careful practitioner will seek to avoid this issue as well by presenting the motion within that time.

If the stay of enforcement has expired and the tenant is still in possession, the practitioner will then have to place the judgment with the sheriff for eviction. The procedure can vary somewhat in different counties. Generally, the sheriff will select a date and provide advance notice to the tenant, often by posting a special notice. Eviction of a commercial tenant can be effectuated by changing the locks under the supervision of the sheriff. If the landlord desires to have the person on the premises removed, the sheriff will generally supervise movers hired by the landlord.

Following the commencement of an action, the landlord and the tenant may enter into a settlement agreement terminating the lease and the tenant's possession rights. The careful practitioner will obtain the tenant's consent to a judgment for possession to be entered in the event the tenant violates the terms of settlement and refuses to vacate the premises voluntarily. The landlord can then present the judgment for possession to the sheriff for eviction instead of having to file a new eviction case.

Sometimes the landlord and the tenant will agree to reinstate the lease pursuant to a settlement agreement. Some courts allow the parties to memorialize the terms of the settlement in an agreed order and permit the parties to agree that the court will retain jurisdiction to enforce the terms of the settlement agreement. *See, e.g., Block 418, LLC v. Uni-Tel Communications Group, Inc.,* 398 Ill.App.3d 586, 925 N.E.2d 253, 338 Ill.Dec. 756 (2d Dist. 2010). If the tenant breaches the settlement agreement, the landlord can then file a motion to enforce the agreement and seek a judgment for possession. This saves the landlord the time and expense associated with filing a new lawsuit. However, some courts have been reluctant to supervise the parties' agreements. In those courts, the practitioner may want to dismiss the case without prejudice, which would allow the landlord to reinstate the case if the tenant breaches the settlement agreement. The landlord will have up to one year from the date the lawsuit is voluntarily dismissed to refile the case. 735 ILCS 5/13-217. Practitioners should note that after taking a voluntary dismissal, Illinois law authorizes only a single refiling of the action. *Flesner v. Youngs Development Co.,* 145 Ill.2d 252, 582 N.E.2d 720, 164 Ill.Dec. 157 (1991).

g. Joinder of Action for Recovery of Rent

(1) [8.20] Nature of rent action

735 ILCS 5/9-106 and 5/9-209 allow the landlord to join a claim for rent in the eviction complaint. *Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, ¶14, 993 N.E.2d 1095, 373 Ill.Dec. 536. The action for rent, however, does not lose its distinct character simply by being joined with an action for possession. "An action *for rent* is founded upon an express or implied contract." [Emphasis in original.] *Sianis v. Kettler,* 168 Ill.App.3d 1071, 523 N.E.2d 157, 160, 119 Ill.Dec. 689 (1st Dist. 1988), citing *Fender v. Rogers,* 97 Ill.App. 280, 282 (4th Dist. 1901). The notices that are required for an action for possession are not required for an action for rent. *Sianis, supra; Fender, supra.*

Indeed, the joinder of actions for possession and rent is purely optional. In a complicated situation, a practitioner may want to consider separating the actions so as to avoid confusion over the defenses to the possession action.

(2) [8.21] Payment of use and occupancy pending trial

735 ILCS 5/9-201 permits a landlord to recover use and occupancy charges — generally equating to market-value rent — pending resolution of a joined claim for rent and eviction. *See Circle Management, LLC v. Olivier,* 378 Ill.App.3d 601, 882 N.E.2d 129, 137, 317 Ill.Dec. 555 (1st Dist. 2007). Use and occupancy awards are expressly authorized by statute even though a lessee may ultimately establish a right to rescind the lease, vacate the premises, or obtain other relief. *Id.* They are intended to dissuade tenants from unduly delaying turnover to obtain rent-free use of the leased premises to the prejudice of the landlord. Prior to *Circle Management,* Illinois courts regularly enforced use and occupancy awards by granting immediate possession to the landlord as a sanction for failure to pay.

Two cases have raised questions about the viability of this enforcement mechanism, at least in the residential context. *See id.; Rotheimer v. Arana,* 384 Ill.App.3d 569, 892 N.E.2d 1183, 323 Ill.Dec. 191 (1st Dist. 2008). In each case, the appellate court held that awarding the landlord immediate possession as a sanction for failure to pay use and occupancy improperly deprived the residential tenant of the statutory right to raise and present defenses to the underlying action, including breach of the implied warranty of habitability by the landlord.

There is an open question regarding whether Illinois appellate courts will extend this holding to the commercial leasing context, which does not recognize the implied warranty of habitability and often involves less sympathetic commercial tenants. Moreover, asking for a lesser or more nuanced sanction for failure to pay use and occupancy, such as (a) barring a tenant from producing evidence of defenses at trial, (b) setting an immediate trial date, or (c) entering default judgment in the underlying action, might produce a different result. As a practical matter, however, trial courts have been reluctant to award possession to landlords as a sanction for failure to pay use and occupancy since *Rotheimer, supra,* and *Circle Management, supra,* were decided — even in the commercial context. It will likely take additional test cases in the appellate court to resolve the issue.

(3) [8.22] Proof of lost rent and landlord's duty to mitigate

In proving up lost rent, the landlord typically faces two interrelated issues: (a) the duty to mitigate and (b) the recovery of future rent or damages. See §§8.23 and 8.24 below.

(a) [8.23] Duty to mitigate

By the time the action for rent comes to judgment, the landlord has already lost a certain amount of back rent. Proof of that unpaid back rent should be a simple matter of proving up a business record. However, 735 ILCS 5/9-213.1 states that "[a]fter January 1, 1984, a landlord or his or her agent shall take reasonable measures to mitigate the damages recoverable against a defaulting lessee." This obligation, of course, is triggered only if and when the tenant abandons the premises. *Block 418, LLC v. Uni-Tel Communications Group, Inc.,* 398 Ill.App.3d 586, 925 N.E.2d 253, 258, 338 Ill.Dec. 756 (2d Dist. 2010).

Under the current state of the law construing §9-213.1, the landlord's burden to mitigate damages is different from that imposed by the common law on contracting parties. Under the common law, failure to mitigate damages is an affirmative defense to be pleaded and proved by the defendant. But two Illinois appellate courts have so far found that §9-213.1 imposes on the plaintiff-landlord the obligation to prove mitigation as an aspect of the landlord's case-in-chief: *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 506, 230 Ill.Dec. 1013 (1st Dist. 1998); *Snyder v. Ambrose,* 266 Ill.App.3d 163, 639 N.E.2d 639, 203 Ill.Dec. 319 (2d Dist. 1994). *See St. Louis North Joint Venture v. P & L Enterprises, Inc.,* 116 F.3d 262, 265 (7th Cir. 1997).

St. George and *Snyder* differ in the scope of the burden imposed on the landlord. *Snyder* holds that the landlord must prove satisfaction of its duty to mitigate as a prerequisite to recovery. The *Snyder* court found that since the landlord has exclusive possession of the facts regarding its efforts to mitigate, a failure to bring that information forward creates a presumption in favor of the tenant. The court in *St. George,* however, observed that mitigation concerns only the measure of damages, not the legal right to recover. Accordingly, it held that a landlord's failure to mitigate did not bar the rent claim but could reduce it.

The author believes that there is a good-faith basis for reversing the holdings of *St. George* and *Snyder*. *In re Estate of Conklin,* 116 Ill.App.3d 426, 451 N.E.2d 1382, 72 Ill. Dec. 59 (4th Dist. 1983), summarized Illinois law shortly before the passage of 735 ILCS 5/9-213.1. The court noted that there were, at that time, no fewer than three lines of authority, holding variously that (1) the landlord had no obligation of mitigation whatsoever, (2) the landlord was obligated to follow the general contract rule that it may not sit idly by and allow damages to accumulate, and (3) the landlord had no general obligation to mitigate but only a duty to accept a suitable subtenant when offered. 451 N.E.2d at 1384. Section 9-213.1 could have been intended merely to reconcile these lines of authority so as to establish a duty to mitigate, not to reverse the usual burden of proving mitigation. As the *Snyder* court acknowledged, the statute is silent on the issue of who has the burden to prove satisfaction of the duty, and as the *St. George* court noted, the duty to mitigate is not correctly spoken of as a duty. Further, a 2018 First District Appellate Court opinion, after reviewing the legislative history of §9-213.1, examining the caselaw, and citing the 2015 edition of this chapter, has questioned aspects of both *Snyder* and *St. George. Takiff Properties Group Ltd. #2 v. GTI Life, Inc.,* 2018 IL App (1st) 171477, ¶23, 124 N.E.3d 11, 429 Ill.Dec. 242. The *Takiff* court "disagree[d] with *Snyder's* suggestion that section 9-213.1 transformed the mitigation doctrine into something other than an affirmative defense to be alleged, if not proven, by the defendant-tenant" and observed that "*St. George Chicago, Inc.* considered mitigation of the tenant's liability, not the landlord's mitigation of its damages, as called for by the statute." *Id.*

Most significantly, the *Takiff* court held, as a matter of first impression, that the landlord's §9-213.1 obligation to mitigate can be waived by a lease provision. 2018 IL App (1st) 171477 at ¶¶13, 23, 29 – 30. The court found the obligation to mitigate was waived by a provision that stated, "[i]f the Lessee abandons the premises . . . [u]pon and after entry into possession without termination of the lease, the Lessor may, but need not, relet the premises." [Emphasis omitted.] 2018 IL App (1st) 171477 at ¶3. Practitioners should note that a provision like this is common in well-drafted commercial leases.

If the obligation of mitigation has not been contractually waived or if a practitioner wishes to don "belt and suspenders," compliance with §9-213.1 requires only "reasonable measures to mitigate." 735 ILCS 5/9-213.1. Whether reasonable measures have been taken is a question of fact. *MXL Industries, Inc. v. Mulder,* 252 Ill.App.3d 18, 623 N.E.2d 369, 191 Ill.Dec. 124 (2d Dist. 1993); *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 178 Ill.Dec. 444 (3d Dist. 1992); *St. George, supra,* 695 N.E.2d at 508 – 509. The careful practitioner should be prepared to show evidence of at least some effort to advertise or list the property for rent.

It is not necessarily unreasonable for the landlord to offer to lease the property at a rental rate either higher or lower than the rate under the defaulted lease. *See MXL Industries, supra; JMB Properties, supra; Chicago Title & Trust Co. v. Baskin Clothing Co.,* 219 Ill.App.3d 726, 579 N.E.2d 1045, 162 Ill.Dec. 231 (1st Dist. 1991). *But see MBC, Inc. v. Space Center Minnesota, Inc.,* 177 Ill.App.3d 226, 532 N.E.2d 255, 126 Ill.Dec. 570 (1st Dist. 1988) (attempt to rent at rate 50-percent higher was unreasonable despite broker's advice); *Kallman v. Radioshack Corp.,* 315 F.3d 731, 741 (7th Cir. 2002) (affirming as not clearly erroneous trial court's finding that attempts to mitigate were unreasonable when landlord asked for higher rent than was paid by defaulting tenant while delaying improvements to property that would attract tenants); *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 41 – 43, 332 Ill.Dec. 438 (2d Dist. 2009) (holding that landlord's insistence on inclusion of unreasonable lease term in renegotiated lease that otherwise had terms substantially similar to defaulted lease constituted failure to mitigate and precluded landlord from recovering lost rent and reletting costs). The *JMB Properties* court also held that reletting to a tenant whose rent was principally based on percentage rent rather than base rent was not unreasonable but affected only the proof of damages.

(b) [8.24] Recovery of future rent

If, at the time of judgment, the landlord has not been able to lease the property or has not been able to lease the property for either the full term or the full rental rate of the defaulted lease, the landlord will also face the issue of future rent or damages. The landlord is not permitted to recover rent that will accrue in the future unless there is some provision in the lease specifically authorizing such recovery. *See People ex rel. Nelson v. West Town State Bank,* 373 Ill. 106, 25 N.E.2d 509 (1940); *Miner v. Fashion Enterprises, Inc.,* 342 Ill.App.3d 405, 794 N.E.2d 902, 913, 276 Ill.Dec. 652 (1st Dist. 2003); *Johnstowne Centre Partnership v. Chin,* 110 Ill.App.3d 595, 442 N.E.2d 680, 683, 66 Ill.Dec. 254 (4th Dist. 1982), *rev'd on other grounds,* 99 Ill.2d 284 (1983). *See also Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, ¶¶14 – 17, 993 N.E.2d 1095, 373 Ill.Dec. 536 (no award of future rent in form of unamortized improvement costs). In the absence of such a provision in the lease, "a lessor has the options of suing for rent installments as they come due, suing for several accrued installments, or suing for the entire amount at the end of the lease term." *Miner, supra,* 794 N.E.2d at 913. *See also Dorris v. Center,* 284 Ill.App. 344, 1 N.E.2d 794, 795 (4th Dist. 1936); *Marshall v. John Grosse Clothing Co.,* 184 Ill. 421, 56 N.E. 807 (1900). Note, however, that if the lessor obtains a judgment for less than all of the rent due as of the date of the judgment, any subsequent effort to obtain that accrued but unrequested rent may be barred by res judicata. *Miner, supra,* 794 N.E.2d at 914 – 915.

If there is a lease provision authorizing the recovery of future rent, there is now, the author believes, an open question under Illinois law regarding the scope of recoverable future rent. In *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d

503, 230 Ill.Dec. 1013 (1st Dist. 1998), the landlord's lease permitted it to recover a future rent differential. The lease permitted recovery of the difference between (1) the present value of the aggregate rent for the remainder of the term and (2) the present value of the aggregate fair rental value of the premises for the same period. The court found that "the best result that a defaulting tenant can ever expect is that the landlord is successful in immediately reletting the premises at the then prevailing market rate." 695 N.E.2d at 507. Accordingly, the rent differential provision satisfied the landlord's duty to mitigate under 735 ILCS 5/9-213.1 by giving the tenant a "best case scenario." *Id*. However, *Takiff Properties Group Ltd. #2 v. GTI Life, Inc.,* 2018 IL App (1st) 171477, 124 N.E.3d 11, 429 Ill.Dec. 242, not only questioned *St. George*'s holding, but found that the obligation to mitigate under §9-213.1 can be waived by a lease provision. The ramifications of this decision are interesting: The decision makes it at least theoretically possible to enforce a lease that waived the obligation of mitigation and required immediate payment of future rent for the remainder of the term. However, the courts may find repugnant the prospect of a landlord windfall — recovery of all future rent from the previous tenant, and then collection of additional rent from a new tenant leasing the space during the previous tenant's term — and entertain other arguments to avoid what would be a radical change in Illinois law.

In a similar vein, *2460-68 Clark, LLC v. Chopo Chicken, LLC,* 2022 IL App (1st) 210119, 198 N.E.3d 655, 459 Ill.Dec. 628, enforced a liquidated damages provision that provided for payment of rent through the end of the lease term and noted the provision did not implicate the duty to mitigate under §9-213. Notably, the remaining lease term in *Chopo* was only ten months, and the tenant did not challenge the liquidated damages provision as a penalty. Courts asked to examine a longer period or to address whether such a provision is a penalty might reach a different conclusion.

No cases have been found that deal specifically with the impact of §9-213.1 on the landlord's obligation to accept a substitute tenant tendered by the defaulting tenant. The prior caselaw on the landlord's right to withhold consent to a subtenant may thus remain applicable. See §8.9 above.

h. [8.25] Collection of Attorneys' Fees

Almost every commercial lease will contain a provision entitling the landlord to recover the attorneys' fees incurred in enforcing the terms of the lease or collecting unpaid rent. Those provisions are enforceable. *E.g., Fox v. Fox Valley Trotting Club,* 8 Ill.2d 571, 134 N.E.2d 806, 810 – 811 (1956); *Stride v. 120 West Madison Building Corp.,* 132 Ill.App.3d 601, 477 N.E.2d 1318, 1322, 87 Ill.Dec. 790 (1st Dist. 1985). The court, however, will award only reasonable attorneys' fees. Thus, the landlord bears the burden of presenting sufficient evidence on which the trial judge can render a decision as to the reasonableness of the fees. *Fitzgerald v. Lake Shore Animal Hospital, Inc.,* 183 Ill.App.3d 655, 539 N.E.2d 311, 315, 132 Ill.Dec. 1 (1st Dist. 1989).

The landlord's "petition for fees must specify the services performed, by whom they were performed, the time expended thereon and the hourly rate charged therefor." *Id.,* quoting *Kaiser v. MEPC American Properties, Inc.,* 164 Ill.App.3d 978, 518 N.E.2d 424, 427, 115 Ill.Dec. 899 (1st Dist. 1987). "Because of the importance of these factors, it is incumbent upon the petitioner to present detailed records maintained during the course of the litigation containing facts and computations upon which the charges are predicated." *Kaiser,* 518 N.E.2d at 427 – 428. *See Fitzgerald, supra,* 539 N.E.2d at 315. The trial court will then "consider a variety of additional

factors such as the skill and standing of the attorneys, the nature of the case, the novelty and/or difficulty of the issues and the work involved, the importance of the matter, the degree of responsibility required, the usual and customary charges for comparable services, the benefit to the client . . . and whether there is a reasonable connection between the fees and the amount involved in the litigation." *Id.,* quoting *Kaiser, supra,* 518 N.E.2d at 428. Both *Fitzgerald* and *Kaiser* direct the trial court to make a careful item-by-item review of attorneys' fees awards. The practitioner should prepare billing records in accordance with those cases.

4. Tenant Defenses

a. [8.26] Defenses to Possession and Germaneness

A tenant's defenses to an action of possession must be germane. 735 ILCS 5/9-106 states: "[N]o matters not germane to the distinctive purpose of the proceeding shall be introduced by joinder, counterclaim or otherwise." Eviction actions are summary, statutory proceedings; "[a] court hearing a forcible entry and detainer claim is considered 'a court of special and limited jurisdiction,' " and the proceeding is limited to "the issue of who is entitled to immediate possession." *Avenaim v. Lubecke,* 347 Ill.App.3d 855, 807 N.E.2d 1068, 1074, 283 Ill.Dec. 227 (1st Dist. 2004), quoting *Yale Tavern, Inc. v. Cosmopolitan National Bank,* 259 Ill.App.3d 965, 632 N.E.2d 80, 85, 198 Ill.Dec. 21 (1st Dist. 1994), and citing *American National Bank v. Powell,* 293 Ill.App.3d 1033, 691 N.E.2d 1162, 229 Ill.Dec. 439 (1st Dist. 1997). *See Wells Fargo Bank, N.A. v. Watson,* 2012 IL App (3d) 110930, ¶14, 972 N.E.2d 1234, 362 Ill.Dec. 201; *People ex rel. Department of Transportation v. Walliser,* 258 Ill.App.3d 782, 629 N.E.2d 1189, 1194, 196 Ill.Dec. 345 (3d Dist. 1994).

"Germane" means "closely allied," "closely related," or "appropriate." *Bismarck Hotel Co. v. Sutherland,* 92 Ill.App.3d 167, 415 N.E.2d 517, 522, 47 Ill.Dec. 512 (1st Dist. 1980), quoting *Rosewood Corp. v. Fisher,* 46 Ill.2d 249, 263 N.E.2d 833, 838 (1970); *Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, ¶17, 993 N.E.2d 1095, 373 Ill.Dec. 536. *See Wells Fargo Bank, supra,* 2012 IL App (3d) 110930 at ¶15. "Matters which are considered germane to the issue of possession are construed more strictly in actions involving commercial leases." *General Parking Corp. v. Kimmel,* 79 Ill.App.3d 883, 398 N.E.2d 1104, 1107, 35 Ill.Dec. 154 (1st Dist. 1979).

Claims that are germane to the issue of possession generally fall into one of four categories:

1. claims asserting a paramount right of possession;

2. claims denying the breach of the agreement vesting possession in the plaintiff;

3. claims challenging the validity or enforceability of the agreement on which the plaintiff bases the right to possession; or

4. claims questioning the plaintiff's motivation for bringing the action. *Campana Redevelopment, supra,* 2013 IL App (2d) 120988 at ¶16; *Wells Fargo Bank, supra,* 2012 IL App (3d) 110930 at ¶15; *Avenaim, supra,* 807 N.E.2d at 1074; *Powell, supra,* 691 N.E.2d at 1170; *Walliser, supra,* 629 N.E.2d at 1194.

"Title disputes, particularly serious title disputes, cannot be determined in a forcible entry and detainer proceeding." *Avenaim, supra,* 807 N.E.2d at 1074 (citing several cases, including two contrary cases in which determination of ownership was nevertheless held germane to issue of possession). *See Wells Fargo Bank, supra,* 2012 IL App (3d) 110930 at ¶15 (citing several cases for holding that defenses asserted were collateral attacks on mortgage foreclosure judgment and not germane).

"Illinois courts have consistently held that a claim that seeks damages and not possession is not germane to the purpose of a forcible entry and detainer proceeding." *Milton v. Therra,* 2018 IL App (1st) 171392, ¶24, 107 N.E.3d 925, 424 Ill.Dec. 206, citing *Sawyier v. Young,* 198 Ill.App.3d 1047, 556 N.E.2d 759, 763, 145 Ill.Dec. 141 (1st Dist. 1990). *See Walliser, supra,* 629 N.E.2d at 1194. Note, however, that the amount of rent paid or payable under the lease is germane to an eviction action based on a failure to pay rent. *Kelley/Lehr & Associates, Inc. v. O'Brien,* 194 Ill.App.3d 380, 551 N.E.2d 419, 425, 141 Ill.Dec. 426 (2d Dist. 1990).

In the typical commercial lease, claims 1 and 3, as listed above, are very unlikely to arise. It is highly unlikely that the tenant will have some other instrument on which it can claim a right of possession paramount to that of the landlord. For a rare counter-example, *see Wendy & William Spatz Charitable Foundation v. 2263 North Lincoln Corp.,* 2013 IL App (1st) 122076, ¶28, 998 N.E.2d 909, 376 Ill.Dec. 199 (when lease contains option to purchase that is exercised in accordance with its terms, lessee then enjoys complete defense to eviction). Furthermore, a challenge to the validity or enforceability of the lease will simply leave the tenant without a lease under which it can claim possession.

Likewise, claim 4, which questions the landlord's motivation, is unlikely to succeed in a commercial context. While residential tenants may rely on a statute prohibiting the termination of a lease in retaliation for complaints to governmental authorities, commercial tenants, by definition, are not covered by that statute. *Heller v. Goss,* 80 Ill.App.3d 716, 400 N.E.2d 70, 72, 35 Ill.Dec. 933 (1st Dist. 1980). In *Heller,* the court suggested that the defense of a retaliatory eviction might otherwise exist "because of a lawful attempt by a tenant to compel his landlord to comply with the law." *Id.* But in that case the tenant did not meet the standard. The tenant claimed that the city was evicting him in retaliation for the tenant's constitutional challenge to a city ordinance. But the tenant's challenge to the ordinance did not constitute an attempt to compel the landlord to comply with the law. No case has been found recognizing retaliatory eviction in the commercial context.

Accordingly, the only defense likely to be found germane to a commercial eviction action is one that denies breach of the lease. The most common such defense is waiver.

> **The forfeiture of leases is not favored and courts will readily adopt any circumstances that indicate an intent to waive a forfeiture.**
>
> **An act of a landlord which affirms the existence of a lease and recognizes a tenant as his lessee after the landlord had a knowledge of a breach of the lease results in the landlord waiving his right to a forfeiture of the lease.** *Housing Authority for LaSalle County v. Little,* 64 Ill.App.3d 149, 380 N.E.2d 1201, 1202, 21 Ill.Dec. 25 (3d Dist. 1978).

See Waukegan Times Theatre Corp. v. Conrad, 324 Ill.App. 622, 59 N.E.2d 308, 312 (2d Dist. 1945); *Schivarelli v. Chicago Transit Authority,* 355 Ill.App.3d 93, 823 N.E.2d 158, 165, 291 Ill.Dec. 148 (1st Dist. 2005).

One common way to waive a default is by accepting overdue rent. The common-law rules on the subject, however, have been modified somewhat by 735 ILCS 5/9-209. Under the common law, any acceptance of rent after service of a notice of default terminating a lease could be construed as a waiver. But 735 ILCS 5/9-209 promulgates certain language that, if included in the notice of default, will prevent many such waivers. The statutory language allows the landlord to accept partial payments during the notice period and full payment of the overdue rent after the notice period without waiving the default. *Elizondo v. Medina,* 100 Ill.App.3d 718, 427 N.E.2d 381, 383, 56 Ill.Dec. 301 (1st Dist. 1981); *Lehndorff USA (Central) Ltd. v. Cousins Club, Inc.,* 40 Ill.App.3d 875, 353 N.E.2d 171 (1st Dist. 1976). Full payment of the stated overdue rent during the notice period, however, will cure the default, which is why it is important to be accurate in the calculation of the overdue rent. *Madison v. Rosser,* 3 Ill.App.3d 851, 279 N.E.2d 375 (1st Dist. 1972). Furthermore, acceptance of rent in excess of the overdue amount, *i.e.,* acceptance of rent accruing after the breach, may constitute waiver of the default even if the notice period has expired. *See Okey, Inc. v. American National Bank & Trust Co.,* 96 Ill.App.3d 987, 422 N.E.2d 221, 225, 52 Ill.Dec. 540 (1st Dist. 1981); *Bismarck Hotel, supra,* 415 N.E.2d at 521; *Little, supra,* 380 N.E.2d at 1202; *Westerman v. Gilmore,* 17 Ill.App.2d 455, 150 N.E.2d 660, 663 – 664 (3d Dist. 1958); *McGill v. Wire Sales Co.,* 175 Ill.App.3d 56, 529 N.E.2d 682, 685, 124 Ill.Dec. 701 (1st Dist. 1988).

Waiver, of course, is usually a question of fact to be assessed in light of all of the relevant circumstances. The practitioner should note that unusual circumstances may avoid a finding of waiver by acceptance of rent. *E.g., LaSalle National Bank v. First City Corp.,* 58 Ill.App.3d 575, 374 N.E.2d 913, 16 Ill.Dec. 138 (1st Dist. 1978) (acceptance of rent that accrued prior to breach constituting ground for termination of lease was not waiver of right to enforce forfeiture); *Soltwisch v. Blum,* 9 Ill.App.3d 760, 292 N.E.2d 742 (3d Dist. 1973) (landlord did not waive right to terminate second lease by accepting past-due rent for first lease); *Schivarelli, supra,* 823 N.E.2d at 167 (acceptance of rent did not constitute waiver of default for failure to pay utility bills because governing body of municipal agency was not aware of failure). One case has held that the landlord did not waive a rent default when she merely held, without cashing, a check from the tenant. *Wang v. Marcus Brush Co.,* 354 Ill.App.3d 968, 823 N.E.2d 140, 291 Ill.Dec. 130 (1st Dist. 2005). *See also Village of Palatine v. Palatine Associates, LLC,* 2012 IL App (1st) 102707, ¶75, 966 N.E.2d 1174, 359 Ill.Dec. 486 (acceptance of partial payment does not constitute waiver).

In cases in which there is a dispute over the amount of unpaid rent, the tenant may seek to escrow the disputed amounts pending resolution of the dispute. There is, however, generally no statutory or caselaw basis for escrowing disputed rent. *But see Oak Park Trust & Savings Bank v. Village of Mount Prospect,* 181 Ill.App.3d 10, 536 N.E.2d 763, 129 Ill.Dec. 713 (1989) (upholding village ordinance authorizing tenants to pay disputed rent in escrow if landlord breached obligations under residential lease to render unit habitable). Furthermore, the Illinois Supreme Court has rejected an attempt to establish such an escrow by preliminary injunction, at least in the absence of any bankruptcy or insolvency of the landlord. *Kanter & Eisenberg v. Madison Associates,* 116 Ill.2d 506, 508 N.E.2d 1053, 108 Ill.Dec. 476 (1987). Accordingly, a tenant escrows disputed rent at its own risk. If the tenant is later found not to have paid the correct amount of rent, it will lose possession.

Finally, tenants sometimes seek to withhold rent because of some deficiency in the premises. In the residential context, a breach of the warranty of habitability has been found to be germane to an action for possession due to unpaid rent; municipal ordinances may also give residential tenants such rights. *See Oak Park Trust & Savings Bank, supra.* But the warranty of habitability does not attach to commercial tenancies. *J.B. Stein & Co. v. Sandberg,* 95 Ill.App.3d 19, 419 N.E.2d 652, 657 – 658, 50 Ill.Dec. 544 (2d Dist. 1981); *Yuan Kane Ing v. Levy,* 26 Ill.App.3d 889, 326 N.E.2d 51 (1st Dist. 1975).

Tenants also cannot claim constructive eviction as a defense to possession. That defense requires the tenant to vacate possession and is at best a defense to a claim for rent. *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 969, 178 Ill.Dec. 444 (3d Dist. 1992); *Metropolitan Life Insurance Co. v. Nauss,* 226 Ill.App.3d 1014, 590 N.E.2d 524, 528, 168 Ill.Dec. 887 (4th Dist. 1992).

b. [8.27] Defenses to Rent

Because rent actions are founded in contract, tenants may assert as a defense to a rent claim any defense recognized in contract law.

One defense that is indigenous to rent claims is that of constructive eviction. The caselaw predicates the defense on one of two doctrines. Some cases ground the defense in the covenant of quiet enjoyment, finding that a constructive eviction "is something of a serious and substantial character done by the landlord with the intention of depriving the tenant of the enjoyment of the premises." *Shaker & Associates, Inc. v. Medical Technologies Group, Ltd.,* 315 Ill.App.3d 126, 733 N.E.2d 865, 872, 248 Ill.Dec. 190 (1st Dist. 2000), citing *American National Bank & Trust Company of Chicago v. Sound City, U.S.A., Inc.,* 67 Ill.App.3d 599, 385 N.E.2d 144, 145, 24 Ill.Dec. 377 (2d Dist. 1979); *Metropolitan Life Insurance Co. v. Nauss,* 226 Ill.App.3d 1014, 590 N.E.2d 524, 528, 168 Ill.Dec. 887 (4th Dist. 1992) ("grave and permanent character"), citing *Advertising Checking Bureau, Inc. v. Canal-Randolph Associates,* 101 Ill.App.3d 140, 427 N.E.2d 1039, 1044, 56 Ill.Dec. 634 (1st Dist. 1981). *See St. Louis North Joint Venture v. P & L Enterprises, Inc.,* 116 F.3d 262, 265 (7th Cir. 1997); *Brown v. Lober,* 75 Ill.2d 547, 389 N.E.2d 1188, 1191, 27 Ill.Dec. 780 (1979). The landlord's intention to deprive the tenant of the covenant of quiet enjoyment can be implied from its actions. *Shaker, supra,* 733 N.E.2d at 872.

Other cases ground the defense in an implied warranty of tenantability. *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 969, 178 Ill.Dec. 444 (3d Dist. 1992); *RNR Realty, Inc. v. Burlington Coat Factory Warehouse of Cicero, Inc.,* 168 Ill.App.3d 210, 522 N.E.2d 679, 119 Ill.Dec. 17 (1st Dist. 1988); *First National Bank of Evanston v. Sousanes,* 96 Ill.App.3d 1047, 422 N.E.2d 188, 191, 52 Ill.Dec. 507 (1st Dist. 1981). The premises are not tenantable if "the interference with occupancy is of such a nature that the property cannot be used for the purpose for which it was rented." *JMB Properties, supra,* 604 N.E.2d at 969, citing *RNR, supra,* 522 N.E.2d at 685.

Thus, to assert constructive eviction, the tenant must plead and prove one of these standards. In addition, the tenant must meet two other elements:

1. The tenant must provide the landlord with a reasonable opportunity to remedy the problem. *Metropolitan Life, supra,* 590 N.E.2d at 528; *Applegate v. Inland Real Estate Corp.,* 109 Ill.App.3d 986, 441 N.E.2d 379, 383, 65 Ill.Dec. 466 (2d Dist. 1982). Note that the fact that the landlord has made some efforts at repair does not preclude a claim of constructive eviction. *Shaker, supra,* 733 N.E.2d at 873.

2. Also, if the interference is not remedied, the tenant must vacate the premises within a reasonable time; otherwise, the tenant is deemed to have waived the breach of covenant. *Id.; JMB Properties, supra,* 604 N.E.2d at 969; *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 412, 122 Ill.Dec. 150 (1st Dist. 1988); *Sousanes, supra,* 422 N.E.2d at 191. Whether the length of time before vacation was reasonable is a question of fact for which the tenant bears the burden. *Shaker, supra,* 733 N.E.2d at 873.

The latter element is the source of the term "constructive eviction." The defense is based on the eviction by the landlord of the tenant. If the tenant remains in the premises, it has not been evicted.

Other affirmative defenses, such as laches, estoppel, and unclean hands, would require a substantial showing by a tenant. *Schivarelli v. Chicago Transit Authority,* 355 Ill.App.3d 93, 823 N.E.2d 158, 168, 291 Ill.Dec. 148 (1st Dist. 2005).

A tenant may defend a rent action on the grounds that it exercised an option for early termination of the lease. Long-standing Illinois law establishes that a tenant who holds an option to cancel or extend a commercial lease must strictly comply with the terms of the option. *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶¶33 – 34, 100 N.E.3d 596, 421 Ill.Dec. 579, citing *Dikeman v. Sunday Creek Coal Co.,* 184 Ill. 546, 56 N.E. 864 (1900), and its progeny; *Genesco, Inc. v. 33 North LaSalle Partners, L.P.,* 383 Ill.App.3d 115, 889 N.E.2d 769, 773, 321 Ill.Dec. 504 (1st Dist. 2008); *Thomson Learning, Inc. v. Olympia Properties, LLC,* 365 Ill.App.3d 621, 850 N.E.2d 314, 320, 302 Ill.Dec. 877 (2d Dist. 2006), citing *T.C.T. Building Partnership v. Tandy Corp.,* 323 Ill.App.3d 114, 751 N.E.2d 135, 140, 256 Ill.Dec. 82 (1st Dist. 2001), *MXL Industries, Inc. v. Mulder,* 252 Ill.App.3d 18, 623 N.E.2d 369, 374, 191 Ill.Dec. 124 (2d Dist. 1993), and *LaSalle National Bank v. Graham,* 119 Ill.App.3d 85, 456 N.E.2d 323, 324, 74 Ill.Dec. 821 (5th Dist. 1983). The *Thomson Learning* court noted, however, the possibility of equitable relief if "(1) the delay in strictly complying was slight; (2) the lessee would suffer undue hardship if strict compliance were not excused; and (3) the lessor would not suffer prejudice if strict compliance were excused." 850 N.E.2d at 324, citing 1 Joseph M. Perillo, CORBIN ON CONTRACTS §2.15, p. 203 (rev. ed. 1993).

A tenant who has in its lease a restrictive covenant prohibiting the landlord from leasing nearby space to competitors has a right to terminate the lease and surrender possession upon the landlord's breach of that covenant, at least absent contrary language in the lease. *Johnstowne Centre Partnership v. Chin,* 99 Ill.2d 284, 458 N.E.2d 480, 483, 76 Ill.Dec. 80 (1983); *University Club of Chicago v. Deakin,* 265 Ill. 257, 106 N.E. 790 (1914).

5. Miscellaneous Remedies

a. [8.28] Distraint

The distraint statute, 735 ILCS 5/9-301, *et seq.,* allows a lessor to seize the personal property of a tenant who has failed to pay rent. *Southwest Bank of St. Louis v. Poulokefalos,* 401 Ill.App.3d 884, 931 N.E.2d 285, 291 – 292, 341 Ill.Dec. 677 (1st Dist. 2010). The lessor may make such a seizure as soon as rent is past due, but such rent must be fixed and certain, and distraint is not available for other defaults on a lease. *Lord v. Johnson,* 120 Ill.App. 55 (3d Dist. 1905); *Atkins v. Byrnes,* 71 Ill. 326 (1874). Once such a seizure is made, the lessor must immediately file a distress warrant (6 ILLINOIS CIVIL PRACTICE FORMS §116.26 (2003)) with the clerk of the circuit court along with an inventory of the property to be levied on. 735 ILCS 5/9-302. The distress warrant need not be filed instantly, but it must be done as quickly as practicable. *Schoenfeld v. Kulwinsky,* 197 Ill.App. 472 (1st Dist. 1916). Although such a procedure may appear to border on self-help, it has been found constitutional by the Illinois Supreme Court. *USA I Lehndorff Vermoegensverwaltung GmbH & Cie v. Cousins Club, Inc.,* 64 Ill.2d 11, 348 N.E.2d 831, 835 (1976).

Once the distress warrant is filed, the court clerk will issue a summons to the tenant. 735 ILCS 5/9-303. However, if the tenant is out of state or cannot be found through reasonable effort, 735 ILCS 5/9-304 requires the same notice as in an attachment action, as per 735 ILCS 5/4-127. From there, the action will proceed in the same manner as a general action for attachment, with the distress warrant standing as the complaint and amendable as such. 735 ILCS 5/9-305. The tenant may assert defenses and file counterclaims as in an ordinary claim for rent. 735 ILCS 5/9-306. For instance, a judgment may be offset if the landlord has violated covenants in the lease. *Baumgartner v. Montavon,* 276 Ill.App. 498 (2d Dist. 1934). The statute of limitations will run on a distraint action six months after the termination of the lease. 735 ILCS 5/9-313.

When a landlord receives a favorable judgment in a distraint proceeding and process has successfully been served on the tenant, the landlord will be awarded the amount of rent due and the judgment will be enforceable against the seized property and any other personal property of the tenant, provided that the seized property is sold first. 735 ILCS 5/9-307, 5/9-308. On the other hand, when a landlord has given the requisite notice and receives a favorable judgment by default, there will likewise be awarded the amount of rent due at the time the proceeding was commenced, but that judgment will be enforceable only against the property seized. 735 ILCS 5/9-309. The amount of rent due shall include the value of any articles or products of the premises or labor to be received as rent. 735 ILCS 5/9-314. When judgment is entered in favor of the tenant, the property will be returned along with any balance deemed due on a counterclaim. 735 ILCS 5/9-310.

A tenant may have distrained property released by posting a bond twice the amount of the rent claimed. 735 ILCS 5/9-311. On the other hand, seized property that is in imminent danger of waste or decay may be sold immediately upon application to the court, the proceeds to be deposited with the clerk of the court pending the outcome of the proceeding. 735 ILCS 5/9-312.

b. [8.29] Ejectment

Ejectment is not a typical remedy for a commercial landlord-tenant relationship. Ejectment proceedings provide for the adjudication of both the right of possession and the superiority of interest or title. Ejectment proceedings are thus appropriate only when there is a serious contest over both possession and title, since title disputes are beyond the scope of the eviction statute. *Urbach v. Green,* 15 Ill.App.2d 186, 145 N.E.2d 808, 810 (1st Dist. 1957); *Layzod v. Martin,* 305 Ill.App. 1, 26 N.E.2d 423, 425 (4th Dist. 1940).

If ejectment is an appropriate remedy, the action is governed by 735 ILCS 5/6-101, *et seq.* Practitioners should note that the statute requires the pleading to allege certain matters with particularity and to meet other technical requirements. At trial, the plaintiff must recover on the strength of its own title and not the weakness of the defendant's. *Smith v. Malone,* 317 Ill.App.3d 974, 742 N.E.2d 785, 789, 252 Ill.Dec. 247 (4th Dist. 2000); *Illinois Railway Museum, Inc. v. Siegel,* 132 Ill.App.2d 77, 266 N.E.2d 724, 729 (2d Dist. 1971). In other words, the plaintiff must ultimately show a higher and better title than the defendant. 735 ILCS 5/6-104. *See Cree Development Corp. v. Mid-America Advertising Co.,* 294 Ill.App.3d 324, 689 N.E.2d 1148, 1152, 228 Ill.Dec. 727 (5th Dist. 1997); *Bulatovic v. Dobritchanin,* 252 Ill.App.3d 122, 625 N.E.2d 26, 32, 192 Ill.Dec. 66 (1st Dist. 1993).

III. [8.30] HOLDOVER BY TENANT AFTER LEASE TERM

Once the lease ends according to its terms, the legal dynamic between the landlord and the tenant changes. Many of the protections that the law offers the tenant during the lease terminate with the lease. After all, the tenant is deemed to know the contents of the lease it executed, and when the lease terminates by its own terms, the tenant is deemed to know that the right to possession is at an end. Another dynamic is added as well: the landlord may not want the tenant to leave.

A. [8.31] Landlord's Choice: New Lease or Tenant at Sufferance

Most commercial leases contain an express holdover provision granting the landlord an option to

1. treat the holdover tenant as a tenant at sufferance; or

2. establish a new lease for a period of time on the same terms as the original lease.

That holdover lease provision is enforceable because it tracks the common law.

Under Illinois law, the termination of a lease and the surrender of the premises are different events, and a tenant who remains in possession of the premises after his lease expires or is terminated becomes a tenant at sufferance. . . . At the sole option of the landlord, a tenant at sufferance may be evicted as a trespasser or treated as a holdover

> **tenant . . . and when the landlord chooses the latter, a holdover tenancy, which is governed by the same terms of the original lease, is created.** *Hoffman v. Altamore,* 352 Ill.App.3d 246, 815 N.E.2d 984, 988, 287 Ill.Dec. 340 (2d Dist. 2004), quoting *Meyer v. Cohen,* 260 Ill.App.3d 351, 632 N.E.2d 22, 29, 197 Ill.Dec. 953 (1st Dist. 1993).

See also Troccoli v. L & B Products of Illinois, Inc., 189 Ill.App.3d 319, 545 N.E.2d 219, 220 – 221, 136 Ill.Dec. 695 (1st Dist. 1989); *Bismarck Hotel Co. v. Sutherland,* 92 Ill.App.3d 167, 415 N.E.2d 517, 520, 47 Ill.Dec. 512 (1st Dist. 1980); *Wanous v. Balaco,* 412 Ill. 545, 107 N.E.2d 791 (1952); *Weber v. Powers,* 213 Ill. 370, 72 N.E. 1070 (1904).

The holdover tenancy is created by the landlord's election, regardless of the tenant's intentions. *Troccoli, supra,* 545 N.E.2d at 221; *Bismarck Hotel, supra,* 415 N.E.2d at 520; *Bellows v. Ziv,* 38 Ill.App.2d 342, 187 N.E.2d 265 (1st Dist. 1962). Indeed, "[i]t is the intention of the landlord, not the tenant, that determines whether a holdover tenancy is to be created." *Wendy & William Spatz Charitable Foundation v. 2263 North Lincoln Corp.,* 2013 IL App (1st) 122076, ¶37, 998 N.E.2d 909, 376 Ill.Dec. 199; *Troccoli, supra,* 545 N.E.2d at 221. *See Bismarck Hotel, supra; Weber, supra,* 72 N.E. at 1074; *Balaban & Katz Corp. v. Channel Amusement Co.,* 336 Ill.App. 113, 83 N.E.2d 27, 30 (1st Dist. 1948). *Cf. Oliva v. Amtech Reliable Elevator Co.,* 366 Ill.App.3d 148, 851 N.E.2d 256, 261, 303 Ill.Dec. 358 (1st Dist. 2006) (when extension option did not require notice, tenant's holdover and payment of rent was sufficient to exercise option).

The landlord's intention, of course, is generally an issue of fact. "While the landlord's acceptance of rent following expiration of the lease may indicate the landlord's election to treat the tenant as a holdover, other facts and circumstances bearing on the landlord's intent should be considered as well." *Troccoli, supra,* 545 N.E.2d at 221. *See Bismarck Hotel, supra,* 415 N.E.2d at 520; *Sheraton-Chicago Corp. v. Lewis,* 8 Ill.App.3d 309, 290 N.E.2d 685, 686 – 687 (1st Dist. 1972). The caselaw suggests that mere acceptance of rent and a holdover by the tenant are not necessarily enough to create a holdover tenancy. Indeed, the landlord's intent not to create a holdover tenancy may be indicated by the filing of a prompt eviction action or the offer to enter into a new lease on different terms. *E.g., Ebert v. Dr. Scholl's Foot Comfort Shops, Inc.,* 137 Ill.App.3d 550, 484 N.E.2d 1178, 1186, 92 Ill.Dec. 323 (1st Dist. 1985). Of course, if the landlord and the tenant have entered into a new contract, there is no right to assert a holdover under the terms of the original lease. *Weber, supra,* 72 N.E. at 1075.

In addition, the question whether the tenant has held possession past lease expiration may be one of fact. Generally, the issue is "whether, after the expiration of the lease term, the tenant exercised dominion over the premises indicative of an intent to continue the tenancy." *Hoffman, supra,* 815 N.E.2d at 988. For instance, a tenant may be in possession if it vacates the premises but promises to do work to restore the premises, excludes the landlord from doing that work, and hires a contractor to perform it. *Crystal Lake Limited Partnership v. Baird & Warner Residential Sales, Inc.,* 2018 IL App (2d) 170714, ¶67, 138 N.E.3d 75, 434 Ill.Dec. 916. By contrast, the tenant may not be in possession even though some personalty or signage has been left behind and it is tardy in performing restoration work if it does not interfere with the landlord's use or possession of the premises. *J.M. Beals Enterprises, Inc. v. Industrial Hard Chrome, Ltd.,* 271 Ill.App.3d 257, 648 N.E.2d 249, 251 – 252, 207 Ill.Dec. 793 (1st Dist. 1995). *See MXL Industries, Inc. v. Mulder,* 252

Ill.App.3d 18, 623 N.E.2d 369, 377, 191 Ill.Dec. 124 (2d Dist. 1993); *Hoopes v. Prudential Insurance Company of America,* 48 Ill.App.3d 146, 362 N.E.2d 802, 804 – 805, 6 Ill.Dec. 167 (4th Dist. 1977). A tenant who was in the process of moving and whose move went over to the morning after the termination date was not held liable for holdover. *Commonwealth Bldg. Corp. v. Hirschfield,* 307 Ill.App. 533, 30 N.E.2d 790, 792 – 793 (1st Dist. 1940).

If the landlord elects to establish a holdover tenancy, the law does not incorporate every term of the prior lease but only those that are considered appropriate. For instance, it has been held that a holdover tenant does not retain an option to purchase that it held as part of the original lease. *Wanous, supra,* 107 N.E.2d at 793; *Butz v. Butz,* 13 Ill.App.3d 341, 299 N.E.2d 782 (5th Dist. 1973).

Often the holdover provision in the lease will allow the landlord to establish a new lease at a higher rental than originally stated in the lease, such as double rent. Early cases held that such a provision is reasonable and valid. *Commonwealth Building, supra,* 30 N.E.2d at 793; *Fasking v. Goldberg,* 299 Ill.App. 590, 20 N.E.2d 618, 619 – 620 (1st Dist. 1939). *Stride v. 120 West Madison Building Corp.,* 132 Ill.App.3d 601, 477 N.E.2d 1318, 87 Ill.Dec. 790 (1st Dist. 1985), however, has thrown some doubt on those early holdings.

The court in *Stride* refused to enforce a double rent holdover clause on two grounds. First, it found that the provision was an unenforceable penalty clause rather than an enforceable liquidated damages clause. 477 N.E.2d at 1321. That holding, however, was grounded in certain language of the clause that additionally awarded the landlord actual damages for holdover. In light of this provision, the court found that the parties believed actual damages to be ascertainable and thus the imposition of double rent was a penalty. In a particular case, *Stride* might be distinguishable on this ground if the holdover provision at issue omits the additional actual damages language.

Second, the *Stride* court found that the holdover must be "in bad faith" before double rent could be awarded, even though the lease provision did not require bad faith. 477 N.E.2d at 1321 – 1322. The reasoning of the *Stride* court is opaque, but it seems to have found that *Fasking, supra,* and what is now 735 ILCS 5/9-202, discussed below, required a "finding of wilfulness" before double rent could be awarded. 477 N.E.2d at 1321. This interpretation of the *Stride* court has been subsequently noted, although also questioned. *E.g., Beals, supra,* 648 N.E.2d at 252.

735 ILCS 5/9-202 provides that a tenant who, after written demand, willfully withholds possession will be liable for double rent. Thus, even in the absence of a lease provision, a landlord may be able to recover double rent if the terms of the statute can be met. *E.g., Rexam Beverage Can Co. v. Bolger,* 620 F.3d 718, 729 (7th Cir. 2010). The statute is penal in nature and requires strict compliance. *Stride, supra,* 477 N.E.2d at 1321; *Stuart v. Hamilton,* 66 Ill. 253 (1872).

The question whether a holdover is "willful" is one of fact. *Beals, supra,* 648 N.E.2d at 252. The standard of "willfulness" has been variously interpreted. *Stride* required a showing of bad faith, but the *Beals* court found that to be possibly too broad a standard. *Id.* The *Beals* court also noted that several cases had found that a bona fide dispute over possession would bar a finding of willfulness, but thought that possibly too narrow a standard. *Id. See generally Brown v. Veile,* 254 Ill.App.3d 575, 626 N.E.2d 395, 402, 193 Ill.Dec. 362 (5th Dist. 1993), *appeal denied,* 155 Ill.2d

562 (1994); *In re Marriage of Irvine,* 215 Ill.App.3d 629, 577 N.E.2d 462, 465, 160 Ill.Dec. 332 (4th Dist. 1991); *Pleasure Driveway & Park District of Peoria v. Jones,* 51 Ill.App.3d 182, 367 N.E.2d 111, 117 – 118, 9 Ill.Dec. 677 (3d Dist. 1977). The court in *Beals* opted for a standard under which a tenant that "remains in possession for colorably justifiable reasons" should not be held liable for double rent. 648 N.E.2d at 252. In other words, the tenant must "know" that its retention of possession is wrongful before it can be deemed willful. *Id. Accord Rexam Beverage Can, supra,* 620 F.3d 728 – 733 (applying rule in *Beals*); *Wendy & William Spatz, supra,* 2013 IL App (1st) 122076 at ¶44 (no double rent awarded when tenant held over due to bona fide dispute over exercise of option to purchase).

A willful holdover was found to exist in a case in which the tenant simply had been unable to find other premises. *Kruse v. Ballsmith,* 332 Ill.App. 301, 75 N.E.2d 140, 146 (2d Dist. 1947).

A landlord may also be entitled to double rent if the tenant gives notice of its intent to quit on a particular date and then fails to deliver up possession. 735 ILCS 5/9-203; *Stave v. Great Atlantic & Pacific Tea Co.,* 262 Ill.App. 221 (1st Dist. 1931).

B. [8.32] Differences in Remedies for Holdover

If the landlord deems the tenant to be one at sufferance, the landlord is nevertheless obligated to obtain possession through the eviction statute. By the terms of this statute, however, the landlord is not obligated to give notice of default or demand possession. 735 ILCS 5/9-213; *Balaban & Katz Corp. v. Channel Amusement Co.,* 336 Ill.App. 113, 83 N.E.2d 27, 29 (1st Dist. 1948); *Scoville v. Thomas Paper Stock Co.,* 329 Ill.App. 443, 69 N.E.2d 25 (1st Dist. 1946) (abst.). See 735 ILCS 5/9-102(a)(4) (action may be maintained when lessee "holds possession without right after the termination of the lease or tenancy by its own limitation, condition or terms").

Furthermore, a tenant who retains possession after termination of a lease has no protectable property interest in the leasehold and is not entitled to injunctive relief. *Pullem v. Evanston Young Men's Christian Ass'n,* 124 Ill.App.3d 264, 464 N.E.2d 785, 788, 79 Ill.Dec. 881 (1st Dist. 1984); *General Parking Corp. v. Kimmel,* 79 Ill.App.3d 883, 398 N.E.2d 1104, 1108, 35 Ill.Dec. 154 (1st Dist. 1979).

9 Tenant's Duties, Rights, and Remedies

R. KYMN HARP
DAVID P. RESNICK
Robbins DiMonte, Ltd.
CATHERINE A. COOKE
Latimer LeVay Fyock LLC
Chicago

I. [9.1] SCOPE OF CHAPTER

In any discussion of the duties, rights, and remedies of a commercial real estate tenant, the challenge is to distill generally applicable concepts into useful bits of information.

Commercial real estate leases, like virtually all documents and agreements relating to commercial real estate transactions and interests, are, to a large extent, consistent only in their variety. In commercial real estate practice, there are few, if any, "standard form" documents or agreements. To be sure, there are provisions in commercial real estate leases that any experienced practitioner would expect to see, and there are some generally applicable legal concepts that apply, but the variety of issues that may arise — and the language used in each commercial lease — will directly and materially impact the "duties, rights, and remedies" of a tenant under any commercial lease.

The best answer to most questions about what are the rights, duties, and remedies of a tenant under a commercial real estate lease is "It depends." What does it depend on? It depends primarily on what the parties to the lease — the landlord and tenant — intended, as (presumably) reflected by the express terms and conditions of the lease. However, two common challenges frequently exist, and they apply equally to commercial tenants and commercial landlords. They are (a) poorly written lease provisions that do not clearly and definitively set forth the intention of the landlord and tenant in a way that cannot reasonably be misunderstood and (b) inclusion of perceived "standard boilerplate" provisions in a lease without fully understanding their legal or practical effects on the leased premises, the parties, and the greater project of which the leased premises may be a part. When the intent of the parties is not abundantly clear, a court may find the answer implied by the facts and circumstances.

This chapter discusses some of the key provisions that have repeatedly tripped up unsuspecting tenants and landlords. This chapter's focus is on the duties, rights, and remedies of commercial real estate tenants from the tenant's perspective. When representing a landlord, however, it may be useful to remember that rights and remedies of tenants often reflect a mirror image of duties and limitations on landlords. A commercial landlord may not have all the freedoms it thinks it has with respect to the leased premises, or other parts of a project in which the leased premises may be a part.

The following discussion highlights some areas in which the rights, duties, and remedies of the commercial real estate tenant (and, by mirror image, the landlord) appear not to have been what one or the other party thought they were.

II. [9.2] GENERAL LEASE PRINCIPLES AND RULES OF CONSTRUCTION

A "lease" is generally described as a contract for exclusive possession of land and improvements for a term of years or other duration, usually for a specified rent or other compensation. *Urban Investment & Development Co. v. Maurice L. Rothschild & Co.,* 25 Ill.App.3d 546, 323 N.E.2d 588, 592 (1st Dist. 1975); *Feeley v. Michigan Avenue National Bank,* 141 Ill.App.3d 187, 490 N.E.2d 15, 18, 95 Ill.Dec. 542 (1st Dist. 1986).

In determining the duties, rights, and remedies of a tenant under a commercial lease in Illinois, the general rules of contract construction will apply. *Walgreen Co. v. American National Bank & Trust Company of Chicago,* 4 Ill.App.3d 549, 281 N.E.2d 462, 465 (1st Dist. 1972); *Feeley, supra,* 490 N.E.2d at 18; *Chicago Title & Trust Co. v. Southland Corp.,* 111 Ill.App.3d 67, 443 N.E.2d 294, 297, 66 Ill.Dec. 611 (1st Dist. 1982). Interpretation of a lease is a question of law when the terms are plain and unambiguous. *Madigan Bros. v. Melrose Shopping Center Co.,* 123 Ill.App.3d 851, 463 N.E.2d 824, 828, 79 Ill.Dec. 270 (1st Dist. 1984).

"An ambiguous contract is one capable of being understood in more senses than one; an agreement obscure in meaning, through indefiniteness of expression, or having a double meaning." *Advertising Checking Bureau, Inc. v. Canal-Randolph Associates,* 101 Ill.App.3d 140, 427 N.E.2d 1039, 1042, 56 Ill.Dec. 634 (1st Dist. 1991), quoting *First National Bank of Chicago v. Victor Comptometer Corp.,* 123 Ill.App.2d 335, 260 N.E.2d 99, 102 (1st Dist. 1970). However, the mere fact that the parties to a lease "dispute" the meaning of a lease provision and assign conflicting interpretations does not render the provision "ambiguous." *McGann v. Murry,* 75 Ill.App.3d 697, 393 N.E.2d 1339, 1342 – 1343, 31 Ill.Dec. 32 (3d Dist. 1979); *Greggs USA, Inc. v. 400 East Professional Associates, LP,* 2021 IL App (1st) 200959, ¶13, 198 N.E.3d 1062, 459 Ill.Dec. 685, *reh'g denied* (Aug. 27, 2021); *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 506 – 507, 230 Ill.Dec. 1013 (1st Dist. 1998); *Ford v. Dovenmuehle Mortgage, Inc.,* 273 Ill.App.3d 240, 651 N.E.2d 751, 754 – 755, 209 Ill.Dec. 573 (1st Dist. 1995). Whether ambiguity exists is a question of law for the court. *Advertising Checking Bureau, supra,* 427 N.E.2d at 1042; *Pioneer Trust & Savings Bank v. Lucky Stores, Inc.,* 91 Ill.App.3d 573, 414 N.E.2d 1152, 1154, 47 Ill.Dec. 36 (1st Dist. 1980).

It is well-settled in Illinois that, when construing a written lease, the court must give words their commonly accepted meaning and must construe every part with reference to all other portions of the lease "so that every part may stand, if possible, and no part of it, either in words or sentences, shall be regarded as superfluous or void if it can be prevented." *Kokenes v. Cities Service Oil Co.,* 24 Ill.App.3d 483, 321 N.E.2d 338, 340 (1st Dist. 1974), quoting *Szulerecki v. Oppenheimer,* 283 Ill. 525, 119 N.E. 643, 646 (1918). *See also Southland, supra,* 443 N.E.2d at 297.

In construing a lease, the instrument is to be considered as a whole and the primary object is to derive the intent of the parties. However, a contract must be enforced as written, and when the terms of a lease are clear and unambiguous, they will be given their natural and ordinary meaning. *Gerardi v. Vaal,* 169 Ill.App.3d 818, 523 N.E.2d 1327, 1331, 120 Ill.Dec. 416 (3d Dist. 1988); *Uncle Tom's, Inc. v. Lynn Plaza, LLC,* 2021 IL App (1st) 200205, ¶61, 196 N.E.3d 1034, 458 Ill.Dec. 474.

The foregoing sounds pretty straightforward, but unless attorneys and their clients draft leases with a comprehensive understanding of the interplay between particularly drafted provisions and every other part of the lease — including so-called "standard boilerplate" provisions — they may find themselves surprised by what they have "agreed to."

PRACTICE POINTER

✓ Drafting a commercial real estate lease is similar to drafting any other commercial document, except that the meaning and intent of contractual lease provisions are colored by an extensive body of underlying real property law that has developed over the centuries.

A commercial real estate lease should say what the parties mean and mean what it says. Words have meaning; phrases have meaning; each provision has meaning. The interplay of words, phrases, and all provisions in a lease will help determine the meaning of each other word, phrase, or provision. *See Kokenes, supra,* 321 N.E.2d at 340; *Szulerecki, supra,* 119 N.E. at 646.

PRACTICE POINTERS

✓ Be sure the words and phrases you use mean what your client believes they mean before proceeding.

✓ If there are provisions of a commercial real estate lease you do not fully understand — including provisions you believe are "standard boilerplate" provisions — you need to learn what they mean and how they affect other parts of the lease, and your client's rights, duties, and remedies, before advising your client to proceed.

III. [9.3] LEASEHOLD EASEMENTS

An easement creates an interest in land and must, therefore, be founded on a deed or other writing, or on prescription, which presumes a pervious grant. *Brunotte v. De Witt,* 360 Ill. 518, 196 N.E. 489, 495 (1935); *The Fair v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 4 Ill.App.2d 454, 124 N.E.2d 649, 654 (1st Dist. 1954); *Hess v. Miller,* 2019 IL App (4th) 180591, ¶27, 133 N.E.3d 1235, 433 Ill.Dec. 955. It may be created by covenant or agreement as well as by grant, for such agreements are in legal effect grants. *Chicago Title & Trust Co. v. Wabash-Randolph Corp.,* 384 Ill. 78, 51 N.E.2d 132, 136 (1943); *D.M. Goodwillie Co. v. Commonwealth Electric Co.,* 241 Ill. 42, 89 N.E. 272, 283 (1909); *The Fair, supra,* 124 N.E.2d at 654.

"No particular words are necessary to constitute a grant, and any words which clearly show the intention to give an easement, which is by law grantable, are sufficient to effect that purpose." *Wabash-Randolph, supra,* 51 N.E.2d at 136. *See also The Fair, supra,* 124 N.E.2d at 654. The agreement must be construed so as to carry out the plain intent of the parties. *Barber v. Allen,* 212 Ill. 125, 72 N.E. 33, 36 (1904).

A. [9.4] Parking

Parking rights are fertile ground for disputes between commercial tenants and landlords. A significant source of litigation is imprecise drafting, which can result in the creation of implied easements having a scope larger than the developer intended.

As illustrated in the cases discussed in §§9.5 and 9.6 below, the law in Illinois is that when the landlord makes no reservation of the right to alter the common areas in the lease, and when the site plan attached to the lease accurately and clearly delineates the common areas, the tenant has an easement in the particular configuration of common space delineated by the lease and plats.

1. [9.5] Shopping Center Parking

In *Madigan Bros. v. Melrose Shopping Center Co.,* 123 Ill.App.3d 851, 463 N.E.2d 824, 79 Ill.Dec. 270 (1st Dist. 1984), a shopping center tenant sought a permanent injunction to prevent a landlord from constructing a restaurant or other building in the shopping center's parking area, without consent of the tenant.

The lease included a provision that stated:

> **this lease includes the non-exclusive right to Tenant and its agents, servants, successors, assigns, licensees, invitees, customers, suppliers and patrons to use and enjoy throughout the term of this lease the "common areas" of the Shopping Center, to-wit, the driveways, entrances, exits, roadways, parking areas, sidewalks, malls and other features and facilities provided for the general uses and purposes of the Shopping Center.** 463 N.E.2d at 826.

The lease further provided: "The location and arrangement of said parking areas, sidewalks, pedestrian malls, entrances and exits and roadways will substantially conform with the plat attached hereto and shall be kept open at all times." *Id.*

Additionally, the lease provided that the landlord would provide, operate, manage, and maintain all parking areas

> **together with any enlargement or rearrangement thereof required by enlarging the Shopping Center [**and provided that the tenant shall**] have, hold and enjoy the demised premises and the entire . . . building together with all other improvements and all easements, rights and appurtenances which are part of the demised premises during the full term of the lease and any extensions thereof, without hindrance or ejection by any persons lawfully claiming under Landlord.** *Id.*

Attached to the lease as exhibits were (a) a plot plan of the shopping center showing the leased space; (b) a legal description of the shopping center; and (c) an exhibit showing "the number and area of existing and proposed automobile parking spaces in the Shopping Center together with existing and proposed driveways, entrances, exits and roadways." *Id.* The third exhibit was subsequently amended to show the exact location of the parking area and indicate the specific number of parking spaces being provided in the shopping center. The lease was also amended to permit the landlord to construct a bank in the parking area in return for the landlord waiving a restriction against the tenant opening a new store within four miles of the shopping center.

The tenant sought to enjoin the landlord's construction of the restaurant or other buildings in the shopping center's parking area, claiming the lease created for the benefit of the tenant a

nonexclusive easement in and to the shopping center parking areas. The landlord denied that the tenant had any easement rights under the lease and otherwise denied interfering with any of tenant's rights under its lease. The landlord claimed that the landlord had reserved the right to make changes to the location or configuration of the parking areas and that the lease required only that the landlord maintain the specified ratio of parking spaces to leasable area, which would be done under the landlord's construction plan.

The court held that the lease was clear and unambiguous in granting the tenant the use and enjoyment of the shopping center's parking facilities. The court stated that "[t]he principal function of a court in construing a written contract is to discern and to give effect to the intention of the parties as expressed in the language of the document when read as a whole" and that "[w]hen the terms of a contract are clear and unambiguous, they must be enforced." 463 N.E.2d at 828.

After considering the documents presented, the court concluded that the intent of the parties was to grant the shopping center tenants an easement in the parking areas for ingress, egress, and parking, as set out in the site plan, noting that

> **[i]t is the law in Illinois that where no reservation by the landlord of the right to alter the common areas is made in the lease and where the site plan attached to the lease accurately and precisely delineates the common areas, the tenant has an easement to the particular configuration of common space delineated by the lease and attached plats.** *Id.*

In *Walgreen Co. v. American National Bank & Trust Company of Chicago,* 4 Ill.App.3d 549, 281 N.E.2d 462 (1st Dist. 1972), Walgreens was a tenant in the Village Green Shopping Center in Park Ridge. Walgreens filed an action to enjoin the landlord and Fotomat from permitting or causing construction of a structure of any kind in the parking area. In particular, Walgreens sought to enjoin the erection of an approximately 40-square-foot kiosk within an area comprising roughly three parking spaces that was to be operated by Fotomat for the sale of photographic equipment and supplies and for film processing. The trial court granted the injunction requested by Walgreens, and the landlord appealed. The principal issue on appeal was whether the landlord breached its lease with Walgreens by leasing an area in the parking lot of the shopping center to Fotomat for construction of a kiosk.

Article 7(a) of the lease to Walgreens provided in part as follows:

> **It is an express condition of this lease that at all times during the continuance of this lease, Landlord shall provide, maintain, repair, adequately light when necessary during Tenant's business hours, clean, supervise and keep available the Parking Areas as shown on said attached plan (which Parking Areas shall contain at least 150,000 square feet and shall provide for the parking of at least 400 automobiles), and also adequate service areas, pedestrian malls, sidewalks, curbs, roadways and other facilities appurtenant thereto. Said Parking Areas shall be for the free and exclusive use of customers, invitees and employees of Tenant and of other occupants of said Shopping Center, shall have suitable automobile entrances and exits from and to adjacent streets and roads, shall be level and shall be suitably paved and pitched to streets for surface water run off.** 281 N.E.2d at 465.

The lease provided that Walgreens would pay its proportionate share of costs for operating and maintaining the parking facilities in proportion to the relative square footage of the Walgreens to the total area of all retail facilities in the shopping center. Also, Walgreens was not obligated to open its store or pay rent until "[a]ll the parking and other facilities described in Article 7 have been completed, paved and lighted and are available for use." *Id.*

The Fotomat kiosk was to be placed in a part of the shopping center designated on the plan attached to the Walgreens lease as a parking lot. It was designed to serve customers who drove up on either side of it in a motor vehicle. The kiosk was to have dimensions of 9 feet × 4½ feet, eliminating three parking spaces. Even with the elimination of the three parking spaces, the parking lot would still have in excess of 150,000 square feet and sufficient space for more than 400 parking spaces.

The landlord claimed that the plot plan attached to the Walgreens lease was only descriptive and illustrative, since Article 7(a), by stating "which Parking Areas shall contain at least 150,000 square feet and shall [provide for the parking of] at least 400 automobiles," set forth the landlord's contractual obligation. 281 N.E.2d at 466. The landlord argued that there was no other way to give meaning and effect to this language in Article 7(a) that specified the minimum square footage of the parking area and minimum number of parking spaces.

The court held that the rules of contract construction apply to written leases and that:

> **[t]he principal function of a court in construing a written agreement is to discern and to give effect to the intention of the parties as expressed in the language of the document when read as a whole. . . . A court cannot remake a contract and give a litigant a better bargain than he himself was satisfied to make; and when the terms of a contract are clear and unambiguous, they must be enforced. [**Citations omitted**].** *Id.*

The court noted that

> [t]**he lessor foresaw the possibility of a need to expand the retail facilities and as a part of the plot plan reserved the right to rearrange the interior walls of one of the buildings in the shopping center, and in addition it reserved the right to expand the retail establishments into two specified areas. No provision, however, was made for diminishing the designated number of parking lots.** 281 N.E.2d at 467.

The court found from the language in the lease and the attached plot plan that the lease was clear and unambiguous. "The plot plan set forth with exactitude the location of the retail facilities, the pedestrian mall, the sidewalks, the roadways, the service drives, the parking areas, and 463 parking places." *Id.*

The lease provided under Article 7(b) that Walgreens was to pay its proportionate share of costs to operate and maintain the parking lots and under Article 7(a) that the customers, invitees, and employees of Walgreens and other shopping center tenants were to be given free and exclusive use of the parking areas. After considering the evidence presented, the court concluded that the lease granted Walgreens and other tenants in the shopping center "an easement in the parking areas for ingress, egress, and parking as set out in the plan" and upheld the injunction against constructing the Fotomat kiosk. *Id.*

2. [9.6] Office Building Parking

In *Mutual of Omaha Life Insurance Co. v. Executive Plaza, Inc.,* 99 Ill.App.3d 190, 425 N.E.2d 503, 54 Ill.Dec. 638 (2d Dist. 1981), the tenants in a multistory commercial office building sued the manager and owner for breach of parking rights provisions in a lease. At the time of execution of the lease, a parking lot was provided adjacent to the office building, consisting of approximately 148 spaces for use by all tenants in the building and their clients. The parking lot had five points of ingress and egress: two on North Court Street (a two-way street) and one each on Park Street and Locust Street (two-way streets) and North Church Street (a one-way street). Parking was available to the general public on three of the five streets.

Subsequently, the landlord entered into a lease with Coopers and Lybrand (C & L) for 27 percent of the total rentable area. As part of the C & L lease, the landlord granted C & L employees exclusive access and use of 32 parking spaces in the previously existing common parking lot and an additional 18 spaces in a newly constructed parking lot on Locust Street across from the premises. The restricted parking areas were cordoned off by chains, and access to the restricted parking areas was controlled by plastic pass cards inserted into a gate mechanism to raise a gate. The access gate to the 32 restricted parking spaces in the former common lot was one of the two access points on North Court Street previously providing common access to the common parking lot.

The trial court ruled that the lease had been breached by partially restricting access to parking that was required under the lease to be available to all tenants but concluded that removal of the parking restriction would not solve the claimed harm of inconvenience, that no direct economic or money loss to tenants had been proved, and that injunctive relief was not appropriate under these circumstances. The tenants appealed.

The appellate court reversed the ruling of the trial court and held: "The rule in Illinois is now clearly that language such as we have in the lease in question creates an easement appurtenant over a parking area in a shopping center, and this is the law elsewhere as well." 425 N.E.2d at 507. Although the parties did not cite any authorities that specifically applied the rules that have developed in the shopping center cases (see §9.5 above) to parking appurtenant to an office building, the court determined that there was "no logical basis for having one set of rules for shopping centers and a different set of rules for other contractual relationships." *Id.,* quoting *Crest Commercial, Inc. v. Union-Hall, Inc.,* 104 Ill.App.2d 110, 243 N.E.2d 652, 657 (2d Dist. 1968).

The court noted:

> **It might, of course, be argued that the furnishing of customer parking is absolutely essential to the tenants' business in a shopping center whereas parking in connection with the less competitive setting of an office building is a mere convenience. . . . However, here the tenants have been found to have an easement appurtenant by express contract and from that contractual relationship it follows, in our opinion, that the use of the appurtenant parking area may not be reduced nor substantially altered during the term of the lease. [**Citation omitted**]. *Id.***

The court went on to state that "[t]he grant of an easement appurtenant as found by the trial court is a proper subject of mandatory injunction even if only minor interference is shown." 425 N.E.2d at 508, citing *Ogilby v. Donaldsons's Floors, Inc.,* 13 Ill.2d 305, 148 N.E.2d 758, 760 – 761 (1958). The court noted that to show irreparable injury, a party is not required to show that the injury is beyond the possibility of compensation, nor must the injury be great, and "the fact that no actual damages could be proved and the jury could award only nominal damages 'often furnishes the very best reason why a court of equity should interfere.' " 425 N.E.2d at 508, quoting *Newell v. Sass,* 142 Ill. 104, 31 N.E. 176, 180 (1892).

PRACTICE POINTER

✓ If a commercial lease describes available parking — and especially if it makes reference to a plot plan/site plan that delineates the location of buildings, roads, parking, curb cuts, etc. — and the landlord thereafter attempts to alter the parking or access rights without a clear and unequivocal right to do so, the tenant will have a legal right to assert a breach of lease and obtain a mandatory injunction to prevent the change, or require that the status quo ante be restored. For the landlord to avoid this outcome, it is important to provide in the lease an express reservation of the right to alter existing or planned parking at the landlord's discretion, if that is the landlord's intent.

B. [9.7] Obstruction and Reduction of Passageways

Construction of a glass bay entrance to a tenant's store in a shopping center that extended five feet beyond the building lines depicted on a site plan attached to other tenant leases, and which disrupted sightlines to adjacent stores, was found to constitute an unpermitted obstruction or reduction of a private passageway created by the site plan. *The Fair v. Evergreen Park Shopping Plaza of Delaware, Inc.,* 4 Ill.App.2d 454, 124 N.E.2d 649, 652 (1st Dist. 1954).

The court found that when a right of passageway is granted over a strip of land having definite boundaries, the right extends over the full width of the tract described. The Fair (a major tenant facing the mall in the shopping center) was entitled to use the entire mall. The court concluded that the injury was a continuing one, and because there was no adequate remedy at law, "[t]he remedy for the obstruction or reduction of a private passageway is by injunction." 124 N.E.2d at 656, citing *Carpenter v. Capital Electric Co.,* 178 Ill. 29, 52 N.E. 973, 975 (1899).

C. [9.8] Office Building Corridors

As with parking rights discussed in 9.4 – 9.6 above, a floor plan attached to a lease may establish an implied easement in favor of tenants that would bar the landlord from relocating corridors reflected on the floor plan; however, express language in the lease clearly permitting a landlord to relocate the corridors will overcome any contrary implication arising from the floor plan. *Advertising Checking Bureau, Inc. v. Canal-Randolph Associates,* 101 Ill.App.3d 140, 427 N.E.2d 1039, 1042 – 1043, 56 Ill.Dec. 634 (1st Dist. 1991).

IV. COVENANT OF QUIET ENJOYMENT

A. [9.9] General Principles

It has long been the law in Illinois that a covenant of quite enjoyment is implied in all lease agreements. *Blue Cross Ass'n v. 666 North Lake Shore Drive Associates,* 100 Ill.App.3d 647, 427 N.E.2d 270, 273, 56 Ill.Dec. 190 (1st Dist. 1981); *64 East Walton, Inc. v. Chicago Title & Trust Co.,* 69 Ill.App.3d 635, 387 N.E.2d 751, 755, 25 Ill.Dec. 875 (1st Dist. 1979); *Berrington v. Casey,* 78 Ill. 317, 319 (1875); *Wade v. Halligan,* 16 Ill. 507, 511 (1855); *Midway Park Saver v. Sarco Putty Co.,* 2012 IL App (1st) 110849, ¶25, 976 N.E.2d 1063, 364 Ill.Dec. 500.

A covenant of quiet enjoyment "promises that the tenant shall enjoy the *possession* of the premises in peace and without disturbance." [Emphasis in original.] *Checkers, Simon & Rosner v. Lurie Co.,* No. 87 C 5405, 1987 WL 18930, *3 (N.D.Ill. Oct. 20, 1987). This does not mean, however, that no breach of the covenant of quiet enjoyment may be found in a leasehold without a finding that the lessor intended to deprive the lessee of possession. *Blue Cross Ass'n, supra,* 427 N.E.2d at 273. It simply means that a tenant must be in possession of the premises to claim a breach of the covenant of quiet enjoyment. If the tenant has already vacated the premises before the disturbance has commenced, no breach of the covenant of quiet enjoyment occurs. *Checkers, Simon & Rosner, supra,* 1987 WL 18930 at *3.

An implied covenant of quiet enjoyment includes, "absent a lease clause to the contrary, the right to be free of the lessor's intentional interference with full enjoyment and use of the leased premises." *Infinity Broadcasting Corporation of Illinois v. Prudential Insurance Company of America,* No. 86 C 4207, 1987 WL 6624, *5 (N.D.Ill. Feb. 9, 1987), *aff'd,* 869 F.2d 1073 (7th Cir. 1989) (quoting *American Dairy Queen Corp. v. Brown-Port Co.,* 621 F.2d 255, 258 (7th Cir. 1980)).

If the landlord breaches the covenant of quiet enjoyment, the lessee may remain in possession and claim damages for breach of lease. In such case, the measure of damages is the difference between the rental value of the premises in light of the breached covenant of quiet enjoyment and the rent that the tenant agreed to pay under the lease, together with such special damages as may have been directly and necessarily incurred by the tenant in consequence of the landlord's wrongful act. *64 East Walton, supra,* 387 N.E.2d at 755.

Although Illinois cases defining the precise scope of a covenant of quiet enjoyment are rare, BLACK'S LAW DICTIONARY, pp. 1248 – 1249 (11th ed. 1993) has defined "quiet enjoyment" in connection with the landlord-tenant relationship as "the tenant's right to freedom from serious interferences with his or her tenancy." *Manzaro v. McCann,* 401 Mass. 880, 519 N.E.2d 1337, 1341 (1981) (more than one day of ringing smoke alarms in apartment building could be sufficient interference with tenants' quite enjoyment of leased premises to justify relief against landlord).

B. [9.10] Judicial Interpretations of the Covenant of Quiet Enjoyment

In *Blue Cross Ass'n v. 666 North Lake Shore Drive Associates,* 100 Ill.App.3d 647, 427 N.E.2d 270, 273, 56 Ill.Dec. 190 (1st Dist. 1981), the First District Appellate Court discussed the covenant

of quiet enjoyment in the lease as granting the tenant a right of quiet and peaceful possession and enjoyment of the whole premises and equated a breach of quiet enjoyment under a lease to a private nuisance. "A private nuisance in a leasehold situation is 'an individual wrong arising from an unreasonable, unwarranted or unlawful use of one's property producing such material annoyance, inconvenience, discomfort, or hurt that the law will presume a consequent damage.' " *Id.,* quoting *Great Atlantic & Pacific Tea Co. v. LaSalle National Bank,* 77 Ill.App.3d 478, 395 N.E.2d 1193, 1198, 32 Ill.Dec. 812 (1st Dist. 1979).

The tenant had entered into a five-year lease on August 22, 1978, with a five-year renewal option, for approximately 53,000 square feet of the 15th floor of the building located at 666 North Lake Shore Drive in Chicago. The lease stated that the premises were to be used for computer installation and general office space, and the tenant expended in excess of $2 million in leasehold improvements, installed approximately $6 million in computer equipment, and was fully operational in August 1980.

In April 1979, the building was purchased by a new owner for the purpose of converting it to a mixed-use residential, commercial, and office facility. In August 1979, the new owner advised the tenant that the renovation program required alternations in the plaintiff's leasehold in the form of physical penetrations for installation of plumbing, ventilation, and electrical risers to service the condominium and office areas on floors above and below the tenant's leased premises. The tenant refused to permit penetrations into the plaintiff's leased space. Notwithstanding the tenant's refusal, the landlord proceeded with construction and penetrated the tenant's space for installation of the risers in accordance with the landlord's renovation plans. The tenant sued to obtain a preliminary injunction, but the trial court declined to issue injunctive relief. The tenant appealed.

On appeal, the appellate court reversed the trial court, stating: "Paragraph 42A of the lease expressly grants [tenants] the right of quiet and peaceful possession and enjoyment. The meaning of this clause is not controverted. [Tenants] had a right to seek injunctive relief for its breach when the conduct of [landlord] substantially interfered with [tenants'] use and enjoyment of the premises." 427 N.E.2d at 273.

C [9.11] Private Nuisance Distinguished

Similar to breach of the covenant of quiet enjoyment is the tort of maintaining a nuisance. In *Great Atlantic & Pacific Tea Co. v. LaSalle National Bank,* 77 Ill.App.3d 478, 395 N.E.2d 1193, 1198, 32 Ill.Dec. 812 (1st Dist. 1979), the First District Appellate Court stated:

> **A private nuisance is a nontrespassory invasion of another's interest in the private use and enjoyment of land. . . . It is an individual wrong arising from an unreasonable, unwarranted or unlawful use of one's property producing such material annoyance, inconvenience, discomfort, or hurt that the law will presume a consequent damage. . . . What is an unreasonable use of one's property under the circumstances, is determined by weighing the following factors:**
>
> **(a) The extent of the harm involved;**
>
> **(b) the character of the harm involved;**

(c) the social value that the law attaches to the type of use or enjoyment invaded;

(d) the suitability of the particular use or enjoyment invaded to the character of the locality; and

(e) the burden on the person harmed or avoiding the harm.

. . . The weight that each factor is accorded is relative to the circumstances of the case." [Citations omitted**]**.

PRACTICE POINTER

✓ Generally speaking, a breach of a covenant of quiet enjoyment is a breach of a contractual covenant contained (or implied) in a lease, constituting a cause of action against a landlord. If the "material annoyance, inconvenience, discomfort, or hurt" is caused by a nearby property owner or cotenant, the proper cause of action against such adjacent property owner or cotenant is likely "maintaining a private nuisance" rather than a breach of any covenant of quiet enjoyment, since there is no privity of contract through which a "covenant" of any sort might arise.

D. [9.12] Light and Air

The covenant of quiet enjoyment does not guarantee a tenant a right to unobstructed light and air. In *Keating v. Springer,* 146 Ill. 481, 34 N.E. 805, 807 (1893), the Illinois Supreme Court held that "a landlord will not be liable for obstructing his tenant's windows by building on the adjacent [lot], in the absence of any covenant or agreement in the lease forbidding him to do so."

Similarly, in *Baird v. Hanna,* 328 Ill. 436, 159 N.E. 793, 794 (1927), the Illinois Supreme Court held that "[t]he simplest rule, and that best suited to a country like the United States, in which changes are continually taking place in the ownership and in the use of lands, is that no easement of light can be acquired without express grant of an interest in, or covenant relating to, the lands over which the right is claimed."

E. [9.13] Television and Radio Signals

A claimed right to unobstructed transmission of television and radio signals has been held to the same standard and analysis as a claimed right to unobstructed light and air. While not actually a landlord-tenant case, *People ex rel. Hoogasian v. Sears, Robuck & Co.,* 52 Ill.2d 301, 287 N.E.2d 677 (1972), is instructive in its clarification that claimed easements for television and radio signals will be governed by the same analysis as claimed easements for light and air.

In *Hoogasian,* certain villages in the Chicago area sued to enjoin Sears from constructing the high-rise office building that became known as "Sears Tower" (now Willis Tower), contending that the tower would distort television reception and depress real estate values, and therefore constitute

a nuisance. The Illinois Supreme Court upheld dismissal of the case, determining that the same standard applicable to light and air applies to television and radio signals, and applied the general rule that a landowner has no legal right to the free flow of light and air across the adjoining land of his or her neighbor. *See also Infinity Broadcasting Corporation of Illinois v. Prudential Insurance Company of America,* No. 86 C 4207, 1987 WL 6624, *5 (N.D.Ill. Feb. 9, 1987), *aff'd,* 869 F.2d 1073 (7th Cir. 1989).

F. [9.14] Damages for Breach of the Covenant of Quiet Enjoyment

In *64 East Walton, Inc. v. Chicago Title & Trust Co.,* 69 Ill.App.3d 635, 387 N.E.2d 751, 25 Ill.Dec. 875 (1st Dist. 1979), the landlord did not contest that there was a breach of the covenant of quiet enjoyment but did contest the amount of damages awarded. In analyzing the scope of damages a tenant could recover for breach of the covenant of quiet enjoyment, the court stated:

> **The relevant law, although by no means plentiful, is clear. A covenant of quiet enjoyment is implied in all lease agreements. . . . If the lessor breaches the covenant, the lessee may remain in possession and thus be liable for rent but still maintain an action for damages. . . . The measure of damages in such a case is the difference between the rental value of the premises involved and the rent which the lessee has agreed to pay, together with such special damages as may have been directly and necessarily occasioned to the lessee by the lessor's wrongful act. . . . Thus, we must examine the wrongful acts of defendant and determine whether they directly and necessarily occasioned the damages awarded, keeping in mind that a trial court's assessment of damages will be set aside only if it is manifestly erroneous. [**Citations omitted.**]** 387 N.E.2d at 755.

V. [9.15] CONSTRUCTIVE EVICTION

A constructive eviction occurs when a landlord commits an act of a grave and permanent character with the intent to deprive the tenant of the enjoyment of the premises. *Advertising Checking Bureau, Inc. v. Canal-Randolph Associates,* 101 Ill.App.3d 140, 427 N.E.2d 1039, 1044, 56 Ill.Dec. 634 (1st Dist. 1991); *Gibbons v. Hoefeld,* 299 Ill. 455, 132 N.E. 425, 428 – 429 (1921); *Perry v. Evanston Young Men's Christian Ass'n,* 92 Ill.App.3d 820, 416 N.E.2d 340, 345 – 346, 48 Ill.Dec. 309 (1st Dist. 1981).

An action for constructive eviction cannot be maintained unless the tenant vacates the premise within a reasonable time after the premises became untenantable. *JMB Properties Urban Co. v. Paolucci,* 237 Ill.App.3d 563, 604 N.E.2d 967, 969, 178 Ill.Dec. 444 (3d Dist. 1992); *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 609, 5 Ill.Dec. 282 (2d Dist. 1977); *City of Chicago v. American National Bank,* 86 Ill.App.3d 960, 408 N.E.2d 379, 380 – 381, 42 Ill.Dec. 1 (1st Dist. 1980). If a tenant fails to vacate the premises within a reasonable time, the tenant will be considered to have waived the landlord's breach of covenant and will not be able to maintain an action for constructive eviction. *JMB Properties, supra,* 604 N.E.2d at 969.

The term "eviction" is applied to every class of expulsion, but not to mere trespass on the tenant's possession by the landlord. *Lynch v. Baldwin,* 69 Ill. 210, 212 (1873). There is a constructive eviction when the premises leased are rendered useless to the tenant or the tenant is deprived, in whole or in part, of the possession and enjoyment as a result of the willful or wrongful act of the landlord evidencing an intention on the part of the landlord to deprive the tenant of the use of the demised premises. *John Munic Meat Co. v. H. Gartenberg & Co.,* 51 Ill.App.3d 413, 366 N.E.2d 617, 620, 9 Ill.Dec. 360 (1st Dist. 1977); *Barrett v. Boddie,* 158 Ill. 479, 42 N.E. 143 (1895). However, it is not essential that there be an express intention of the landlord to deprive the tenant of their beneficial enjoyment, and because persons are presumed to intend the natural and probable consequence of their acts, acts or omissions of the landlord making it necessary for the tenant to move from the demised premises may constitute a constructive eviction. *John Munic Meat, supra,* 366 N.E.2d at 620. Upon the occurrence of conditions sufficient to justify a claim of constructive eviction, a commercial tenant must vacate the premises within a reasonable time, and ordinarily there can be no constructive eviction unless the tenant surrenders possession or abandons the premises. If a tenant continues to occupy the premises, it is considered a waiver of the right to abandon. *Gillette v. Anderson,* 4 Ill.App.3d 838, 282 N.E.2d 149, 152 (2d Dist. 1972); *John Munic Meat, supra,* 366 N.E.2d at 620.

Constructive eviction relieves the tenant from the responsibility to pay rent, but only after the tenant vacates the premises. *Shaker & Associates, Inc. v. Medical Technologies Group, Ltd.,* 315 Ill.App.3d 126, 733 N.E.2d 865, 872, 248 Ill.Dec. 190 (1st Dist. 2000); *Dell'Armi Builders, Inc. v. Johnston,* 172 Ill.App.3d 144, 526 N.E.2d 409, 411, 122 Ill.Dec. 150 (1st Dist. 1988). A tenant's obligation to pay rent is not suspended while the tenant continues to occupy the premises. As long as the tenant remains in possession of the premises, it is obligated to pay rent. *American National Bank, supra,* 408 N.E.2d at 381.

As noted by the cited cases, a constructive eviction requires a willful or wrongful act by the landlord. Typically, when interference with use of the premises comes from one who is not the landlord, such as another tenant or a nearby landowner, no constructive eviction will be found. When the landlord authorizes one tenant to do on the premises acts whose natural consequence is to interfere with the peaceful use of another tenant, however, there is a constructive eviction, in which case the tenant is no longer obligated to pay rent. *See Wade v. Halligan,* 21 Ill.470, 480 (1859).

VI. [9.16] CRIMINAL ACTIVITIES

As a general rule, a landowner has no duty to protect others from criminal activities undertaken by another. *Jackson v. Shell Oil Co.,* 272 Ill.App.3d 542, 650 N.E.2d 652, 655, 208 Ill.Dec. 958 (1st Dist. 1995); *Sanchez v. Wilmette Real Estate Management Co.,* 404 Ill.App.3d 54, 934 N.E.2d 1029, 1034, 343 Ill.Dec. 426 (1st Dist. 2010); *Rowe v. State Bank of Lombard,* 125 Ill.2d 203, 531 N.E.2d 1358, 1364, 126 Ill.Dec. 519 (1988), citing *Fancil v. Q.S.E. Foods, Inc.,* 60 Ill.2d 552, 328 N.E.2d 538, 542 (1975).

However, if a special relationship exists between the parties, a duty to protect others from criminal activities does exist. *Jackson, supra,* 650 N.E.2d at 655; *Sanchez, supra,* 934 N.E.2d at 1034; *Rowe, supra,* 531 N.E.2d at 1364.

There are four categories of special relationships that may give rise to a duty to protect an individual from criminal activities by third persons, if it can be demonstrated that the criminal attack was reasonably foreseeable, including (a) common carrier and passenger; (b) innkeeper and guest; (c) custodian and ward; and (d) business inviter and invitee. *Sanchez, supra,* 934 N.E.2d at 1034; *Hills v. Bridgeview Little League Ass'n,* 195 Ill.2d 210, 745 N.E.2d 1166, 1187, 253 Ill.Dec. 632 (2000). However, before a duty will be imposed, the plaintiff must demonstrate that the criminal attack was reasonably foreseeable. *Hills, supra,* 745 N.E.2d at 1187; *Rowe, supra,* 531 N.E.2d at 1364.

The exception to the rule that no duty exists to protect persons from criminal acts committed by third parties requires establishment of two elements: (a) there must be a special relationship between the parties; and (b) the criminal act must have been reasonably foreseeable. *Jackson, supra,* 650 N.E.2d at 655.

The Illinois Supreme Court has repeatedly held, however, that "the simple relationship between a landlord and tenant" is not a "special" relationship imposing a duty on the landlord to protect a tenant from the criminal attacks of others. *Sanchez, supra,* 934 N.E.2d at 1034, quoting *Rowe, supra,* 531 N.E.2d at 1364. *See also Pippin v. Chicago Housing Authority,* 78 Ill.2d 204, 399 N.E.2d 596, 598, 35 Ill.Dec. 530 (1979); *Phillips v. Chicago Housing Authority,* 89 Ill.2d 122, 431 N.E.2d 1038, 1040, 59 Ill.Dec. 281 (1982); *Martin v. Usher,* 55 Ill.App.3d 409, 371 N.E.2d 69, 70, 13 Ill.Dec. 374 (1st Dist. 1977).

However, if the landlord voluntarily undertakes to provide security measures, the landlord may be responsible for criminal activities if the security measures are negligently undertaken and such negligence is the proximate cause of injury to the plaintiff. *Sanchez, supra,* 934 N.E.2d at 1035; *Rowe, supra,* 531 N.E.2d at 1364; *McKenna v. AlliedBarton Security Services, LLC,* 2015 IL App (1st) 133414, ¶23, 35 N.E.3d 1007, 394 Ill.Dec. 38. Whether a landlord's agreement to provide lighting or a door buzzer and intercom system, constituted a voluntary undertaking by the landlord to provide security measures for the protection of a tenant or third parties was a question of fact. *Bourgonje v. Machev,* 362 Ill.App.3d 984, 841 N.E.2d 96, 113 – 114, 298 Ill.Dec. 953 (1st Dist. 2005).

VII. [9.17] REPAIRS

Absent a covenant in a lease obligating the landlord to make repairs, a landlord generally has no obligation to repair the leased premises, unless the landlord has actual knowledge of a defect at the time of entering into the lease and fraudulently conceals it. *Baxter v. Illinois Police Federation,* 63 Ill.App.3d 819, 380 N.E.2d 832, 835, 20 Ill.Dec. 623 (1st Dist. 1978); *Elizondo v. Perez,* 42 Ill.App.3d 313, 356 N.E.2d 112, 113, 1 Ill.Dec. 112 (1st Dist. 1976).

It is clear, however, that when a lease provides express covenants assigning responsibilities between landlord and tenant for repair and maintenance of leased property, those covenants will supersede any implied or common-law covenants and shall determine the responsibilities and liability of the respective parties. *McGann v. Murry,* 75 Ill.App.3d 697, 393 N.E.2d 1339, 1342, 31 Ill.Dec. 32 (3d Dist. 1979); *Hardy v. Montgomery Ward & Co.,* 131 Ill.App.2d 1038, 267 N.E.2d

748, 751 (5th Dist. 1971). An express covenant to repair will not be enlarged by construction. *Kaufman v. Shoe Corporation of America,* 24 Ill.App.2d 431, 164 N.E.2d 617, 620 (3d Dist. 1960). The ordinary meaning of the word "repair" is to fix, mend, or put together that which is torn or broken. It involves the idea of something preexisting that has been affected by decay. *Sandelman v. Buckeye Realty, Inc.,* 216 Ill.App.3d 226, 576 N.E.2d 1038, 1040, 160 Ill.Dec. 84 (1st Dist. 1991).

A general covenant of a tenant to keep the premises in repair merely binds the tenant to make only ordinary repairs reasonably required to keep the premises in good condition. *Quincy Mall, Inc. v. Kerasotes Showplace Theatres, LLC,* 388 Ill.App.3d 820, 903 N.E.2d 887, 230, 328 Ill.Dec. 227 (4th Dist. 2009); *Sandelman, supra,* 576 N.E.2d at 1040. It does not make the tenant responsible for making structural repairs. *Kaufman, supra,* 164 N.E.2d at 620; *Expert Corp. v. LaSalle National Bank,* 145 Ill.App.3d 665, 496 N.E.2d 3, 5, 99 Ill.Dec. 657 (1st Dist. 1986); *Mandelke v. International House of Pancakes, Inc.,* 131 Ill.App.3d 1076, 477 N.E.2d 9, 12, 87 Ill.Dec. 408 (1st Dist. 1985).

Alterations or additions of a structural or substantial nature that are made necessary by extraordinary or unforeseen future events not within the contemplation of the parties at the time of lease execution are ordinarily the responsibility of the landlord. *Expert Corp., supra,* 496 N.E.2d at 5. Likewise, renewals or replacements that would last a lifetime rather than maintain the condition of the premises are extraordinary repairs outside the scope of a tenant's obligations under a general covenant of repair. *Sandelman, supra,* 576 N.E.2d at 1040; *Schultz Bros. v. Osram Sylvania Products, Inc.,* No. 10 C 2995, 2011 WL 4585237, *3 (N.D.Ill. Sept. 30, 2011). When a deficiency is so substantial and unforeseen that it would be unreasonable to expect the tenant to make repairs that basically benefit not the tenant but the landlord, those repairs may be deemed structural. *Baxter, supra,* 380 N.E.2d at 835.

In order to shift the responsibility to make structural or extraordinary repairs to the leased premises, a lease must clearly and unambiguously state that the obligation to make those structural or extraordinary repairs is that of the tenant and not of the landlord. When the lease explicitly shifts the burden to the tenant, however, by requiring the tenant to make all repairs and replacements, ordinary and extraordinary, structural and nonstructural, the provision will be enforced against the tenant in accordance with its clear meaning. *Schultz Bros., supra,* 2011 WL 4585237 at *3, citing *Sandelman, supra,* 576 N.E.2d at 1040. *See also Quincy Mall, supra,* 903 N.E.2d at 891; *Kallman v. Radioshack Corp.,* 315 F.3d 731, 738 (7th Cir. 2002).

A. Common Issues Involving the Duty To Repair

1. [9.18] Roof Replacement

An ordinary covenant requiring a tenant to keep the premises in good repair does not include a requirement that the tenant replace a roof that has become so weathered or run down that it cannot be repaired. *Sandelman v. Buckeye Realty, Inc.,* 216 Ill.App.3d 226, 576 N.E.2d 1038, 1040, 160 Ill.Dec. 84 (1st Dist. 1991).

2. [9.19] Plaster Walls and Ceiling

An ordinary covenant requiring a tenant to keep the premises in good repair will require the tenant to repair plaster falling from a ceiling. Plaster is not a structural element of a building. Falling plaster cannot be considered so unforeseeable or be so substantial as to transform it into a structural element requiring repair by the landlord. *Baxter v. Illinois Police Federation,* 63 Ill.App.3d 819, 380 N.E.2d 832, 835, 20 Ill.Dec. 623 (1st Dist. 1978); *Hardy v. Montgomery Ward & Co.,* 131 Ill.App.2d 1038, 267 N.E.2d 748, 751 (5th Dist. 1971).

In contrast, if the wall (or ceiling) itself needs to be replaced, the obligation to reconstruct a defective wall would not fall on the tenant under a general covenant of repair. *Expert Corp. v. LaSalle National Bank,* 145 Ill.App.3d 665, 496 N.E.2d 3, 5, 99 Ill.Dec. 657 (1st Dist. 1986). The *Expert* court reasoning that "reconstruction" means to rebuild, not merely to repair.

3. [9.20] Heating Systems

Conversion and replacement of a heating system to a new type of heating system because the existing system has been discontinued may not be covered by a tenant's duty to repair under a general covenant of repair. *Baxter v. Illinois Police Federation,* 63 Ill.App.3d 819, 380 N.E.2d 832, 835, 20 Ill.Dec. 623 (1st Dist. 1978); *Kaufman v. Shoe Corporation of America,* 24 Ill.App.2d 431, 164 N.E.2d 617, 620 (3d Dist. 1960).

B. [9.21] Landlord's Control and Obligation To Maintain

When a landlord retains control of portions of the premises leased to the tenant, absent an express provision to the contrary in the lease, the landlord, as the party in control, is obligated to use ordinary care to maintain that portion of the premises in a reasonably safe condition. *Vesey v. Chicago Housing Authority,* 145 Ill.2d 404, 583 N.E.2d 538, 541 – 542, 164 Ill.Dec. 622 (1991); *McCoy v. Chicago Housing Authority,* 333 Ill.App.3d 305, 775 N.E.2d 168, 170 – 171, 266 Ill.Dec. 606 (1st Dist. 2002).

C. [9.22] Independence of Tenant's Obligation To Pay Rent and Landlord's Duty To Repair

"The general rule in Illinois, as elsewhere, is that the obligation to pay the rent and the covenant to make repairs are separate and independent covenants and that the failure to make the promised repairs does not discharge the obligation to pay the rent." *Zion Industries, Inc. v. Loy,* 46 Ill.App.3d 902, 361 N.E.2d 605, 608, 5 Ill.Dec. 282 (2d Dist. 1977). However, if the failure to repair is of such a serious nature as to constitute a constructive eviction — even a partial constructive eviction — the obligation to pay rent is suspended. *Id.; Goldberg v. Cosmopolitan National Bank of Chicago,* 33 Ill.App.2d 83, 178 N.E.2d 647, 649 (1st Dist. 1961).

Since a tenant must vacate the premises to claim constructive eviction, the tenant's liability for rent will continue as long as possession is continued, even if the landlord has committed acts justifying abandonment of the premises. *Zion Industries, supra,* 361 N.Ed.2d at 608; *Automobile Supply Co. v. Scene-in-Action Corp.,* 340 Ill. 196, 172 N.E. 35, 38 (1930).

D. [9.23] Breach of Landlord's Covenant To Make Repairs

In *American National Bank & Trust Company of Chicago v. K-Mart Corp.,* 717 F.2d 394 (7th Cir. 1983), the Seventh Circuit Court of Appeals analyzed Illinois law as it applies to a landlord's breach of its obligations under a lease to repair and maintain the leased premises. "Under Illinois law, a tenant has various remedies available on breach of landlord's covenant to repair. The tenant may (1) abandon the premises if they become untenantable by reason of the breach, (2) remain in possession and recoup damages in an action for rent, (3) make the repairs and deduct the cost from the rent or sue landlord for the cost, or (4) sue landlord for breach of the covenant and recover the damages usually measured by the difference between the rental value of the premises in repair and out of repair." 717 F.2d at 398, citing *Book Production Industries, Inc. (Consolidated Book Publishers Division) v. Blue Star Auto Stores, Inc.,* 33 Ill.App.2d 22, 178 N.E.2d 881, 885 (2d Dist. 1961).

The measure of damages is the difference between the rental value of the premises if kept in the condition of repair required by the landlord's covenant and the rental value of the premises in the condition in which they actually are, plus any special damages. *Zion Industries, supra,* 361 N.E.2d at 612; *Oppenheimer v. Szulerecki,* 297 Ill. 81, 130 N.E. 325, 327 (1921).

"This theory of damages is known as diminution of rental value and reflects the sum a tenant is entitled to recover to restore him to the position he would have been in had he received the benefit of his bargain, that is, the benefit of premises in repair." *K-Mart Corp., supra,* 717 F.2d at 399. The question of rental value, both for premises in and out of repair, is the proper subject of expert testimony. *City of Chicago v. Bank of Ravenswood,* 93 Ill.App.3d 52, 416 N.E.2d 1115, 1118 – 1119, 48 Ill.Dec. 593 (1st Dist. 1981); *K-Mart Corp., supra,* 717 F.2d at 400.

VIII. [9.24] RESTRICTIVE COVENANTS IMPEDING THE STREAM OF COMMERCE

It is not uncommon for grantors and lessees to try to bind real property and adjacent or nearby land to "exclusive use" or "prohibited use" restrictions to try to prevent competition from competing businesses. In determining whether such a provision is enforceable, courts will look at whether the restriction is reasonable and whether the restriction, in fact, protects a legitimate business or proprietary interest.

> **It is well-established that covenants restricting the use of real estate, restraining trade or otherwise impeding the stream of commerce are disfavored in the law and will be construed in favor of free alienation in the event of an inequitable or unjust result. . . . Courts carefully scrutinize the validity of restrictive covenants, and their enforceability is conditioned upon the reasonableness of the restraint imposed. . . . Moreover, the party seeking enforcement of a restrictive covenant must allege and prove some legitimate business or propriety interest requiring protection for which enforcement is sought. [**Citations omitted.**]** *American National Bank & Trust Company of Chicago v. Tufano,* 222 Ill.App.3d 778, 584 N.E.2d 400, 401, 165 Ill.Dec. 221 (1st Dist. 1992).

IX. [9.25] PREMISES LIABILITY

Recovery in tort for negligence requires that there be a breach of a duty owed to the plaintiff by the defendant. *Kuhn v. General Parking Corp.,* 98 Ill.App.3d 570, 424 N.E.2d 941, 945, 54 Ill.Dec. 191 (1st Dist. 1981); *Boyd v. Racine Currency Exchange, Inc.,* 56 Ill.2d 95, 306 N.E.2d 39, 40 (1973). The existence of a legal duty is a question of law. *Kuhn, supra,* 424 N.E.2d at 945; *Barnes v. Washington,* 56 Ill.2d 22, 305 N.E.2d 535 (1973). Typically, a landlord is not liable for injuries sustained by a third party on the premises leased to a tenant and under the tenant's control. *Kuhn, supra,* 424 N.E.2d at 945; *Coshenet v. Holub,* 80 Ill.App.3d 430, 399 N.E.2d 1022, 1023, 35 Ill.Dec. 733 (2d Dist. 1980); *Hanna v. Creative Designers, Inc.,* 2016 IL App (1st) 143727, ¶23, 63 N.E.3d 1036, 407 Ill.Dec. 604.

At common law, a lessor who retains control over portions of the building has a duty to all persons lawfully on the premises to maintain those portions of the premises in reasonable repair. *Rowe v. State Bank of Lombard,* 125 Ill.2d 203, 531 N.E.2d 1358, 1366, 126 Ill.Dec. 519 (1988); *Kuhn, supra,* 424 N.E.2d at 945; *Gula v. Gawel,* 71 Ill.App.2d 174, 218 N.E.2d 42, 44 (1st Dist. 1966). Generally, this rule applies to common areas and not to premises demised to a tenant and under the tenant's control. *Rowe, supra,* 531 N.E.2d at 1366; *Wright v. Mr. Quick, Inc.,* 109 Ill.2d 236, 486 N.E.2d 908, 909, 93 Ill.Dec. 375 (1985); *Campbell v. Harrison,* 16 Ill.App.3d 570, 306 N.E.2d 643, 645 (1st Dist. 1973). However, in *Campbell,* the court found that the lessor could be liable for injuries caused by the disrepair of the tenant's walls and ceiling if the lessee could show that the lessor retained control over the walls and ceiling. 306 N.E.2d at 645 – 646.

Generally, the tenant in possession, not the landlord, is liable for injuries sustained by third parties and caused by failure to keep the property in good repair. *Fan v. Auster Co.,* 389 Ill.App.3d 633, 906 N.E.2d 663, 675 – 676, 329 Ill.Dec. 465 (1st Dist. 2009); *Guerino v. Depot Place Partnership,* 273 Ill.App.3d 27, 652 N.E.2d 410, 413, 209 Ill.Dec. 870 (2d Dist. 1995). "The basic rationale for this doctrine of lessor immunity is that a lease is a conveyance of property which ends the lessor's control over the premises, a prerequisite of tort liability." *Fan, supra,* 906 N.E.2d at 676, quoting *Guerino, supra,* 652 N.E.2d at 413. This general rule has a number of exceptions, however, including (a) when a landlord has expressly agreed to keep the premises or parts of the premises in good repair or (b) when the landlord has voluntarily assumed the maintenance obligation by its conduct. *Fan, supra,* 906 N.E.2d at 676; *Guerino, supra,* 652 N.E.2d at 413 – 414; *O'Rourke v. Oehler,* 187 Ill.App.3d 572, 543 N.E.2d 546, 552, 135 Ill.Dec. 163 (4th Dist. 1989).

When a landlord retains control of a portion of the leased premises, it is the landlord, not the tenant, as the party in control, who has the duty to use ordinary care in maintaining that portion of the premises in a reasonably safe condition. *Klitzka v. Hellios,* 348 Ill.App.3d 594, 810 N.E.2d 252, 256, 284 Ill.Dec. 599 (2d Dist. 2004).

There are several exceptions to the traditional rule that a landlord who is not in control of the premises is not liable for injuries sustained by third parties. These exceptions include circumstances in which

a. a latent defect exists at the time of leasing that the landlord knew or should have known about;

b. a landlord fraudulently conceals a dangerous condition;

c. the defect causing the harm amounts to a nuisance;

d. the landlord makes a promise at the time of leasing to repair a condition;

e. the landlord "violates a statutory requirement of which a tenant is in the class designated to be protected by such requirement"; and

f. the landlord voluntarily undertakes to render a service. *Id.*

The traditional common-law rule is that a landlord is under no obligation to repair portions of premises leased to and under the exclusive possession and control of a tenant, unless the landlord knew at the time of entering into the lease that the premises were defective, and the landlord concealed the defect. *Jordan v. Savage,* 88 Ill.App.2d 251, 232 N.E.2d 580, 584 (1st Dist. 1967). Even when a landlord has no legal obligation to keep the premises, or part thereof, in repair, the landlord may become liable if the landlord volunteers to make a repair and does so negligently. *Id.*

Generally, the owner or occupant in control of premises has a duty to properly maintain electrical wiring owned or controlled by such owner or occupant (as opposed to wiring owned or controlled by a utility company) to safeguard those on the premises from dangers posed by such wiring. *O'Rourke, supra,* 543 N.E.2d at 552.

> **As Dean Prosser observed: "[t]he lessee acquires an estate in the land, and becomes for the time being both owner and occupier, subject to all of the responsibilities of one in possession, to those who enter upon the land and those outside of its boundaries."** *Rowe, supra,* 531 N.E.2d at 1366, quoting William LLoyd Prosser et al, PROSSER AND KEETON ON TORTS §63, at 434 (5th ed. 1984).

X. [9.26] ASSIGNMENT OF LEASE; UNREASONABLY WITHHOLDING CONSENT

When a lease forbids any sublease or assignment without the consent of the landlord, the landlord cannot unreasonably withhold its consent to a sublease. *Vranas & Associates, Inc. v. Family Pride Finer Foods, Inc.,* 147 Ill.App.3d 995, 498 N.E.2d 333, 339, 101 Ill.Dec. 151 (2d Dist. 1986); *Jack Frost Sales, Inc. v. Harris Trust & Savings Bank,* 104 Ill.App.3d 933, 433 N.E.2d 941, 949, 60 Ill.Dec. 703 (1st Dist. 1982); *Golf Management Co. v. Evening Tide Waterbeds, Inc.,* 213 Ill.App.3d 355, 572 N.E.2d 1000, 1003, 157 Ill.Dec. 536 (1st Dist. 1991).

A condition precedent to a landlord's obligation to consent to a sublease or assignment is that the landlord must be presented with a suitable tenant to take over the lease. A landlord is justified to withhold consent until the landlord is provided with satisfactory proof of the financial ability and responsibility of the proposed assignee or subtenant, consistent with reasonable commercial standards. The proposed tenant must also be ready, willing, and able to take over the lease and perform the tenant's obligations under the lease. *Vranas, supra,* 498 N.E.2d at 339; *Jack Frost Sales, supra,* 433 N.E.2d at 949; *Golf Management, supra,* 572 N.E.2d at 1003.

In *Vranas,* the tenant had entered into a contract to sell its business to a financially responsible and experienced purchaser that planned to conduct the same type of business from the premises. 498 N.E.2d at 340. The sale was subject to the parties receiving the landlord's consent to the proposed assignment of lease, and the landlord withheld its consent, leading to the sale not going through. Subsequently, Family Pride abandoned the premises, and the landlord sued for unpaid rent and expenses arising from the abandonment. Family Pride counterclaimed for damages arising out of the landlord's unreasonable withholding of consent to the proposed assignment.

The court held that when a tenant has presented a landlord with a commercially reasonable tenant who is ready, willing, and able to assume the existing lease, but the landlord unreasonably refuses to grant consent, the tenant is entitled to recover as damages from the landlord lost profits that are attributable to the landlord's wrongful conduct. 498 N.E.2d at 342.

XI. [9.27] HOLDING OVER; DOUBLE RENT AS PENALTY

Section 9-202 of the eviction statute, 735 ILCS 5/9-101, *et seq.,* provides as a remedy for a tenant willfully holding over after expiration of the term of the lease, damages in the amount of "double rent." The specific provision is as follows:

> **If any tenant or any person who is in or comes into possession of any lands, tenements or hereditaments, by, from or under, or by collusion with the tenant, wilfully holds over any lands, tenements or hereditaments, after the expiration of his or her term or terms, and after demand made in writing, for the possession thereof, by his or her landlord, or the person to whom the remainder or reversion of such lands, tenements or hereditaments belongs, the person so holding over, shall, for the time the landlord or rightful owner is so kept out of possession, pay to the person so kept out of possession, or his or her legal representatives, at the rate of double the yearly value of the lands, tenements or hereditaments so detained to be recovered by a civil action.** 735 ILCS 5/9-202.

The right of a landlord to collect double rent when a tenant willfully holds over after expiration of the lease has long been recognized. But it is also recognized that the statute is highly penal, and a recovery of double rent will be granted only when the landlord strictly complies with its terms and will not be granted when the landlord terminates the lease. *Stride v. 120 West Madison Building Corp.,* 132 Ill.App.3d 601, 477 N.E.2d 1318, 1321, 87 Ill.Dec. 790 (1st Dist. 1985); *Wendy & William Spatz Charitable Foundation v. 2263 North Lincoln Corp.,* 2013 IL App (1st) 122076, ¶44, 998 N.E.2d 909, 376 Ill.Dec. 199 (noting that "a landlord is not entitled to double rent when the tenant did not retain possession of the premises in bad faith, such as [when] there is a bona fide dispute as to such rights to possession").

Recognizing the limitations of the double rent remedy under §9-202, many commercial leases include express provisions providing for double rent as a landlord remedy in the event of any holding over under any circumstances, whether by expiration of the lease term by lapse of time, termination of the lease term upon the tenant's default, or otherwise. In this circumstance, the issue becomes whether the double rent (or any increased rent amount resulting from termination of the leased term) constitutes legitimate liquidated damages or constitutes an unpermitted penalty.

To this point, the court in *Stride* stated:

> **The general rule of contracts that a plaintiff is only entitled to recover damages to the extent of his injury is applicable to cases of breach of a lease. . . . Where damages are difficult to ascertain, the parties may specify a particular sum as liquidated damages. . . . However, if the clause fixing damages is merely to secure performance of the agreement, it will be treated as a penalty and only actual damages proved can be recovered. . . . In doubtful cases, we are inclined to construe the stipulated sum as a penalty. [**Citations omitted.**]** 477 N.E.2d at 1321.

The lease at issue in *Stride* provided that the landlord could recover "all damages sustained by reason of the Lessee's retention of possession." *Id.* From that, the court concluded that the parties believed that damages would be ascertainable and therefore held that the lease provision granting the landlord double rent for holding over was not a liquidated damages provision. Rather, it was a penalty to assure prompt performance under the lease, and therefore was not enforceable against the tenant.

XII. [9.28] MITIGATION OF DAMAGES

Illinois landlords and their agents are required to use reasonable measures to mitigate damages recoverable against a defaulting lessee. 735 ILCS 5/9-213.1. The term "reasonable measures" is not defined by statute, and Illinois courts have held that whether the landlord has complied with the reasonable-measures standard is a question of fact, to be determined on a case-by-case basis. *Danada Square, LLC v. KFC National Management Co.,* 392 Ill.App.3d 598, 913 N.E.2d 33, 41, 332 Ill.Dec. 438 (2d Dist. 2009).

Section 9-213.1 of the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* is mandatory, however, and it is the responsibility of the landlord, when proving damages, to also prove that it took reasonable measures to mitigate damages, whether or not the landlord's requirement to mitigate damages was raised as an affirmative defense by the tenant. *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 508 – 509, 230 Ill.Dec. 1013 (1st Dist. 1998); *Snyder v. Ambrose,* 266 Ill.App.3d 163, 639 N.E.2d 639, 640 – 641, 203 Ill.Dec. 319 (2d Dist. 1994).

The landlord has the burden to prove mitigation of damages as a prerequisite to recovery. *Snyder, supra,* 639 N.E.2d at 641; *St. Louis North Joint Venture v. P & L Enterprises, Inc.,* 116 F.3d 262, 265 (7th Cir. 1997). Losses that are reasonably avoidable are not recoverable. *Nancy's Home of Stuffed Pizza, Inc. v. Cirrincione,* 144 Ill.App.3d 934, 494 N.E.2d 795, 800, 98 Ill.Dec. 673 (1st Dist. 1986); *Culligan Rock River Water Conditioning Co. v. Gearhart,* 111 Ill.App.3d 254, 443 N.E.2d 1065, 1068, 66 Ill.Dec. 902 (2d Dist. 1982).

In dicta, the court in *St. George, supra,* stated that failure to take reasonable measures to mitigate damages may not necessarily bar recovery by the landlord, but it will result in the landlord's recovery being reduced. 695 N.E.2d at 509. How this would work from an evidentiary standpoint, however, is not entirely clear. Presumably, the landlord could introduce evidence at

trial that, although the landlord did not take reasonable measures to mitigate damages, if it had, damages would have been reduced by some specified amount. If the landlord fails to introduce even that evidence, however, the question appears to remain open as to whether the landlord adequately proved damages — since the burden of proof of damages remains with the landlord and there is no suggestion that the statutory requirement to prove mitigation shifts to the tenant.

At least one case has, in dicta, questioned aspects of both *St. George, supra,* and *Snyder, supra,* disagreeing that proof of mitigation must be demonstrated by the landlord as a prerequisite to recovering damages and has suggested that the issue of mitigation of damages is an affirmative defense that must be raised by the tenant, or it is waived. *Takiff Properties Group Ltd. #2 v. GTI Life, Inc.,* 2018 IL App (1st) 171477, ¶23, 124 N.E.3d 11, 429 Ill.Dec. 242.

As a matter of first impression, the court in *Takiff* went on hold that the landlord's obligation to mitigate can be contractually waived by a commercial tenant and was contractually waived by the tenant, rendering the issue of mitigation moot. 2018 IL App (1st) 171477 at ¶31.

Possession as a condition precedent to landlord's duty to mitigate. Notwithstanding any general duty of landlord to mitigate damages, a landlord has no duty to mitigate until the landlord comes into possession. *2460-68 Clark LLC v. Chopo Chicken, LLC,* 2022 IL App (1st) 210119, ¶34, 198 N.E.3d 655, 459 Ill.Dec. 628; *Block 418, LLC v. Uni-Tel Communications Group, Inc.,* 398 Ill.App.3d 586, 925 N.E.2d 253, 258, 338 Ill.Dec. 756 (2d Dist. 2010); *St. George Chicago, Inc. v. George J. Murges & Associates, Ltd.,* 296 Ill.App.3d 285, 695 N.E.2d 503, 507 – 508, 230 Ill.Dec. 1013 (1st Dist. 1998). Discussing the application of this principle, the *Chopo Chicken* court noted that an eviction proceeding is a summary proceeding to recover possession. Since a landlord has no duty to mitigate until the landlord is in possession, and, in an eviction action, a landlord is not in possession until the eviction court grants the landlord an order of possession and landlord recovers possession, landlord's efforts to mitigate, or the lack thereof, are not relevant. 2022 IL App (1st) 210119 at ¶34.

Liquidated damages provision makes mitigation irrelevant. It is the general rule in Illinois that, in the case of an enforceable liquidated damages provision, mitigation is irrelevant and should not be considered in assessing damages. *Chopo Chicken, supra,* 2022 IL App (1st) 210119 at ¶33. A liquidated damages provision is an agreement by the parties as to the amount of damages that must be paid in the event of default. *Id*. Liquidated damages are commercial leases are not uncommon.

In *Chopo Chicken, supra,* the court considered a provision that included an itemization of damages recoverable by landlord from tenant, including "a sum equal to the amount of unpaid rent and other charges and adjustments called for herein for the balance of the term hereof, which sum shall be due to Landlord as damages by reason of Tenant's default hereunder," constituted a liquidated damages provision. 2022 IL App (1st) 210119 at ¶32.

Similarly, in *St. George, supra,* 695 N.E.2d at 507, the court found that a so-called "rent differential" formula (*i.e.,* the amount determined by the *excess* if any of the present value of the aggregate monthly base rent and operating expense adjustments for the remainder of the term as then in effect *over* the then present value of aggregate fair rental value of the premises for the balance of the term the present value calculated in each case at three percent) constituted a liquidated damages provision.

XIII. [9.29] ATTORNEYS' FEES

In *64 East Walton, Inc. v. Chicago Title & Trust Co.,* 69 Ill.App.3d 635, 387 N.E.2d 751, 759, 25 Ill.Dec. 875 (1st Dist. 1979) the lease provided, in part:

> **Legal and Similar Expenses: Lessee or Lessor, as the case may be, shall pay all costs, expenses and reasonable attorneys' fees that may be incurred or paid by the other in successfully enforcing the covenants and agreements in this Lease or in any successful suit for damages wherein Lessee or Lessor, as the case may be, is determined to have defaulted.**

At trial, among other damages, the court awarded $10,679.80 as attorneys' fees, which the landlord challenged on appeal. The appellate reversed and remanded the issue of proper attorneys' fees to be awarded, noting:

> **Legal fees may not be blindly awarded by a court, however. In *Canham v. Saisi,* [**65 Ill.App.3d 686, 382 N.E.2d 654, 22 Ill.Dec. 334 (1st Dist. 1978),**] this court stated that in setting reasonable attorneys' fees, courts should consider:**
>
> **[T]he nature of the controversy, the question at issue, the significance or importance of the subject matter, the degree of responsibility involved, the standing or skill of the person employed, and the time and labor involved. . . . The allowance should only be in such amount as will compensate for the services rendered, and must be fair and just to all parties concerned; namely, the attorney to be compensated, the client, and the person required to make the payment. . . . Furthermore, it should appear that the work being compensated for was reasonably required and necessary for the proper performance of the legal services involved in the case.** 387 N.E.2d at 759 –760.

In *Larkin Bank v. Ishak,* 43 Ill.App.3d 918, 357 N.E.2d 840, 841, 2 Ill.Dec. 620 (2d Dist. 1976), the court approved the reasoning in the Florida case of *Lyle v. Lyle,* 167 So.2d 256, 257 (Fla.App. 1964), where it was stated:

> **As between a lawyer and his client the matter of the fee is one of contract between the two, but a fee to be allowed by the court is something else and must be proved as any other fact, and determined and allowed by the court in its judicial discretion. The [**reasonableness**] of the attorney's fees is not the subject of judicial notice, neither is it to be left to local custom, conjecture or guesswork. Each award must be made on its own merits and should be justified by the circumstances in each particular case.** [Citations omitted.] 357 N.E.2d at 841.

XIV. EVICTION STATUTE

A. [9.30] Exclusive Remedy for Possession

"[N]o person has the right to take possession, by force, of premises occupied or possessed by another, even though such person may be justly entitled to such possession. The [eviction] statute

[formerly the forcible entry and detainer statute] provides the complete remedy at law for settling such disputes. Persons seeking possession must use this remedy rather than use force." *People Evans,* 163 Ill.App.3d 561, 516 N.E.2d 817, 819, 114 Ill.Dec. 662 (1st Dist. 1987), citing *Phelps v. Randolph,* 147 Ill. 335, 35 N.E. 243, 245 (1893). "The force that the statute prohibits can be actual or constructive. A breach of the peace need not occur." *Evans, supra,* 516 N.E.2d at 819, citing *Phelps, supra,* 35 N.E. at 245.

"The [statute] reflects the long-established public policy that violence and even bloodshed could result from individuals using force and violence to regain possession of real property, even if the possession is rightfully theirs. *Evans, supra,* 51 N.E.2d at 819, citing *Doty v. Burdick,* 83 Ill. 473, 477 (1876).

The eviction statute provides a summary statutory procedure for determining the sole issue of possession. *Yale Tavern, Inc. v. Cosmopolitan National Bank,* 259 Ill.App.3d 965, 632 N.E.2d 80, 198 Ill.Dec. 21 (1st Dist. 1994). "The purpose of the [statute] is to provide a speedy remedy to allow a person who is entitled to the possession of certain real property to be restored to possession." *Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, ¶13, 993 N.E.2d 1095, 373 Ill.Dec. 536, quoting *Wells Fargo Bank, N.A. v. Watson,* 2012 IL App (3d) 110930, ¶14, 972 N.E.2d 1234, 362 Ill.Dec. 201. It is a "limited proceeding, focusing on the central issue of possession." *Campana Redevelopment, supra,* 2013 IL App (2d) 120988 at ¶13, quoting *American National Bank v. Powell,* 293 Ill.App.3d 1033, 691 N.E.2d 1162, 1169, 229 Ill.Dec. 439 (1st Dist. 1997).

"The only questions that are to be answered in such a proceeding concern which party is entitled to immediate possession and whether a defense that is germane to the distinctive purpose of the action defeats plaintiff's asserted right to possession." *Campana Redevelopment, supra,* 2013 IL App (2d) 120988 at ¶13, quoting *Subway Restaurants, Inc. v. Riggs,* 297 Ill.App.3d 284, 696 N.E.2d 733, 736, 231 Ill.Dec. 437 (1st Dist. 1998). *See also General Parking Corp. v. Kimmel,* 79 Ill.App.3d 883, 398 N.E.2d 1104, 1106, 35 Ill.Dec. 154 (1st Dist. 1979).

The Illinois Supreme Court has defined "germane" as meaning, "closely allied; closely related, closely connected; appropriate." *Rosewood Corp. v. Fisher,* 46 Ill.2d. 249, 263 N.E.2d 833, 838 (1970). However, §9-209 of the eviction statute specifically permits a landlord to couple the claim for possession with a claim for rent. *Campana Redevelopment, supra,* 2013 IL App (2d) 120988 at ¶9.

B. [9.31] Tenant Claims and Defenses

Claims that are germane to the issue of possession generally fall into one of four categories:

1. claims asserting a paramount right to possession;

2. claims denying a breach of the agreement on which the plaintiff bases the right to possession;

3. claims challenging the validity or enforceability of the agreement; and

4. claims questioning the plaintiff's motivation for bring the action. *Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, ¶16, 993 N.E.2d 1095, 373 Ill.Dec. 536, citing *Avenaim v. Lubecke,* 347 Ill.App.3d 855, 807 N.E.2d 1068, 1074, 283 Ill.Dec. 227 (1st Dist. 2004).

Only claims and defenses germane to the distinctive purpose of the action may be included. *Campana Redevelopment, supra,* 2013 IL App (2d) 120988 at ¶13, citing *Subway Restaurants, Inc. v. Riggs,* 297 Ill.App.3d 284, 696 N.E.2d 733, 736, 231 Ill.Dec. 437 (1st Dist. 1998). Matters that are considered germane to the issue of possession are construed more strictly in actions involving commercial leases. *Clark Oil & Refining Corp. v. Banks,* 34 Ill.App.3d 67, 339 N.E.2d 283, 287 (1st Dist. 1975); *General Parking Corp. v. Kimmel,* 79 Ill.App.3d 883, 398 N.E.2d 1104, 1107, 35 Ill.Dec. 154 (1st Dist. 1979).

1. [9.32] Landlord's Amortized Improvement Costs vs. Unamortized Improvement Costs

In *Campana Redevelopment, LLC v. Ashland Group, LLC,* 2013 IL App (2d) 120988, 993 N.E.2d 1095, 373 Ill.Dec. 536, the plaintiff landlord sought to recover unamortized improvement costs as part of its joint action for eviction and for rent. The landlord's cost of making improvements to the premises for the benefit of the tenant was specifically amortized over the ten-year life of the lease. The landlord claimed that the unamortized cost of the improvements was a component of rent and could, therefore, be recovered through an eviction action under §9-209 of the eviction statute. 735 ILCS 5/9-209.

While the appellate court agreed that past-due installments for unamortized improvement costs might properly be included as a component of past-due rents, the court held that installments of the unamortized improvement costs not yet due and owning could not be included because they could not reasonably be deemed to constitute past-due rent. Following such reasoning, the court concluded that the landlord's claim for recovery of unamortized improvement costs that were not yet due and owing was not germane to an eviction action, and, therefore, the court vacated the trial court's award of $119,495.74 in unamortized improvement costs. 2013 IL App (2d) 120988 at ¶20.

2. [9.33] Wrongful Eviction

> **Eviction as a defense to a claim for rent . . . suspends the obligation of payment either in whole or in part, because it involves a failure of the consideration for which rent is paid. . . . We are dealing now with an eviction which is actual and not constructive. If such an eviction, though partial only, is the act of the landlord, it suspends the entire rent because the landlord is not permitted to apportion his own wrong. [**Omissions in original.**]** *Goldberg v. Cosmopolitan National Bank of Chicago,* 33 Ill.App.2d 83, 178 N.E.2d 647, 649 (1st Dist. 1961), quoting Justice Cardozo in *Fifth Ave. Bldg. Co. v. Kernochan,* 221 N.Y. 370, 117 N.E. 579, 580 (App. 1917).

The term "eviction" is applied to every class of expulsion, but not to mere trespass on the tenant's possession by the landlord. *Barrett v. Boddie,* 158 Ill. 479, 42 N.E. 143, 144 (1895).

In *Goldberg, supra,* the partial eviction resulted from the landlord taking possession of a portion of a parking area that had been leased to the tenant and excluding the tenant from using the same. Upon actual eviction (as opposed to constructive eviction) from a portion of the premises, a lessee may continue in possession of the remainder, with no obligation to pay rent. The main reason for this is that enjoyment of the whole premises is the foundation for the obligation to pay rent, and the obligation to pay rent cannot be apportioned. *Goldberg, supra,* 178 N.E.2d at 649; *Hayner v. Smith,* 63 Ill. 430, 434 – 435 (1872).

3. [9.34] Right of Setoff

> **It is established law that liability for rent continues so long as the tenant is in possession and equally well established that a tenant may bring an action against his landlord for breach of a covenant or may recoup for damages in an action brought to recover rent.** *Quincy Mall, Inc. v. Kerasotes Showplace Theatres, LLC,* 388 Ill.App.3d 820, 903 N.E.2d 887, 892, 328 Ill.Dec. 227 (4th Dist. 2009), quoting *Jack Spring, Inc. v. Little,* 500 Ill.2d 351, 280 N.E.2d 208, 213 (1972).

However, when a landlord breaches its obligations under a lease to make repairs or to place the premises in tenantable condition, the tenant may satisfy its obligation to pay rent by making the repairs and setting off against rent otherwise due to the landlord the amount spent by the tenant in making the repairs. *Quincy Mall, supra,* 903 N.E.2d at 892, citing *Loy v. Sparks,* 304 Ill.App. 35, 25 N.E.2d 893, 894 – 895 (2d Dist. 1940).

Note that in *Poulos v. Reda,* 165 Ill.App.3d 793, 520 N.E.2d 816, 821, 117 Ill.Dec. 465 (1st Dist. 1987), the First District Appellate Court held:

> **While it is true that in some instances a landlord's breach of his covenants under a lease has been held germane to [**an eviction**] action . . . this holding has been confined to residential dwellings and has not been extended to commercial leases. . . . Where a commercial lease is involved, matters which are considered germane to the issue of possession are construed more strictly . . . and a commercial occupant cannot raise a landlord's failure to repair as a defense in [**an eviction**] action for the nonpayment of rent. [**Citations omitted.**]**

In fact, it appears to be the law in Illinois that while a commercial landlord's failure to make repairs may not, in and of itself, be an issue germane to an eviction action, if a tenant rightfully makes such repairs, the amount expended by the tenant to make the repairs may be set off against rent and the right of setoff will be a defense germane to a forcible entry and detailer action brought by the landlord based on an alleged breach by the tenant in the payment of rent. *Quincy Mall, supra,* 903 N.E.2d at 892.

> **Thus, when a commercial landlord fails to replace a critical component of the leased premises, which is vital to the operation of its commercial tenant's business — in violation of the landlord's duty to do so . . . — the commercial tenant may set off such replacement cost, provided that (1) the tenant has informed the landlord of the need to replace the necessary component; (2) the landlord failed to replace the necessary component in a timely manner; and (3) the tenant informed the landlord of its intent to set off the reasonable costs of the necessary replacement.** *Id.*

XV. OPTIONS TO EXTEND OR CANCEL LEASE

A. [9.35] Exercising Options To Extend Lease — Strict Compliance Required

In *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶4, 100 N.E.3d 596, 421 Ill.Dec. 579, the lease had an initial term ending December 31, 2011, but provided for two additional options to extend the lease:

> **Tenant shall have the option to extend the term of this Lease for two additional five (5) year periods [**the First Extension Option expiring December 31, 2016, and the Second Extension Option, expiring December 31, 2021**]. The option to renew shall be exercised with respect to the entire Demised Premises only and shall be exercisable by Tenant delivering the Extension Notice to Landlord, in the case of the First Extension Option, on or prior to January 1, 2011 and in the case of the Second Extension Option, on or prior to January 1, 2016, in all cases, time being of the essence.**

B. [9.36] Required Notice

In *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶5, 100 N.E.3d 596, 421 Ill.Dec. 579, the lease contained a provision governing notices that provided, in part, that

> **[**e**]xcept as otherwise expressly provided in this Lease, any * * * notices * * * or other communications given or required to be given under this Lease * * * shall be deemed sufficiently given or rendered only if in writing, * * * sent by registered or certified mail (return receipt requested) addressed to Landlord at Landlord's address set forth in this Lease, with a copy to Masterworks Development Corporation, 56 West 45th Street, 4th Floor, New York, New York 10036, Attention: Jon D. Horowitz, Esq.; or * * * to such other address as * * * Landlord * * * may designate as its new address for such purpose by notice given to the other in accordance with the provisions of this Article 27.**

The lease also provided that the landlord could waive strict performance of a lease term only by executing a written instrument to that effect and, even then, the waiver of one breach would not result in the waiver of subsequent breaches.

C. [9.37] Imprecise Exercise

In *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶8, 100 N.E.3d 596, 421 Ill.Dec. 579, the tenant, on November 9, 2010, through its attorney, sent a written extension notice to extend the lease term for the "First Extension Option" via Federal Express rather than via registered mail or certified mail as provided under the express terms of the lease. The landlord did not dispute the notice and treated the notice as having effectively extended the term of the lease to December 31, 2016.

Subsequently, the tenant claimed to have effectively exercised the "Second Extension Option" to extend the term to December 31, 2021. On August 16, 2012, the tenant, again through its attorney, e-mailed the landlord raising matters that the tenant "would like to discuss" and included the following statement: "We are now in the first of two (2) five (5) year options. Tenant would like to exercise the second option now, so we don't have to do this again as soon." 2018 IL App (1st) 171222 at ¶9.

There were additional proposals and suggestions in the e-mail that created issues concerning the definiteness of the purported exercise of the Second Extension Option, but for purposes of the court's ruling in *Casdan,* it is unnecessary to address that concern.

D. [9.38] Claim That Landlord Received Actual Notice

The tenant's position in *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, 100 N.E.3d 596, 421 Ill.Dec. 579, was that through various conversations and e-mails occurring prior to January 1, 2016, the landlord received *actual notice* of the tenant's exercise of the "Second Extension Option." Before and after January 1, 2016, the tenant made clear to the landlord that the tenant wanted to remain in the demised premises, make various leasehold improvements, and renew the lease. Further, because the landlord had accepted the notice of exercise of the first extension by means other than as strictly provided under the terms of the lease, the landlord could not insist on strict adherence to the terms of the lease for exercise of the second extension.

E. [9.39] Trial Court Ruled in Tenant's Favor

Following a hearing, in *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, 100 N.E.3d 596, 421 Ill.Dec. 579, the trial court entered summary judgment in the tenant's favor, finding that the e-mail of August 16, 2012, was a clear and unambiguous exercise of the "Second Extension Option."

F. [9.40] Appellate Court Reversed

On appeal, in *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶¶30 – 31, 100 N.E.3d 596, 421 Ill.Dec. 579, the trial court's summary judgment ruling was reviewed de novo, with the appellate court noting that "[w]e review the court's judgment, not its reasoning," and reversed the trial court's judgment in favor of tenant.

G. [9.41] Appellate Court's Reasoning

In explaining its decision, the court in *Michigan Wacker Associates, LLC v. Casdan, Inc.,* 2018 IL App (1st) 171222, ¶¶33 – 37, 100 N.E.3d 596, 421 Ill.Dec. 579, stated:

> **Our supreme court's seminal decision in *Dikeman v. Sunday Creek Coal Co.,* 184 Ill. 546, 56 N.E. 864 (1900), remains the leading authority on this options matter. The contractually mandated time for performance is generally an essential term of a contract. . . . Unless that term is waived, an option is lost due to untimeliness. . . .**

Discussing the nature of the option before it, *Dikeman* stated "[the**] agreement was purely a privilege given to the lessee without any corresponding right or privilege of the lessor, and the only stipulation was that the right should be exercised at a certain time." [*Id.*].**

Since *Dikeman*, courts have generally required strict compliance with options. See. . . . *T.C.T. Building Partnership v. Tandy Corp.,* 323 Ill.App.3d, 114, 115, 119, 120, 256 Ill.Dec. 82, 751 N.E.2d 135 (2001) (treating the method for exercising an option as a condition precedent requiring strict compliance). Strict compliance is dictated not only by precedent, but by the needs of commercial transactions and fairness. . . . Options to cancel or extend commercial leases are invaluable to a lessee, and a lessor generally does not receive consideration for the lessor's agreement to be bound by an exercise of the option. . . . Thus, a lessor may insist on a writing to further certainty as the lessor foregoes other opportunities to lease the space. . . .

Consequently, actual or oral notice is insufficient to exercise an option where a party has failed to provide timely written notice. . . . Furthermore, cases finding actual notice to be sufficient outside the options context have no bearing on notice in options cases. . . .

In addition, tenant does not dispute that it failed to strictly comply with the method of notice prescribed by the lease. Instead, tenant argues that actual notice is a sufficient substitute for the lease requirements and landlord waived strict compliance with the requisite method of notice. . . .

***Dikeman* and its progeny clearly defeat tenant's assertion that actual notice is sufficient.**

PRACTICE POINTER

✓ One of the key lessons to be learned from *Casdan, supra,* is that exercising an option — any option — is not a casual undertaking. Strict compliance with the method of exercise specified in the option instrument is essential. It must be specific, certain, and unconditional. It must also be timely, and the method of notice of exercise must strictly adhere to the notice requirements of the option instrument. Even actual notice of an attempted exercise of an option will not suffice if strict compliance with the method of exercise is not observed.

H. [9.42] Not All Mistakes Are Fatal

While recognizing the fundamental rule that a tenant seeking to exercise an option to extend or cancel a commercial lease must strictly comply with the terms of that option, in *900 North Rush LLC v. Intermix Holdco, Inc.,* 2019 IL App (1st) 181914, 146 N.E.3d 52, 438 Ill.Dec. 298, the court ruled that not all mistakes in exercise are fatal.

In *Intermix,* written notice of the tenant's intended exercise of an option to extend a lease was timely given in proper form — but the signature block of the notice named a sister company as the party giving the notice rather than the tenant. The lease provided that the *tenant* must exercise the option to extend. The landlord claimed the notice was fatally defective because it was not timely given by the tenant, but rather to a stranger under the lease.

The tenant under the lease was Intermix Holdco, Inc. The signature block of the notice to extend identified that it was signed by Old Navy, LLC, instead of Intermix. Both Old Navy and Intermix are owned by Gap, Inc., and the person signing the notice was a member of Gap's real estate department.

The lease in question was particularly described in the notice, identifying the landlord, the tenant, the date of the lease, the leased premises, and the term of lease. Even the section of the lease pursuant to which the option to extend was being exercised was referenced in the notice of exercise.

The trial court granted summary judgment in favor of the tenant, finding as a matter of law that the option to extend the term of the lease had been properly executed, notwithstanding the landlord's objection that the tenant did not *strictly* comply with the term which required that the *tenant* exercise the option rather than a stranger to the lease.

The *Interix* court found that the inclusion of Old Navy in the signature block was mere surplusage, and held that "[w]hile it is true that a technicality can sometimes result in a forfeiture as a result of the strict compliance standard applied to options in commercial leases, the technicality here is not material to the terms required by the lease for effectively exercising the option." 2019 IL App (1st) 181914 at ¶¶25 – 27.

PRACTICE POINTER

✓ Although the tenant ultimately prevailed in *Interix,* it expended over $125,000 in attorneys' fees and litigation expenses to prevail. This dispute could have been avoided by paying close attention to all details of exercise of the option to extend the lease.

XVI. [9.43] RENT DUE TO PRIOR LANDLORD — NOT RECOVERABLE BY NEW LANDLORD

In *1002 E. 87th Street LLC v. Midway Broadcasting Corp.,* 2018 IL App (1st) 171691, 107 N.E.3d 868, 424 Ill.Dec. 149, the plaintiff (87th Street) filed suit to evict the defendant (Midway) for unpaid rent, with 87th Street also seeking to collect on a guaranty of the lease. The trial court dismissed, finding that 87th Street lacked standing to recover rent that accrued before it owned the property. The trial court also granted the tenant, Midway, attorneys' fees in defending the action, as the prevailing party. The appellate court affirmed.

Under the facts of the case there was no question Midway was behind on the rent it owed to the prior owner of the leased premises before the premises were conveyed to 87th Street by deed. The premises were sold, however, and the new owner, 87th Street, claimed Midway was in default by reason of past-due rent owed to the prior owner.

The lease provided that Midway would pay rent "without abatement, demand, deduction or offset whatsoever" and also provided that the landlord "shall include the party named as such in the first paragraph thereof, its representatives, assigns and successors in title to the Premises." 2018 IL App (1st) 171691 at ¶6. The lease further provided that when an original owner conveys the property, the "[t]enant agrees to attorn to such new owner." *Id.* Additionally, this provision of the lease provided that when the original landlord conveys the property, all liabilities and obligations of the original landlord "shall be binding upon the new owner." *Id.* The lease further provided that the prevailing party in enforcing the lease "shall be entitled to recover from the nonprevailing party any costs, expenses and reasonable attorney's fees incurred." *Id.*

However, 87th Street claimed that as a successor standing in the shoes of the landlord to which the tenant had a duty to attorn, it had standing to sue under the provisions of the lease, which provided that "[n]o failure of landlord to exercise any power * * * or to insist upon strict compliance * * * and no custom or practice of the parties * * * shall constitute a waiver of Landlord's right to demand exact compliance with the terms." 2018 IL App (1st) 171691 at ¶18.

The appellate court in *87th Street* held as follows:

> **In general, a landlord has standing to sue for unpaid rent. 735 ILCS 5/9-209 (West 2014), *American Management Consultants, LLC v. Carter,* 392 Ill.App.3d 39, 44, 333 Ill.Dec. 605, 915 N.E.2d 411 (2009). If a landlord conveys property by warranty deed without reserving any rights, he or she also conveys the leases for the property, as well as the right to receive unaccrued rent. *Pros Corporate Management Services, Inc. v. Ashley S. Rose, Ltd.,* 228 Ill.App.3d 573, 580, 170 Ill.Dec. 173, 592 N.E.2d 609 (1992). If a tenant fails to pay rent that becomes due, the new landlord has standing to sue for it. *Id.* at 580-81, 170 Ill.Dec. 173, 592 N.E.2d 609; *American Management Consultant, LLC,* 392 Ill.App.3d at 44; 333 Ill.Dec. 605, 915 N.E.2d 411; *Dasenbrock v. Interstate Restaurant Corp.,* 7 Ill.App.3d 295, 298, 287 N.E.2d 151 (1972). But the new landlord does not have a right to recover rent due from before it owned the property. *Lipschultz v. Robertson,* 407 Ill. 470, 474, 95 N.E.2d 357 (1950) (conveyed lease gives right to receive unaccrued rents). The original landlord retains any right to recover past due rent. *Dasenbrock,* 7 Ill.App.3d at 302, 287 N.E.2d 151.** 2018 IL App (1st) 171691 at ¶17.

Additionally, the *87th Street* court held that because 87th Street must be able to prove a breach of contract claim to collect on the guaranty, and 87th Street cannot prevail on its breach of lease claim for past-due rent owned to the prior owner, 87th Street could not bring an action to collect on the lease guaranty. 2018 IL App (1st) 171691 at ¶27.

Finally, because the tenant, Midway, prevailed on its defense of the claims by the successor landlord seeking to evict Midway and to collect past-due rent under the lease and under the guaranty, Midway was entitled to recover costs, expenses, and reasonable attorneys' fees incurred in defense of the successor landlord's action from 87th Street.

XVII. [9.44] RECEIVER'S ABILITY TO INCREASE RENT SPECIFIED UNDER A LEASE

In *LOMTO Federal Credit Union v. 6500 Western LLC,* 2018 IL App (1st) 173106, 103 N.E.3d 950, 422 Ill.Dec. 586, the appellate court held that, unless expressly limited by the lease, a receiver has the right to increase the rent to fair market value even if there is a written lease specifying a lower monthly rent.

The property at issue was a commercial property in foreclosure. Pursuant to the foreclosure proceeding, a receiver was appointed. The property was subject to a written commercial lease with a remaining term of approximately five years. The receiver determined that the rental payable under the existing written lease was far below fair rental value and was insufficient to enable the receiver to operate, manage, and conserve the mortgaged property. In fact, the rental under the lease was a flat rate of $8,000 per month, gross rent, amounting to a flat rate of roughly $3.43 per square foot per year. The receiver's market expert determined that fair rental should instead be a base rent in the range of $14 to $18 per square foot per year, triple net, with the tenant paying, in addition, all property taxes, building insurance, and common area maintenance, amounting to a monthly rent closer to the range of $32,600 to $42,000 per month, triple net.

Pursuant to the Code of Civil Procedure, the court authorized the receiver to raise the rental for the property to $14 to $18 per square foot per year, triple net. 735 ILCS 5/15-1704(g). The tenant objected to the rental increase, claiming that the receiver has no authority, pursuant to §15-1704(g), to increase rental specified under a written lease.

Section 15-1704(g) provides, in pertinent part (with emphasis added as reflected in the *LOMTO* court's opinion), as follows:

> **Notwithstanding any other provision of this Article, a receiver shall not charge an occupant of the mortgaged real estate *a rental amount above that which the occupant had been paying for use and occupancy* of the mortgaged real estate prior to the appointment of a receiver without leave of court. The court may allow an increase of rent if, upon motion by the receiver, the court finds by a preponderance of the evidence, that the increase of rent is necessary to operate, manage, and conserve the mortgaged real estate pursuant to this Section. . . . Nothing in this subsection (g) shall alter the terms of any lease agreement. [**Emphasis added**].**

In particular, the tenant in *LOMTO, supra,* pointed out that the final limitation of §15-1704(g) is that "Nothing in this subsection (g) shall alter the terms of any lease agreement." 2018 IL App (1st) 173106 at ¶14. Since the written lease agreement at issue included — as a specified term — that rent would be $8,000 per month gross rent, the tenant argued that increasing the rent to a range of $32,600 to $42,000 per month, triple net, was an alteration of the lease agreement, which is expressly prohibited by §15-1704(g).

The appellate court in *LOMTO* held that permitting the receiver to increase the rental from $8,000 per month gross rental to a range of $32,600 to $42,000 per month, triple net, *was not*, in fact, an alteration of the lease agreement.

The *LOMTO* court also held:

> **Additionally, increasing rents pursuant to subsection (g) does not alter the terms of defendants' existing lease agreements. Section 15-1704(g) was in effect when the parties executed their lease agreements. "[C]ontracting parties are presumed to have entered into the contract with a knowledge of the existing law as it relates to their agreement," and by operation of law, such "laws, statutes and ordinances become implied terms of the contract." *S.D. Service, Inc. v. 915-925 W. Schubert Condominium Ass'n,* 132 Ill.App.3d 1019, 1023, 88 Ill.Dec. 163, 478 N.E.2d 478 (1985). Since the lease agreements did not specifically exclude the effect of subsection (g), defendants are deemed to have accepted this provision as an implied term of their agreements. *Id.* The subsection's last sentence merely reflects this rule of law by stating that an increase in rent pursuant to this statutory provision does not alter the terms of any lease agreement.**
>
> **For these reasons, we find that section 15-1704(g) allows the receiver to seek an increase in rent from defendants through leave of court.** 2018 IL App (1st) 173106 at ¶¶21 – 22.

Although the court's reasoning is arguably tortured and circuitous to achieve a desired result, the solution to avoid this outcome is provided in the *LOMTO* opinion. As noted above, the court's reasoning turned on the sentence: "*Since the lease agreements did not specifically exclude the effect of subsection (g), defendants are deemed to have accepted this provision as an implied term of their agreements*." [Emphasis added]. 2018 IL App (1st) 173106 at ¶21.

PRACTICE POINTER

✓ When drafting a commercial lease from the tenant's perspective, be sure to include a provision substantially as follows:

> ***Notwithstanding anything set forth or implied herein to the contrary, the rental payable hereunder shall not be increased by application of 735 ILCS 5/15-1704(g) under any circumstance, and any right a receiver may otherwise have to increase the rental payable hereunder by application of 735 ILCS 5/15-1704(g) is excluded from this lease.*** [Emphasis added].

XVIII. [9.45] LEASE GUARANTY MUST BE SUPPORTED BY CONSIDERATION

L.D.S., LLC v. Southern Cross Food, Ltd., 2017 IL App (1st) 163058, 96 N.E.3d 424, 420 Ill.Dec. 339, addresses the need for consideration to support the enforceability of a guaranty of lease. *L.D.S.* has a long procedural history, having been reversed and remanded in 2011 on a prior appeal, and then subsequently tried at a bench trial.

At trial, the court made a finding of fact that the lease had been executed on July 20, 2006. As required by the lease, the tenant gave the landlord a check for the security deposit as of July 21, 2006, and the landlord gave the tenant the keys and possession of the leased premises on July 21, 2006. Reportedly, the landlord believed he was dealing with Quiznos (corporate), but discovered on July 21, 2006, that the lessee was a *franchisee* of Quiznos. On July 21, 2006, the landlord told the tenant that since the tenant was merely a franchisee, the landlord also required a personal guaranty.

On July 26, 2006, following further negotiations, the tenant's principal, Brendan Skehan, executed a personal guaranty of the lease in favor of the landlord. Subsequently, the tenant defaulted under the lease and the landlord sued Skehan on his personal lease guaranty.

In finding that the lease guaranty was not enforceable, the court discussed the requirement that a guaranty must be supported by sufficient consideration to be enforceable.

> **The issue presented in the instant case is whether there was sufficient consideration for the guaranty purportedly signed by Skehan. . . . If a guaranty is executed after the underlying obligation was entered into, new consideration is generally needed for the guaranty. *Tower Investors, LLC v. 111 East Chestnut Consultants, Inc.,* 371 Ill.App.3d 1019, 1028, 309 Ill.Dec. 686, 864 N.E.2d 927 (2007). However, if a guaranty is executed contemporaneously with the original contract, the consideration for the original contract is sufficient consideration for the guaranty and no new consideration is required for the guaranty. *Tower Investors,* 371 Ill.App.3d at 1028, 309 Ill.Dec. 686, 864 N.E.2d 927; *Pedott v. Dorman,* 192 Ill.App.3d, 85, 94, 139 Ill.Dec. 156, 548 N.E.2d 541 (1989); *Continental National Bank of Fort Worth v. Schiller,* 89 Ill.App.3d 216, 219 – 20, 44 Ill.Dec. 471, 411 N.E.2d 593 (1980); *Vaughn v. Commissary Realty, Inc.,* 30 Ill.App.2d 296, 302, 174 N.E.2d 567 (1961).** *L.D.S.,* 2017 IL App (1st) 163058 at ¶36.

Having found as a matter of fact that the guaranty requirement arose after execution of the lease and that the guaranty was executed after the lease had commenced with no new consideration being given, the court held the guaranty failed for lack of consideration and was unenforceable.

XIX. COVID-19 ERA DEFENSES

A. [9.46] Force Majeure

Force majeure is a contractual remedy that may be included within a lease. As a contractual provision, it will be construed in accordance with its terms, using the usual rules of contract construction. *In re Hitz Restaurant Group,* 616 B.R. 374, 377 (Bankr. N.D.Ill. 2020). In Illinois, contracts are enforced according to their terms. *Consolidated Coal Co. of St. Louis v. Schneider,* 163 Ill. 393, 45 N.E.126, 129 (1896). Under Illinois law, a force majeure clause will only excuse contractual performance if the triggering event cited by the nonperforming party was, in fact, the proximate cause of that party's nonperformance. *In re Hitz, supra.*

If a lease includes a force majeure provision, it will supersede the common-law doctrine of impossibility. *In re Hitz, supra*. *See also Commonwealth Edison Co. v. Allied-General Nuclear Services,* 731 F.Supp. 850, 855 (N.D.Ill. 1990); *Morgan Street Partners, LLC v. Chicago Climbing Gym Co.,* No. 20-cv-4468, 2022 WL 602893, *5 (N.D.Ill. Mar. 1, 2022).

In the absence of an applicable force majeure provision in a lease, the common-law defenses of the impossibility, impracticability, and frustration of purpose may be available to relieve the tenant from liability for failure to perform.

B. [9.47] Impossibility, Impracticability, and Commercial Frustration

On March 18, 2022, the Illinois Appellate Court issued its first opinion addressing efforts by a commercial tenant to escape liability under its lease by reason of the COVID-19 pandemic. *55 Jackson Acquisitions, LLC v. Roti Restaurants, LLC,* 2022 IL App (1st) 210138, 202 N.E.3d 998, 461 Ill.Dec. 1, is lengthy, factually detailed, and instructive. It is useful because it lays out the issues to be considered when the doctrines of impossibility, impracticability, and frustration of purpose are interposed as defenses to commercial lease enforcement.

The facts present in *Roti Restaurants* are not unusual for COVID era lease disputes.

The landlord and tenant entered into a multiyear commercial lease commencing on January 1, 2017, for the operation of a restaurant to sell "food for on and off premises consumption, including the sale of beer, liquor and wine, and ancillary items found in . . . other Roti establishments." 2022 IL App (1st) 210138 at ¶7. The lease obligated the tenant to conduct and operate its business in a "proper, lawful, and reputable manner" and to "comply in all matters with all laws, ordinances, rules, regulations, orders, and public authorities or officers exercising any power of regulation or supervision over tenant or the premises, or the use or operation thereof." *Id*. The tenant timely opened its restaurant and operated its restaurant in compliance with the lease.

On March 9, 2020, JB Pritzker, Governor of Illinois, declared all counties in the State of Illinois as a disaster area in response to the outbreak of COVID-19. See Gubernatorial Disaster Proclamation, www2.illinois.gov/sites/gov/documents/coronavirusdisasterproc-3-5-2021.pdf. On March 11, 2020, the World Health Organization characterized the COVID-19 outbreak as a pandemic. WHO Director-General's opening remarks at the media briefing on COVID-19, Word Health Organization, www.who.int/director-general/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020. On March 13, 2020, President Trump declared a nationwide emergency pursuant to §501(b) of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), Ch 68, Pub.L. No. 100-707 (1988), codified at 42 U.S.C. §§5121 – 5207, covering all states and territories, including Illinois. President Donald J. Trump Directs FEMA Support Under Emergency Declaration for COVID-19, Federal Emergency Management Agency, www.fema.gov/news-release/20200514/president-donald-j-trump-directs-fema-support-under-emergency-declaration. On March 18, 2020, the Commissioner of Health of the City of Chicago issued a Shelter in Place For COVID-19 Order. Order of the Commissioner of Health of the City of Chicago, www.chicago.gov/content/dam/city/depts/cdph/HealthProtectionandResponse/Order%20re%20Shelter%20in%20Place%20FINAL.pdf (case sensitive). On March 20, 2020, the Governor of Illinois issued Executive Order 2020-10, directing Illinois residents to stay at home. On March 26. 2020, the Commissioner of Health of the City of Chicago issued Order No. 2020-3 applying the Governor's stay-at-home order, closing numerous public areas, restricting public and private gatherings, and restricting travel. On March 26, 2020, President Trump declared a major disaster in Illinois pursuant to §401 of the Stafford Act.

In the midst of the onset of the COVID-19 disaster, the tenant, Roti, "closed the premises" on Mach 18, 2020, and stopped paying rent. *Roti Restaurants, supra,* 2022 IL App (1st) 210138 at ¶17. In August 2020, the landlord filed suit for eviction and rent, alleging that Roti entered into a lease to rent the premises but failed to pay rent under the lease since March 2020. The landlord sought possession and $79,173.88 in past due rent as of the date of filing the complaint. 2022 IL App (1st) 210138 at ¶13.

Roti defended the lawsuit by admitting it was a party to the lease but arguing that it was essentially dispossessed on the premises in March 2020 and excused from performance of the lease because it was complying with public health orders. 2022 IL App (1st) 210138 at ¶16. It also claimed that it was excused from performance because of civil unrest resulting in looting and rioting that began on May 28, 2020. 2022 IL App (1st) 210138 at ¶17. Roti asserted that both the public health orders and the unrest "made it illegal and impossible or impracticable for Roti to operate a restaurant at the premises as anticipated under the lease, its sole permitted use of the Premises." *Id.*

Roti raised five affirmative defenses. An affirmative defense claiming COVID-19 constituted a physical casualty was rejected based on the language of the lease. The other four affirmative defenses, as well as two counterclaims, were based on the common-law doctrines of impossibility or impracticability of performance and commercial frustration of purpose. There was no applicable force majeure provision in the lease, resulting in only common-law defenses being available.

Cross-motions for summary judgement. Eventually, both the landlord and the tenant filed cross-motions for summary judgement, which were heard on January 8, 2021.

Roti's motion for summary judgment was based primarily on the common-law doctrines of impossibility and frustration of purpose. It was supported by a sworn declaration alleging facts in support of its defense that the public orders relating to COVID-19 made it impossible or impractical to conduct business as a restaurant from the premises.

The landlord's motion for summary judgement argued that Roti had not established impossibility or frustration of purpose and that Roti was in default, without legal excuse, for failure to pay rent as required by the lease. In support of the landlord's motion for summary judgment the landlord filed a sworn declaration alleging that other restaurants or cafes in the vicinity of the premises remained open and operating during the COVID-19 pandemic and, in fact, a Potbelly and a Starbucks in the same building as the premises "are currently open for business and have been open during much of the pandemic." 2022 IL App (1st) 210138 at ¶37. Roti responded that the landlord's sworn declaration did not specifically refute Roti's declaration that the public orders made it impossible and impractical to operate its business and noted that other businesses "have different physical setups, business models, and management decision-making." 2022 IL App (1st) 210138 at ¶39.

The trial court granted Roti's motion for summary judgment and denied the landlord's motion for summary judgement based on the doctrines of impossibility and frustration of purpose, noting that restaurants cannot make enough money to pay their staff during governmental restrictions for COVID-19 and opined that restaurants would not be profitable until they could return to full

operational capacity. The trial court ruled that "the lease remains in full force and effect except that all rent payments by Roti are abated until the public health orders are lifted such that Roti can return to full operational capacity." *55 Jackson Acquisition LCC v. Roti Restaurants, LLC,* 2021 WL 90782260 (Ill.Cir. Jan. 13, 2021). The landlord appealed.

On appeal. Addressing the doctrines of impossibility, impracticability, and frustration of purpose, the Fist District Appellate Court succinctly spelled out the conditions for application of each doctrine, noting that in each case the doctrines of impossibility, impracticability, and commercial frustration are to be narrowly construed. 2022 IL App (1st) 210138 at ¶¶54 – 61.

Impossibility. The doctrine of impossibility, the appellate court noted, excuses performance only if the performance is rendered objectively impossible because the subject matter of the contract is destroyed or by operation of law. The doctrine applies only if the parties did not and could not anticipate the circumstances creating the impossibility, the party claiming impossibility did not contribute to the circumstance, and that party demonstrates it tried all practical alternatives to allow performance. The person claiming impossibility has the burden to prove it. 2022 IL App (1st) 210138 at ¶54.

Impracticability. The doctrine of impracticability applies only when, "after a contract is made, a party's performance is made impractical without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made." 2022 IL App (1st) 210138 at ¶55. As with the doctrine of impossibility, a party claiming impracticability is expected to make a reasonable effort to overcome obstacles to performance and will be excused only if performance is impractical despite reasonable efforts. A party seeking to excuse performance by reason of impracticability must show that it can operate *only* at a loss and that the loss will be so severe and unreasonable that failure to excuse performance would result in a grave injustice. *Id.*

Commercial Frustration. The doctrine of commercial frustration rests on the proposition that, "from the nature of the contract and the surrounding circumstances" at the time the parties entered into the contract, the parties "must have known that it could not be performed unless some particular condition or circumstance would continue to exist." 2022 IL App (1st) 210138 at ¶56. The parties must be deemed to have entered into the contract on the basis that "the condition or circumstance would continue to exist, so that the contract is construed to be subject to an implied condition that the parties shall be excused if performance becomes impossible from such condition or circumstance ceasing to exist." *Id.*

The outcome. Applying the doctrines of impossibility, impracticability, and commercial frustration to the COVID-19 pandemic, the appellate court found "no genuine dispute that the parties did not and could not anticipate the circumstances allegedly causing impossibility — the COVID-19 pandemic and the public health orders — when they entered into the lease, nor that Roti did not contribute to the circumstances of the pandemic and said orders." 2022 IL App (1st) 210138 at ¶58. Similarly, the appellate court found "no genuine dispute that the allegedly frustrating event — again, COVID-19 and the orders — were not reasonably foreseeable when the lease was formed." *Id.*

The appellate court then noted, however, that summary judgment is a drastic means of disposing of litigation and should be granted only when there is no genuine issue of a material fact. In reversing the trial court, the appellate court found that a genuine issue of material fact prevented entry of summary judgment for either party. 2022 IL App (1st) 210138 at ¶59. Roti claimed that operating a restaurant from the premises during the pandemic was impossible. The landlord claimed other restaurants in the vicinity, including restaurants in the same building as the premises, were open during the pandemic.

Objective vs. subjective impossibility. The *factual issue* was whether Roti's efforts established that Roti had tried all available practical alternatives to perform under the lease and that operating a restaurant during the pandemic was *objectively* impossible. To be excused, performance must be *objectively* impossible. To be objectively impossible, the facts must show that "*the thing cannot be done.*" If the facts show only that "*I cannot do it,*" the facts establish only *subjective* impossibility, which is not sufficient to excuse performance. 2022 IL App (1st) 210138 at ¶60.

Having found a genuine issue of fact, the appellate court reversed and remanded for further proceedings to determine whether Roti can show that its performance in compliance with the public health orders was impossible, impracticable, or frustrated.

10 Leaseholds and Mortgagees

JOHN M. RAFKIN
Jones Day
Chicago

I. SCOPE OF CHAPTER

A. [10.1] In General

This chapter addresses the concerns that real estate lenders (at times referred to herein as "mortgagees") have with the leases and related agreements, such as work letters, that encumber and create value for their collateral. These concerns will have a direct effect on the relationship between the landlord-borrower and its tenants and can have a significant impact on the lease negotiation process. From a pre-default, underwriting standpoint, a mortgagee's concerns will generally reflect those of the landlord. In a default situation, however, the mortgagee's interests may diverge. The existence of a mortgagee (and the landlord-borrower's anticipation of the interests and concerns of its future mortgagees) will often lead to the inclusion of specific lender-friendly provisions in a lease. It may also lead to a separate agreement — the subordination, non-disturbance, and attornment agreement (sometimes referred to as an "SNDA") — that attempts to resolve the varying and conflicting interests of the mortgagee and the tenant that arise when the landlord-borrower is in default under the loan documents. When things go wrong, the mortgagee will seek to protect itself and its investment, sometimes to the detriment of the tenant. The third-party interests of the mortgagee add an additional layer of complexity, as well as additional lawyers to the process. Because of these competing interests and the inevitable added legal expense, the interjection of a lender into lease negotiations is sometimes less than welcome.

B. [10.2] Forms

This chapter includes forms of certain mortgagee-oriented provisions to be included in leases, as well as forms of agreements to be used by the mortgagee, landlord, and tenant for various purposes (the assignment of leases and rents; the subordination, non-disturbance, and attornment agreement; and the estoppel certificate). See §§10.26 – 10.29 below. These forms demonstrate how specific problems may be handled by practitioners and may provide a helpful starting point. Of course, no form is suitable for all situations. The included forms should, therefore, be reviewed carefully and modified to reflect the facts and circumstances of the transaction. In addition, these forms should be reviewed to determine whether changes in the law that have occurred since the publication of this chapter warrant revisions. The practitioner should also note that these provisions and forms generally are drafted to benefit the mortgagee. In some instances, the text of this chapter, and the forms themselves, discuss objections commonly raised by tenants and suggest possible compromises.

II. CONCERNS OF THE MORTGAGEE

A. [10.3] In General

A mortgagee has two primary concerns when underwriting a real estate loan: (1) assurance that the income stream from the property will be sufficient to cover operating expenses and debt service and that it will be uninterrupted throughout the term of the loan; and (2) assurance that the value of the property will be maintained so that the loan can be refinanced at loan maturity or, if foreclosure becomes necessary, so that as much of the principal amount of the loan (together with all other

costs such as accrued interest and enforcement costs) as possible can be recovered in a subsequent sale of the property. Although the mortgagee will perform due diligence on the property's location, physical structure, environmental condition, zoning, and demographics, it is the property's leases that create the collateral's value and represent the mortgagee's source of repayment. A mortgagee will view the property similarly to a financial instrument and will, therefore, need to assess the quality and creditworthiness of the instrument, which requires an analysis of the lease terms from both a financial standpoint (how much rent is to be paid and whether the tenant is able to pay the rent) and a legal standpoint (the certainty of the tenant's obligation to pay the rent).

A mortgagee, therefore, will want to review all leases carefully. If a lease has not been executed at the time a loan is made, the mortgagee usually will want approval rights over both the economic terms of the lease and the form of the lease document. This will ensure that the income produced is adequate and continuous and that the mortgagee will be protected in a default/foreclosure situation. Existing leases will also be reviewed in the same way, but it will be more difficult to amend an existing lease to insert any of the mortgagee protections discussed in this chapter. Although many leases provide that a tenant will modify its lease if required by a prospective mortgagee, such clauses are usually tempered by a proviso requiring that these modifications will not materially and adversely change the rights and obligations of the tenant. Therefore, such clauses are of only modest benefit to a new mortgagee and are rarely invoked. Thus, the mortgagee will usually obtain its substantive protections through either an estoppel certificate or a subordination, non-disturbance, and attornment agreement. This approach may be more palatable to the tenant because the certificate or agreement will be effective against that particular mortgagee (and its successors) only and will not constitute a permanent amendment to the lease.

B. [10.4] Income Stream Analysis

Sufficient and continuous cash flow is of critical importance to the mortgagee. It is this cash flow that not only pays for the debt service on the loan but also maintains the collateral's value. The cash flow pays for the taxes on the property (nonpayment of which can result in liens that prime the mortgage), the operating expenses, and the maintenance and repair of the property. The cash flow provides the funds to invest in new tenants through the construction of tenant improvements, the grant of allowances, and the payment of brokerage commissions. In this regard, the mortgagee's interest is aligned with the borrower's: each seeks to maximize cash flow to protect its interest and, in the borrower's case, to provide a return on its equity investment. If the property does not perform as expected, the mortgagee may one day be the owner and, like any real estate owner, it will want assurance that the cash flow will be sufficient to carry the property.

A real estate borrower will prefer to finance its construction, acquisition, or refinancing of a property with nonrecourse financing, in which the lender's security is limited solely to the property. It should be noted, however, that nonrecourse loans to single-asset entities are rarely completely nonrecourse; there will typically be exceptions for certain "bad acts" and other circumstances in which the lender will have recourse to the other assets of the borrower (if any), a general partner, or a carve-out guarantor. These acts and circumstances may include fraud; waste; unapproved transfer of the collateral; misappropriation of rents, insurance proceeds, or condemnation awards; bankruptcy events; and environmental problems.

In situations in which the mortgagee does not have recourse to any other assets of the borrower (assuming none of the "bad acts" discussed above have occurred), the quality of the leases and the creditworthiness of the tenants, as well as the physical quality of the property, will be scrutinized carefully. The availability of nonrecourse financing also will depend on the general economic climate. The easy availability of nonrecourse financing during past real estate cycles often led to overbuilding and falling values. As a result, lenders became more cautious in their underwriting and loan structuring (cash management, required reserves, and maintenance of financial covenants/testing). When credit underwriting is tight, lenders require more repayment guarantees and other credit enhancements. These alternate sources of repayment reduce, but they certainly do not eliminate, the lender's reliance on the property and its income stream. But when the credit markets loosen up due to heavy capital source competition and higher asset pricing, loan pricing becomes more aggressive (in favor of the borrower) and underwriting and structuring again begin to be stretched. There is less reliance on recourse and other credit enhancement, and therefore as the pendulum swings back toward the nonrecourse side of the arc, there is a concomitantly heavier reliance on the property's income stream.

In addition, when competition among potential lenders to fund real estate deals increases, borrowers have been able to obtain one or more tiers of mezzanine financing to raise sufficient equity for the acquisition or construction of the property. "Mezzanine financing" is financing that is subordinate to the mortgage loan and is secured by the borrower's equity in the property (which is the difference between the amount of the prior, superior mortgage loan and the value of the property). This security is achieved either by granting the mezzanine lender a deeply subordinated junior mortgage or, more usually, by pledging the equity in the borrower owned by its partners or members. While a detailed discussion of mezzanine financing is beyond the scope of this chapter, what is relevant is the fact that the rental income stream of a property may be supporting many layers of debt, which add up to a higher overall loan-to-value percentage. The different lenders themselves often have divergent interests due to their relative security priorities. Each of these lenders will review the leases from a slightly different perspective, depending on whether the lender's security is real property (a mortgage) or personal property (an equity pledge).

The obvious first step in a review of a property's leases is the analysis of the economic terms of the leases and the financial capacity of the key tenants. A tenant's ability to pay the scheduled rent (and, in many cases, its proportionate share of the property's taxes and operating expenses) will directly affect both property value and the "quality" of the loan. The tenant's financial condition will be more important than the borrower's, at least to the extent that the loan is nonrecourse to the borrower. When there is not a significant tenant base to support the loan, as when a property is only partially constructed or partially leased, the borrower will probably be required to remain personally liable. Furthermore, the lender may require additional support for the loan, such as repayment guarantees, completion guarantees, or operating deficit guarantees from deep-pocket guarantors. The extent of this additional support will vary as the market becomes more or less competitive and the recourse pendulum swings back and forth. As construction is completed and leases are signed at the property, the other credit sources usually will be released or will "burn off." At that point, the lender will be shifting its reliance from these alternate credit sources to the financial condition of the tenants.

The mortgagee's income stream analysis will examine how rent is calculated, how it is escalated, under what conditions it can be abated, how operating expenses and taxes are passed through to the tenant, whether the lease may be terminated, and whether the leased premises may be contracted (with a corresponding reduction in rent). The percentage rent provisions in a retail lease will be analyzed along with the financial condition and sales results of the tenant and an analysis of the retail climate to assess the adequacy of the rent being charged, as well as the strength of the property's income stream. The landlord's agreement to construct tenant improvements, or provide an allowance to the tenant in lieu of the landlord performing the work, will be analyzed, and the mortgagee will review the lease to confirm that such costs will be recouped (with interest) through the rent payments. In a "soft" office building market, up-front rent abatement may be substantial, with a higher rental rate at the back end of the lease. This allows the landlord-borrower to value the property following the rent abatement period based on a higher rent than if the abatement were amortized over the term (which would have the effect of lowering the rent and therefore the building's valuation). In these situations, the mortgagee will want to ensure that there are mitigating provisions in the lease to protect its income stream. For example, with respect to free-rent periods, the mortgagee may want the lease to provide for the recovery of the abated rent in the event the tenant defaults during the lease term.

The mortgagee will also need to determine whether rent abatement, or a right to set off amounts against the rent, will be triggered by other events such as a failure to provide services or pay amounts owed to the tenant. In an abatement situation triggered by a service interruption, the mortgagee may insist that the abatement be limited to cases in which the landlord has been given adequate notice of the problem with a reasonable chance to cure it. In addition, the problem should not have been a result of force majeure, and the cause should have been within the landlord's control (as opposed to a problem that also affects other buildings in the area, *e.g.,* a general utility failure). Finally, the service interruption should have resulted in the premises' untenantability. A tenant will usually resist these limitations, arguing that the source of the untenantability is irrelevant and that it should not be required to pay rent if it cannot use the premises. A landlord will often prevail in this argument, however, if the lease requires the tenant to carry business-interruption insurance that will cover the rent payments during the period of untenantability. As a further protective measure, the mortgagee, whether in the lease or in a subordination, non-disturbance, and attornment agreement, will attempt to require the tenant to give the mortgagee notice of the landlord's default and will attempt to obtain an ability to cure the default prior to the tenant being able to exercise its abatement or setoff rights.

Some leases (especially with larger, high-credit tenants that have the leverage to demand it) may contain a provision allowing the tenant to set off amounts against its rent in the event the landlord fails to perform under the lease. In a "tenant-friendly" economic climate, tenants sometimes also have the ability to negotiate direct agreements with lenders that provide that the lender will fund tenant improvement funds directly to the tenant (or into a title company-controlled escrow) notwithstanding the fact that the landlord-borrower may be in default under its loan. Some of these tenant-negotiated lease setoffs relate to (1) failure by the landlord to complete construction by a specified date, resulting in the imposition of liquidated damages; (2) failure to pay tenant improvement allowances or other tenant inducements; or (3) reimbursement for costs incurred by the tenant under any "self-help" remedies granted to the tenant resulting from the landlord's failure to provide services or make repairs under the lease. These provisions will be of concern to the

mortgagee because they give the tenant the contractual right to reduce the income stream on which the mortgagee is relying. A similar concern involves anchor or other destination tenants in retail centers, typically department stores, supermarkets, "big box" stores, or other large traffic generators. A mortgagee will want these tenants to have stringent operating requirements since the smaller tenants rely on them to draw their customer traffic. Any right of these large tenants to "go dark" will have a direct impact on the income stream for the remainder of the property (*i.e.,* the percentage rents based on the other tenants' gross sales).

The mortgagee will carefully review the lease provisions dealing with the payment of operating expenses and taxes. Leases often require the tenant to contribute to the operating expenses and real estate taxes on a net basis, based on its proportionate share of rentable area in the property. If the lease incorporates a tax or operating expense "stop" or "base year" such that the tenant will be paying only those taxes and operating expenses in excess of the stop amount or base year, the mortgagee will need to back out these amounts to analyze net effective rent. Similarly, the mortgagee will be concerned about any unusual exclusions from operating expenses or tax definitions, or any limits on a tenant's responsibility for payment of those expenses and taxes, since inclusion of these clauses will impact the cash flow available to pay debt service. Since taxes are paid in arrears in Illinois, the mortgagee will review the leases to determine whether the taxes being contributed by the tenants are being paid on a cash basis or on an accrual basis. The method in which the taxes are being contributed will impact the cash flow of the building if the mortgagee forecloses and needs to account for such tax contributions following the expiration of the lease. If an office building has had multiple owners, it is not unusual for some of the leases to be on a cash basis (with the contributions being made by the tenant in a particular year being credited for taxes payable during that year, regardless of the fact that they were assessed in the prior year) and others in the same building to be on an accrual basis (with the contributions being made by the tenant in a particular year being credited against the taxes assessed during that year to be paid the following year). Since the building will be operated either on a cash or an accrual basis, this inconsistency among the building's leases can lead to confusion and disputes with the tenants once the mortgagee acquires title.

When the property being financed is to be constructed, the mortgagee will need to analyze the prerequisites in the lease to the commencement of rent and assess the landlord's ability to satisfy them. It is customary for the tenant to request, in addition to the completion of the tenant's premises, that a certain level of construction in the balance of the property be completed before its rent commences. Similarly, a retail tenant may require that another important tenant be operating, which will require the mortgagee to analyze the construction and operating plans of the other tenant. Moreover, if the landlord is constructing the tenant's improvements, it would not be unusual for the tenant to demand additional ("two for one") rent abatement for late delivery of the finished premises or even a "kick-out date" when the tenant can terminate the lease if the work has not been completed. Accordingly, in order to assess the predicted income stream of the to-be-constructed building, the landlord's construction abilities, the scope of the improvements to be constructed, and the construction scheduling will all need to be reviewed.

The mortgagee will also be concerned with any termination rights granted to a tenant. The mortgagee will want to ensure that, at the very least, upon a termination the landlord will be reimbursed for the unamortized portion of its up-front costs, such as tenant improvements (or

allowances), leasing commissions paid, and occasionally attorneys' fees. These items are sometimes paid with loan proceeds, and the mortgagee will want to ensure its ability to recoup those costs. Any termination fee should also cover the forgone rent and contributions to operating expenses and taxes during the expected period of downtime needed to re-lease the vacated premises. Similarly, any contraction rights (*i.e.,* rights to terminate the lease with respect to only a portion of the premises) should also reimburse the landlord proportionately for these costs. Although termination rights are fairly common in connection with a failure to rebuild damaged premises within a certain time frame after a casualty or upon the occurrence of a significant condemnation, the mortgagee will want to review the time periods to make sure they provide adequate time to settle the insurance claims, complete the preconstruction requirements and design tasks, and complete the restoration. Since the loan documents will often require the mortgagee to disburse the insurance proceeds to rebuild the property, the mortgagee will need to be confident that the leases will not be terminated and that there will be tenants in place once the property is restored. On the other hand, many loan documents permit the mortgagee to use the insurance proceeds or condemnation award from a substantial casualty or condemnation to pay down the loan balance. The mortgagee will review the leases and the subordination provision (discussed in greater detail in §§10.12 and 10.13 below) to ensure that this application of the proceeds will be permitted.

The mortgagee will need to review any other lease provisions that impose unusual obligations on the landlord. Some of these obligations may be purely monetary, as when a landlord is required to buy out or assume a tenant's current lease obligations in another building or to perform work or provide an allowance at a future date. The work letter may allow the tenant to increase the allowance at certain times, increasing the rent concomitantly, or to provide for the payment to the tenant of certain "soft" costs, such as moving expenses and the costs of furniture and computer and telephone systems. The mortgagee will need to consider that these costs are not being invested in the building and will not become collateral. Thus, they will not accrete to the value of the collateral if the tenant defaults. Other landlord obligations may have costs that are more hidden. For example, the tenant may have been granted an expansion option allowing it to increase its premises at below-market rent. Another example is a large tenant being given such extensive expansion options that they may impede the leasing of the rest of the building.

Finally, a mortgagee will review the leases with the thought in mind that it may become a future owner. It will therefore be important to determine whether any of the lease covenants are personal to the borrower and therefore are impossible for any landlord other than the borrower to perform. An example of such personal obligations is granting parking rights at another building owned by the current landlord that is not subject to the lender's mortgage or the provision of free health club memberships, catering services, or auditorium usage at a separate location. A well-drafted SNDA will be sure to exclude these "impossible" obligations in the event the mortgagee (or its transferee) ever takes title.

C. [10.5] Maintenance of Collateral Value

As noted in §10.3 above, the mortgagee needs to ensure that the value of the property will be maintained for refinancing and foreclosure purposes. As with the maintenance of the income stream, the mortgagee's and the borrower's interests are somewhat aligned. However, the time horizons of these parties may not be the same. A borrower-owner may intend to "flip" the property

upon completion and may not have much concern with the long-term effects of various lease provisions, except to the extent they affect the property's current value. In the lender's case, the loan term could be as short as a few months for a bridge loan to as long as ten years or more for a securitized or life company loan. A lender may be forced to foreclose upon maturity of the loan and will expect to hold the property for a while afterward. In any case, a lender will always assume, in a worst-case scenario, that it will be owning the property for a number of years, possibly beginning far in the future. The lender will therefore need to focus, at the loan's inception, on the future value of the property. These differing time expectations between the lender and the borrower may result in different levels of risk appetite with respect to the long-term lease provisions.

Some lease provisions have a direct, overt effect on the future value of the property, such as insurance requirements, rebuilding and restoration obligations, and day-to-day maintenance and repair obligations of the landlord and the tenant (for its premises or even the entire building, if the building is a "triple net lease" of a warehouse, for instance). For example, the mortgagee will note whether the tenant is prohibited from performing major alterations (or alterations that affect the building systems or structural elements) without the landlord's consent and will be certain to require in the loan documents that the landlord-borrower obtain the mortgagee's approval prior to consenting to such major, or invasive, alterations. Another value-maintenance concern related to tenant construction is the tenant's restoration obligations at the expiration of the term. A tenant may have constructed unusual improvements such as interior staircases, vaults, raised flooring, kitchen facilities with "black iron" fixtures, or extensive cabling. Removal of these items can be quite expensive and will have an effect on the property's economic condition at the end of the lease term.

Other lease provisions will have a more indirect effect on the future value of the property, such as the assignment and subletting terms. Here, the mortgagee will want to ensure that the assignee or subtenant will be using the premises for a permitted use that does not violate an exclusive use granted to another tenant and that, in a retail context, the new tenant complements the tenant mix. Both the landlord and the mortgagee will be concerned that the assignment and subleasing provisions do not permit the tenant to compete with the landlord for the same potential tenants, particularly when the original tenant is paying below-market rent (either because the market rate has escalated or because the tenant is an anchor in a shopping center or another important traffic-driving tenant) and can afford to offer low sublease rents. A right for the landlord to recapture the space that the tenant desires to sublet, or to share in any sublease profits, could be an effective way to prevent this unwanted competition. If the tenant is to be released from liability under the lease upon an assignment (such a release would be fairly uncommon except if the assignment is a result of a merger or acquisition), the mortgagee will need to analyze the conditions precedent to the assignment and ensure that the new tenant will have at least as strong a financial condition as the current tenant.

The mortgagee will also be concerned with the imposition of mechanics liens on its collateral in connection with work being done by the tenant's contractors. In Illinois, a mechanics lien has priority over a previously recorded mortgage to the extent that value is added by the work performed. See §16 of the Mechanics Lien Act, 770 ILCS 60/0.01, *et seq.; LaSalle Bank National Ass'n v. Cypress Creek 1, LP,* 242 Ill.2d 231, 950 N.E.2d 1109, 351 Ill.Dec. 281 (2011); *LaSalle Bank National Ass'n v. Cypress Creek I, L.P.,* 2013 IL App (3d) 130196-U; *LB Steel, LLC v. Carlo Steel Corp.,* 2018 IL App (1st) 15350, ¶¶28 – 29, 122 N.E.3d 274, 428 Ill.Dec. 265. A prior

mechanics lien that attaches to the fee interest in the property obviously decreases the value of the property, as it will ultimately have to be paid off by the mortgagee prior to foreclosure. Although the loan documents will contain protective measures against the imposition of mechanics liens by the landlord-borrower's contractors (through stringent loan disbursement procedures and escrow and title insurance requirements), the mortgagee will ensure that, at least with large tenant build-outs, similar protections against mechanics liens resulting from the tenant's build-out have been provided for in the work letter. Often, improvements or allowances for larger tenants are financed by the mortgagee; therefore, disbursement of these through a construction escrow, which provides protection against mechanics liens, may be required.

Finally, the mortgagee will consider several other issues that may affect the maintenance of the property's value, including (1) any exclusive uses granted to a tenant (such as a bank in an office building or the exclusive right to sell certain products in a retail center); (2) the timing of the lease rollovers (*i.e.,* whether a large percentage of the leases expire at the same time); (3) whether the tenant has been granted an option to purchase the property (although this would be unusual for an office building tenant, it is more common in leases of industrial buildings and build-to-suit single-user facilities); (4) how parking rights for tenants will be provided and maintained; (5) how the name of the property will be determined; (6) long-term rights to use the property's roof; (7) the signage rights of the tenants (especially any exterior signage rights); and (8) how various expansion options and renewal options (and any rights of first offer or first refusal) interact to ensure that there are no conflicts among them.

D. [10.6] Mortgagee Protection in the Lease

Sections 10.9 – 10.25 below discuss the lease protections a mortgagee will seek in a default situation, in which it will be obtaining title to the property through foreclosure or the seizing of control of the rental income stream. A sophisticated lease will also incorporate certain provisions that are designed to help the mortgagee prevent interruption to the property's income stream and maintain the collateral value. These are rights that the mortgagee will use before it is forced to exercise more drastic remedies, such as foreclosure. If the lease does not contain these provisions, the mortgagee may attempt to incorporate them into the subordination, non-disturbance, and attornment agreement. In fact, it is not uncommon for some of the provisions to be contained in both the lease and the SNDA, protecting the mortgagee that is not entitled to, or that does not require, an SNDA. Although many of these protections also appear as loan document covenants, their incorporation into the lease may allow the mortgagee, as a third-party beneficiary, to enforce them against the tenant.

One protection that may be included in the lease is a provision that requires the tenant to give the mortgagee notice of a landlord default and an opportunity to cure such default before the tenant attempts to terminate the lease or, if it is entitled to do so, set off rent. These notice and cure rights require the tenant to allow the mortgagee a period of time to cure the default (preferably longer than the period of time that the landlord has under the lease) and, if necessary to effect such a cure, to obtain possession of the property. Another protection is an agreement by the tenant not to amend the lease (which could potentially reduce the rent or increase the landlord's obligations) without the mortgagee's consent. A tenant will often attempt to limit these mortgagee approval rights to material amendments or only amendments that affect the economic terms of the lease. For leases

that are senior to the mortgage (see the discussion in §10.10 below), absent an agreement between the tenant and the mortgagee or the landlord and the mortgagee, the landlord and the tenant are free to modify, amend, or terminate the lease without the mortgagee's consent. *Metropolitan Life Ins. Co. v. W.T. Grant Co.,* 321 Ill.App. 487, 53 N.E.2d 255 (1st Dist. 1944); *Central Republic Trust Co. v. Petersen Furniture Co.,* 279 Ill.App. 492 (1st Dist. 1935). The mortgagee will therefore require that a prohibition on amendment or termination be included in the lease to protect its income stream. Many leases will include other protections that are also typically found in an SNDA, such as a limitation on the mortgagee's personal liability, protection of the mortgagee in the event the security deposit is not delivered to it, and prohibitions against setoffs and defenses. An example of a lender-friendly mortgagee protection clause is included in §10.26 below.

E. [10.7] Loan Document Protections

A mortgagee will be able to ensure that the protections discussed in §10.6 above are incorporated into the leases by including a variety of covenants in the loan agreement, in the mortgage, or in the assignment of leases and rents. For example, the mortgagee may require that the landlord-borrower obtain the mortgagee's approval prior to entering into certain leases. The landlord will likely attempt to limit this right to leases of a certain size and/or duration. A minimum level of financial wherewithal for the tenants (such as a minimum net worth or a minimum credit rating from a rating agency) may also be required.

PRACTICE POINTER

✓ The mortgagee should be careful to consider potential expansion rights and term extensions when setting approval thresholds based on premises size or term duration. Thus, even if the lease is initially under the threshold size or is shorter than the threshold term, the existence of expansion and extension options that, if exercised, would bring the premises size or term duration above such thresholds should subject that lease to the approval process.

Often, parties will agree in advance on a satisfactory lease form, which the borrower will be required to use without substantial or material modification. Although it is fairly common practice to preapprove a lease form in this way, there is always potential for conflict due to the uncertainty of what would constitute a substantial or material modification. A landlord may attempt to use this uncertainty to its advantage in lease negotiations, claiming that its lender will not let it change the lease form. Sophisticated tenants understand, however, that lenders will usually require strict adherence to the form only with respect to those provisions that directly impact their interests, such as abatement rights, application of insurance proceeds, and the subordination and mortgagee protection clauses.

Sometimes the borrower will seek to have the lender agree that its approval rights or requirement to use the preapproved form will not be invoked if the lease satisfies certain parameters. These leasing parameters can be quite detailed, calling for minimum credit standards for the tenants, average net effective rent per square foot (which is determined by deducting out

operating expenses and tax pass-throughs, abatement periods, improvement allowances, and other concessions from the rent payable over the term, and dividing the result by the number of years in the term and again by the number of rentable square feet in the premises. These parameters can differ within the same property depending on the premises size, location, or type of space if the property is multiuse (office space, retail space, and telecommunications space would all have very different market rents)), maximum improvement allowances, a minimum percentage of the allowance to be applied to "hard" construction costs, and maximum leasing commission costs. Finally, a strong borrower may be able to convince the mortgagee that its approval rights (especially in cases in which leasing parameters have been met) should be limited solely to the approval of the creditworthiness of the tenant, leaving the landlord-borrower wide discretion to negotiate the lease terms (other than, perhaps, tampering with mortgagee protection clauses).

The mortgagee may also include other lease-related provisions in the loan documents such as covenants to comply with the terms of the leases; covenants to deliver notices to the mortgagee upon the default of any of the significant tenants under their leases; covenants to deliver updated rent rolls and leasing reports; covenants to deliver financial information supporting percentage rent payments; covenants not to amend, restate, terminate, or accept a surrender of the leases unless the tenant is in default thereunder and is being dispossessed; covenants to deliver to the mortgagee any lease termination fees (to be held as additional security for the loan and perhaps disbursed to pay for the costs of re-tenanting the terminated space); covenants to deliver to the mortgagee tenant security deposits (to be held as additional security for the loan); and covenants limiting the landlord's ability to consent to assignments and subleases of the more significant leases.

It is common, both in balance sheet and in securitized loans, for lenders to control the property's cash flow by having all rents paid into lockboxes controlled by either the mortgagee or a bank (or loan servicer) acting as the mortgagee's agent. The rents are then disbursed to the landlord-borrowers only after the debt service has been paid and other reserves have been funded (*e.g.,* for taxes and insurance, for capital improvements, and for re-tenanting costs expected upon lease rollovers). In some cases, the mortgagees (or their agents) will control the cash flow further by disbursing amounts for operating expenses strictly in accordance with preapproved budgets.

F. [10.8] Estoppel Certificates

As part of the underwriting of the loan, the mortgagee may require the delivery of estoppel certificates from the property's tenants (or at least a certain percentage of them, including the more significant ones) to verify certain lease terms, ensure that the income stream is what it expects, and ensure that there are no defaults or other problems with the leases and/or the landlord. Often the tenant will be required to provide such a certificate pursuant to the terms of its lease. This lease provision may specifically set out the statements that the tenant must make, such as the factual terms of the lease — rent amount, commencement and termination dates, amount of the security deposit, whether any default exists under the lease, and whether the premises have been fully constructed and accepted by the tenant. The lease may also have a "catchall" that requires the tenant to respond to other reasonable requirements of the mortgagee.

PRACTICE POINTER

✓ A savvy tenant will be sure to limit this "catchall" to a requirement to make other statements of a factual nature only, as opposed to other statements that may alter the substantive terms of the lease. This limitation will protect the tenant from a mortgagee that is attempting to use the estoppel certificate as an informal subordination, non-disturbance, and attornment agreement by including mortgagee protection or other agreements with which the tenant would not otherwise be obligated to agree.

The estoppel certificate will generally state that the lease is in full force and effect and will specifically list all lease amendments, storage and parking leases, rooftop licenses, and other agreements (such as letter agreements and work letters). The mortgagee may consider attaching a copy of the lease and all amendments to the estoppel certificate to ensure that it has reviewed the correct and complete lease. Landlords often object to this procedure, claiming that it adds a great deal of effort and expense to the estoppel process, since it is often the landlord-borrower that has the task of obtaining them. Furthermore, landlords will argue that attaching the full lease will only make the estoppel certificate seem more intimidating and may prompt the tenants to have their attorneys review it, whereas a short certificate may have a better chance of escaping attorney review.

The estoppel certificate will confirm the factual and economic terms, including the size of the premises, the amount of rent and pass-throughs, that all conditions precedent to the rent commencement date have been satisfied, the tenant's proportionate share, the amount of any security deposit, whether the improvement allowance has been fully paid or the landlord's work has been completed, the rent payment status, that rent has not been paid more than one month in advance, whether any abatements or setoffs exist, whether any defaults by the landlord or the tenant exist, and that the lease contains all agreements relating to the premises (*i.e.,* that no side letters or other agreements exist). The estoppel certificate is also a convenient way to deliver notice of the mortgagee's existence to the tenant and to provide its notice address. A form of a fairly extensive estoppel certificate is included in §10.27 below.

The mortgagee may attempt to use the estoppel certificate to obtain protections that may be missing from the lease. The mortgagee may add any provisions customarily contained in an SNDA (such as notice and cure rights, subordination affirmation, and lender exculpation) with the thought that the estoppel certificate form may be more familiar to the tenant and will be more acceptable because it appears less formal and less intimidating. Conversely, many lenders elect to forgo the separate estoppel certificate and put the factual estoppel provisions into an SNDA. The mortgagee may also use the estoppel certificate as a form of lease amendment, modifying or clarifying certain lease terms or providing for certain lease modifications in the event the mortgagee takes title to the property and becomes the landlord under the lease.

A careful tenant will respond to the estoppel certificate request only as required by the lease, being wary of statements that may alter the lease terms (such as a statement that it will not terminate its lease without the mortgagee's consent, which may be deemed a waiver of an expressly-negotiated termination right set forth in the lease) and, when appropriate, modifying statements with a "to its knowledge" standard.

Although caselaw in Illinois is sparse, a court has found tenant estoppel certificates to be enforceable. In *Uncle Tom's, Inc. v. Lynn Plaza, LLC,* 2021 IL App (1st) 200205, 196 N.E.3d 1034, 458 Ill.Dec. 474, the tenant attempted to contest the inclusion of management and certain other fees in the common area maintenance charges despite having executed an earlier estoppel certificate that stated that the tenant had "no defenses to or offsets against the enforcement of the Lease or any provision thereof." In this case, prior to the execution of the estoppel certificate, the tenant had challenged the charges and then abandoned its claim and paid the disputed charges. The court held that the tenant was estopped from challenging the common area maintenance charges that it was aware of when it signed the estoppel certificate. 2021 IL App (1st) 200205 at ¶50. *Lynn Plaza* highlights both the enforceability of estoppels in Illinois and the caution and attention to detail that a tenant should exercise when executing an estoppel certificate.

III. [10.9] EXERCISE OF REMEDIES BY THE MORTGAGEE (AND THE ANTICIPATION OF SUCH REMEDIES)

The mortgagee protections discussed in §§10.6 – 10.8 above are intended to reduce the potential for borrower defaults by protecting cash flow and collateral value. This does not always work, of course, and in the event of a default by the landlord-borrower under the loan documents, and the decision by the mortgagee to exercise its remedies, the mortgagee will need to perform an analysis of each of the property's leases, this time from a slightly different perspective. The mortgagee will now be reviewing the leases in anticipation of foreclosure and will need to determine whether the leases, either by their terms, as a matter of law, or pursuant to separate agreements, will survive the foreclosure. As is discussed in §10.10 below, it is possible that the mortgagee will have the right to terminate certain leases; therefore, the mortgagee's analysis will need to include a determination of whether it will want each lease to survive a foreclosure. This analysis will be primarily financial (determining whether the tenant's financial condition and the rent being paid are adequate), but it will also include the more subtle value-maintenance considerations that a real estate owner would typically take into account, such as tenant mix, size of the premises, lease rollover, re-tenanting possibilities, and duration of term.

There is little Illinois caselaw on the matters discussed in §§10.10 – 10.25 below. Nonetheless, there are a number of excellent survey articles available that discuss the issue of priority and subordination. Although some of the articles are somewhat old at this point, they are still relevant and accurately outline the issues. These include Joshua Stein, *Needless Disturbances? Do Nondisturbance Agreements Justify All the Time and Trouble?,* 37 Real Prop.Prob. & Tr.J. 701 (2003); Thomas C. Homberger and Lawrence A. Eiben, *Who's on First — Protecting the Commercial Mortgage Lender,* 36 Real Prop.Prob. & Tr.J. 411 (2001); Joshua Stein and Andrea Parette Ascher, *The Logic of Subordination, Nondisturbance and Attornment Agreements: Overview and Some Questions,* I COMMERCIAL REAL ESTATE FINANCING: WHAT BORROWERS AND LENDERS NEED TO KNOW NOW 2000 (PLI Real Estate Law & Practice Course, Handbook Series No. 456, 2000); and Morton P. Fisher, Jr. and Richard H. Goldman, *The Ritual Dance Between Lessee and Lender — Subordination, Non-Disturbance and Attornment,* 30 Real Prop.Prob. & Tr.J. 355 (1995). There are also a few recently updated legal encyclopedia entries that deal with some of the narrower points discussed above, including 68A AM.JUR.2d *Secured Transactions* §656 (2014) (updated 2023); 51 AM.JUR.2d *Liens* §656 (2021) (updated 2023); and 79 C.J.S. *Secured Transactions* §112 (2017) (updated 2023).

A. [10.10] Priority in Illinois

The priority of a lease in relation to a mortgage will affect the manner in which the lease is handled in a foreclosure. Generally, the priority of encumbrances on a landlord's estate will be determined by the order in which the encumbrances were established. Although Illinois' priority law, 765 ILCS 5/30, reads as a pure notice statute, the Illinois courts have interpreted it to be a race notice statute. *Simmons v. Stum,* 101 Ill. 454 (1882). In Illinois, the first party to record without knowledge of another interest will have priority over subsequent rights to the property. *Id. See also* Cory Torgesen, *The Illinois Conveyance Act: A 200-Year-Old Labyrinth Whose Changing Walls Continue to Provide Inadequate Protection for Subsequent Purchase,* 37 S.Ill.U.L.J. 695 (2013). Thus, if a tenant enters into a lease before the recording of a mortgage and records its lease or a memorandum thereof, the tenant, absent other agreement, will have priority over such subsequently recorded mortgage. While recording the lease is the most effective method of establishing priority, failure to record will not defeat the tenant's claim of priority. Illinois courts have adopted the view that the tenant's possession and occupancy of the property may constitute constructive notice to a later recording mortgagee of the tenant's rights regarding the property, sufficient to establish priority. *Italo American National Union v. Mead Cycle Co.,* 12 Ill.App.2d 479, 139 N.E.2d 865 (1st Dist. 1957) (abst.); *Bullard v. Turner,* 357 Ill. 279, 192 N.E. 223 (1934).

It should be noted that many leases contain provisions prohibiting the recording of the lease. A landlord will prohibit a tenant's recording of the lease mainly to keep title clean, uncluttered, and unclouded for future financings and conveyances. Nonetheless, recording a lease or a memorandum thereof is important in certain circumstances: (1) if the lease is for space in a property under construction and possession is not possible, or the tenant is otherwise unable to take immediate possession or at least commence construction of its improvements; (2) if the tenant intends to mortgage its leasehold, because the tenant's mortgagee will typically insist on a recording of the lease to memorialize the chain of title and to obtain a title insurance policy on the leasehold mortgage; and (3) if the lease contains important rights, such as a right of first refusal to purchase the property, when notice to third parties who may be seeking to obtain an interest in the property may be important. *See FirstMerit Bank, N.A. v. Suburban Auto Rebuilders, Inc.,* 2014 IL App (1st) 132748-U, ¶8. Although leasehold mortgages are generally prohibited in office lease contexts, they are more common in ground lease situations, single-user buildings, industrial buildings, and certain retail contexts. Therefore in most cases either the tenant's possession will be obvious or the lease (or a memorandum) will have been recorded, so one should generally be able to determine whether the lease or the mortgage is prior in time.

B. [10.11] Foreclosure in Illinois

Under Illinois law, and subject to the limitations discussed below, the interests of holders of leases that have priority over a mortgage will not be terminated by a foreclosure of the mortgage. See the discussion of *Fisher v. Deering,* 60 Ill. 114 (1871), in §10.15 below. In contrast, the interests of holders of leases that are junior to a mortgage (*i.e.,* when the mortgage has priority as discussed in §10.10 above) and are named in the foreclosure proceedings will be terminated by judicial order. 735 ILCS 5/15-1404 through 5/15-1503. Illinois law is somewhat less clear as to the treatment of holders of leases that are junior to a mortgage but that are not named in the foreclosure proceeding. Other states treat these junior lessees in one of two ways regardless of whether the tenant was

named in the foreclosure proceeding. Some states, such as California and Utah, known as "cutoff" states, hold that any junior tenant's lease is automatically terminated, or "cut off," upon foreclosure. *See Principal Mutual Life Insurance Co. v. Vars, Pave, McCord & Freedman,* 65 Cal.App.4th 1469, 77 Cal.Rptr.2d 479 (1998); *Dover Mobile Estates v. Fiber Form Products, Inc.,* 220 Cal.App.3d 1494, 270 Cal.Rptr. 183 (1990); *Bailey v. Citibank, N.A.,* 66 Cal.App.5th 335, 359, 280 Cal.Rptr.3d 546 (2021); *Consolidated Realty Group v. Sizzling Platter, Inc.,* 930 P.2d 268 (Utah App. 1996). In these states, the courts reason that a tenant's right to possession derives from the mortgagor's right to possession. Accordingly, when the mortgagor's right to possession is terminated, so is the tenant's right. Since there is no privity of estate or contract between the mortgagee and the junior tenant, there is nothing to bind either the tenant or the mortgagee to the terms of the lease.

Other states, such as New York and New Jersey, known as "election" states, consider the tenant to be a necessary party to a foreclosure proceeding. In these states, failure to join the junior tenant in the foreclosure action will render the judicial decree invalid as to such tenant. Consequently, the mortgagee will have failed to establish its right to possession of the property as against the tenant and will take title (through the foreclosure sale) subject to that lease. The transfer of title from the mortgagor to the mortgagee by virtue of the foreclosure sale will thus render the mortgagee the new landlord to the tenant, and the tenant will remain obligated to its new landlord. See §10.15 below for a more detailed discussion of attornment. For further discussion of election-cutoff distinctions, see John J. Gearen et al., *Into* Harms' *Way: Now That* Harms v. Sprague *Has Established the Lien Theory of Mortgages in Illinois, Does Foreclosure Cut Off Junior Leases or Can a Mortgagee Elect to Preserve Them?,* 34 DePaul L.Rev. 449 (1985).

While Illinois courts have not explicitly held whether Illinois is an election or a cutoff state, the language of the Illinois Mortgage Foreclosure Law, 735 ILCS 5/15-1101, *et seq.,* appears to indicate that Illinois is an election state. That Law provides that any disposition of mortgaged real estate through foreclosure remains subject to the interests of those not made a party to the proceeding or interests not otherwise barred or terminated by foreclosure. 735 ILCS 5/15-1501(a). Tenants in possession are not necessary parties to foreclosure proceedings in Illinois. *See Applegate Apartments Limited Partnership v. Commercial Coin Laundry Systems,* 276 Ill.App.3d 433, 657 N.E.2d 1172, 212 Ill.Dec. 827 (1st Dist. 1995). Furthermore, the statute affirmatively states that even if a lessee with a subordinate interest in the real estate being foreclosed does appear as a party to the foreclosure proceeding, the lessee's lease will not be terminated unless the termination is specifically ordered by the court in the foreclosure judgment. 735 ILCS 5/15-1501(d). *See also Fifth Third Mortgage Co. v. Foster,* 2013 IL App (1st) 121361, 994 N.E.2d 101, 373 Ill.Dec. 616; *Lisle Savings Bank v. Tripp,* 2021 IL App (2d) 200019, ¶12, 175 N.E.3d 802, 448 Ill.Dec. 133. Most practitioners agree, therefore, that a reasonable interpretation of this language suggests that Illinois is an election state. See Alan Wayte, *Real Estate Financing Documentation: Coping with the New Realities,* SC42 ALI-ABA 57 (Jan. 15, 1998). While Illinois courts have not yet explicitly held that this is the case, some appellate courts appear to have supported this interpretation by assuming, under varying fact situations, that the rights of tenants under junior leases are not automatically cut off by foreclosure proceedings to which the tenants were not made parties or of which they were not properly notified. *Applegate Apartments, supra; Agribank, FCB v. Rodel Farms, Inc.,* 251 Ill.App.3d 1050, 623 N.E.2d 1016, 191 Ill.Dec. 426 (3d Dist. 1993).

A mortgagee that remains concerned that the Illinois courts might take a cutoff position, which would leave all junior tenants free to vacate the premises after foreclosure, should, therefore, obtain a separate agreement from those tenants it wishes to keep or make sure that their leases provide for an agreement to attorn to the mortgagee (or other purchaser at a foreclosure sale) following foreclosure. Although it remains somewhat unclear in Illinois (assuming that Illinois was determined to be a cutoff state) whether an explicit attornment agreement would eliminate the right of an unnamed junior tenant to vacate the premises after foreclosure, if the agreement were placed in a document to which both the mortgagee and the tenant were parties, then, at a minimum, the rationale behind the cutoff position (the lack of privity of estate or contract) would be eliminated and the argument for the cutoff position would be severely weakened. See §10.15 below for a more detailed discussion of attornment agreements.

The lease might also provide that, at the mortgagee's election, the lease will be considered superior to the mortgage. RESTATEMENT (SECOND) OF PROPERTY: LANDLORD & TENANT §4.1, cmt. c (1977), provides that the mortgagee "holding what would otherwise be a paramount interest may subordinate his interest to that of the tenant by agreement in the instrument creating his interest, by consenting to the lease or by entering into a separate agreement with the landlord, the tenant, or both." Thus, for example, a mortgagee that desires to maintain a junior lease in place following foreclosure may do so by altering the priority and subordinating the mortgage to the lease. It should also be noted that although a lease may be prior in time when executed, amendments to that lease that are executed after recordation of the mortgage will be subordinate and could be terminated upon a foreclosure. *See Dime Savings Bank of New York, FSB v. Montague Street Realty Associates,* 90 N.Y.2d 539, 686 N.E.2d 1340, 664 N.Y.S.2d 246 (N.Y.App. 1997). This could be quite problematic when that amendment contained an extension, an expansion option, or a change in the economic terms of the lease. The mortgagee should, therefore, be careful that the lease that was thought to be prior to the mortgage is, in fact, prior in its entirety.

The following is a provision that the practitioner may find helpful to include in a lease that is subordinate or has automatically been subordinated by the terms of the lease. It allows the mortgagee to elect, at a later time, to subordinate the mortgage to the lease (and its amendments):

Tenant and Landlord agree that any Mortgagee may elect that this Lease (including all amendments hereto) shall have priority over such Mortgage and, upon notification to Tenant by such Mortgagee, this Lease (including all amendments hereto) shall be deemed to have priority over such Mortgage, regardless of the date of this Lease (or any amendments hereto) or Tenant's possession of the Premises. If requested by any Mortgagee that this Lease (including all amendments hereto) be made superior to any Mortgage, Landlord and Tenant each agrees that it shall execute all documents as may reasonably be required by such Mortgagee to subordinate such Mortgage to this Lease (including all amendments hereto) and effect the superiority of this Lease (including all amendments hereto) to such Mortgage.

C. Subordination of the Lease

1. [10.12] Automatic Subordination Clause in the Lease

Given the importance to mortgagees of a lease being subordinate to a first priority mortgage, it is fairly customary for an automatic subordination clause to be included in a lease. This clause

generally contains an acknowledgment by the tenant that its leasehold estate is subordinate to all existing mortgages and an agreement that its leasehold estate will be subordinate to all future mortgages on the property.

PRACTICE POINTER

✓ The mortgagee should be careful to prohibit the tenant from subordinating the lease to a junior mortgagee or lienholder, which would permit the lease to be terminated in a foreclosure of the junior mortgage or lien — an undesirable consequence for the first position mortgagee.

Automatic subordination provisions have been recognized by Illinois courts as a valid means to subordinate an existing (prior) lease to a future mortgage. *Hartwig Transit, Inc. v. Menolascino,* 113 Ill.App.3d 165, 446 N.E.2d 1193, 68 Ill.Dec. 796 (1st Dist. 1983). *But see FirstMerit Bank, N.A. v. Suburban Auto Rebuilders, Inc.,* 2014 IL App (1st) 132748-U, ¶8, in which a previously exercised right of first refusal to purchase the property that was set forth in the lease was found to survive a foreclosure. Illinois title companies will generally insure the priority of a mortgage established through a properly drafted automatic subordination provision in the lease. Nevertheless, a well-drafted lease will also require that the tenant, at the request of any mortgagee, execute a subordination agreement confirming the subordination. As consideration for the execution of the subordination agreement, the tenant may require an agreement from the mortgagee assuring the tenant's right to continued occupancy of the premises even after foreclosure, as long as it is not in default under the lease. See §10.14 below for a discussion of non-disturbance agreements.

The following is a sample automatic subordination clause to be included in a lease:

Tenant hereby acknowledges and agrees that this Lease and any modifications, renewals, extensions, restatements, and amendments thereof and all rights, options, liens, or charges created thereby are and shall continue to be subject and subordinate to any and all first priority mortgages now on the Property of which these Demised Premises form a part; to any and all first priority mortgages that may be placed on the Property hereafter, at any time during the term of this Lease; and to all of the terms and provisions of the foregoing, to the rights, liens, and charges created thereby, to any advances and disbursements made thereunder, and to any consolidations, extensions, amendments, restatements, modifications, or renewals thereof; and to any other first priority lien security instrument on the Property that may after this date be held by the Mortgagee.

2. [10.13] Separate Agreement To Subordinate

If the lease does not provide for automatic subordination to all future mortgages, a separate subordination agreement between the mortgagee and the tenant will achieve the same goal. This type of agreement is usually executed in recordable form and may be recorded to notify any third party that the lease is subordinate to the mortgage. It is generally believed, however, that recordation is not necessary in Illinois unless the lease has been recorded, in which case the

recordation of the subordination, non-disturbance, and attornment agreement is recommended (and may be required by the title company) to evidence the reversal of priority. In addition, a separate subordination agreement would be prudent in the event that the parties seek to subordinate an important right set forth in a lease (such as a right of first refusal) as to which the automatic subordination language in the lease may be insufficient. The language effecting the subordination in a separate agreement may be based on the subordination clause in the SNDA, an example of which may be found in §10.28 below.

D. [10.14] Non-Disturbance

A tenant whose lease is not subordinate to a mortgage (whether pursuant to an automatic subordination agreement or a separate agreement) has little incentive to reverse its priority and risk termination upon foreclosure. As mentioned in §10.12 above, tenants with bargaining leverage will usually insist that the automatic subordination provision in a lease be effective only if the mortgagee grants a reciprocal non-disturbance agreement; *i.e.,* an agreement to the effect that the tenant's possession of the premises will not be disturbed (the tenant will not be named in the foreclosure proceeding) as long as the tenant is not in default under the terms of the lease beyond applicable cure periods. The non-disturbance provisions may be incorporated into the lease as a corollary to the automatic subordination clause or may be included in a separate agreement (the non-disturbance part of the subordination, non-disturbance, and attornment agreement). A tenant will be concerned that the non-disturbance not only applies to the tenant's right to remain in possession of the premises, but also serves as recognition by the mortgagee of all of the tenant's rights under the lease, not just those that "touch and concern the land," such as possession. See the discussion of attornment agreements in §10.15 below.

It hardly needs to be mentioned that a non-disturbance agreement can be critical to a tenant that is investing in leasehold improvements, has below-market rental rates, or is tied to a particular property and location for any reason. The non-disturbance agreement effectively removes the mortgagee's flexibility upon foreclosure to determine which tenants it wishes to retain; however, the mortgagee will be reluctant to execute an agreement with a tenant whose lease is not at or above market rent, is for a small space, or otherwise contains undesirable provisions. Nonetheless, mortgagees will often agree to the non-disturbance agreements, even with respect to less than desirable existing leases, for a variety of reasons. First, the assurance of the continuation of the tenant's rent payment, even though it may be below market, may be worth the loss of flexibility. Second, granting the non-disturbance agreement as the quid pro quo for the subordination of the previously superior lease has the advantage of allowing the lease to be terminated pursuant to the foreclosure proceeding if the tenant is then in default, rather than having to maintain an eviction proceeding. Third, the subordination of the lease will also have the effect of subordinating any of the provisions of the lease that may contradict the mortgage (*e.g.,* the lease and the mortgage may (and probably do) differ with respect to the use of insurance proceeds in the event of a casualty). Resolving this conflict in the mortgagee's favor may be worth the loss of flexibility with respect to disturbance. Finally, SNDAs often contain a number of valuable extra rights and agreements for the benefit of the mortgagee, such as notice and cure rights, exculpations, and releases (these are discussed in greater detail in §§10.16 – 10.23 below). Again, gaining these rights may be worth the loss of flexibility with respect to disturbance.

The landlord-borrower in its loan agreement will seek to obligate the mortgagee to give non-disturbance agreements (coupled with subordination, attornment, and the other typical provisions) on the mortgagee's customary form to all existing tenants, knowing that most tenants will require them if being asked to subordinate their leases. It also would not be unusual for the parties to attach an approved form of the SNDA to the loan agreement. The landlord-borrower will also seek to have the mortgagee agree to grant non-disturbance agreements to all future tenants (or at least future tenants over a certain size). Mortgagees have different perspectives on this issue. Some are willing to execute SNDAs with any tenant, trusting the landlord to make rational economic decisions in their tenant choices. Others will agree to grant them only to tenants whose leases need to be approved under the loan documents or that meet various conditions (such as leasing parameters). Since most mortgagees typically retain the right to approve the form and substance of significant leases, the approval of the form and substance of the SNDA will be part of the review process. The mortgagee at this point will be able to, in effect, amend the lease by requiring in the SNDA that the more unusual or onerous lease provisions not be binding on the mortgagee if it succeeds to the interest of the landlord.

E. [10.15] Attornment

Attornment historically dealt with the agrarian relations of the feudal system. The employment of the attornment agreement between a tenant and a mortgagee in Illinois emerged as a result of early caselaw with respect to the foreclosure of a mortgage that was subject to a superior lease. In *Fisher v. Deering,* 60 Ill. 114 (1871), the court held that the foreclosure purchaser — the tenant's new landlord — could bind the tenant only if the tenant attorned to the foreclosure purchaser. Subsequently, however, Illinois adopted 735 ILCS 5/9-215, which expressly gives an assignee of the landlord all the rights and remedies of the landlord. Illinois courts have since determined that this statute nullifies the requirement for an attornment agreement with respect to a tenant whose lease is superior to the mortgage. *See Telegraph Savings & Loan Ass'n v. Guaranty Bank & Trust Co.,* 67 Ill.App.3d 790, 385 N.E.2d 97, 24 Ill.Dec. 330 (1st Dist. 1978). When the lease is superior, neither the tenant nor the mortgagee may elect, without the concurrence of the other, to terminate the lease as a result of the foreclosure.

The situation is not as clear with respect to leases that are subordinate to the mortgage. If Illinois courts were to decide that Illinois is a cutoff state, then leases that are subordinate to the mortgage with tenants that are not named in a foreclosure proceeding would be terminated, allowing the tenants to vacate the premises. Therefore, if a mortgagee determines (for economic or other reasons) that a particular lease should survive foreclosure, that mortgagee should enter into an attornment agreement with that tenant before foreclosure proceedings are initiated. Such an agreement to attorn may be incorporated into the lease (many lease forms, including the lease provisions in §10.26 below, contain attornment provisions) or in a separate agreement (the attornment part of the subordination, non-disturbance, and attornment agreement). In the attornment agreement, "[t]he tenant . . . agrees to recognize that another party who would not otherwise have privity [the mortgagee] may enforce the lease agreement as though the third party were originally a beneficiary of the agreement." Robert D. Feinstein and Sidney A. Keyles, *Foreclosure: Subordination, Non-Disturbance and Attornment Agreements,* 3 Prob. & Prop. 38, 39 (1989). This attornment provision would not strictly be required if Illinois were determined to be an election state and the tenant were not named in the foreclosure proceeding. However, the attornment provision may be useful to resolve any uncertainty related to which lease terms survive the foreclosure.

De facto attornment has been found without an explicit agreement (either separately or in the lease) as a result of the actions of the parties indicating consent to the attornment. One Illinois court found that payment of the rent by the tenant was sufficient evidence of attornment. *Yarc v. American Hospital Supply Corp.,* 17 Ill.App.3d 667, 307 N.E.2d 749, 753 (2d Dist. 1974). However, without an express attornment agreement, there may still be uncertainty as to which of the lease terms have survived. Some may argue that only those terms of a lease that "touch and concern" the land will survive. These would exclude many terms that would be quite important to tenants, such as the payment of improvement allowances, the provisions of certain services, certain expansion options, or parking rights. There is a lack of authority on this issue in Illinois, so both parties should consider incorporating into the attornment agreement a specific agreement that those lease terms that do not necessarily "touch and concern" the land will survive the foreclosure. The object of the attornment agreement, therefore, is to create the privity of contract (rather than just the privity of estate) required to keep all of the lease terms intact and enforceable (except to the extent that any such terms are expressly modified by the SNDA). Such an agreement transforms the foreclosure purchaser into a third-party transferee that would take title to the property subject to the leases and all lease terms. The attornment provision of the SNDA, if it is reciprocal (*i.e.,* if the mortgagee agrees to recognize and assume all of the terms of the lease that benefit the tenant), will have value to the tenant, as it will ensure that all the lease terms negotiated at lease execution will be enforceable against its new landlord.

It is, therefore, prudent to ensure that there is an attornment agreement, either incorporated into the lease or in a separate agreement. Typical attornment language may be found both in the lease form mortgagee protection language in §10.26 below and in the sample SNDA included in §10.28 below. It should be noted that some commentators have raised a question as to the binding effect on the tenant of the attornment provision in a lease since the mortgagee is not a party to the lease and have cited *Jetzinger v. Consumers Sanitary Coffee & Butter Stores,* 268 Ill.App. 482 (1st Dist. 1932), as authority for this proposition. The court in *Jetzinger* held that there was no privity of estate or contract between the mortgagee and a tenant whose lease was entered into after the mortgage. To reduce this risk, the mortgagee may require that the attornment language be placed in a document to which it is a party, such as an SNDA, or in a document running in the mortgagee's favor (*e.g.,* an estoppel certificate).

F. [10.16] Additional Agreements

Most subordination, non-disturbance, and attornment agreements contain not only the subordination, non-disturbance, and attornment provisions discussed in §§10.12 – 10.15 above, but also a number of other agreements, most of which benefit the mortgagee. As a general matter, the SNDA will be drafted so that the agreements will apply not only to the mortgagee upon foreclosure, but also to any purchaser at a foreclosure sale and, commonly, any transferee of these parties. Thus, the new owner of the building that purchases it from the mortgagee after the foreclosure has been completed will enjoy the protections negotiated by the mortgagee in the SNDA.

Aside from those additional agreements that are crafted to correct deficiencies in the lease or that provide that particularly impossible (or onerous) obligations of the landlord will not apply to the mortgagee (or its transferee) upon a foreclosure, SNDAs often contain the agreements discussed in §§10.17 – 10.23 below. Also see the sample SNDA included in §10.28 below for a fairly extensive array of these additional agreements.

1. [10.17] Notice and Cure Rights

The subordination, non-disturbance, and attornment agreement will generally require the tenant to give notice to the mortgagee of any landlord defaults that could potentially disrupt cash flow (either by termination of the lease or through rent abatement). The mortgagee will be granted a period of time to cure the default before the tenant will have the right to abate rent or terminate the lease. The period will be negotiated, with the mortgagee seeking a period beyond the landlord's grace period in the lease (if any), and the tenant seeking to limit the cure period to a period that runs concurrently with the landlord's cure period. Because some defaults of the landlord cannot be cured unless the mortgagee takes actual possession of the property (repair obligations, for example), the SNDA may extend the mortgagee's cure period to the period of time reasonably necessary for the mortgagee to obtain title through the exercise of its remedies under the loan documents. This period can be quite lengthy depending on whether the landlord-borrower contests the proceedings; therefore, tenants will want to ensure that this extended cure period does not apply to material defaults that deprive them of the beneficial use of the premises.

2. [10.18] Exculpation from Prior Landlord's Actions

The subordination, non-disturbance, and attornment agreement will provide that the mortgagee is not responsible for the previous actions or defaults of the landlord (or any other prior landlord) and that any setoff rights and defenses against the payment of rent to which the tenant may be entitled at the time of foreclosure (or deed in lieu of foreclosure) will not be effective against the mortgagee. Without such an exculpation agreement, the mortgagee takes the mortgagor's rights (*i.e.,* title to the property) subject to the tenant's right of setoff. *Kelley/Lehr & Associates, Inc. v. O'Brien,* 194 Ill.App.3d 380, 551 N.E.2d 419, 141 Ill.Dec. 426 (2d Dist. 1990). The mortgagee seeks this protection for obvious reasons: it is not in control of the property prior to its taking title and does not want to be liable for unforeseen obligations that it did not underwrite and for which it will receive no compensation. The tenant will therefore be required to seek its remedies for damages for these defaults against the original landlord. This may be of limited value, of course, as the prior landlord probably has no other assets and was a single-purpose entity to begin with. If, however, the setoff right represents an important remedy to an important tenant, then a mortgagee may be more willing to permit a limited setoff right for certain kinds of defaults, such as the failure to pay a significant improvement allowance. In this case, the mortgagee may protect itself by disbursing this allowance through an escrow, so the mortgagee will have the ability to ensure that the tenant receives the payment. Additionally, the allowance will have been amortized into the rent payable over the term, with interest; thus, the mortgagee will be able to recoup this setoff over time through the rent payments.

A related issue may arise with respect to ongoing nonmonetary defaults. Many SNDA forms simply exculpate the mortgagee as the new landlord from any defaults of the prior landlord. A careful tenant will want to modify this provision to make it clear that any defaults that still exist when the mortgagee takes title (*i.e.,* continuing defaults) will not be waived and the mortgagee will have the obligation to cure these defaults. This covers the problem of repairs that the prior landlord failed to make and other similar nonmonetary defaults. It is unlikely, however, that the tenant will be able to convince the mortgagee that it should cure the prior landlord's monetary defaults (*e.g.,* reimbursements for overestimated taxes and operating expenses). This will require the tenant to seek redress against the prior landlord.

3. [10.19] Construction and Allowances

Subordination, non-disturbance, and attornment agreements will often specifically exculpate the mortgagee, and any other transferee, from any construction obligations of the landlord-borrower with respect to the building and with respect to the tenant's premises. A tenant that has agreed to lease space in a building to be constructed will, therefore, need to be assured that the building will actually be built on time and will require either performance guaranties (at least with respect to its premises) or strict termination, abatement, and setoff rights. A larger tenant may also be able to negotiate termination fees to be paid to compensate for damages if the lease is terminated due to the landlord's nonperformance. Such a tenant will need to ensure that the SNDA does not vitiate the agreements set forth in the lease and that the mortgagee will honor those agreements and pay the damages if it has foreclosed. In addition, a tenant may be able to require that the allowance be paid into escrow at the signing of the lease, which will ensure that it will be available when the tenant has completed its work and satisfied the payout conditions. Provisions protecting the tenant's ability to access its tenant improvement allowance have become more common, and tenants have been successful in requiring that the allowance be paid by the mortgagee (which is funding such allowance to the landlord pursuant to the loan documents) either directly to the tenant or into a title company escrow, notwithstanding the existence of a default by the landlord under its loan documents (including the existence of bankruptcy proceedings involving the landlord-borrower).

4. [10.20] Prepaid Rent and Security Deposits

Subordination, non-disturbance, and attornment agreements will generally prohibit the tenant from prepaying rent other than the security deposit. Such a provision in the SNDA thus makes applicable to all leases (both senior and junior) the common-law rule that applies only to a junior lease — that if the tenant prepays rent and the landlord defaults in its loan from the mortgagee, the prepaid rent need not be acknowledged by the mortgagee or a receiver appointed to collect those rents. *See First Nat. Bank of Chicago v. Gordon,* 287 Ill.App. 83, 4 N.E.2d 504 (1st Dist. 1936). The mortgagee will also want the tenant to acknowledge that the mortgagee will not be responsible for (or be required to return) a security deposit (cash or letter of credit) that it did not receive from the landlord-borrower. In this situation, the tenant may be obligated to post the security deposit again and would, therefore, be forced to pursue its remedies against the original landlord-borrower for recompense.

5. [10.21] Representations, Warranties, and Indemnities

A mortgagee will seek to exculpate itself from any representations or warranties made by the prior landlord to the tenant (*e.g.,* with respect to the environmental condition of the property or its compliance with building codes). These are lease provisions over which the mortgagee has no control; however, recognizing that they are often necessary to induce the tenant to lease the premises, the mortgagee may permit them to be made in the lease if the mortgagee will not be responsible for them if they are incorrect. Similarly, because the mortgagee is not in control of the property prior to a foreclosure, the mortgagee will not want to be bound by any indemnification obligations in the lease that would be applicable to or cover problems occurring prior to its taking title.

6. [10.22] Nonrecourse

The subordination, non-disturbance, and attornment agreement will generally contain a provision to the effect that the tenant will have recourse only to the mortgagee's interest in the building regardless of anything to the contrary contained in the lease. This protects the mortgagee against leases that do not contain this protection for the landlord for a variety of reasons (*e.g.,* the landlord may have been a single-purpose entity and not concerned about recourse, or the landlord may have been an Illinois land trust and the trustee exculpation in the lease would not apply to a new owner that is not a land trust). It will also protect the mortgagee against personal recourse in the event that foreclosure in fact terminated the lease but the tenant attorned by paying rent, forming a new lease with a month-to-month tenancy. A lender-friendly SNDA form (such as the one included in §10.28 below) will exculpate the lender from personal recourse for its actions under the SNDA as well (not just under the lease after it takes title to the property). A careful tenant will be sure to modify this provision, which could have the effect of rendering worthless the mortgagee's covenant not to disturb the tenant, since recourse is limited to its interest in the property and that interest is not obtained until after the foreclosure.

7. [10.23] Direct Agreements with the Tenant

The subordination, non-disturbance, and attornment agreement may also contain a number of agreements with the tenant that are designed to protect the mortgagee from wrongful acts of the landlord-borrower. For example, the loan documents will contain certain leasing parameters and limits on the landlord's ability to amend or terminate existing leases. Nonetheless, the mortgagee may want to have the tenant agree directly with it not to amend or terminate the lease without the mortgagee's consent. Similarly, the SNDA may require the tenant to seek the consent of the mortgagee directly prior to its subleasing the premises or assigning the lease. The SNDA may also require the tenant to pay any termination payments directly to the mortgagee to maintain control over the property's revenues. Finally, as mentioned above, the SNDA may serve as an amendment to the lease to clarify language or correct mistakes or to provide that certain personal or other obligations will not apply to the mortgagee as the new landlord.

G. [10.24] Deed in Lieu of Foreclosure

Title to the property may be obtained by the mortgagee through a deed in lieu of foreclosure. 735 ILCS 5/15-1401. This consensual transaction will avoid the legal proceedings of a foreclosure, as well as the attendant costs (and stigma on the borrower). It should be noted, however, that junior liens and junior encumbrances, such as leases, will not and cannot be terminated through a deed in lieu. This also means that the risk of inadvertent termination of a lease will be avoided. There will be no need for an attornment agreement since the mortgagee, upon taking title, will be a consensual, contractual transferee of the landlord-borrower, taking subject to the leases. It is also possible that there is a subordination, non-disturbance, and attornment agreement in existence with respect to one or more of these leases that may give the mortgagee-transferee some of the protections discussed in §§10.14 – 10.23 above, even though it obtained title through a consensual transaction. It should be noted, however, that a lender will often keep its mortgage in place so that after it gains title, it may foreclose out junior liens. At that point, the lender will have the same issues with respect to the potential lease terminations as it would have had had it foreclosed its mortgage in the first place.

H. [10.25] Assignment of Leases and Rents

To provide itself with additional security for its loan, the mortgagee typically will include language in the mortgage or in a separate collateral document that assigns to it the landlord's interest in the property leases and the rents therefrom. This collateral assignment of leases and rents is considered a lien on a real property interest; therefore, the mortgagee must record the assignment to perfect its security interest. As noted in §10.7 above, the assignment will often contain a number of representations from the landlord-borrower covering the leases, as well as covenants governing the landlord's ability to enter into, amend, and manage the relationships with the tenants under the leases. The execution and delivery of a collateral assignment of leases and rents does not, however, automatically permit the mortgagee to collect the rents when it chooses. For the assignment to be effective in Illinois, it must be a present assignment of the leases and rents with a "license" back to the landlord to collect the rents and deal with the leases for as long as the landlord is not in default under the loan documents. Upon the occurrence of such default, however, the mortgagee must still satisfy a "possession" condition as discussed below before it will be able to collect rents directly from the tenants.

Illinois has adopted the lien theory of mortgages. *See Harms v. Sprague,* 105 Ill.2d 215, 473 N.E.2d 930, 85 Ill.Dec. 331 (1984). Consequently, the mortgagee holds only a lien against the property — the mortgagor retains title to the property, including the right to all rents produced by the property, until the mortgagor defaults under the mortgage and the mortgagee has taken possession of the property (this is sometimes referred to in the literature on this subject as the "rents and profits rule"). *See, e.g., 1518 West Chicago Avenue, LLC v. South Melrose, LLC (In re 1518 West Chicago Avenue, LLC),* 427 B.R. 439 (Bankr. N.D.Ill. 2010); *M. Ecker & Co. v. LaSalle National Bank,* 268 Ill.App.3d 874, 645 N.E.2d 335, 206 Ill.Dec. 330 (1st Dist. 1994); *DeKalb Bank v. Purdy,* 166 Ill.App.3d 709, 520 N.E.2d 957, 117 Ill.Dec. 606 (2d Dist. 1988); *Metropolitan Life Ins. Co. v. W.T. Grant Co.,* 321 Ill.App. 487, 53 N.E.2d 255 (1st Dist. 1944).

It is generally understood that to collect rents, either such "possession" must be actual possession of the property or the mortgagee must have taken some affirmative action to gain actual possession of the property. *See Comerica Bank-Illinois v. Harris Bank Hinsdale,* 284 Ill.App.3d 1030, 673 N.E.2d 380, 220 Ill.Dec. 468 (1st Dist. 1996); *In re Cadwell's Corners Partnership,* 174 B.R. 744 (Bankr. N.D.Ill. 1994); *In re Wheaton Oaks Office Partners Limited Partnership,* 27 F.3d 1234 (7th Cir. 1994). To overcome the landlord's right to continue to collect rents without the mortgagee having to take actual possession, the mortgagee must obtain judicial authorization. *See Comerica Bank-Illinois, supra.* This requirement may be satisfied by (1) obtaining judicial intervention in the form of injunctive relief (*i.e.,* causing a court to issue a temporary injunction requiring the tenant to deposit its rent with a clerk of the court) (*DeKalb Bank, supra*) or (2) having a receiver appointed for the property (*Metropolitan Life Ins., supra*). (For further discussion of the cases entitling the mortgagee to collect rents, *see 1518 West Chicago Avenue, supra, In re Cadwell's Corners Partnership, supra,* and *DeKalb Bank, supra.* See also Robert C. Feldmeier, *Enforcing Assignment-of-Rents Provisions in Illinois,* 86 Ill. B.J. 436 (1998), for a discussion of *Comerica Bank-Illinois* as well as another case, *Fidelity Mutual Life Insurance Co. v. Harris Trust & Savings Bank,* 71 F.3d 1306 (7th Cir. 1995), which suggests that guarantees of a borrower's obligation to turn rents over to a lender, without the lender having taken possession of the property, may be enforceable.) Although the appointment of a receiver constitutes constructive possession

sufficient to overcome the landlord's right to receive the rents, the mortgagee can take some comfort in the fact that this action is not sufficient to make the mortgagee a "mortgagee in possession," which then would be bound to perform the covenants of the lease. *See United States Fidelity & Guaranty Co. v. Old Orchard Plaza Limited Partnership,* 284 Ill.App.3d 765, 672 N.E.2d 876, 220 Ill.Dec. 59 (1st Dist. 1996).

The 1996 amendments to the Illinois Conveyances Act, 765 ILCS 5/0.01, *et seq.,* do not appear to have alleviated the requirement of actual or constructive possession as described above. The Conveyances Act provides that an assignment of rents is perfected upon "recordation without the assignee taking any other affirmative action." 765 ILCS 5/31.5(b). However, "[u]nless otherwise agreed to by the parties, the mere recordation of an assignment does not affect who is entitled, as between the assignor and the assignee, to collect or receive rents until the assignee enforces the assignment under applicable law." 765 ILCS 5/31.5(d). It is unclear whether the amendments allow the mortgagee to specifically provide, in the assignment-of-rents agreement, that appointment of a receiver is not necessary to enforce the assignment of rents. John C. Murray, *Insurance of a Secured Lender's Interest in Rents Pursuant to a Separate Assignment of Rents,* 434 PLI/Real 59 (1998). However, in an unreported bankruptcy court case decided shortly after the amendments were enacted, the court still appeared to follow the traditional approach regarding actual and constructive possession. *See In re Woodfield Gardens Associates,* No. 97 B 26706, 1998 WL 276453 (Bankr. N.D.Ill. May 28, 1998). In this situation, perfection of the assignment "establishes priority but not a determination as to title to and the right to possession of the rents as between the parties to the recorded security instrument." Murray, *supra*.

In 2018, Illinois courts further explored the effect of the 1996 amendments to the Illinois Conveyances Act on the requirement of possession in enforcing an assignment of rents. In *U.S. Bank National Ass'n v. Randhurst Crossing LLC,* 2018 IL App (1st) 170348, 105 N.E.3d 132, 423 Ill.Dec 327, a mortgagee filed a foreclosure complaint against the mortgagor, but the mortgagor filed for bankruptcy before the mortgagee could appoint a receiver to collect the rents. The bankruptcy court granted the mortgagee's motion to consider the rents "cash collateral" (and therefore not available to the mortgagor without the bankruptcy court's authorization). After the bankruptcy case was dismissed, the trial court granted the mortgagee's request for a receiver and ordered the mortgagor to turn over pre-receivership rents. On appeal, the court held (as a matter of first impression) that the mortgagor was required to turn over pre-receivership rents because the entry of the cash collateral order by the bankruptcy court was sufficient to give the mortgagee constructive possession over (and therefore entitlement to) the pre-receivership rents. The court analogized to other cases in which "there was no receiver appointed, yet the appellate court found that the actions taken by the mortgagee were sufficient to establish possession over the property," noting that because the mortgagor was unable to use the rents without court approval, appointing a receiver would not have accomplished anything more. 2018 IL App (1st) 170348 at ¶60.

In *BMO Harris Bank N.A. v. Joe Contrarino, Inc.,* 2017 IL App (2d) 160371, 74 N.E.3d 1091, 412 Ill.Dec 168, a group of secured lenders recorded mortgages containing an assignment of rents. The lenders and the borrower thereafter entered into unrecorded agreements to forebear from foreclosure in exchange for the borrower's property manager's agreement to transmit the rents directly to the secured lenders. Another lender subsequently obtained a judgment against the borrower in separate foreclosure proceedings and asserted a claim to these rents. The court

determined that the prior forbearance agreements were an agreement to "otherwise" enforce the assignment of rents under 765 ILCS 5/31.5(d); therefore, the original secured lenders were entitled to the rents pursuant to the assignment-of-rents agreement. In further support of this ruling, the court noted that Illinois courts have previously "recognized a mechanism — a lockbox arrangement or other direct-payment system — by which parties can enforce assignments of rents other than through court authorization." 2017 IL App (2d) 160371 at ¶59. Although collection of rents still requires "possession," the trend appears to favor giving constructive possession a broad interpretation, including in some instances eliminating the requirement of appointing a receiver or requiring court intervention altogether.

Illinois courts have apparently never directly examined whether an assignment of leases and rents to which a tenant has specifically consented might eliminate entirely the requirement of either actual or constructive possession (such as appointing a receiver). It is unlikely, however, that this alternative could be employed successfully in Illinois because the courts have suggested that private agreements eliminating the possession requirement are contrary to Illinois public policy. *See Comerica Bank-Illinois, supra.* The courts fear that such agreements might allow mortgagees to strip the rents from the property and leave the mortgagor and tenants without resources for maintenance and repair. This rationale continues to be supported by recent caselaw, even as courts interpret "possession" more broadly. *See U.S. Bank National, supra.*

Finally, it should be noted that an ability to collect rents under the leases will not necessarily be sufficient to repay the principal portion of the mortgagee's loan. Accordingly, the mortgagee will probably still need to obtain title to the fee property to resell it and recoup the loan principal. This fact, together with the probable requirement of taking possession of the property to collect rents under the assignment of rents, explains why lenders in most cases will not simply rely on this assignment. At best, remedies under an assignment of rents will be used in conjunction with a more traditional foreclosure.

IV. APPENDIX — SAMPLE FORMS

A. [10.26] Lease Provisions — Subordination and Attornment, Mortgagee Protection

(A) Tenant hereby agrees that this Lease and any modifications, renewals, extensions, restatements, and amendments thereof and all rights, options, liens, or charges created thereby are and shall continue to be subject and subordinate to any or all first priority mortgages now on the Property of which these Demised Premises form a part, and any or all first priority mortgages that may be placed on the Property hereafter, at any time during the term of this Lease, and all of the terms and provisions thereof and all the rights, liens, and charges created thereby, to any advances and disbursements made thereunder, to any consolidations, extensions, amendments, restatements, modifications, or renewals thereof, and to any other first priority lien security instrument on the Property that may after this date be held by Mortgagee (all of the foregoing being a "Mortgage"). Tenant shall, from time to time within ____ days following request from Landlord, execute and deliver any documents or instruments that may reasonably be required by any Mortgagee to confirm such subordination.

(B) At the request of any holder of a Mortgage from time to time (Mortgagee), Tenant shall attorn to such Mortgagee, its successors in interest, or any purchaser in a foreclosure sale. If a Mortgagee, or its successor or assign, shall succeed to the rights of Landlord under this Lease, whether through possession or foreclosure action or the delivery of a deed in lieu thereof, then at the request of the successor landlord and upon such successor landlord's written agreement to accept Tenant's attornment and to recognize Tenant's interest under this Lease [and all of Tenant's rights thereunder**], Tenant shall be deemed to have attorned to and recognized such successor landlord as Landlord under this Lease. The provisions of this section are self-operative and require no further instruments to give effect hereto; provided, however, that Tenant shall promptly execute and deliver any instrument that such successor landlord may reasonably request (1) evidencing such attornment; (2) setting forth the terms and conditions of Tenant's tenancy; and (3) containing such other terms and conditions as may be required by such Mortgagee, provided such terms and conditions do not increase the rent, materially increase Tenant's obligations, or materially and adversely affect Tenant's rights under this Lease.**

Upon such attornment, this Lease shall continue in full force and effect as a direct lease between such successor landlord and Tenant on all of the terms, conditions, and covenants set forth in this Lease, except that such successor landlord shall not be (1) liable for any act or omission of Landlord, or required to cure any default of Landlord [except to the extent (a) such act or omission constitutes a nonmonetary default of Landlord; (b) such act or omission continues beyond the date when such successor landlord succeeds to Landlord's interest; and (c) Tenant shall have given prompt written notice of such act or omission to Mortgagee, with an opportunity to cure the same, in accordance with the terms hereof**]; (2) subject to any offsets, defenses, claims, or counterclaims that Tenant may have against Landlord; (3) bound by any Rent or Additional Rent that Tenant may have paid more than one month in advance; (4) liable for any security or other deposit, or surrender of any letter of credit, whether or not still held by Landlord, unless such security or other deposit was actually received by Mortgagee or such successor landlord, and in the event of receipt of any such security deposit, Mortgagee's or such successor landlord's obligations with respect thereto shall be limited to the amount of such security deposit actually received by Mortgagee or such successor landlord, and Mortgagee or such successor landlord shall be entitled to all rights, privileges, and benefits of Landlord set forth in this Lease with respect thereto; (5) bound by any agreement between Landlord and Tenant not expressly set forth in this Lease (or any exhibit thereto), as amended (subject to Mortgagee's right to consent thereto); (6) bound by any agreement, amendment, extension, modification, cancellation, or termination of this Lease that was made without the prior written consent of Mortgagee, [**except to the extent the same is expressly provided for in this Lease,**] which consent may be withheld, conditioned, or delayed for any reason, in the sole discretion of Mortgagee; (7) obligated to complete any construction or improvement work (or related work or obligations) required pursuant to the provisions of this Lease, whether to the Demised Premises or to any other portion of the Property; (8) liable for any payment to Tenant of any sums, or the granting to Tenant of any credit, in the nature of a contribution toward the cost of any construction or improvement work (or related work or obligations) performed by or on behalf of Tenant, or for preparing, furnishing, or moving into the Premises or any portion thereof; (9) obligated to perform or provide any services not related to Tenant's possession or quiet enjoyment of the Premises, or provide any services or**

perform any obligations under this Lease that are personal to Landlord (or any prior landlord) or are impossible for Mortgagee or such successor landlord to provide or perform; (10) liable or responsible for payment of any brokerage or other commission or compensation due with respect to this Lease or any amendment, renewal, extension, expansion, contraction, termination, or surrender thereof; (11) liable to Tenant under this Lease or otherwise from and after such time as Mortgagee or such successor landlord ceases to be the owner of the Property; (12) liable for any failure to provide any additional space at the Property pursuant to an option or right under this Lease, if such failure is a result of Landlord's or any prior landlord's prior leasing or granting of a conflicting option or right on such space to another tenant; (13) bound by, or liable for any breach of, any representation or warranty or indemnity agreement of any kind contained in this Lease or otherwise made by Landlord; or (14) personally liable or personally obligated to perform any such term, covenant, or provision, Mortgagee's and such successor landlord's liability being limited in all cases to its interest in the Property.

(C) Tenant and Landlord agree that any Mortgagee may elect that this Lease shall have priority over such Mortgage and, upon notification to Tenant by such Mortgagee, this Lease (including all amendments hereto) shall be deemed to have priority over such Mortgage, regardless of the date of this Lease or any amendment hereto (or Tenant's possession of the Premises). If requested by any Mortgagee that this Lease (including all amendments hereto) be made superior to any Mortgage, Landlord and Tenant each agrees that it shall execute all documents as may reasonably be required by such Mortgagee to subordinate such Mortgage to this Lease and effect the superiority of this Lease (including all amendments hereto) to such Mortgage in connection with any financing of the Property, Tenant shall consent to any reasonable modifications of this Lease requested by any Mortgagee (or potential Mortgagee), provided such modifications do not increase the Rent, materially increase the obligations, or materially and adversely affect the rights of Tenant under this Lease.

(D) As long as any Mortgage exists, Tenant shall not seek to terminate this Lease, seek to abate or set off any Rent or other amounts payable hereunder, or seek or pursue damages against Landlord by reason of any act or omission of Landlord until Tenant shall have given Mortgagee, at the same time as it is sent to Landlord, a copy of any notice served on Landlord by Tenant that alleges a default by or failure on the part of Landlord to perform any of its obligations under the Lease. Tenant further agrees that in the event of any act or omission by Landlord that would (either immediately or after a period of time) give Tenant the right to damages from Landlord, to abate or set off any Rent or other amounts payable under this Lease, or to terminate this Lease, Tenant shall not sue for such damages, abate or set off such Rent or other amounts, or exercise any such right to terminate until Tenant shall have given Mortgagee until the expiration of [60 days beyond**] the period set forth in this Lease for Landlord's cure of such default; provided, however, that if the nature of the default is such that it cannot reasonably be cured within such [**60-day**] period, such period shall be extended as necessary to allow Mortgagee a reasonable time to cure the default, as long as Mortgagee has commenced such cure within such [**60-day**] period and thereafter cures the default with due diligence. Furthermore, [**provided that Tenant continues to have effective use and occupancy of the Premises for the normal operation of Tenant's business,**] Mortgagee shall have a period ending [**60 days**] after the date on which it obtains possession of the Premises to cure or correct**

such default if the default is of a nature that it cannot be cured by Mortgagee until it obtains possession of the Premises but is curable by Mortgagee thereafter. It is specifically agreed that Tenant shall not, as to Mortgagee, require cure of any such default that is personal to Landlord and, therefore, not susceptible to cure by Mortgagee.

(E) The provisions of this section shall (1) inure to the benefit of Landlord, Mortgagee, and any other future owner of the Building or the Real Property; and (2) apply notwithstanding that, as a matter of law, this Lease may terminate upon the foreclosure of any such Mortgage.

B. [10.27] Estoppel Certificate

ESTOPPEL CERTIFICATE

[date**]**

[Lender**]**

_____
_____
Attn: _____

Re: Mortgage Loan to [Borrower**] on [**Property**]**

Ladies and Gentlemen:

For the purpose of providing information to you, together with your successors and assigns _____ (Lender) and _____ (Landlord), regarding the premises (Premises) located in the building commonly known as _____, located at _____ (Building), in which the undersigned _____ is the tenant (Tenant) under that certain lease agreement, as amended, as set forth below (Lease). It is intended that Landlord and Lender shall rely upon the contents and accuracy of this certificate. Tenant does hereby certify to Lender and Landlord as follows:

1. **The following information is true, correct, and complete:**

   a. **Date of Lease: _____**

   b. **Suite Number of the Premises: _____**

   c. **The Premises consists of _____ sq. ft.**

   d. **The following constitute all amendments and modifications to the Lease: _____**
   _____
   _____

e. The Term of the Lease: _____

Date of Commencement:_____

Date of Expiration: _____

f. Tenant has the following renewal option(s): _____

g. Tenant has the following expansion option(s): _____

h. The [Net Rent**] [**Fixed Rent**] [**Base Rent**] per month is $_____, escalating as set forth in section ____ of the Lease.**

i. The Percentage Rent and Breakpoint: _____

j. The Security Deposit held by Landlord is $_____ [, which is held in the form of a letter of credit that has been delivered to Landlord**].**

k. Tenant pays its proportionate share of the following charges, in the following percentages (list as appropriate):

Operating Expenses	_____
Utilities	_____
Taxes	_____
[Common Area Maintenance**]**	_____
Insurance	_____
Charges Under a Reciprocal Easement Agreement	_____
Other (please state)	_____

The foregoing charges are paid in excess of [Tax/Expense Stop**] [**Base Year**].**

2. The Lease is in full force and effect and is the legal, valid, and binding obligation of Tenant, enforceable against Tenant in accordance with its terms. The Lease has not been amended, modified, supplemented, or superseded either orally or in writing, except as may be specified in section 1 above. The Lease constitutes the entire agreement between Tenant and Landlord with respect to the Premises and the Building, and there are no other agreements with respect thereto except for the Lease, as amended and modified as set forth above, and the following agreements: [list all storage leases, parking agreements, rooftop antenna licenses, etc.**].**

3. Tenant is in full and complete possession of the Premises under the terms of the Lease, such possession having been delivered by Landlord and having been accepted by Tenant. Tenant has no contract to acquire the Building (or any part thereof), nor does Tenant have any purchase option, right of first refusal, or similar right with respect to the acquisition of the Building (or any part thereof).

4. All rent, charges, and other payments due Landlord under the Lease have been paid to and including _____, 20__, and Tenant has not paid and shall not pay these obligations more than one month in advance.

5. [As of the date of this Estoppel Certificate, and to Tenant's knowledge,**] Neither Tenant nor Landlord is in default under the Lease nor has any event occurred that, with the passage of time (after notice, if any, required by the Lease), would become a default under the Lease, except _____.**

6. [As of the date of this Estoppel Certificate, and to Tenant's knowledge,**] Tenant is entitled to no claims, counterclaims, defenses, or setoffs against Landlord arising from the Lease, nor is Tenant entitled to any concession, rebate, allowance, or free rent for any period after the date of this Certificate, except _____.**

7. Tenant agrees that in the event of any claimed breach or default by Landlord under the Lease, Tenant shall notify Lender of such claimed breach or default by certified mail, return receipt requested, or by overnight courier, at the following address:

_____
_____
_____
Attn: _____

with a copy to:

_____
_____
_____
Attn: _____

8. Tenant has not assigned, mortgaged, sublet, encumbered, or otherwise transferred any or all of its interest under the Lease.

9. Tenant has not received notice of any prior sale, transfer, assignment, hypothecation, or pledge of Landlord's interest in the Building or of rents under the Lease, other than Landlord's assignment of rents to Lender, which assignment Tenant hereby acknowledges. Tenant agrees that upon notification in writing by Lender that rental payments are to be made to Lender, Tenant shall cease making rental payments pursuant to the terms of the Lease to Landlord and shall thereafter make them to Lender as directed in such notice.

10. All tenant improvement work, and all Landlord's work, if any, under the terms of the Lease has been completed, and all required contributions or consideration by Landlord to Tenant on account of such Tenant improvements (if any) have been received by Tenant to its satisfaction, and the Premises are open for the use of Tenant and its employees, customers, and invitees. Tenant has advanced no sums to, or on behalf of, Landlord for which it has not been reimbursed, including, if applicable, any and all construction or Tenant improvement allowances.

11. Tenant is not the subject of, nor is there pending or contemplated by Tenant, or (to Tenant's knowledge) threatened against Tenant, any bankruptcy (whether voluntary or involuntary), insolvency, assignment for the benefit of creditors, petition seeking organization or arrangement, or any similar proceeding in any federal, state, or other court with jurisdiction over Tenant and its business and operations.

12. The provisions of this Certificate shall be binding on Tenant and its successors and assigns and shall inure to the benefit of Lender and Landlord and their respective successors and assigns.

13. The undersigned hereby certifies that [he**] [**she**] is duly authorized to sign and deliver this Certificate on behalf of Tenant and that this Certificate may be relied on by Lender and its successors and assigns in connection with the making of the mortgage loan referred to above.**

[TENANT**], a**
_____

By: _____
Name: _____
Its: _____

Date: _____

C. [10.28] Subordination, Non-Disturbance, and Attornment Agreement

This instrument prepared by
and after recording return to:
_____
_____
_____
_____

SUBORDINATION, NON-DISTURBANCE, AND ATTORNMENT AGREEMENT

THIS SUBORDINATION, NON-DISTURBANCE, AND ATTORNMENT AGREEMENT (Agreement) is made and entered into as of _____, 20__, by and among _____, a _____ (Landlord), and _____, a _____ (Tenant), and _____, a _____ (together with its successors and assigns, "Lender").

WITNESSETH:

WHEREAS, Tenant and Landlord have entered into that certain Lease dated _____, 20__, which Lease demises certain premises more particularly described in the Lease (Premises) in that certain real property (Property) commonly known as _____ and more particularly described in Exhibit ____ attached hereto and made a

part hereof (said Lease, together with any and all amendments, modifications, extensions, renewals, restatements, consolidations, and replacements thereof now existing or hereafter entered into (subject to Lender's right to consent thereto, as more particularly described herein), is collectively called the "Lease");

WHEREAS, by making a mortgage loan, Lender has become the owner of an indebtedness and holder of a certain Note, secured by a Mortgage from Landlord (as amended, restated, or otherwise modified from time to time, the "Mortgage"), which has been or will be recorded in the records of _____ County, Illinois, and which mortgage loan shall also be secured by an assignment of Landlord's interest in the Lease as more particularly set forth in a certain Assignment of Leases and Rents between Landlord and Lender delivered in connection therewith (as amended, restated, or otherwise modified from time to time, the "Assignment of Leases");

WHEREAS, Landlord and Tenant jointly and severally acknowledge and agree to the aforesaid Assignment of Leases, and more particularly, the covenants and agreements of Landlord set forth therein; and

WHEREAS, the parties hereto desire to establish additional rights of quiet and peaceful possession for the benefit of Tenant, and further to define the covenants, terms, and conditions precedent to such additional rights;

NOW, THEREFORE, in consideration of the covenants, terms, conditions, agreements, and demises herein contained, and in consideration of other good and valuable consideration, each to the other, the sufficiency and receipt of which are hereby acknowledged, the parties hereto agree, covenant, and warrant as follows:

1. Lender, Landlord, and Tenant do hereby acknowledge and agree that the Lease and any modifications, renewals, extensions, restatements, and amendments thereto (subject to Lender's right to consent thereto, as more particularly described herein) and all rights, options, liens, or charges created thereby are and shall continue to be subject and subordinate in all respects to the Mortgage and all of the terms and provisions thereof and of the Loan Documents (as defined in the Mortgage), to all the rights, liens, and charges created thereby, to any advances and disbursements made thereunder, to any consolidations, extensions, amendments, restatements, modifications, or renewals thereof, and to any other mortgage or other security instrument on the Premises that may hereafter be held by Lender.

2. Subject to the observance and performance by Tenant of all of the covenants, terms, and conditions of the Lease on the part of Tenant to be observed and performed (subject to applicable cure periods), Lender hereby agrees (a) that Tenant's possession, use, and quiet enjoyment of the Property under the Lease shall not be diminished or interfered with by Lender; and (b) that Tenant's occupancy of the Property shall not be disturbed by Lender for any reason whatsoever, including any foreclosure proceeding or other action brought pursuant to the Loan Documents. In furtherance of the foregoing, provided Tenant is not in default under the terms of the Lease (subject to applicable cure periods), Lender shall not join Tenant as a defendant in any action or proceeding foreclosing the Mortgage unless such

joinder is necessary under applicable law and then only for such purpose and not for the purpose of terminating the Lease. Tenant waives all joinder and/or service of any and all foreclosure actions by Lender under the Note and Mortgage on the Property, and of any actions at law by Lender to gain possession of the Property. It shall not be necessary, except as required by law, for Lender to name Tenant as a party to enforce its rights under the Note or Mortgage, or any other instrument collateralizing the loan, or to prosecute any action at law to gain possession of the Property.

3. Lender, for itself and its successors and assigns, and/or for any other purchaser at a foreclosure sale under the Mortgage (or transferee by deed in lieu of foreclosure or otherwise), and for any transferee of Lender or such purchaser or transferee who thereafter acquires the Property, and for the successors and assigns of the foregoing (any and all of the foregoing persons and entities being collectively referred to herein as the "New Landlord"), hereby covenants that in the event New Landlord obtains title to the Property, either by foreclosure, by deed in lieu of foreclosure, or by any other action or proceeding instituted under or in connection with the Mortgage, and thereafter obtains the right of possession of the Property, except as otherwise hereinafter set forth, the Lease shall continue in full force and effect, [and New Landlord shall recognize the Lease and Tenant's rights thereunder, and assume all of the obligations of Landlord thereunder**], and shall thereby establish direct privity of estate [**and contract**] between and for the benefit of such New Landlord and Tenant with the same force and effect and with the same relative priority in time and right as though the Lease were originally made directly between New Landlord and Tenant.**

[NOTE: The recognition and assumption language may be added to the above paragraph upon the tenant's request to ensure that all of the terms of the lease will survive the foreclosure, including ones that do not necessarily "touch and concern the land" (except to the extent they are expressly amended by other sections of the SNDA).]

4. In the event the interests of Landlord under the Lease shall be transferred to Lender or New Landlord by reason of foreclosure, deed in lieu of foreclosure, or otherwise, Tenant, for itself and its successors and assigns, hereby covenants and agrees to make full and complete attornment to Lender or New Landlord as substitute landlord on the same terms, covenants, and conditions as provided in the Lease, except as otherwise hereinafter set forth, so as to establish direct privity of estate and contract between Lender or New Landlord and Tenant, with the same force and effect and relative priority in time and right as though the Lease (together with all guarantees of Tenant's obligations under the Lease) were originally made directly between and for the benefit of Lender or New Landlord and Tenant. Tenant agrees to execute and deliver at any time and from time to time upon the request of Lender or any New Landlord (a) any reasonable instrument or certificate evidencing such attornment; and/or (b) a replacement lease between Lender or New Landlord and Tenant for the balance of the term of the Lease, and otherwise on the same terms and conditions as the Lease. Tenant waives the provisions of any statute or rule of law now or hereafter in effect that may give or purport to give it any right or election to terminate or otherwise adversely affect the Lease or the obligations of Tenant thereunder by reason of any foreclosure or similar proceeding.

5. Tenant agrees to give Lender, in accordance with the provisions of section 10 hereof and at the same time as such notice is sent to Landlord, a copy of any notice served on Landlord by Tenant that alleges a default by, or failure on the part of, Landlord to perform any of its obligations under the Lease. Tenant further agrees that in the event of any act or omission by Landlord that would (either immediately or after a period of time) give Tenant the right to damages from Landlord, to abate or set off any rent or other amounts payable under the Lease, or to terminate the Lease, Tenant shall not sue for such damages, abate or set off such rent or other amounts, or exercise any such right to terminate until it shall have given Lender until the expiration of [60 days beyond**] the period set forth in the Lease (if any) for Landlord's cure of such default; provided, however, that if the nature of the default is such that it cannot reasonably be cured within such [**60-day**] period, such period shall be extended as necessary to allow Lender a reasonable time to cure the default, as long as Lender has commenced such cure within such [**60-day**] period and thereafter cures the default with due diligence. Furthermore, [**provided that Tenant continues to have effective use and occupancy of the Property for the normal operation of Tenant's business,**] Lender shall have a period ending [**60 days**] after the date on which it obtains possession of the Property to cure or correct such default if the default is of a nature that it cannot be cured by Lender until it obtains possession of the Property but is curable by Lender thereafter. It is specifically agreed that Tenant shall not, as to Lender, require cure of any such default that is personal to Landlord and, therefore, not susceptible to cure by Lender.**

6. Notwithstanding anything contained herein or in the Lease to the contrary, Landlord and Tenant hereby covenant and agree that no New Landlord shall be

(a) liable for any act or omission of any prior landlord (including Landlord), or required to cure any default of any prior landlord (including Landlord) [except to the extent (i) such act or omission constitutes a nonmonetary default of Landlord; (ii) such act or omission continues beyond the date when New Landlord succeeds to Landlord's interest; and (iii) Tenant shall have given prompt notice of such act or omission to Lender, and an opportunity to cure it, in accordance with the terms hereof**];**

(b) subject to any offsets, defenses, claims, counterclaims, or setoffs that Tenant may have against any prior landlord (including Landlord);

(c) bound by any rent or additional rent that Tenant may have paid more than one month in advance;

(d) liable for any security or other deposit, or surrender of any letter of credit, whether or not still held by any prior landlord (including Landlord), unless such security or other deposit was actually received by Lender or New Landlord, and in the event of receipt of any such security deposit, Lender's or New Landlord's obligations with respect thereto shall be limited to the amount of such security deposit actually received by Lender or New Landlord, and Lender or New Landlord shall be entitled to all rights, privileges, and benefits of Landlord set forth in the Lease with respect thereto;

(e) bound by any agreement between Landlord and Tenant not expressly set forth in the Lease (or any exhibit thereto), as amended (subject to Lender's right to consent thereto);

(f) bound by any agreement, amendment, extension, modification, cancellation, or termination of the Lease that was made without the prior written consent of Lender, which consent may be withheld, conditioned, or delayed for any reason, in the sole discretion of Lender;

(g) obligated to complete any construction or improvement work (or related work or obligations) required pursuant to the provisions of the Lease, whether to the Premises or to the Property;

(h) liable for any payment to Tenant of any sums, or the granting to Tenant of any credit, in the nature of a contribution toward the cost of any construction or improvement work (or related work or obligations) performed by or on behalf of Tenant, or for preparing, furnishing, or moving into the Property or any portion thereof;

(i) obligated to perform or provide any services not related to Tenant's possession or quiet enjoyment of the Property or provide any services or perform any obligations under the Lease that are personal to Landlord (or any prior landlord) or are impossible for Lender or New Landlord to provide or perform;

(j) liable or responsible for payment of any brokerage or other commission or compensation due with respect to the Lease or any amendment, renewal, extension, expansion, contraction, termination, or surrender thereof;

(k) liable to Tenant under the Lease or otherwise from and after such time as Lender or New Landlord ceases to be the owner of the Property;

(*l*) liable for any failure to provide any additional space in the Building pursuant to an option or right under the Lease, if such failure is a result of any prior landlord's prior leasing or granting of a conflicting option or right on such space to another tenant;

(m) bound by, or liable for any breach of, any representation or warranty or indemnity agreement of any kind contained in the Lease or otherwise made by any prior landlord (including Landlord); or

(n) personally liable or personally obligated to perform any such term, covenant, or provision, Lender's and such New Landlord's liability being limited in all cases to its interest in the Property.

[Add specific amendments to, or clarifications of, the Lease.**]**

7. Tenant agrees that Landlord's consent, approval, or waiver under or with respect to the Lease or the Property or any matter related thereto shall not be effective unless such consent, approval, or waiver is accompanied by the written consent of Mortgagee. [This rather restrictive provision may be softened by limiting it to the material matters discussed in the next sentence.**] Without limiting the generality of the foregoing, without the prior written consent of Mortgagee, Tenant shall not (a) enter into any agreement amending, restating, modifying, extending, or renewing (except for extension and renewal rights set forth in the Lease as of the date hereof) or terminating the Lease or granting any concessions or allowances to Tenant thereunder; (b) create any setoff or claims against rents or prepay rent more than [**one month**] in advance; (c) cancel the term of, or surrender, the Lease; or (d) assign or sublet all or any part of the Property, except only pursuant to any assignment or sublease that, under the express provisions of the Lease, Tenant is entitled to make without the prior consent of Landlord. In the event Tenant terminates the Lease by paying a lease cancellation fee, termination fee, surrender fee, settlement amount, accelerated rent, or other such payment, whether pursuant to a right set forth in the Lease or as may otherwise be agreed between Landlord and Tenant with Lender's prior written consent, Tenant shall deliver the payment to Lender, to be held by Lender [**in accordance with the terms of the Mortgage and the other loan documents**] [**as additional collateral for the mortgage loan**]. Any options or rights contained in the Lease to acquire title to the Property (or any portion thereof) are hereby made subject and subordinate to the rights of Lender under the Mortgage and the other loan documents. Any right of Tenant to purchase the Property, including any right of first refusal, right of first offer, or similar provisions, shall not apply to a foreclosure sale, or conveyance by deed in lieu of foreclosure, of the Property by or to Lender (or by or to any New Landlord) and shall be deemed extinguished upon the foreclosure of the Mortgage or the conveyance of the Property by deed in lieu thereof.**

8. Tenant acknowledges that Landlord has executed and delivered an Assignment of Leases to Lender as additional security for the aforesaid mortgage loan. Tenant agrees, except to the extent prohibited by law or legal proceedings, to make rental payments as directed by Lender upon the demand by Lender. Landlord's execution of this Agreement shall constitute an express authorization for Tenant to make such payment to Lender. Landlord agrees to indemnify Tenant for any rent payments made to Lender at Lender's direction. Tenant agrees that it shall not subordinate the Lease to any other lien without first obtaining Lender's prior written consent. Tenant agrees that any of its right, title, and interest in and to insurance proceeds and condemnation awards (or other similar awards arising from eminent domain proceedings) with respect to damage to, or the condemnation (or similar taking) of, any of the Property shall be subject and subordinate to Lender's right, title, and interest in and to such proceeds and awards under the terms of the Mortgage.

9. Landlord and Tenant hereby jointly and severally agree for the benefit and reliance of Lender and New Landlord as follows:

(a) Neither this Agreement, the Mortgage, the Assignment of Leases, nor anything to the contrary contained in the Lease shall, prior to Lender's or New Landlord's acquisition of Landlord's interest in and possession of the Property, operate to give rise to or create any responsibility or liability for the control, care, management, or repair of the Property on

Lender or New Landlord or impose responsibility for the carrying out by Lender or New Landlord of any of the covenants, terms, and conditions of the Lease, nor shall said instruments operate or make Lender or New Landlord responsible or liable for any waste committed on the Property by any party whatsoever, for any dangerous or defective condition of the Property, or for any negligence in the management, upkeep, repair, or control of the Property resulting in loss, injury, or death to Tenant or any other tenant, or to any licensee, invitee, guest, employee, agent, or contractor. Notwithstanding anything to the contrary contained in the Lease, Lender, its successors and assigns, or New Landlord, as applicable, shall be responsible for performance of only those covenants and obligations of the Lease accruing after Lender's or New Landlord's acquisition of Landlord's interest in and possession of the Property, and Lender's or New Landlord's obligations to Lessee shall be further limited as herein provided.

(b) If New Landlord gains title to the Property and becomes the substitute landlord, it is agreed that New Landlord may sell, transfer, convey, or assign its interest without notice to or consent of Tenant or any other person or entity.

(c) Notwithstanding anything to the contrary contained in the Lease, Tenant shall look solely to the Property for recovery of any judgment or damages from Lender or any other New Landlord, and neither Lender nor such other New Landlord nor any present or future partner, member, or shareholder of Lender or such other New Landlord shall have any personal liability, directly or indirectly, under or in connection with the Lease [or this Agreement**], or any amendment or amendments to [**it**] [**either**] made at any time or times, heretofore or hereafter, and Tenant hereby forever and irrevocably waives and releases any and all such personal liability. In addition, neither Lender nor any other New Landlord, nor any successor or assign of Lender or such other New Landlord, shall have, at any time or times hereafter, any personal liability, directly or indirectly, under or in connection with or secured by any agreement, lease, instrument, encumbrance, claim, or right affecting or relating to the Property or to which the Property is now or hereafter subject. The limitation of liability provided in this paragraph is in addition to, and not in limitation of, any limitation on liability applicable to Lender or any New Landlord set forth in the Lease, provided by law, or provided in any other contract, agreement, or instrument.**

10. Any notices to Tenant, Landlord, or Lender hereunder shall be in writing, shall be effective upon receipt, and shall be sent by certified mail, return receipt requested, or by overnight courier, addressed as follows:

Tenant: _____
_____
_____
_____

Lender: _____
_____
_____
_____

Landlord: _____
_____
_____
_____

or as to each party, to such other address as the party may designate by a notice given in accordance with the requirements contained in this section 10.

11. This Agreement contains the entire agreement between the parties hereto. No variations, modifications, or changes herein or hereof shall be binding on any party hereto unless set forth in a document duly executed by or on behalf of such party.

12. This instrument may be executed in multiple counterparts, all of which shall be deemed originals and with the same effect as if all parties hereto had signed the same document. All of such counterparts shall be construed together and shall constitute one instrument, but in making proof, it shall be necessary to produce only one such counterpart.

13. Whenever used herein, the singular number shall include the plural, and the plural the singular. The words "Lender," "Landlord," and "Tenant" shall include their heirs, executors, administrators, beneficiaries, successors, and assigns, and the terms and provisions of this Agreement shall inure to the benefit of and be binding on the respective parties hereto and such heirs, executors, administrators, beneficiaries, successors, and assigns.

14. Nothing contained in this Agreement shall in any way impair or affect the lien created by the Mortgage. Landlord hereby agrees, for itself and its successors and assigns, that (a) this Agreement shall not (i) constitute a waiver by Lender of any of its rights against Landlord under the Mortgage or any of the other loan documents; and/or (ii) in any way release Landlord from its obligation to comply with all of the terms, provisions, conditions, covenants, and agreements set forth in the Mortgage and the other loan documents; and (b) the provisions of the Mortgage and the other loan documents shall remain in full force and effect and shall be complied with by Landlord.

15. The terms and provisions of this Agreement shall run with the land.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement by authority duly given, as of the date and year above written.

TENANT:

_____, a
_____

By: _____
Name: _____
Its: _____

LANDLORD:

_____, a
_____

By: _____
Name: _____
Its: _____

LENDER:

_____, a
_____

By: _____
Name: _____
Its: _____

Consent of Guarantor of Lease [if any**]**

_____

[Add notary pages and Exhibit ____ legal description.**]**

D. [10.29] Assignment of Leases and Rents

This instrument prepared by
and after recording return to:

_____
_____
_____
_____

ASSIGNMENT OF LEASES AND RENTS

THIS ASSIGNMENT OF LEASES AND RENTS (Assignment) is made and entered into as of _____, 20__, by and between _____, a _____ (Assignor), and _____, a _____ (Assignee);

WITNESSETH:

WHEREAS, Assignor and Assignee have executed that certain Loan Agreement, dated as of even date herewith (as amended, restated, or otherwise modified from time to time, the "Loan Agreement");

WHEREAS, pursuant to the Loan Agreement, Assignee has agreed to make a loan to Assignor in the principal amount of $_____ (Loan);

WHEREAS, as evidence of the indebtedness incurred under the Loan, Assignor has executed and delivered to Assignee a Promissory Note of even date with this Assignment (as amended, restated, or otherwise modified from time to time, the "Note"), payable to Assignee in the principal amount of the Loan, payment of which is secured by a Mortgage of even date with this Assignment from Assignor (as amended, restated, or otherwise modified from time to time, the "Mortgage") covering the real estate and property more particularly described in the Mortgage; and

WHEREAS, the execution and delivery of this Assignment are conditions precedent to the performance by Assignee of its obligations under the Loan Agreement;

NOW, THEREFORE, in consideration of the making of the Loan by Assignee and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Assignor does hereby absolutely and unconditionally grant, sell, convey, assign, transfer, set over, and deliver unto Assignee the following:

(a) all right, title, and interest in and to all leases, subleases, licenses, concession and occupancy agreements, and other agreements, written or oral, now in existence or hereafter arising, for the use and occupancy of all or any portion of the Property described in Exhibit ____ attached hereto and hereby incorporated herein (Property), together with, subject to the terms of the Loan Agreement, all the rights, power, and authority of Assignor to alter, amend, modify, restate, or change the

terms of such leases, subleases, licenses, and agreements, and to surrender, cancel, or terminate such leases, subleases, licenses, and agreements, and to commence proceedings for dispossession or eviction of lessees thereunder, together with any and all extensions and renewals thereof and any and all future leases, subleases, licenses, and occupancy and concession agreements, on all or any part of the Property (all of such leases, agreements, subleases, licenses, and tenancies being collectively called the "Leases"); it being the intention hereby to establish an absolute and present transfer and assignment of all such Leases and Rents (as defined below) to Assignee;

(b) any and all guarantees of the lessees' (collectively, "Lessees") obligations under any of the Leases; and

(c) the absolute, unconditional, immediate, present, and continuing right to collect and receive all rents, income, receipts, revenues, issues, license fees, occupancy fees, concession fees, and profits now due or that may become due or to which Assignor may now or hereafter (whether upon expiration of any applicable period of redemption or otherwise) become entitled or which Assignor may demand or claim, arising or issuing from or out of the Leases, or from or out of the Property or any part thereof, including but not limited to minimum rents, fixed rents, base rents, additional rents, and percentage rents; all security given under leases in the form of cash, letters of credit, or otherwise; parking fees, rents, or maintenance charges; tax, operating expenses, common area maintenance charges, and insurance contributions; return of any premium now or to be paid or payable under any policy of insurance covering all or any part of the Property; proceeds of sale of electricity, gas, chilled and heated water, and other utilities and services; deficiency rents, interest, and liquidated damages following default or late payments of rent; fees payable on account of, or for the termination or cancellation of, any Lease (whether provided for under the terms of such Lease or otherwise); all proceeds payable under any policy of insurance covering loss of rents resulting from untenantability caused by destruction or damage to the Property or by any other cause; all rights and claims for damage against tenants arising out of defaults under the Leases, including rights to termination fees and compensation with respect to rejected Leases pursuant to §365(a) of the federal Bankruptcy Code or any replacement Section thereof; all tenant improvements, betterments, and fixtures located on the Property; and any and all rights and claims of any kind that Assignor may have against any Lessee under any Lease or any subtenants or occupants of the Property (all of such rents, contributions, reimbursements, fees, security, money, payments, improvements, rights, and claims being collectively called the "Rents"), LESS AND EXCEPTING THEREFROM, HOWEVER, any sums that by the express provisions of any Lease are payable directly to any governmental authority or to any other person, firm, or corporation other than the lessor under any Lease, but subject in all respects, however, to the limited license granted in this Assignment by Assignee to Assignor to collect and receive the Rents and to deal with the Property as lessor of it.

TO HAVE AND TO HOLD the same unto Assignee and its successors and assigns, to secure the payment and performance by Assignor to Assignee of the following described obligations (collectively, the "Obligations"):

(a) payment of the Loan with interest thereon according to the terms of the Note, the Loan Agreement, the Mortgage, this Assignment, and the other loan documents and instruments executed and delivered in connection therewith (all of the foregoing being the "Loan Documents");

(b) payment to Assignee of all other sums, with interest, becoming due or payable by Assignor under the provisions of this Assignment and the other Loan Documents, and any additional sums with interest as may be borrowed from Assignee and its successors or assigns, or by the then-record owner or owners of the Property, whether or not evidenced by another promissory note or notes, which by the terms thereof is or are secured by the Loan Documents; and

(c) due, prompt, and complete observance and performance of each and every obligation, covenant, and agreement of Assignor contained in the Loan Documents.

Assignor further covenants, agrees with, and represents to Assignee as follows:

1. *Assignor's Warranties and Representations.* Assignor represents and warrants to Assignee as follows:

(a) *Ownership of Leases and Rents.* Assignor is the owner in fee simple absolute of the Property. Assignor has good and marketable title to the Leases and Rents and has all requisite right, power, and authority to assign the Leases and Rents, and no other person or entity has any right, title, or interest therein.

(b) *No Default.* None of the Lessees are in default under any of the terms or provisions of their respective Leases, nor is Assignor in default under any of the Leases, except as set forth on the Rent Roll delivered to Assignee in connection with the Loan.

(c) *No Modification of Leases or Anticipation or Hypothecation of Rents.* (i) The Leases executed before the date of this Assignment are valid and unmodified and are in full force and effect, and Assignor has delivered true, complete, and correct copies thereof (including all amendments, exhibits, work letters, and related agreements) to Assignee; (ii) Assignor has not previously sold, assigned, transferred, mortgaged, hypothecated, or pledged the Leases or the Rents, whether now due or to become due; (iii) the Rents now due or to become due for any periods after the date of this Assignment have not been collected, waived or released, discounted, set off, or otherwise discharged or compromised, and payment thereof has not been anticipated for a period of more than one month in advance; (iv) except for security deposits under the Leases, all of which have been delivered to Assignee (including those held in the form of a letter of credit), Assignor has not received any funds or deposits from any Lessee for which credit has not already been made on account of accrued rents; (v) no Lease contains any right or option of first offer or first refusal to purchase all or any portion of the

Property; (vi) Assignor has not done anything that might prevent Assignee from or limit Assignee in operating under or enforcing any of the provisions of this Assignment; and (vii) Assignor has not done anything that might provide any Lessee a defense permitting that Lessee to resist enforcement of any of the Leases to which it is a party.

2. ***Assignor's Covenants and Agreements.***

[NOTE: This form does not contain all of the representations, warranties, and covenants commonly found in a loan transaction dealing with the leasing of the property or maintaining and managing the leases, it being assumed that most of such representations, warranties, and covenants will be incorporated into the loan agreement.**]**

(a) ***Amendment and Modification.*** **[**Except as otherwise permitted under the Loan Agreement,**] Assignor shall not enter into, modify, amend, restate, waive, set off, consent to the assignment or subleasing of Lessee's interest in, cancel, accept the surrender of, or terminate any Lease or in any manner release or discharge any Lessee or any guarantor of any Lessee's obligations without the prior written consent of Assignee, which consent may be withheld in Assignee's sole and absolute discretion.**

(b) ***Marshaling of Assets.*** **To the greatest extent permitted by law, Assignor hereby waives any and all rights to require marshaling of assets by Assignee.**

(c) ***Notice.*** **Assignor hereby authorizes Assignee to give notice in writing to the Lessees at any time upon the occurrence of an Event of Default under this Assignment directing them to pay to Assignee (or as directed by Assignee) the Rents due and to become due under the Leases.**

(d) ***Further Assignments.*** **Assignor shall not make any further assignments of the Leases or the Rents, income, profits, products, proceeds, or other benefits therefrom, without the prior written consent of Assignee, which consent may be withheld in Assignee's sole and absolute discretion.**

(e) ***Obligations as Landlord.*** **[**Except as otherwise permitted under the Loan Agreement,**] Assignor shall comply with and observe all of its obligations as Landlord under the Leases. Assignee may, at its option and election, perform any agreement or obligation under the Leases that Assignor shall fail to perform, and Assignee may take any other action that Assignee deems necessary for the preservation and maintenance of its interest in the Leases and Rents. Assignor agrees to reimburse Assignee for all expenses or advances made by Assignee in connection with the above (including, without limitation, attorneys' fees and expenses), together with interest at the Default Rate from the date of the expenditure to the date of reimbursement, but no act or expenditure of or by Assignee shall relieve Assignor from the consequences of that failure. Assignor agrees to enforce Lessees' obligations under the Leases [**, except as otherwise permitted under the Loan Agreement**]; to appear in and defend any action or proceeding arising under, occurring out of, or in any manner connected with the Leases or the obligations, duties, or liabilities of Assignor and any Lessee thereunder; and, upon request by Assignee, to do so in the name and on behalf of Assignee at the expense of Assignor.**

(f) ***Advance Rent.*** **Assignor shall not collect, waive, release, discount, set off, or otherwise discharge or compromise the Rents for a period of more than one month in advance.**

(g) ***Option To Purchase.*** **Assignor shall not enter into any Lease containing any right or option of first offer or first refusal to purchase all or any portion of the Property.**

(h) ***Security Deposits.*** **Assignor shall deliver to Assignee all security deposits [**in excess of $_____**] received by Assignor or any agent of Assignor in connection with the Leases. Such security deposits shall be pledged to Assignee as additional collateral securing the Obligations pursuant to the terms of the Loan Documents. The security deposits shall be released by Assignee upon the expiration or earlier termination of the applicable Leases (upon certification by Assignor that such deposits will be returned to the applicable Lessees) or released to Assignor upon Assignor's certification to Assignee that a default has occurred under the applicable Leases and the security deposit will be applied to cure such default. Security deposits held in the form of letters of credit shall be in form and substance satisfactory to Assignee, shall by their terms run to the benefit of Assignee as Assignor's mortgagee (or shall otherwise be in a form transferable to Assignor as Assignor may require), and shall be pledged to Assignor and held by Assignor as additional collateral securing the Obligations. Such letters of credit shall be delivered to Assignor upon Assignor's request therefor, for the purpose of drawing on them, the proceeds of which shall be applied as if they were cash security. Any excess of such drawing not applied to cure the Lessee's default under the applicable Lease shall be delivered to Assignee, to be held as a cash security deposit as additional collateral for the Obligations.**

(i) ***Bankruptcy of Tenant.*** **If any Lessee is or becomes the subject of any proceeding under the federal Bankruptcy Code, as amended from time to time, or any other federal, state, or local statute that provides for the possible termination or rejection of the Leases assigned hereby, Assignor covenants and agrees that if any such Lease is so terminated or rejected, no settlement for damages shall be made without the prior written consent of Assignee, and any check or other sums delivered in payment of damages for termination or rejection of any such Lease shall be made payable and delivered jointly to Assignor and Assignee. Assignor hereby assigns any such payment to Assignee and further covenants and agrees that upon the request of Assignee, it shall duly endorse to the order of Assignee any check, the proceeds of which shall be applied in accordance with the terms of the Loan Documents.**

[NOTE: Either the mortgage, the loan agreement, or this assignment should have a collateral assignment of the deposit accounts in which the security deposits will be held, as well as a pledge of any letters of credit held or to be received in lieu of cash security deposits, which pledges should be perfected as required by the Uniform Commercial Code.**]**

3. ***Authorization of Lessees.*** **Assignor by this Assignment irrevocably authorizes and directs each Lessee and any successor to the interest of each such Lessee, upon receipt of any request of Assignee, to pay to Assignee the Rents due and to become due under the Lease. Assignor agrees that each Lessee shall have the right to rely on the request by Assignee, that the Lessee shall pay the Rents to Assignee without any obligation or right to inquire as to whether an Event of Default exists notwithstanding any notice from or claim of Assignor to**

the contrary, and that Assignor shall have no right or claim against that Lessee for any Rents paid by that Lessee to Assignee. Assignor indemnifies and agrees to hold each Lessee free and harmless from and against all liability, loss, cost, damage, or expense (including, without limitation, attorneys' fees and expenses) suffered or incurred by that Lessee by reason of its compliance with any demand for payment of Rents made by Assignee contemplated by this section 3. Assignee shall be deemed a creditor of any Lessee with respect to any assignments that Lessee makes for the benefit of creditors and any bankruptcy or similar proceeding (without any obligation to file timely claims in that proceeding).

4. ***Event of Default.*** **The term "Event of Default" as used in this Assignment shall have the meaning ascribed to such term in the Loan Agreement.**

5. ***License.*** **Provided that there exists no Event of Default that has not been fully cured, Assignor shall have the right under a license granted hereby and Assignee hereby grants to Assignor a license (but limited as provided in section 6 below) to collect, but not more than one month in advance, all of the Rents arising from or out of the Leases or any renewals or extensions thereof, or from or out of the Property or any part thereof, but only as trustee for the benefit of Assignee, and to take any other actions with respect to Leases and Lessees not prohibited by the terms of this Assignment or the other Loan Documents, subject to Assignee's prior written consent if such consent is required under the terms of this Assignment or any of the other Loan Documents. Provided no Event of Default exists hereunder that has not been fully cured, Assignor may use the Rents in any manner not inconsistent with the Loan Documents. The license granted hereby shall be revoked automatically upon the occurrence of an Event of Default.**

6. ***Remedies.*** **Upon or at any time after the occurrence of an Event of Default, Assignee at its option shall have the complete right, power, and authority hereunder then or thereafter to exercise and enforce any or all of the following rights and remedies:**

(a) without taking possession of the Property, [except to the extent required by applicable law,**] in Assignee's own name, to demand, collect, receive, sue for, attach, and levy the Rents, and give proper receipts, releases, and acquittances therefor, and after deducting all necessary and proper costs and expenses of operation and collection, as determined by Assignee, including attorneys' fees and costs, and apply the net proceeds thereof with any funds of Assignor deposited with Assignee, in reduction or payment of the Obligations in the order of priority as Assignee may, in its sole discretion, determine;**

(b) to exercise any and all rights and remedies contained in the Loan Agreement, the Note, the Mortgage, and the other Loan Documents, including but not limited to acceleration of all sums due under the Note, as well as any rights and remedies as may be available to Assignee at law or in equity; without limiting the above, Assignee shall have the rights of a secured party under the applicable Uniform Commercial Code; any requirement of the Uniform Commercial Code of reasonable notice to Assignor shall be met if that notice is mailed, postage prepaid, to Assignor, at its address as shown on the records of Assignee, at least ten days before the date of sale, disposition, or other event giving rise to the requirement of notice;

(c) without regard to the adequacy of the security or solvency of Assignor or waste, with or without any action or proceeding, through any person or by any agent, or by a receiver to be appointed by the court, and irrespective of Assignor's possession, then or thereafter to enter on, take possession of, manage, and operate the Property or any part of the Property together with all books, documents, records, papers, and accounts of Assignor relating to the Property and to exclude Assignor and its agents, or employees wholly therefrom; as attorney-in-fact or agent of Assignor or personally or by its agents or attorneys to make, modify, amend, enforce, cancel, terminate, or accept surrender of any Lease now in effect or hereinafter in effect on the Property or any part of the Property; to remove and evict any Lessee; to increase or decrease Rents under any Lease; to decorate, clean, improve, and repair and otherwise do any act or incur any cost or expense that Assignee may deem necessary to protect the security hereof, as fully and to the same extent as Assignor could do if in possession; to insure and reinsure the Property and all risks incidental to Assignee's possession, operation, and management thereof and in such event to apply the Rents collected to the operation and management of the Property, but in the order of priority as Assignee shall deem proper, to the payment of management, brokerage, and attorneys' fees and disbursements, and to the payment of the Obligations and to the establishment and maintenance, without interest, of any reserves deemed necessary or desirable by Assignee, including without limitation a reserve for replacements; and/or

(d) to make any payments or do any acts that Assignor is obligated to make or do under this Assignment, the Loan Agreement, or any of the other Loan Documents and fails to make or do in the manner and to the extent as Assignee may deem necessary to protect the Property or any of the Leases, including the right to appear in and defend any action or proceeding purporting to affect the Property or any of the Leases, or the rights or powers of Assignee, and also the right to perform and discharge each and every obligation, covenant, and agreement of Assignor contained in any Lease and in exercising any powers to pay necessary costs and expenses, employ counsel, and incur and pay attorneys' fees and expenses.

All rights and remedies of Assignee under this Assignment shall be cumulative, shall be in addition to all other rights and remedies of Assignee under the other Loan Documents, at law or in equity, and may be exercised concurrently or independently, from time to time, as Assignee shall elect. All rights and remedies may be exercised without notice to Assignor. If not exercised before a foreclosure sale pursuant to the Mortgage, all remedies provided in this Assignment may be exercised at any time during the period of redemption after a foreclosure sale whether or not an Event of Default exists. Upon issuance of a deed or deeds pursuant to foreclosure of the Mortgage, all right, title, and interest of Assignor in and to the Leases shall, by virtue of this instrument, thereupon vest in and become the absolute property of the grantee or grantees in such deed or deeds without any further act or assignment by Assignor.

Any amounts received by Assignor or its agents for performance of any actions prohibited by the terms of this Assignment, including any amounts received in connection with any cancellation, modification, or amendment of any of the Leases prohibited by the terms of this Assignment, and any amounts received by Assignor as Rents, income, issues, or profits from the Premises from and after the occurrence of any Event of Default, shall be held by Assignor as trustee for Assignee, and all such amounts shall be accounted for to Assignee and shall not be commingled with other funds of Assignor. Any person acquiring or receiving all or any portion of such trust funds shall acquire or receive them in trust for Assignee as if such person had actual or constructive notice that such funds were impressed with a trust in accordance herewith; by way of example and not of limitation, such notice may be given by an instrument recorded with the Recorder of the county in which the Property is located stating that Assignor has received or will receive such amounts in trust for Assignee.

7. ***Assignee Not Obligated.*** **Assignee shall not be obligated to perform or discharge, nor does it by this Assignment undertake to perform or discharge, any obligation, duty, or liability under any of the Leases. Assignor shall and does hereby agree to indemnify and hold Assignee harmless of and from any and all liability, loss, cost, or damage that Assignee may incur under or in connection with any of the Leases or this Assignment, and of and from any and all claims, suits, actions, liabilities, and demands whatsoever that may be asserted against it under or in connection with the Leases or this Assignment or by reason of any alleged obligations or undertakings on its part to perform or discharge any of the terms, covenants, or agreements contained in any of the Leases. Should Assignee incur any liability, loss, cost, or damage under any of the Leases or by reason of this Assignment or in the defense of any claims or demands, that amount, including costs, expenses, and attorneys' fees and costs, shall be secured hereby, and Assignor shall reimburse Assignee therefor immediately upon demand.**

8. ***Application of Rents.*** **All sums collected and received by Assignee out of the rents, issues, income, and profits of the Property following the occurrence of any one or more Events of Default shall be applied in accordance with the Illinois Mortgage Foreclosure Law, 735 ILCS 5/15-1101,** ***et seq.,*** **and, unless otherwise specified in that Law, in such order as Assignee shall elect in its sole and absolute discretion.**

9. ***Exculpation of Assignee.*** **The acceptance by Assignee of this Assignment with all of the rights, powers, privileges, and authority created hereby shall not, before entry on and taking possession of the Property by Assignee, be deemed or construed either to constitute Assignee a "mortgagee in possession" nor thereafter or at any time or in any event obligate Assignee to appear in or defend any action or proceeding relating to the Leases, the Rents, or the Property or to take any action under this Assignment or to expend any money or incur any expenses or perform or discharge any obligation, duty, or liability under any Lease or to assume any obligation or responsibility for any security deposits or other deposits delivered to Assignor by any Lessee and not assigned and delivered to Assignee, nor shall Assignee be liable in any way [**(except for its willful misconduct or gross negligence)**] for any loss sustained by Assignor resulting from Assignee's failure to let the Property after default or from any other act or omission of Assignee in managing the Property after default or for any injury or damage to person or property sustained by any person or entity in or about the Property.**

This Assignment shall not operate to place responsibility for the control, care, management, or repair of the Property on Assignee, nor for the carrying out of any of the terms and conditions of the Lease; nor shall it operate to make Assignee responsible or liable for any waste committed on the Property by any Lessee or any other person or entity or for any dangerous or defective condition of, on, in, under, or around the Property.

10. ***No Waiver or Election of Remedies.***

(a) ***Waiver.*** **Neither the collection of the Rent and application as provided for in this Assignment nor the entry on and taking possession of the Property by Assignee shall be deemed to cure or waive any default under the Loan Agreement, the Note, the Mortgage, or any of the other Loan Documents or invalidate any act done pursuant to any notice. The enforcement of any right or remedy by Assignee once exercised shall continue for as long as Assignee shall elect, notwithstanding that the collection and application of the Rents may have cured the original default. If Assignee shall after that time elect to discontinue the exercise of any such right or remedy, the same or any other right or remedy hereunder may be reasserted at any time and from time to time following any subsequent default.**

(b) ***Election of Remedies.*** **The failure of Assignee to assert any of the terms, covenants, and conditions of this Assignment for any period of time or at any time or times shall not be construed or deemed to be a waiver of any right (including the rights implied in section 6 of this Assignment), and nothing contained in this Assignment nor anything done or omitted to be done by Assignee pursuant to this Assignment shall be deemed to be an election of remedies or a waiver by Assignee of any of its rights and remedies under the Loan Agreement, the Note, the Mortgage, or any other Loan Document, at law or in equity. The right of Assignee to collect and enforce the payment and performance of the Obligations and to enforce any other security therefor may be exercised by Assignee, either before, simultaneously with, or after any action taken under this Assignment. Assignee shall not be required to seek the appointment of a receiver or to institute any proceeding of any kind, possessory or otherwise, to secure or enjoy the full benefits of this Assignment.**

No judgment or decree that may be entered on any debt secured or intended to be secured by the Mortgage or any of the other Loan Documents shall operate to abrogate or lessen the effect of this Agreement, which shall continue in full force and effect until the payment and discharge of any and all indebtedness secured by the Mortgage and the other Loan Documents, in whatever form the said indebtedness may be.

11. ***Appointment of Attorney-in-Fact.***

(a) ***Rents.*** **Subject to the license described and limited in section 5 above, Assignor hereby constitutes and appoints Assignee the true and lawful attorney-in-fact, coupled with an interest, of Assignor, empowered and authorized in the name, place, and stead of Assignor to, upon the occurrence of an Event of Default, demand, sue for, attach, levy, recover, and receive all Rents and give proper receipts, releases, and acquittances therefor and, after deducting expenses of collection, to the extent permitted by law, to apply the net proceeds as a credit on any portion of the Obligations selected by Assignee, notwithstanding the fact that**

the portion of the Obligations may not then be due and payable or that the portion of the Obligations is otherwise adequately secured, and Assignor does hereby authorize and direct any Lessee to deliver the payment to Assignee in accordance with this Assignment, and Assignor hereby ratifies and confirms all that its attorney, Assignee, shall do or cause to be done by virtue of the powers granted hereby. The above appointment is irrevocable and continuing, and the rights, powers, and privileges shall be exclusive in Assignee and its successors and assigns, and Assignor hereby warrants that Assignor has not, at any time before the date of this Assignment, assigned this right. A Lessee may not inquire into the authority of Assignee to collect any Rents, and its obligations to Assignor shall be absolutely discharged to the extent of any payment to Assignee.

(b) ***Leases.*** **Subject to the license described and limited in section 5 above, Assignor hereby constitutes and appoints Assignee the true and lawful attorney-in-fact, coupled with an interest, of Assignor, empowered and authorized in the name and stead of Assignor to, upon the occurrence of an Event of Default, subject and subordinate at any time and from time to time any Lease or any part thereof to the lien and security interest of the Mortgage or any other mortgage, deed of trust, or security agreement or to any ground lease of the Property, or to request or require subordination, when the reservation, option, or authority was reserved to Assignor under the Lease, or in any case in which Assignor otherwise would have that right, power, or privilege, and Assignor hereby ratifies and confirms all that its attorney, Assignee, shall do or cause to be done by virtue of the powers granted hereby. The foregoing appointment is irrevocable and continuing, and the rights, powers, and privileges shall be exclusive in Assignee and its successors and assigns, and Assignor hereby warrants that Assignor has not, at any time before the date of this Assignment, assigned this right. Assignor hereby covenants not to exercise any right to subordinate any Lease to the lien of the Mortgage or to any other mortgage, deed of trust, or security agreement or any ground lease unless required to do so by Assignee.**

12. ***Assignor's Indemnities.*** **Assignor hereby agrees to indemnify and hold Assignee, its directors, officers, employees, agents, shareholders, partners, and members, and the successors and assigns of the foregoing, and each of them, free and harmless from and against any and all liability, loss, cost, damage, or expense (including, without limitation, attorneys' fees and expenses) that any of the foregoing may incur under or by reason of this Agreement, or for any action taken by Assignee hereunder, or by reason or in defense of any and all claims and demands that may be asserted against any of the foregoing arising out of any of the Leases, including specifically, but without limitation, any claim by any Lessee of credit for prepaid Rents or any security deposits paid to and received by Assignor but not delivered to Assignee. In the event Assignee incurs any liability, loss, cost, damage, or expense, the amount thereof at the Default Rate shall be payable by Assignor to Assignee immediately without demand and shall be secured hereby and by all other security for the payment of the Loan, including specifically, but without limitation, the lien and security interest of the Mortgage.**

13. ***Delivery of Leases — Further Acts and Assurances.*** **Until the Obligations secured by this Assignment are paid in full and discharged, Assignor shall deliver to Assignee all copies of existing, executed Leases and all other future Leases when executed on all or any part of**

the Property, and shall transfer and assign all other and future Leases on the same terms and conditions as hereby contained, and Assignor hereby covenants and agrees to make, execute, and deliver to Assignee upon demand and at any time or times any and all assignments and other documents and instruments that Assignee may deem reasonably necessary to carry out the true purposes and intent of this Agreement.

14. ***No Merger of Estates.*** **As long as the Obligations secured by this Assignment remain unpaid and undischarged and unless Assignee otherwise consents in writing, the fee and the leasehold estates in and to the Property shall not merge but shall always remain separate and distinct, notwithstanding the union of these estates either in Assignor, in Assignee, or in any Lessee or third party by purchase or otherwise.**

15. ***Continuation — Termination.*** **Upon payment and discharge in full of the Obligations secured by this Assignment and of all sums payable hereunder and compliance with all of the terms of the Mortgage, Loan Agreement, and other Loan Documents as evidenced by a full release of record of the Mortgage, this Assignment shall terminate, and, if requested by Assignor (at Assignor's sole cost and expense), Assignee shall deliver a release hereof in recordable form.**

16. ***Notices.*** **All notices, demands, or documents of any kind that either party hereto may be required or may desire to serve on the other party under this Assignment shall be in writing and shall be given and delivered as provided in the Loan Agreement.**

17. ***Parties Bound.*** **The terms, covenants, conditions, and warranties contained in this Assignment and the powers granted hereby shall run with the land and shall inure to the benefit of and bind all parties hereto and their respective heirs, executors, administrators, legal representatives, successors, and assigns, and all Lessees, all subtenants and assigns of those Lessees, and all subsequent owners of the Property, and all subsequent holders of the Obligations. In this Assignment, when the context requires, the singular number shall include the plural and conversely in each case. All obligations of Assignor hereunder shall be joint and several.**

18. ***Modifications.*** **No provision of this Assignment shall be modified or limited by course of conduct or usage of trade except by a written agreement expressly referring hereto and to the provision modified or limited and signed by Assignor and Assignee.**

19. ***Severability.*** **In case any one or more of the provisions contained in this Assignment shall for any reason be held to be invalid, illegal, or unenforceable in any respect, that invalidity, illegality, or unenforceability shall not affect any other provision of this Assignment, and this Assignment shall be construed as if the invalid, illegal, or unenforceable provision had never been contained herein.**

20. ***Headings.*** **The headings contained in this Assignment are for reference purposes only and shall not in any way affect the meaning or interpretation hereof.**

21. ***Applicable Law.*** **Assignor agrees that this Assignment shall be governed by and construed in accordance with the internal laws (as opposed to conflict of laws principles) of the State of Illinois.**

22. ***Conflicts Between Documents*****. In the event of any conflict between the terms of this Assignment and the terms of the Loan Agreement, the terms of the Loan Agreement shall prevail. A provision in this Assignment shall not be deemed inconsistent with the Loan Agreement by reason of the fact that no provision in the Loan Agreement covers the same matter as the provision in this Assignment.**

23. ***Time of Essence.*** **Time is of the essence with respect to this Assignment and each provision of this Assignment of which time is an element.**

24. ***Capitalized Terms.*** **All capitalized terms used in this Assignment shall have the same meanings as in the Loan Agreement, unless otherwise defined herein.**

25. ***No Third-Party Beneficiaries.*** **This Assignment, the Loan Agreement, the Note, the Mortgage, and the other loan documents are made and entered into for the sole protection and benefit of Assignee and its successors and assigns, and no other persons or entities shall have any right at any time to act hereon; and the proceeds of the Loan do not constitute a trust fund for the benefit of any third party.**

26. ***No Joint Venture.*** **Notwithstanding anything in this Assignment to the contrary, Assignee, by acting pursuant hereto (including but not limited to the exercise by Assignee of any rights or remedies granted hereby), does not intend and shall not be deemed to be a partner or joint venturer with Assignor or any general partner of Assignor. Neither Assignor nor any general partner of Assignor is acting as agent or principal of Assignee for any purpose.**

27. ***Counterparts.*** **This Assignment may be executed in multiple counterparts, all of which shall be deemed originals and with the same effect as if all parties hereto had signed the same document. All of such counterparts shall be construed together and shall constitute one instrument, but in making proof, it shall be necessary to produce only one such counterpart.**

[28. *Exculpation.* The liability of Assignor under this Assignment shall be limited as set forth in the Loan Agreement.**]**

IN WITNESS WHEREOF, this Assignment has been duly executed by the parties hereto as of the date and year first above written.

ASSIGNOR:

_____, a
_____

By: _____
Name: _____
Its: _____

ASSIGNEE:

_____, a
_____

By: _____
Name: _____
Its: _____

[Add notary pages and Exhibit ____ legal description.**]**

11 Reorganization and Liquidation in Landlord-Tenant Relationships

BRIAN P. WELCH
Burke, Warren, MacKay & Serritella, P.C.
Chicago

I. [11.1] SCOPE OF CHAPTER

This chapter examines the effect of the Bankruptcy Code, 11 U.S.C. §101, *et seq.,* on unexpired leases for nonresidential real property. The primary focus of the chapter is §365 of the Bankruptcy Code, the related provisions of the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure, and their effect on landlords of nonresidential property with tenants in bankruptcy.

II. INTRODUCTION TO THE BANKRUPTCY PROCESS

A. [11.2] Forms of Bankruptcy Relief

There are three common forms of bankruptcy relief — Chapter 7, Chapter 11, and Chapter 13. Chapter 7 is a liquidation proceeding in which a trustee is appointed to gather the debtor's nonexempt property, convert that property into cash, and distribute the cash to the debtor's creditors. Chapters 11 and 13 of the Bankruptcy Code generally concern the debtor's reorganization and rehabilitation, rather than liquidation, although some Chapter 11 cases ultimately result in a liquidating plan. Chapter 11 is available to individuals and commonly used business entities such as partnerships, corporations, and limited liability companies. 11 U.S.C. §109. Chapter 13 is available only to individuals with regular income who owe, on the date of filing for bankruptcy, noncontingent, liquidated debts of less than $2,750,000. 11 U.S.C. §109(e). (The debt limit is adjusted periodically by Congress.) In both Chapter 11 and 13 proceedings, the debtor retains its assets, continues to operate its business, and pays creditors pursuant to a court-approved plan of reorganization.

The Small Business Reorganization Act of 2019 (SBRA), Pub.L. No. 116-54, 133 Stat. 1079, was signed into law August 23, 2019, and became effective February 19, 2020. The SBRA provides debtors with the option (based on qualifying considerations) to elect to proceed with a new form of Chapter 11 case under Subchapter V of the Bankruptcy Code. 11 U.S.C. §§1181 – 1195. The SBRA was enacted to provide debtors engaged in a business activity with noncontingent, unsecured debts as of the petition date not more than $2,725,625 arising from commercial or business activities a more cost-effective and less complicate and time-consuming alternative to a traditional Chapter 11 case. When the global pandemic associated with the COVID-19 virus occurred weeks after SBRA went effective, the debt ceiling was increased to $7,500,000 under the Coronavirus Aid, Relief, and Economic Security Act, Pub.L. No. 116-136, 134 Stat. 281 (2020). The expansion of the debt ceiling has been renewed from time to time and is presently extended through mid-2024. See 11 U.S.C. §1182.

Although it is by definition a Chapter 11 case, relief under Subchapter V is available to small business entities and individuals qualifying pursuant to the applicable debt ceiling. In a Subchapter V case, the debtor's goal remains a reorganization pursuant to a court-approved plan, but the process is stripped of many requirements that have made a traditional Chapter 11 reorganization case too complex and/or costly for many small business debtors.

B. [11.3] Commencement of a Bankruptcy Case

A bankruptcy case under any chapter typically begins with the filing of a voluntary petition for relief with the bankruptcy court. 11 U.S.C. §301. The commencement of a voluntary case constitutes an "order for relief." *Id.* The dates of the petition and order for relief are significant in that they are a time reference for many of the provisions in the Bankruptcy Code, such as the imposition of the automatic stay pursuant to 11 U.S.C. §362(a) (see §11.5 below) or the commencement of the "stub rent" period (see §11.17 below).

A Chapter 7 or 11 case can also be commenced involuntarily against a debtor by creditors meeting certain requirements. 11 U.S.C. §303. A single creditor whose claim is not subject to a bona fide dispute as to liability or amount may commence an involuntary proceeding when the debtor has fewer than 12 creditors holding noncontingent, undisputed claims in the aggregate amount of $18,600. 11 U.S.C. §303(b)(2). If the debtor has 12 creditors or more, then at least 3 creditors holding noncontingent, undisputed claims in the aggregate amount of at least $18,600 are required to sign the involuntary petition. 11 U.S.C. §303(b)(1). (The debt thresholds are adjusted periodically by Congress.) If an involuntary petition is dismissed, the petitioning creditors may be liable for a judgment for the debtor's fees and costs in contesting the involuntary petition, any damages to the debtor proximately caused by the filing of the involuntary petition, and punitive damages. 11 U.S.C. §303(i).

C. [11.4] Conversion of a Bankruptcy Case

Once a petition is filed, the debtor, a creditor, or any other party in interest can move to convert the case. For example, a party may seek to convert a Chapter 11 reorganization to a Chapter 7 liquidation. 11 U.S.C. §1112. Conversion of a case from one chapter to another constitutes a new "order for relief" (11 U.S.C. §348), and in certain instances, new deadlines will be set in the bankruptcy case.

D. [11.5] Effect of "Order for Relief" — Automatic Stay

The filing of a petition under Chapter 7, 11, or 13 automatically "stays" (*i.e.,* restrains) creditors from taking further action against the debtor, the property of the debtor, or property of the estate to collect their claims or enforce their liens. 11 U.S.C. §362(a). The automatic stay goes into effect upon the filing of the bankruptcy petition, not at the time a creditor receives notice or learns of the bankruptcy. *See In re Swindle,* 584 B.R. 259, 264 (Bankr. N.D.Ill. 2018) (stating that "[t]he automatic stay is a self-executing provision of the Bankruptcy Code and begins to operate nationwide, without notice, once a debtor files a petition for relief"). The automatic stay prohibits creditors from, among other things, (1) commencing a lawsuit against the debtor; (2) prosecuting an existing suit against the debtor; (3) enforcing a judgment against the debtor; (4) attempting to collect, assess, or recover a prepetition claim against the debtor; (5) perfecting or enforcing a lien against the debtor; and (6) attempting to obtain possession of property of the debtor or to exercise control over property of the debtor. 11 U.S.C. §362.

One purpose of the automatic stay is to facilitate the debtor's attempt to obtain a fresh start. *See Swindle, supra,* 584 B.R. at 263 ("The purpose of the automatic stay is to give the debtor a

'breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.' "), quoting *Achterber v. Creditors Trade Ass'n (In re Achterberg),* 573 B.R. 819, 835 (Bankr. E.D.Cal. 2017). The Seventh Circuit has observed that "[t]he purpose of the automatic stay is to preserve what remains of the debtor's insolvent estate and to provide a systematic equitable liquidation procedure for all creditors, secured as well as unsecured . . . thereby preventing a 'chaotic and uncontrolled scramble for the debtor's assets in a variety of uncoordinated proceedings in different courts.' " [Citations omitted.] *In re Holtkamp,* 669 F.2d 505, 508 (7th Cir. 1982), quoting *Litton Systems, Inc. v. Frigitemp Corp. (In re Frigitemp Corp.),* 8 B.R. 284, 289 (S.D.N.Y. 1981). Thus, the automatic stay exists for the benefit of the debtor and its creditors. While creditors are restrained from collection of prebankruptcy obligations, the breathing spell afforded by the Bankruptcy Code exists, in part, to ensure an organized and equitable system in which all creditors share in the recovery. *See In re Dawson,* 390 F.3d 1139, 1147 (9th Cir. 2004) (describing purpose of stay as "two-fold" because "[b]y halting all collection efforts, it gives the debtor a breathing spell from his creditors during which the debtor can try to reorganize" and "[b]y preventing creditors from pursuing, to the detriment of others, their own remedies against the debtors' property the stay protects creditors"), quoting *United States v. Dos Cabezas Corp.,* 995 F.2d 1486, 1491 (9th Cir. 1993).

When a tenant files a bankruptcy petition, the automatic stay prevents the landlord from proceeding against the tenant for past-due rent or for possession of the premises. Any claim the landlord has against the tenant must be adjudicated in the bankruptcy court unless the creditor files a motion and obtains an order from the bankruptcy court granting relief from the automatic stay by terminating, annulling, modifying, or conditioning the stay. 11 U.S.C. §362(d).

E. [11.6] Trustees and Debtors-in-Possession

In every bankruptcy case, an attorney from the U.S. Department of Justice, known as a U.S. trustee, is appointed to serve. The primary function of the U.S. trustee is to promote the efficiency and protect the integrity of the bankruptcy process. The U.S. trustee monitors the conduct of parties to the bankruptcy proceeding, oversees administrative functions of the case, and ensures compliance with applicable laws and procedures. The U.S. trustee also investigates bankruptcy fraud and abuse with the United States attorney, the FBI, and other law enforcement agencies. The U.S. trustee has standing to appear in the bankruptcy case and to object (or otherwise provide input) on matters before the bankruptcy court.

In addition to the U.S. trustee, in every Chapter 7 case and some Chapter 11 cases, a case trustee is also appointed. The case trustee is a private citizen (usually, but not always, an attorney) and is not an employee of the federal government. The trustee's main duty is to preserve the value of any property of the estate for the benefit of creditors, collect the property of the estate, and liquidate it to cash to create a pool of money from which creditors can share.

In a small business case under Subchapter V of Chapter 11, the debtor remains in possession of its assets and continues to operate its business, but a case trustee is appointed with limited duties (as compared to a Chapter 7 trustee or the less common Chapter 11 trustee) to participate in the reorganization process. The Subchapter V trustee, among other things, monitors matters relating to

the debtor's business, its finances, and its efforts to reorganize and has standing to appear in the Subchapter V case and to object (or otherwise provide input) on matters that come before the bankruptcy court, including at any hearing that concerns (1) the value of property subject to a lien; (2) confirmation of a plan filed under Subchapter V; (3) modification of the plan after confirmation; or (4) the sale of property of the estate. 11 U.S.C. §1183(b)(3).

Since Chapter 11 contemplates the debtor's reorganization rather than a liquidation, a Chapter 11 debtor usually remains in control of the business after the filing of the Chapter 11 petition. Such a debtor is referred to as a "debtor-in-possession." The Chapter 11 debtor-in-possession possesses many of the rights, duties, and obligations of a bankruptcy trustee. 11 U.S.C. §1107. If creditors or parties in interest (including the U.S. trustee) become dissatisfied with the debtor-in-possession's performance of its duties, the appointment of a Chapter 11 trustee is one of several available remedies. 11 U.S.C. §1104.

III. UNEXPIRED LEASES FOR NONRESIDENTIAL PROPERTY

A. [11.7] Background

Debtors in bankruptcy are often parties to one or more "executory contracts," which are contracts that "neither party has finished performing" or on which "performance remains due to some extent on both sides." *Mission Product Holdings, Inc. v. Tempnology, LLC,* ___ U.S. ___, 203 L.Ed.2d 876, 139 S.Ct. 1652, 1657 – 1658 (2019), quoting *National Labor Relations Board v. Bildisco & Bildisco,* 465 U.S. 513, 79 L.Ed.2d 482, 104 S.Ct. 1188, 1194 n.6 (1984). The most common executory contract, and the subject of this chapter, is a lease of real property. Courts do not place form over substance, and the mere fact that an agreement for the use of property is labeled as a "lease" does not necessarily make it a lease for purposes of the application of §365 of the Bankruptcy Code. *In re James Wilson Associates,* 965 F.2d 160, 164 (7th Cir. 1992); *Tak Broadcasting Corp. v. Trinity Broadcasting of Florida, Inc. (In re Tak Broadcasting Corp.),* 137 B.R. 728, 732 (W.D.Wis. 1992). "What controls the determination of substance . . . is state law," and "the proper inquiry for a court in determining whether [there is a lease in substance] is whether the parties intended to impose obligations and confer rights significantly different from those arising from the ordinary landlord/tenant relationship." *Acevedo v. SC Real Estate, LLC,* 526 B.R. 761, 766 (N.D.Ill. 2014), quoting *International Trade Administration V. Rensselaer Polytechnic Institute,* 936 F.2d 744, 748 (2d Cir. 1991).

Once in bankruptcy, subject to several conditions, a trustee or debtor-in-possession has the option to assume or reject any lease of nonresidential real property. 11 U.S.C. §365(a). This provision "[a]llows a trustee or debtor in possession to accept the benefits of an advantageous contract by assuming it or to be relieved of the obligations of a burdensome contract by rejecting it." *In re Lake Dearborn, LLC,* 534 B.R. 747, 751 (Bankr. N.D.Ill. 2015), quoting *In re Fitch,* 174 B.R. 96, 100 (Bankr. S.D.Ill. 1994).

By its terms, §365 of the Bankruptcy Code applies only to "unexpired" leases. 11 U.S.C. §365(a). Thus, if the lease expired or was validly terminated prior to the date of the order for relief, the lease is not property of the bankruptcy estate and may not be assumed or rejected. *See Moody*

v. Amoco Oil Co., 734 F.2d 1200, 1213 (7th Cir. 1984). However, the termination must be complete and not subject to reversal, either under state law or under the terms of the lease. *Id.* See also 3 Richard B. Levin and Henry J. Sommer eds., COLLIER ON BANKRUPTCY ¶365.03 (16th ed. 2009). State law determines when a lease "terminates" for the purpose of determining whether a debtor can assume or reject a lease. *Robinson v. Chicago Housing Authority (In re Robinson),* 169 B.R. 171, 174 (N.D.Ill. 1994), *aff'd,* 54 F.3d 316 (7th Cir. 1995).

B. [11.8] Considerations in Assuming or Rejecting Leases

The "decision to assume or reject an executory contract is governed by the business judgment rule." *In re Edison Mission Energy,* No. 12-49219, 2013 WL 5220139, *5 (Bankr. N.D.Ill. Sept. 16, 2013). "The business judgment rule is 'premised upon the debtor's business judgment that assumption would be beneficial to its estate.' " *Id.,* quoting *In re Footstar, Inc.,* 323 B.R. 566, 569 (Bankr. S.D.N.Y. 2005). Under this standard, the trustee or debtor-in-possession is given great deference in the decision to assume or reject, as long as the requirements of §365 are otherwise fulfilled.

Generally, in a Chapter 7 case, the trustee seeks to reject leases that provide no benefit to the estate, drain the estate financially, and/or decrease the distribution to creditors. Since the Chapter 7 trustee ordinarily is not operating the debtor's business, there is little business justification to assume the debtor's leasehold obligations. However, in limited circumstances a Chapter 7 trustee might seek to operate the debtor's business, and even when the trustee is not operating the debtor's business, an unexpired lease with below-market rent can be assumed and assigned to a third party in consideration for payment to the estate by the assignee. 11 U.S.C. §365(f)(2). Importantly, the ability of the trustee or debtor-in-possession to assume and assign a lease exists "notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease." 11 U.S.C. §365(f)(1). Assumption and assignment relieves the trustee and the estate from any liability for any breach that occurs after the assignment. 11 U.S.C. §365(k).

In a Chapter 11 case, the debtor-in-possession engages in a business evaluation of whether the leased premises generate value for its business. If so, a debtor-in-possession will usually seek to assume its lease. If not, the debtor evaluates whether the lease can be assumed and assigned for consideration or whether, alternatively, the lease should be rejected. The Bankruptcy Code provides leverage to a Chapter 11 debtor-tenant with respect to a lease with rental obligations that are burdensome to the estate. Given that the debtor has the ability to simply reject such a lease, leaving the landlord without a tenant and with only a prepetition claim for unpaid rent and an uncertain recovery, Chapter 11 debtors use their right to reject the lease as a tool to engage the landlord in discussions regarding a rent reduction, cure obligations, and/or other nonmonetary obligations under the lease on a going-forward basis.

C. [11.9] Time for Assumption or Rejection of Nonresidential Leases for Real Property

The debtor's right to assume or reject an unexpired lease is "subject to the court's approval." 11 U.S.C. §365(a). Although court approval is not "a condition precedent to an effective assumption or rejection," it is viewed as "a safeguard subjecting the decision of the trustee (and its

business judgment) to review and possible reversal." *In re Joseph C. Spiess Co.,* 145 B.R. 597, 601 (Bankr. N.D.Ill. 1992). An assumption must be approved by the bankruptcy court, and the counterparty to the contract has standing to object to the debtor's election. Fed.R.Bankr.P. 9014. A motion to assume or reject a lease may not be granted ("[e]xcept to the extent that relief is necessary to avoid immediate and irreparable harm") within 21 days of the filing of the bankruptcy petition. Fed.R.Bankr.P. 6003. Section 365 of the Bankruptcy Code does not allow for the partial assumption and/or partial rejection of an unexpired lease to accept the benefits of the contract while rejecting its obligations; rather, the entire agreement must be assumed, as is. *In re United Air Lines, Inc.,* 447 F.3d 504, 505 (7th Cir. 2006); *In re StarNet, Inc.,* 355 F.3d 634 (7th Cir. 2004).

In a Chapter 11 case, the debtor must assume or reject unexpired leases within the earlier of (1) 120 days of the entry of the order for relief or (2) the date of the entry of an order confirming a Chapter 11 plan. 11 U.S.C. §365(d)(4)(A). The bankruptcy court may grant an extension of the 120-day deadline for 90 days, on motion of a party, brought prior to the expiration of the existing deadline. 11 U.S.C. §365(d)(4)(B)(i). Thus, with limited exception, the maximum amount of time that a debtor has to decide whether to assume or reject an unexpired lease is 210 days from the entry of the order of relief. Following the expiration of the 210-day period, further extensions of the deadline can be granted "only upon prior written consent of the lessor in each instance." 11 U.S.C. §365(d)(4)(B)(ii). The failure to timely assume or reject a lease results in the deemed rejection of the lease. 11 U.S.C. §365(d)(4)(A).

IV. REJECTION OF LEASE

A. [11.10] Effective Time of Rejection

The Bankruptcy Code establishes the effective date for rejection of a lease, and generally the rejection of an executory contract or unexpired lease not previously assumed operates as a breach of the contract as of the date immediately prior to the time of the filing of the petition. 11 U.S.C. §365(g)(1).

Courts are divided as to when rejection of a commercial lease becomes effective. Because a debtor must continue to honor its leasehold obligations until the lease is rejected, the effective date of the rejection is significant.

Some courts have held that court approval of a rejection is a condition precedent to effective rejection of a nonresidential lease. *See, e.g., In re Thinking Machines Corp.,* 67 F.3d 1021, 1025 (1st Cir. 1995); *In re 1 Potato 2, Inc.,* 182 B.R. 540, 542 (Bankr. D.Minn. 1995); *Maroon v. Four Star Pizza, Inc. (In re Four Star Pizza, Inc.),* 135 B.R. 498, 500 (Bankr. W.D.Pa. 1992); *In re Federated Department Stores, Inc.,* 131 B.R. 808 (S.D. Ohio 1991); *In re Revco D.S., Inc.,* 109 B.R. 264, 267 (Bankr. N.D. Ohio 1989). In *Revco,* the court held that unilateral acts or decisions of the debtor could not constitute rejection of a lease.

Other courts — including at least one court in the United States Bankruptcy Court for the Northern District of Illinois — have held that rejection may occur prior to court approval. *See, e.g.,*

In re Joseph C. Spiess Co., 145 B.R. 597, 600 (Bankr. N.D. Ill. 1992); *In re Mid Region Petroleum, Inc.,* 111 B.R. 968, 970 (Bankr. N.D. Okla. 1990). In *Joseph C. Spiess, supra,* the court held that court approval of a rejection was not a condition precedent and reasoned that rejection occurred when notice of the motion to reject the contract was given.

The Bankruptcy Code is silent as to whether the bankruptcy court may authorize lease rejection retroactive to a date prior to the entry of an order authorizing rejection. The consideration is important in many bankruptcy cases, because it affects the debtor's postpetition obligations and the nature and priority of the creditor's claim for unpaid rent in the bankruptcy case. If the debtor obtains rejection retroactively, then the unpaid creditor may be limited to a general unsecured claim for rejection damages. Conversely, if retroactive rejection is denied, then the creditor is likely entitled to a priority administrative expense claim for any pre-rejection postpetition rent that is unpaid plus a general unsecured claim for rejection damages.

"In most cases a lease will be considered rejected as of the date of entry of the order approving the rejection, and only in exceptional circumstances . . . will the court adopt a retroactive date." *In re O'Neill Theatres, Inc.,* 257 B.R. 806, 808 (Bankr. E.D.La. 2000). Several jurisdictions have held that bankruptcy courts have the authority to retroactively approve rejection. *See, e.g., Thinking Machines, supra,* 67 F.3d at 1028; *Stonebriar Mall Limited Partnership v. CCI Wireless, LLC (in re CCI Wireless, LLC),* 297 B.R. 133, 138 (D.Colo. 2003); *In re Amber's Stores, Inc.,* 193 B.R. 819, 827 (Bankr. N.D.Tex. 1996). Courts authorizing retroactive rejection have analyzed four factors to determine whether "exceptional circumstances" justify retroactive rejection: (1) whether the motion to reject was filed promptly; (2) whether the debtor promptly took action to set the motion for hearing; (3) whether the debtor had vacated the premises; and (4) whether the landlord had any improper motive in opposing retroactive rejection. *See In re At Home Corp.,* 392 F.3d 1064, 1072 (9th Cir. 2004); *In re New Meatco Provisions, LLC,* No. 2:13-bk-22155-PC, 2013 WL 3760129, *4 (Bankr. C.D.Cal. July 16, 2013).

The United States Supreme Court has stated that "[f]ederal courts may issue *nunc pro tunc* orders, or 'now for then' orders . . . to 'reflect the reality of what has already occurred.' " *Roman Catholic Archdiocese of San Juan, Puerto Rico v. Acevedo Feliciano,* ___ U.S. ___, 206 L.Ed.2d 1, 140 S.Ct. 696, 700 – 701 (2020), quoting *Missouri v. Jenkins,* 495 U.S. 33, 109 L.Ed.2d 31, 110 S.Ct. 1651, 1662 (1990). However, in rejecting the effectiveness of the nunc pro tunc order before it, the Supreme Court stated that "[n]unc pro tunc orders are not some Orwellian vehicle for revisionist history — creating 'facts' that never occurred in fact." 140 S.Ct. at 701, quoting *United States v. Gillespie*, 666 F.Supp. 1137, 1139 (N.D.Ill. 1987). "Put plainly, the court 'cannot make the record what it is not.' " 140 S.Ct. at 701, quoting *Jenkins, supra,* 110 S.Ct. at 1662. At least one court has cited the Supreme Court's decision in *Acevedo Feliciano* to cast doubt on whether retroactive rejection is appropriate. *See In re Donghia, Inc.,* Case No. 20-30487 (JJT), 2020 WL 2465503, **3 – 4 (Bankr. D.Conn. May 12, 2020) (citing *Acevedo Feliciano* while denying retroactive relief, but also finding that trustee seeking retroactive rejection could "only partially satisfy the factors set out in *In re At Home Corp.*"). Still, other courts since *Acevedo Feliciano* have approved requests for retroactive rejection. *See In re Pro Player's Poker Club, Inc.,* 636 B.R. 811, 829 – 830 (Bankr. C.D.Cal. 2022) (concluding that retroactive rejection remains authorized in Ninth Circuit, notwithstanding Supreme Court's decision in *Acevedo Feliciano,* and holding that retroactive rejection is consistent with broad equitable powers conferred on bankruptcy court pursuant to §105(a) of Bankruptcy Code to enter orders "necessary or appropriate to carry out" the purposes of §365(d) of Bankruptcy Code).

B. [11.11] Method of Rejection

A rejection of a lease may be accomplished either by the filing of a motion and court approval within the time frames set forth in §365(d)(4) of the Bankruptcy Code or by failure to assume by the deadlines set forth in §365(d)(4). 11 U.S.C. §365(d)(4); *Salzer v. Jocquel Supply (In re Salzer),* 180 B.R. 523, 527 (Bankr. N.D.Ind. 1993). If a debtor rejects a lease of real property, the rejection constitutes a breach under §365(g) of the Bankruptcy Code and renders the debtor-tenant liable for damages pursuant to §502(b) of the Bankruptcy Code. 11 U.S.C. §365(g); *In re Lake Dearborn, LLC,* 534 B.R. 747, 752 (Bankr. N.D.Ill. 2015); *Sunbeam Products, Inc. v. Chicago American Manufacturing, LLC,* 686 F.3d 372, 377 (7th Cir. 2012). As discussed in §11.13 below, the damages for termination of a lease are capped under the Bankruptcy Code. Following rejection, the debtor may not be compelled, whether by court order or otherwise, to perform under the contract. *Sunbeam Products,* 686 F.3d at 377.

If a lease is deemed rejected pursuant to §365(d)(4), the landlord may, if desired, move for the entry of an order confirming rejection of the lease pursuant to §105 of the Bankruptcy Code, which provides the bankruptcy court broad equitable powers to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. §105(a). Thus, to the extent that a landlord requires an order confirming rejection of the lease to show to potential tenants or purchasers that the subject property is free from any leasehold interests, §105(a) may be helpful in accomplishing this end.

V. DAMAGES UPON REJECTION

A. [11.12] Before Tenant Vacates Leased Premises

The Bankruptcy Code creates a priority scheme for the payment of creditors' claims that has substantial impact on the rights of parties to leases with a debtor. 11 U.S.C. §507. Pursuant to this priority scheme, creditors' claims are categorized into classes and paid accordingly. The claims of one class are not entitled to any distribution until the claims of the classes entitled to "priority" over theirs are paid in-full. To the extent not secured by a security deposit, any amount owed to the landlord before the entry of the order for relief is treated as a general unsecured claim. As such, the landlord's prepetition claim for rent is paid, if at all, only after secured creditors, administrative expenses, and other unsecured claims entitled to priority have been paid.

When an unexpired lease is rejected, the landlord's claim for prepetition rent is treated as a general unsecured claim. However, in most instances, if the debtor occupies the leased premises from the date of the order for relief until the lease is rejected and the premises are vacated, the landlord may be entitled to an administrative claim (*i.e.,* a priority claim) for unpaid rent for that period pursuant to §503 the Bankruptcy Code. 11 U.S.C. §§365(d)(3), 503. Section 365(d)(3) requires the trustee or the debtor-in-possession to "timely perform all obligations of the debtor . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." 11 U.S.C. §365(d)(3). See also 11 U.S.C. §§503(b)(1)(A) (categorizing "the actual, necessary costs and expenses of preserving the estate" as administrative expenses), 507(a)(2) (identifying

"administrative expenses allowed under section 503(b)" as priority claims). In the event that the debtor continues to occupy the leased premises without complying with its rental obligations under §365(d)(3), the landlord may consider the filing of a motion to compel payment of postpetition rent or, in the alternative, to compel rejection of the lease and immediate vacation of the premises.

B. [11.13] After Tenant Vacates Leased Premises

Since a rejection of a lease constitutes a breach by the debtor, the obvious conclusion is that the counterparty to the lease has a claim for damages resulting from the debtor's breach. After the tenant vacates the leased property, the landlord may assert a claim for "rejection damages." The Bankruptcy Code places a cap on a landlord's damages from the rejection of an unexpired lease by the debtor, calculated as follows:

> **(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of —**
>
> > **(i) the date of the filing of the petition; and**
> >
> > **(ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus**
>
> **(B) any unpaid rent due under such lease, without acceleration, on the earlier of such dates.** 11 U.S.C. §502(b)(6).

The complicated and arguably ambiguous language of §502(a)(6) of the Bankruptcy Code has been the subject of much litigation as to precisely how the calculation is made. In any event, the cap on damages is "designed to compensate the landlord for his loss while not permitting a claim so large as to prevent other general unsecured creditors from recovering a dividend from the estate." *In re Handy Andy Home Improvement Centers,* 222 B.R. 571, 574 (Bankr. N.D.Ill. 1998), quoting 4 Lawrence P. King ed., COLLIER ON BANKRUPTCY §502.03 (15th ed. 1998).

Since the lease is considered breached immediately prior to the rejection, the lessor that is damaged possesses only a general unsecured claim for these "rejection damages," which is not entitled to administrative priority, despite the fact that the rejection necessarily occurs after the filing of the bankruptcy petition. *In re National Steel Corp.,* 316 B.R. 287, 304 (Bankr. N.D.Ill. 2004).

Section 502(b)(6) of the Bankruptcy Code is a ceiling on the landlord's claim, subject to the landlord's duty to mitigate its damages. If, for example, the landlord obtains a new tenant for the leased premises the day after the debtor vacates, then the landlord's damages will be minimal. Section 11.17 below discusses the debtor's obligation to pay postpetition rent pursuant to §365(d)(3) of the Bankruptcy Code.

In *In re Atlantic Container Corp.,* 133 B.R. 980, 987 – 988 (Bankr. N.D.Ill. 1991), *In re Conston Corp.,* 130 B.R. 449, 452 (Bankr. E.D.Pa. 1991), and *In re McLean Enterprises, Inc.,* 105

B.R. 928, 933 – 934 (Bankr. W.D.Mo. 1989), courts expressly held that a landlord's rejection damages claim should not be reduced by rent paid postpetition pursuant to §365(d)(3). In *Conston,* the court noted that to reduce the landlord's claim would mean that a debtor that remained in bankruptcy for one year while paying postpetition rent would, in effect, deprive the landlord of any rejection damages, whereas a debtor that rejected its lease upon the filing of its bankruptcy petition would have no impact on the landlord's rejection claim.

VI. ASSUMPTION OF LEASE

A. [11.14] Generally

The Bankruptcy Code provides that if there has been a default of an unexpired lease, the trustee or debtor-in-possession cannot assume the lease unless, at the time of assumption, the trustee or debtor-in-possession

1. cures the default or provides adequate assurances of a prompt cure of the default;

2. compensates, or provides adequate assurance that the trustee or debtor-in-possession will promptly compensate, a party other than the debtor to the contract or lease for any pecuniary loss to that party resulting from the default; and

3. provides adequate assurance of future performance under the lease. 11 U.S.C. §365(b)(1).

An assignment of a lease assumed and assigned under §365 relieves the trustee and the estate from any liability for any breach occurring after the assignment. 11 U.S.C. §365(k).

If a debtor assumes a lease, the debtor must cure all existing defaults (or provide "adequate assurance" of a "prompt[ ] cure") and provide "adequate assurance of future performance" under the lease. 11 U.S.C. §365(b)(1). Once the lease is assumed under §365, the counterparty "has no choice"; it "must continue to perform under the terms of the contract with the debtor." *In re Superior Toy & Manufacturing Co.,* 78 F.3d 1169, 1172 (7th Cir. 1996).

With respect to a debtor's obligation to cure existing defaults, §365(b)(1)(A) provides that a default relating to a nonmonetary obligation need not be cured if it "is impossible for the trustee [or debtor-in-possession] to cure such default by performing nonmonetary acts at and after the time of assumption." 11 U.S.C. §365(b)(1)(A). However, if the nonmonetary default arises from a failure to operate in accordance with the nonresidential real property lease, then "such default shall be cured by performance at and after the time of assumption" and any "pecuniary losses resulting from such default shall be compensated in accordance with the provisions of [§365(b)(1)(A)]." *Id.* Section 365(b)(2) identifies several default provisions that need not be cured by a debtor or trustee upon assumption of a lease, including (1) defaults relating to the debtor's insolvency or financial condition at any time before the closing of the bankruptcy case; (2) defaults relating to the commencement of a bankruptcy case; (3) defaults relating to the appointment of a trustee or other custodian under the Bankruptcy Code; and (4) any penalty payments required under the lease relating to a nonmonetary default. 11 U.S.C. §365(b)(2).

The Bankruptcy Code also provides that in the event a debtor-lessee first assumes then rejects a nonresidential lease of real property, the landlord will be entitled to

> **a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6).** 11 U.S.C. §503(b)(7).

B. [11.15] Shopping Center Leases

The Bankruptcy Code makes it more difficult to assume a shopping center lease than other leases, stating:

> **For the purposes of paragraph (1) of this subsection and paragraph (2)(B) of subsection (f), adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance —**
>
> > **(A) of the source of rent and other consideration due under such lease, and in the case of an assignment, that the financial condition and operating performance of the proposed assignee and its guarantors, if any, shall be similar to the financial condition and operating performance of the debtor and its guarantors, if any, as of the time the debtor became the lessee under the lease;**
> >
> > **(B) that any percentage rent due under such lease will not decline substantially;**
> >
> > **(C) that assumption or assignment of such lease is subject to all the provisions thereof, including (but not limited to) provisions such as a radius, location, use, or exclusivity provision, and will not breach any such provision contained in any other lease, financing agreement, or master agreement relating to such shopping center; and**
> >
> > **(D) that assumption or assignment of such lease will not disrupt any tenant mix or balance in such shopping center.** 11 U.S.C. §365(b)(3).

Most leases that may be assumed may also be assigned by the trustee or debtor-in-possession to a third party. This is true despite the existence of a contractual provision prohibiting assignment. 11 U.S.C. §365(f)(1). *See also In re Howe,* 78 B.R. 226, 231 (Bankr. D.S.D. 1987) (bankruptcy statute providing for assignment of assumed contracts renders unenforceable any contractual provision that directly or indirectly affects assignment of contract). Section 365(b)(3) also provides that an assignment may be made only to certain financially worthy parties. The assignee must have a financial condition similar to the financial condition of the debtor that existed at the beginning of the lease. 11 U.S.C. §365(b)(3)(A).

VII. LANDLORD'S SOURCES OF REVENUE DURING BANKRUPTCY PROCEEDING

A. [11.16] Breathing Spell from Creditors

The commencement of a bankruptcy case "operates as a stay, applicable to all entities" of, among other things, "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). This "automatic stay" provided by §362 of the Bankruptcy Code provides debtors with a crucial "breathing spell" from creditors, which, indeed, is "automatic" upon the filing of the bankruptcy petition. 11 U.S.C. §362. The Bankruptcy Code allows the debtor to withhold prepetition obligations to creditors for a period of time while the debtor stockpiles cash in furtherance of its efforts to reorganize its finances. However, the breathing spell does not extend to postpetition obligations, including a tenant's obligation to pay rent for nonresidential property during the bankruptcy proceeding. 11 U.S.C. §365(d)(3).

B. [11.17] Tenant's Obligation To Pay Rent During Bankruptcy Proceeding

Section 365(d)(3) of the Bankruptcy Code requires the debtor to pay its postpetition obligations under an unexpired lease, stating:

> **The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.** 11 U.S.C. §365(d)(3).

Section 365(d)(3) allows landlords to assert a claim for postpetition rent without meeting the requirements of §503(b)(1). Specifically, unlike other administrative expense claims, claims by landlords for postpetition rent are "allowed in the full amount of rent and other charges due under the lease without a showing by the landlord that the amounts owed are reasonable or of a benefit to the estate." *See In re Microvideo Learning Systems, Inc.,* 232 B.R. 602, 604 (Bankr. S.D.N.Y. 1999).

Section 365(d)(3)'s provision that the trustee, or the debtor-in-possession, is required to "timely perform all the obligations . . . arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected" has "caused a great deal of debate among the Bankruptcy Courts." *Microvideo, supra,* 232 B.R. at 605. The "problem stems from the fact that the Code provides a mandate, timely rent payment, but does not specify a remedy in the event of a default." *Id. See also In re Rich's Department Stores, Inc.,* 209 B.R. 810, 815 (Bankr. D.Mass. 1997). The issue, then, is whether §365(d)(3) gives landlords a superpriority administrative expense claim for postpetition rent, to be paid before the other administrative claimants, regardless of their priority.

Some courts have held that §365(d)(3) does not create a superpriority administrative claim for landlords. *See Microvideo, supra.* Therefore, some courts hold that a landlord will not be allowed immediate payment of rent due postpetition unless the landlord establishes that there is a likelihood that the debtor will pay all of its administrative claims in full. *See In re Orient River Investments, Inc.,* 112 B.R. 126, 134 (Bankr. E.D.Pa. 1990).

Other courts — including at least one court in the United States Bankruptcy Court for the Northern District of Illinois — holds that the payment of postpetition rent under §365(d)(3) is similar to ordinary course payments under 11 U.S.C. §363(c)(1). *See also In re Telesphere Communications, Inc.,* 148 B.R. 525, 531 (Bankr. N.D.Ill. 1992). Those courts require the debtor to timely pay postpetition rent.

Some courts have drawn a distinction between postpetition rent and accrued postpetition rent. For example, in *In re Pudgie's Dev. of NY,* 223 B.R. 421, 427 (Bankr. S.D.N.Y. 1998), the court reasoned:

> **A significant jurisprudential difference exists between the *right* to prompt payment conferred by Section 365(d)(3) and a *claim* for accrued but unpaid rents. Section 365(d)(3) advances the landlord to the head of the line for current payment of ongoing expenses in recognition of his unique, involuntary creditor status. And, as with other post-petition payments essential for the continued operation of the debtor's business, such as for supplies, utilities, employee wages and the like, these payments are not subject to recapture. But once the landlord allows his *right* to timely payment to lapse into an accrued liability for unpaid rents, Section 365(d)(3) becomes irrelevant. The accrued liability for rents is no more than the landlord's lapsed right. A *claim* comes into existence on the basis of that accrued liability, but Section 365(d)(3) does not purport to establish claim priority. The statute does not allow the landlord to permit his right to lapse into a claim for accrued amounts, and later attempt to assert the claim on a superpriority basis ahead of other administrative or superpriority creditors.**
>
> **Section 365(d)(3) does not speak to the landlord's remedy, but other provisions of the Bankruptcy Code do. The landlord may enforce his right to timely performance under Section 365(d)(3) by moving to lift the stay for cause under Section 362(d)(1), or moving directly under Section 365(d)(3) to compel compliance on pain of contempt. What the landlord *may not* do is sit on his rights and allow the rent obligation to accrue, and later attempt to seek a superpriority status as an administrative claimant.** **[**Emphasis in original.**]**

Therefore, landlords should seek to immediately compel the trustee or debtor-in-possession to comply with §365(d)(3) if postpetition rent is not paid by filing a motion with the bankruptcy court for immediate payment of rent. The debtor-tenant may seek to extend, for cause, the time for payment of any rent that falls due within 60 days from the entry of the order for relief; however, the time for performance cannot be extended beyond the 60-day period.

It is important that the landlord bring a motion under §365(d)(3) as soon as possible to ensure that postpetition rent is timely paid. Failure to do so may result in the landlord's forgoing immediate payment and being forced to rely on an administrative claim to recover rent, along with other administrative claimants on a pro rata basis.

In one Chapter 11 case, the United States Bankruptcy Court for the Northern District of Illinois addressed whether a debtor-in-possession is required by §365(d)(3) to pay "stub period" rent as a condition to extend the 60-day (now 120-day) period then allowed under §356(d)(4) for assumption or rejection of nonresidential leases. *In re UAL Corp.,* 291 B.R. 121 (Bankr. N.D. Ill. 2003). The court defined the term "stub period" as the time after the entry of an order for relief, but before the next rent payment is due under a lease. 291 B.R. at 123 – 124. For example, in the United Airlines bankruptcy, the leases at issue required payment in advance on the first of the month, December 1, 2002, but the order of relief was entered on December 9, 2002, the date of the voluntary bankruptcy filing. Therefore, the stub period at issue was December 9 – December 31, after the entry of the order of relief, but prior to January 1, 2003, the date the next lease payment was due. 291 B.R. at 124.

The bankruptcy court noted that §365(d)(3) "creates a special period in the course of a bankruptcy case — the period from the date that an order for relief is entered to the date that an unexpired lease of nonresidential real property is assumed or rejected," a period the bankruptcy court referred to as the "option phase." *Id.* The court noted that although §365(d)(3) appears straightforward by requiring the debtor-in-possession or trustee to "timely" perform objections that "arise" during the option phrase, there is a conflict among the reported decisions regarding situations in which the time to make payment under a lease and the time to which the payment relates are not both within the option phase. *Id.* The reported cases frame the conflict as a choice between the "payment date" approach and the "proration" approach. *Id.*

Under cases adopting the payment date analysis, courts adopt a single rule: a lease obligation must be paid, in full, if and only if it becomes payable during the option phase, regardless of the lease period to which the obligation relates. 291 B.R. at 124 – 125. Accordingly, if taxes are to be paid after the filing of the bankruptcy, the payment date analysis requires the entire bill to be paid "even though the bill relates to periods of occupancy before or after the option phase." 291 B.R. at 125, citing *In re Montgomery Ward Holding Corp.,* 268 F.3d 205 (3d Cir. 2001), and *In re Comdisco, Inc.,* 272 B.R. 671 (Bankr. N.D.Ill. 2002).

Under cases adopting the proration analysis, a payment obligation due during the option phase will be paid only to the extent that the obligation relates to the time period during the option phase. 291 B.R. at 125, citing *In re Handy Andy Home Improvement Centers, Inc.,* 144 F.3d 1125 (7th Cir. 1998), and *Newman v. McCrory Corp*. (*In re McCrory Corp.),* 210 B.R. 934 (S.D.N.Y. 1997).

In *UAL,* the full monthly rent payment was due before the option phase began. The bankruptcy court held that timely payment of the stub period rent was not required under §365(d)(3). 291 B.R. at 126 – 127. The bankruptcy court added, however, that just because timely payment of stub period rent is not required under §365(d)(3) does not mean that "stub period rent must be treated as a prepetition claim," as some of the payment date cases suggest. 291 B.R. at 127. Accordingly, while

the bankruptcy court overruled objections to the debtor's motions for an extension of time to assume or reject unexpired leases and denied the lessor's motions for immediate payment of stub period rent, it did so without prejudice to the lessor's assertion of an administrative expenses claim under Bankruptcy Code §503. 291 B.R. at 127.

VIII. PROOFS OF CLAIM

A. [11.18] Form

The Bankruptcy Code defines a "claim" broadly as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. §101(5)(A).

Fed.R.Bankr.P. 3001(a) defines a "proof of claim" as a "written statement setting forth a creditor's claim." When a claim is based on a lease or other document in writing, "a copy of the writing shall be filed with the proof of claim." Fed.R.Bankr.P. 3001(c)(1). "If the writing has been lost or destroyed, a statement of the circumstances of the loss or destruction shall be filed with the claim. *Id.* Rule 3001(a) requires that a proof of claim conform substantially to Official Bankruptcy Form B 410, Proof of Claim, which is available through the United States Courts website, www.uscourts.gov/forms/bankruptcy-forms/proof-claim-0. Since the form can be restrictive as to how the claim is set forth, creditors often include a narrative attachment to their proof of claim setting forth any pertinent details that the creditor believes will be helpful in substantiating its proof of claim.

The official proof of claim form can also be located through the websites of the various bankruptcy courts in Illinois:

Northern District — www.ilnb.uscourts.gov

Central District — www.ilcb.uscourts.gov

Southern District — www.ilsb.uscourts.gov

B. [11.19] Time for Filing

In a Chapter 7 or 13 case, "a proof of claim is timely filed if it is filed not later than 70 days after the order for relief." Fed.R.Bankr.P. 3002(c). However, "[a] claim arising from the rejection of an executory contract or unexpired lease of the debtor may be filed within such time as the court may direct." Fed.R.Bankr.P. 3002(c)(4).

In a Chapter 11 case, the court will enter an order establishing the deadline for the filing of proofs of claim. Fed.R.Bankr.P. 3003(c)(3). This "bar date" may be extended upon a showing of "cause" by the party seeking the extension. *Id.* Although the bankruptcy rules expressly provide that the "bar date" may be extended, courts will not extend the deadline when the failure to timely

file the proof of claim is based on neglect in the absence of excuse. *See In re National Steel Corp.,* 316 B.R. 510, 514 – 520 (Bankr. N.D.Ill. 2004) (denying creditor's request for leave to file late claim and discussing bar date's "integral role in the administration of the [bankruptcy] case" and distinguishing between "neglect" and "excusable neglect").

The consequences of failing to file a proof of claim can be severe: "Any creditor or equity security holder whose claim or interest is not scheduled or scheduled as disputed, contingent, or unliquidated shall file a proof of claim or interest within the time prescribed by subdivision (c)(3) of this rule; any creditor who fails to do so shall not be treated as a creditor with respect to such claim for the purposes of voting and distribution." Fed.R.Bankr.P. 3003(c)(2). In some courts, deadlines for the filing of proofs of claim are established on the court's own motion, while other courts do not establish these deadlines unless the debtor or some other party in interest files a motion or otherwise seeks to establish a deadline for the filing of proofs of claim (*i.e.,* pursuant to a provision in a confirmed plan of reorganization). In the event that a Chapter 11 case is converted to Chapter 7, "[a]ll claims actually filed by a creditor before conversion of the case are deemed filed in the chapter 7 case." Fed.R.Bankr.P. 1019(3).

C. [11.20] Objection to Proofs of Claim

Once a proof of claim is filed, the claim "is deemed allowed, unless a party in interest . . . objects." 11 U.S.C. §502(a). Section 502(b) of the Bankruptcy Code itemizes a list of bases for objections to claims, but the most common ground for objections to proofs of claims is that "such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." 11 U.S.C §502(b)(1). If, for instance, there is a dispute over the amount of a creditor's claim or the debtor's liability for a claim, a claim objection is the vehicle pursuant to which the dispute is resolved. A proof of claim may also be objected to on the basis that the proof of claim was untimely. 11 U.S.C. §502(b)(9).

An objection to a proof of claim can be prosecuted as a contested matter under Fed.R.Bankr.P. 9014 (*i.e.,* as a motion filed in the bankruptcy case), but may also be included in an adversary proceeding (*i.e.,* a separate lawsuit commenced by the filing of a complaint). Fed.R.Bankr.P. 3007(b), 7001, 9014.

IX. [11.21] BANKRUPTCY STRATEGY

The discussion in §§11.2 – 11.20 above is designed to provide an overview of bankruptcy practice as it relates to landlords with tenants in bankruptcy. This section gives the landlord a five-point plan to follow when a tenant files for bankruptcy:

a. It is important for landlords with tenants in bankruptcy to remember that the race is swift. The landlord must move quickly when a tenant files a bankruptcy case. The landlord, through its attorney, should file an appearance and closely monitor the bankruptcy docket for filings and major case events.

b. If the tenant is in default of any sums due after the filing of its bankruptcy petition, the landlord's attorney should file a motion to compel the tenant to pay postpetition rent pursuant to 11 U.S.C. §365(d)(3). In addition to base rent, the landlord's attorney should determine whether any common area maintenance charges, tax charges, or other fees are due and owing postpetition. If so, those sums should also be demanded in the motion to compel payment of postpetition rent.

c. The landlord's attorney should closely monitor the period for assuming or rejecting the lease. It is advisable to contact the tenant's attorney as soon as possible to learn of the tenant's intentions rather than wait for the deadline to assume or reject to lapse. If the tenant intends to reject the lease, the landlord should begin looking for a new tenant as soon as possible to mitigate its damages. If the tenant intends to assume and assign a shopping center lease, the landlord's attorney must make certain that the assignment complies with 11 U.S.C. §365(b)(3).

d. If the tenant lacks sufficient assets to pay postpetition rent during the bankruptcy proceeding, the landlord's attorney must proceed quickly to force the tenant to vacate the leased premises by filing an appropriate motion pursuant to 11 U.S.C. §365(c)(3).

e. Finally, the landlord should file a proof of claim within the filing deadlines established by the bankruptcy court or the Federal Rules of Bankruptcy Procedure. See §11.19 above.

X. [11.22] CONCLUSION

This chapter is an overview of the Bankruptcy Code and its impact on the commercial landlord-tenant relationship. Bankruptcy law is complex, nuanced, and constantly developing. Changes in the law are certain. Accordingly, this chapter should be used only as a starting point for addressing bankruptcy-related commercial landlord-tenant issues.

12 The Effect of Eminent Domain on the Landlord-Tenant Relationship

JOSEPH B. VANFLEET
Howard & Howard Attorneys PLLC
Managing Attorney, Peoria Office
Co-Chair, Lending Institutions Practice Group

The contribution of Timothy D. Gronewold to previous editions of this chapter is gratefully acknowledged.

VI. Appendix — Sample Forms

A. Automatic Termination Clauses
   1. [12.27] Condemnation Clause
   2. [12.28] Compensation Clause

B. Condemnation Clauses
   1. [12.29] Total Condemnation Clause
   2. [12.30] Partial Condemnation Clause
   3. [12.31] Office Building Clause
   4. [12.32] Shopping Center Clause

C. [12.33] 60-Day Letter

D. [12.34] Tenant's Waiver of Lease

E. [12.35] Cross-Complaint

F. [12.36] Motion for Separate Verdict

G. [12.37] Motion for Apportionment of Condemnation Award

I. [12.1] INTRODUCTION

The Eminent Domain Act, 735 ILCS 30/1-1-1, *et seq.,* which took effect January 1, 2007, remains relatively untouched through today and provides that the "amount of just compensation shall be distributed among all persons having an interest in the property according to the fair value of their legal or equitable interests." 735 ILCS 30/10-5-90. Thus, there is only one award of just compensation to divide between a landlord and a tenant, which creates a conflict between the lessor and the lessee. The lessor and the lessee may initially bargain for an apportionment of a condemnation award, or the lease may be silent on the issue. It is clear that express agreements between the landlord and tenant governing their rights to compensation are enforceable. *Village of Palatine v. Palatine Associates, LLC,* 406 Ill.App.3d 973, 942 N.E.2d 10, 17, 347 Ill.Dec. 177 (1st Dist. 2010). Absent a clear condemnation clause, entitlement to any award is subject to interpretation under Illinois law.

A. [12.2] Scope of Chapter

This chapter addresses the effect of a leasehold interest in a condemnation proceeding from the perspective of the landlord-tenant relationship. The Illinois laws of eminent domain are discussed, and §§12.27 – 12.37 below contain sample forms that should be helpful to a practitioner when a leasehold interest is at issue. This chapter is intended to be an aid and timesaver to the lawyer who must address the impact of a leasehold interest in a condemnation proceeding.

B. [12.3] Right To Condemn

An analysis of the effect of a leasehold interest on an eminent domain proceeding must begin with the government's statutory power to condemn. In short, any landlord-tenant relationship may be affected by the exercise of the power of eminent domain by a condemning authority. See ILL.CONST. art. I, §§1, 2, 15; U.S.CONST. amends. V, XIV.

In *Babbitt v. Youpee,* 519 U.S. 234, 136 L.Ed.2d 696, 117 S.Ct. 727 (1997), in an eight-one decision, the Supreme Court strongly affirmed the sanctity of just compensation under the Fifth Amendment and the necessity for full just compensation for any taking of private property. The Court stated:

> **Amended §207 still trains on income generated from the land, not on the value of the parcel. The Court observed in *Irving* that "[e]ven if . . . the income generated by such parcels may be properly thought of as *de minimis,"* the value of the land may not fit that description.** 117 S.Ct. at 733, quoting *Hodel v. Irving,* 481 U.S. 704, 95 L.Ed.2d 668, 107 S.Ct. 2076, 2082 (1987).

A tenant is entitled to receive full compensation for the amount of the leasehold estate that is taken for public use. *See Bohne v. Bauer,* 21 Ill.App.2d 133, 157 N.E.2d 545 (2d Dist. 1959). This conclusion can be drawn from the long-standing proposition that a lease contains a property interest under the law, as explained in 26 AM.JUR.2d *Eminent Domain* §161 (2004). Moreover, despite *Bohne*'s age and the fact that it predates many aspects of the Eminent Domain Act, it remains good law on this point. *See Village of Palatine v. Palatine Associates, LLC,* 2012 IL App (1st) 102707, ¶50, 966 N.E.2d 1174, 359 Ill.Dec. 486.

It is settled, as a general proposition, that valid contracts "are property protected by the Fifth Amendment against taking by the federal government, and by the Fourteenth Amendment against taking by a state, unless just compensation is made to the owner." 26 AM.JUR.2d *Eminent Domain* §160 (2004). A leasehold falls within the definition of "property" in a constitutional provision that no person's property shall be taken without just compensation. 26 AM.JUR.2d *Eminent Domain* §161 (2004). The test by which to answer the question whether there is such an "estate" or "interest" has been said to be whether the right with respect to real property taken in condemnation is, or is not, so remote or incapable of valuation that it would be disregarded in awarding compensation. *See also Conness v. Indiana, I. & I. Ry.,* 193 Ill. 464, 62 N.E. 221 (1901).

Illinois has long accorded respect to the property rights held by tenants. *See Chicago & N.W. Ry. v. Miller,* 233 Ill. 508, 84 N.E. 683 (1908). *See also Blue Cat Lounge, Inc. v. License Appeal Commission of City of Chicago,* 281 Ill.App.3d 643, 667 N.E.2d 554, 217 Ill.Dec. 465 (1st Dist. 1996), *disagreed with by Club Misty, Inc. v. Laski,* 208 F.3d 615 (7th Cir. 2000). Whether the taking is partial or complete, both the landlord and the tenant are entitled to a share of the compensation. Alfred D. Jahr, LAW OF EMINENT DOMAIN: VALUATION AND PROCEDURE §130, p. 189 (1953), states:

> **When leased property is acquired by eminent domain, the owner of the fee and the lessee have their respective interests in the total award. The lessee or tenant has a possessory right, and the owner or landlord the reversionary right.**

Other commentators have also elaborated on this principle:

> **Leasehold interests also have value. In many cases, property condemned by governmental authority has an existing lease, giving rights of possession to other than the owner. Depending upon the rent to be paid under the lease, other duties and obligations imposed by the lease upon landlord and tenant, and the length of time the lease has to run, the lease can have considerable value, or little or no value.**
>
> **a) Methods of evaluation — market value, income value etc. used. Generally, the value of the leasehold interest is determined under the same procedures as determining the value of the freehold interest itself. The tenant, upon condemnation, is entitled to compensation for the value of the unexpired term of the lease, to wit, the difference between the fair annual rental of the premises for the unexpired term and the amount of rent actually reserved in the lease for that period. The tenant is not, however, entitled to compensation for the inconvenience of being forced to move.**
>
> **b) Special provisions for condemnation in most commercial leases. Many leases have condemnation clauses, specially providing for the respective rights of landlord and tenant in the event of total or partial condemnation of the property.** ALI-ABA, *The Law of Eminent Domain,* EMINENT DOMAIN AND LAND VALUE LITIGATION, pp. 17 – 18 (Jan. 9, 1997).

C. [12.4] Effect of the Condemnation Clause in the Lease

The courts generally enforce the terms of a lease to which the landlord and the tenant have agreed. *Peoria Housing Authority v. Sanders,* 54 Ill.2d 478, 298 N.E.2d 173, 175 (1973). Thus, the courts should hold that a condemnation clause is an enforceable term. *See National Railroad Passenger Corp. v. Faber Enterprises, Inc.,* 931 F.2d 438 (7th Cir. 1991). *See also Elizondo v. Perez,* 42 Ill.App.3d 313, 356 N.E.2d 112, 113, 1 Ill.Dec. 112 (1st Dist. 1976) ("it would be inequitable to nullify the plain wording of the lease and place the landlord at the mercy of a tenant who clearly flouts the provisions of his lease without legal excuse"); *Village of Palatine v. Palatine Associates, LLC,* 406 Ill.App.3d 973, 942 N.E.2d 10, 19, 347 Ill.Dec. 177 (1st Dist. 2010) (under lease, tenant was not entitled to any part of condemnation award because no part of award was specifically made to compensate for tenant's trade fixtures).

A lessor must be careful to disclose to the lessee any pending or future condemnation of which it has knowledge. The lessor's failure to disclose a possible condemnation to a lessee when procuring a lease in which the lessee waives any rights to an award can be grounds for reformation of the lease. *See City of Chicago v. American National Bank & Trust Co.,* 233 Ill.App.3d 1031, 599 N.E.2d 1126, 175 Ill.Dec. 112 (1st Dist. 1992). Thus, even if a possible condemnation is a matter of public record, the prudent attorney will include the disclosure in the lease provision when the lessee waives rights to an award.

Numerous forms exist for possible condemnation clauses in a lease. General forms for leases can be found in 7B AM.JUR. Legal Forms 2d Rev. §97:38 (2006); 11B AM.JUR. Legal Forms 2d §161:695, *et seq*. (2006); Emanuel B. Halper, GROUND LEASES AND LAND ACQUISITION CONTRACTS (1988); Emanuel B. Halper, SHOPPING CENTER AND STORE LEASES (1979); and Milton R. Friedman, FRIEDMAN ON LEASES §13:1 (5th ed. 2011).

Generally speaking, an automatic termination clause terminates the rights of a tenant upon the institution of a condemnation proceeding. See §12.7 below. A condemnation clause, on the other hand, will explain the rights and obligations of both the landlord and the tenant in the event of a taking. Sample forms of automatic termination clauses and condemnation clauses are found in §§12.27 – 12.32 below.

PRACTICE POINTERS

✓ Because a condemnation clause expressly sets forth the rights and obligations of the parties to the lease, in drafting these clauses, one should consider and address

1. the rights of the parties in the event of a total or partial taking;

2. which parties may participate in a formal condemnation proceeding;

3. which parties may participate in the compensation received;

4. the effect of condemnation on rents;

5. whether, in a partial condemnation, the tenant will continue its tenancy;

6. dispositions of improvements and trade fixtures; and

7. cancellation of the lease.

✓ Landlords will generally try to include an automatic termination clause in a lease. On the other hand, from the tenant's perspective, all leases should contain a condemnation clause to force the parties to negotiate and set forth their respective interests prior to a crisis developing. Among the factors influencing the critical need for a condemnation clause are

1. the length of the lease;

2. the proximity to a developing area;

3. the traffic occurring near the property; and

4. the nature and use of the property and surrounding parcels.

The courts will generally ensure that tenants are not deprived of their property rights. *See American National Bank & Trust, supra*. The unit rule requires that a leasehold be valued not separately, but as part of the whole. *City of Chicago v. Anthony,* 136 Ill.2d 169, 554 N.E.2d 1381, 144 Ill.Dec. 93 (1990). A leaseholder, like an owner, is clearly entitled to the value of the property interest that is being taken. *United States v. General Motors Corp.,* 323 U.S. 373, 89 L.Ed. 311, 65 S.Ct. 357, 360 (1945). Determining which interests have been taken necessitates an inquiry into the relative rights of the lessor and the lessee at the time of the taking, as agreed on in the lease. *National Railroad Passenger, supra,* 931 F.2d at 440. When the parties have agreed in advance on the formula to divide the condemnation proceeds for the taking of the leasehold, the resulting sum will likely be deemed fair compensation. *Bradley Facilities, Inc. v. Burns,* 209 Conn. 480, 551 A.2d 746 (1988); 2 Julius L. Sackman and Patrick J. Rohan, NICHOLS' THE LAW OF EMINENT DOMAIN, p. 5-117 (1994).

Illinois practitioners once believed that an Illinois Supreme Court review of the constitutionality of the unit rule might eventually be a possibility. *See Department of Transportation, State of Illinois v. Kelley,* 352 Ill.App.3d 278, 815 N.E.2d 1214, 287 Ill.Dec. 411 (3d Dist.), *cert. denied,* 212 Ill. 2d 530 (2004). The *Kelley* court noted that "not every part of a tract will be as valuable as other parts, and different highest and best uses may be used in valuing the tract as a whole." 815 N.E.2d at 1217. Nevertheless, to date Illinois courts have not seized on this language, and the applicability of the unit rule is still strong. *Anthony, supra,* 544 N.E.2d at 1384.

As noted above in this section, the unit rule requires that a leasehold be valued not separately, but as part of the whole. *Anthony, supra*. However, it is becoming more and more apparent that strict application of the unit rule may not adequately provide just compensation as mandated by the

Fifth Amendment of the United States Constitution. *Kelley, supra*. *See also Department of Transportation v. HP/Meachum Land Limited Partnership,* 245 Ill.App.3d 252, 614 N.E.2d 485, 185 Ill.Dec. 351 (2d Dist. 1993) (finding different values could be placed on different portions of unit of land when there were clearly cognizable different highest and best uses for land); *City of Springfield, Illinois v. West Koke Mill Development Corp.,* 312 Ill.App.3d 900, 728 N.E.2d 781, 785, 245 Ill.Dec. 699 (4th Dist. 2000) ("whole does not necessarily equal the sum of the parts"), quoting *Department of Public Works & Buildings v. Lotta,* 27 Ill.2d 455, 189 N.E.2d 238, 240 (1963). (However, practitioners should note that *West Koke Mill* has been called into doubt by statute as stated in *Enbridge Pipeline (Illinois), LLC v. Monarch Farms, LLC,* 2017 IL App (4th) 150807, 82 N.E.3d 1234. 415 Ill.Dec. 688 (4th Dist. 2017).) The term "just compensation" has been defined by Illinois courts as "the fair market value of the property at its highest and best use on the date the property is condemned." *City of Oakbrook Terrace v. Suburban Bank & Trust Co.,* 364 Ill.App.3d 506, 845 N.E.2d 1000, 1010 – 1011, 301 Ill.Dec. 135 (2d Dist. 2006). (However, practitioners should note that *City of Oakbrook* has been disagreed with by *Palm v. 2800 Lake Shore Drive Condominium Ass'n,* 401 Ill.App.3d 868, 929 N.E.2d 641, 340 Ill.Dec. 990 (1st Dist. 2010).) The court in *Kelley* acknowledged "that when different uses of the [taken] property are easily delineated, a separate valuation may be appropriate." 815 N.E.2d at 1218. In *Kelley,* Presiding Justice Holdridge, specially concurring, argued that cases such as *Kelley* and *HP/Meachum Land, supra,* represent an exception to the unit rule "that should be allowed to swallow up the rule." 815 N.E.2d at 1219. Justice Holdridge also asked the Illinois Supreme Court to revisit this issue to determine whether the unit rule is of continuing validity. *Id*. To date, however, this has not occurred, and practitioners should understand the unit rule is likely to be enforced.

D. [12.5] Federal Law

In 1971, Congress enacted the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (Relocation Assistance Act), Pub.L. No. 91-646, 84 Stat. 1894 (1971). The purpose of the Relocation Assistance Act is to afford fair and equitable treatment for persons who were displaced as a result of federal and federally assisted real estate acquisition programs. It is not intended to create any new substantive rights or liabilities involving actual purchase transactions or eminent domain proceedings but rather to provide a limited statutory privilege for certain otherwise non-compensable injuries or hardships incident to acquisitions. 42 U.S.C. §4602. See also H.R.Rep. No. 1656, 91st Cong., 2d Sess. (1970), reprinted in 1970 U.S.C.C.A.N. 5850. The moving and related expenses applicable to commercial leases are found at 42 U.S.C. §4622.

The provisions of the Relocation Assistance Act were made indirectly applicable to the states for federally assisted programs by conditioning federal assistance on state compliance with the provisions of the Relocation Assistance Act. 42 U.S.C. §4630. The provisions of the Relocation Assistance Act do not apply to the Illinois Department of Transportation. *People ex rel. Department of Transportation v. Walliser,* 258 Ill.App.3d 782, 629 N.E.2d 1189, 196 Ill.Dec. 345 (3d Dist. 1994).

Finally, it is important to note that federal courts rely on §§8.1 and 8.2 of RESTATEMENT (SECOND) OF PROPERTY: LANDLORD & TENANT (1977), which state:

§8.1 Effect of Taking by Eminent Domain on Lease

(1) If there is a taking by eminent domain of all of the leased property for all of the lease term, the lease is terminated.

(2) Except to the extent the parties to a lease validly agree otherwise, if there is a taking by eminent domain of less than all of the leased property or for less than all of the lease term, the lease:

(a) is terminated if the taking significantly interferes with the use contemplated by the parties; and

(b) is not terminated if the taking does not significantly interfere with the use contemplated by the parties, but the tenant is entitled to an abatement of the rent to the extent prescribed in §11.1.

§8.2 Amount of the Condemnation Award Tenant Entitled to Receive

(1) Except to the extent the parties to a lease validly agree otherwise, the tenant is entitled to any award that is made to him in the eminent domain proceedings.

(2) Except to the extent the parties to a lease validly agree otherwise, the tenant is entitled to share in a lump-sum award made in the eminent domain proceedings, which lump-sum award is for his and other interests in the property condemned, and the tenant's share in the lump-sum award is:

(a) if the lease is terminated by the taking, that proportion of the lump-sum award which corresponds to the proportion of the total value of the several interests in the property condemned, valued separately, that represents the value of the unexpired period of the tenant's lease, plus the value discounted to the date of the taking of the payments the tenant is required to make to the landlord even though the lease is terminated; or

(b) if the lease is not terminated by the taking, that proportion of the lump-sum award which corresponds to the proportion of the total value of the several interests in the property condemned, valued separately, that represents the value of a lease of the part of the leased property taken for the unexpired period of the original lease at a rent equal to the difference between the rent reserved in the original lease and the rent payable by the tenant under the original lease after the taking.

See National Railroad Passenger Corp. v. Faber Enterprises, Inc., 931 F.2d 438, 443 – 444 (7th Cir. 1991).

II. PARTIES

A. [12.6] Condemnor

The condemnor's primary responsibility is to ensure that all interested parties are properly named and served in the eminent domain proceeding. See 735 ILCS 30/10-5-10(a). Interested parties include holders of leasehold interests. *See Bohne v. Bauer,* 21 Ill.App.2d 133, 157 N.E.2d 545 (2d Dist. 1959). A leasehold is a property interest that is subject to "just compensation," which is the fair cash market value of the subject property at its highest and best use on the date of the filing of the petition to condemn. *Department of Public Works & Buildings v. Association of Franciscan Fathers of State of Illinois,* 69 Ill.2d 308, 371 N.E.2d 616, 13 Ill.Dec. 681 (1977).

Prior to preparing a complaint for condemnation, the condemnor should first obtain a title search. Tenants and other parties with a possessory interest in the property will appear as interested parties if the interest has been recorded. Unfortunately, many leasehold interests are not recorded, so the condemnor's attorney should investigate the existence of tenants with unrecorded leases. A thorough investigation should uncover all leasehold interests in the property. If all such interests are not named in the complaint, the condemning authority may not obtain clear title. In *City of Joliet v. Mid-City National Bank of Chicago,* No. 05 C 6746, 2012 WL 638735, *6 (N.D.Ill. Feb. 22, 2012), the Northern District stated that the failure to name all tenants of a building as defendants would be a valid defense at the compensation hearing. The court noted that Federal Rule of Civil Procedure 71.1 requires the plaintiff to name only the known defendants at the time of the commencement of the case. *Id*. However, "the plaintiff must add as defendants *all* those persons who have or claim an interest and whose names *have become known or can be found* by a reasonably diligent search of the records" before any hearing regarding compensation. [Emphasis added by court.] *Id.,* quoting Fed.R.Civ.P. 71.1(c)(3).

If the condemning authority is the State of Illinois and the matter has arisen after December 31, 1991, the state must provide a 60-day letter. 735 ILCS 30/10-5-15(a), 30/10-5-15(d). This letter must be provided to only the property owner and not a tenant. 735 ILCS 30/10-5-15(d). A sample form of a 60-day letter is found in §12.33 below.

No matter who the condemning authority is, the condemnor usually will attempt to quickly resolve any leasehold interests by obtaining waivers signed by the tenants. A sample form of a tenant's waiver of lease is found in §12.34 below. If a tenant agrees to sign such a waiver, the condemning authority cannot show the property owner the amount it has agreed to pay the tenant for its leasehold interest and thereby bind the nonconsenting landlord. *Chicago, B. & Q. Ry. v. F. Reisch & Bros.,* 247 Ill. 350, 93 N.E. 383 (1910).

Without a signed waiver, a condemnor can be transformed into an owner-landlord. *People ex rel. Department of Transportation v. Walliser,* 258 Ill.App.3d 782, 629 N.E.2d 1189, 196 Ill.Dec. 345 (3d Dist. 1994). Care must be taken in determining whether this is the goal of the condemnor.

B. [12.7] Condemnee-Landlord

Automatic termination clauses are clauses stating that the lease terminates upon notice or the filing of a condemnation case. These clauses are enforceable, and they serve to bar the tenant from

participation in the condemnation award. Sample forms of automatic termination clauses are found in §§12.27 and 12.28 below. The rationale is that since the clause serves to terminate the lease upon a condemnation, no tenant interest remains to be protected. *Select Lake City Theatre Operating Co. v. Central National Bank in Chicago,* 277 F.2d 814 (7th Cir. 1960). *See also United States v. Advertising Checking Bureau, Inc.,* 204 F.2d 770 (7th Cir. 1953); *Village of Palatine v. Palatine Associates, LLC,* 406 Ill.App.3d 973, 942 N.E.2d 10, 347 Ill.Dec. 177 (1st Dist. 2010). When preparing a termination clause, counsel should be aware that courts have held that a landlord who is guilty of bad faith and unconscionable conduct in dealing with the tenant may lose any resultant benefit of the condemnation award. *Forest Preserve Dist. of Cook County v. Christopher,* 321 Ill.App. 91, 52 N.E.2d 313 (1st Dist. 1943).

Both the landlord and the tenant should be aware that title to the property will relate back to the date of filing of the petition to condemn. *City of Chicago v. McCausland,* 379 Ill. 602, 41 N.E.2d 745, 747 (1942). The landlord's title is not extinguished, however, until the judgment is paid in full. *Bohne v. Bauer,* 21 Ill.App.2d 133, 157 N.E.2d 545, 546 (2d Dist. 1959).

The tenant's portion of the ultimate compensation paid is limited to the difference between the rent paid under the lease and the market rate the tenant will need to pay upon relocation. One commentator has stated:

> **If the actual rental rate of the tenant is equal to the market rate or greater than the market rate, then the tenant has no positive leasehold estate interest and is entitled to no compensation for cancellation of the remainder of the lease term. In a whole taking, the tenant will be able to lease other space in the market at the same rate or a more favorable rate than the above-market rate that the tenant was previously paying; thus the tenant is not denied any rental benefit.**
>
> **In a tenancy at will or a month-to-month lease, there is no possible continuing leasehold benefit, and the tenant is entitled to no compensation for termination of the leasehold interest since it could have been terminated at any time by the landlord without the consent of the tenant.**
>
> **The most common point of contention between landlords and tenants in eminent domain proceedings germinates from a lease provision that states that on condemnation of the leased premises, the lease terminates. The tenant will argue that it was the intention of the parties that the termination of the lease would not have the effect of cutting off the tenant's prospective claim for a beneficial leasehold interest, but that is exactly what the termination of the lease does. At best, such a provision results in litigation over whether the lease is vague. The landlord will argue that references in the lease to the tenant's rights to condemnation compensation relate to the tenant's rights to claim value in any leasehold improvements still owned by the tenant (which frequently are minimal since leases often provide that fixtures installed by the tenant, once installed, become the property of the landlord) or the tenant's rights to relocation assistance.**

Similarly, a provision that permits either the landlord or the tenant to elect to terminate a lease upon a partial eminent domain acquisition has the legal effect of turning the lease into a tenancy at will. A lease that continues only at will or from month to month leaves no possible claim by the tenant for a beneficial leasehold interest. If the landlord is not bound to continue the lease, the tenant cannot claim a vested right in the beneficial lease rate.

Options for renewal of lease terms can be valuable for leasehold interests. The measure of damages in the value of the use and occupancy of the leasehold estate in a whole taking is the leasehold benefit for the remainder of the tenant's term plus the value of the right to renew if such rights exist, less the agreed rent the tenant would pay for the use and occupancy during the option period. James Noble Johnson, *Ultimate Questions: Valuation Issues in Eminent Domain Takings,* 1994 Inst. on Plan. Zoning & Eminent Domain §8.05[4][a].

C. [12.8] Condemnee-Tenant

Generally, in a complete taking, the tenant is entitled to the reasonable value of the unexpired portion of the lease, less the rent that would have been due the landlord. *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319 (1953). If the rent reserved in the lease equals or exceeds market value, the tenant is entitled to nothing. *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955). A tenant who has enjoyed the full term of the lease is not entitled to compensation, but if the complete taking is prior to the lease's expiration, the tenant is entitled to compensation. *Schreiber v. Chicago & E.R. Co.,* 115 Ill. 340, 3 N.E. 427 (1885).

Tenants must understand however, that the courts rarely apply liberal or expanded views to leasehold interests. For example, a temporary one-year prohibition of the tenant's license to sell liquor did not cause a landlord to suffer a taking since a liquor license is a privilege and not a property right. *Blue Cat Lounge, Inc. v. License Appeal Commission of City of Chicago,* 281 Ill.App.3d 643, 667 N.E.2d 554, 217 Ill.Dec. 465 (1st Dist. 1996), *disagreed with by Club Misty, Inc. v. Laski,* 208 F.3d 615 (7th Cir. 2000). Another court held that relocation expenses of the tenant did not benefit the landlord and, thus, did not qualify as restitution damages. *Lempa v. Finkel,* 278 Ill.App.3d 417, 663 N.E.2d 158, 215 Ill.Dec. 408 (2d Dist. 1996). *See also Yellow Cab Co. v. City of Chicago,* 919 F.Supp. 1133 (N.D.Ill. 1996) (municipality-capped lease rates).

In *United States v. Certain Lands in Jo Daviess County, Ill.,* 120 F.2d 561 (7th Cir. 1941), tenant-placed houses that had been on the property for 20 – 30 years were lost to the landlord based on lease provisions. The court held that under Illinois law they became part of the realty. No portion of the condemnation award went to the year-to-year tenants. *See also Village of Palatine v. Palatine Associates, LLC,* 406 Ill.App.3d 973, 942 N.E.2d 10, 19, 347 Ill.Dec. 177 (1st Dist. 2010). *Cf. Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82 (2d Dist. 1975) (in month-to-month lease involving complete taking, court found presumption for tenant).

In *National Railroad Passenger Corp. v. Faber Enterprises, Inc.,* 931 F.2d 438 (7th Cir. 1991), Amtrak condemned a subleased restaurant as the first step in the renovation of Chicago's Union

Station. In denying the lessee compensation for the removable property, the immovable fixtures, and the personal property, the court cited both the common law and the agreed termination-on-condemnation clause in the lease. The court held that the tenant was not entitled to compensation for personal property that it abandoned on the premises. The taking extinguished the tenant's right of first refusal.

A lease provision that accorded substantial value to trade fixtures removable by the tenant was cited as the basis for the landlord to recover the entire condemnation award for the taking of the leasehold in *United States v. 1.357 Acres of Land,* 308 F.2d 200 (7th Cir. 1962). Similarly, personal property of a tenant remained for the benefit of a landlord, pursuant to the lease provisions in *Commercial Delivery Service, supra*. *Accord Select Lake City Theatre Operating Co. v. Central National Bank in Chicago,* 277 F.2d 814 (7th Cir. 1960).

In *City of Lake Forest v. First National Bank of Lake Forest,* 52 Ill.App.3d 893, 368 N.E.2d 156, 10 Ill.Dec. 670 (2d Dist. 1977), following answers to interrogatories, the condemnor discovered that the tenant had voluntarily canceled the lease shortly after the condemnation complaint had been filed. In affirming the trial court's dismissal of the tenant's claim for leasehold damages, the appellate court stated:

> **Union Oil's first assertion on this appeal is that it is entitled to compensation for the value of the leasehold taken when Lake Forest instituted the eminent domain proceedings. It contends that its right to compensation became vested on the date the petition to condemn was filed and that any action it took after the petition was filed is irrelevant to its right to receive compensation. We must disagree. Union Oil's lease contained a provision allowing it to cancel the lease in the event there was a taking by eminent domain. It seems only reasonable that this provision of the lease should be viewed as giving Union Oil a choice of either staying on and continuing to pay rent in order to preserve its right to share in the condemnation award, or of cancelling the lease and thereby extinguishing both its obligation to pay rent and its right to share in the condemnation award. It is absurd to maintain that Union Oil should be in the same position upon cancelling the lease as it would have been had it continued to honor it. It must be remembered that Union Oil was but a lessee, and a lessee's right to compensation consists only of its right to share in the condemnation award of its landlord. Therefore, it seems only fair that when the landlord receives no rent because the lessee has cancelled the lease, then the landlord should not be obligated to share its condemnation award with its former tenant.** 368 N.E.2d at 157.

Accord Schreiber, supra (lease expired prior to condemnation award).

Similarly, it has been held that a lessor cannot be limited in leasehold damages in a partial taking until a gross award for just compensation has been entered. *City of Rockford v. Robert Hallen, Inc.,* 51 Ill.App.3d 22, 366 N.E.2d 977, 9 Ill.Dec. 466 (2d Dist. 1977). Finally, in *City of Chicago v. Shayne,* 46 Ill.App.2d 33, 196 N.E.2d 521 (1st Dist. 1964), the landlord received the entire award when evidence showed that the tenant had failed to pay pre-condemnation rent and offered as no evidence to the value of the leasehold.

In the case of a long-term lease, it has been held that when the right of a landlord to receive rent from the tenant is not affected, the entire amount of the condemnation award may be due the tenant. *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607 (1st Dist. 1963). A landlord's interest in the subject property of a long-term lease is the revenue from the rent, and any reversionary value is so speculative and minimal that it cannot be considered. *Id*. Although *Metropolitan Life* could be interpreted by tenants as setting forth a bright-line rule that landlords are not entitled to any portion of the condemnation award for property subject to a long-term lease, the lack of any definition as to what constitutes a long-term lease raises serious questions to such a conclusion. Moreover, the *Metropolitan Life* court did not attempt to change existing caselaw, thereby leaving open the opportunity to show a reversionary interest when the facts support it. The court in *Metropolitan Life* stated that "[b]ecause the lease is a long-term lease within definition of the Illinois courts and generally accepted real estate concepts, the attribution of any present value to [the landlord's] reversionary interest . . . is so speculative that it must be wholly disregarded." 192 N.E.2d at 612. However, rather than setting forth any "definition of the Illinois courts and generally accepted real estate concepts," the court's analysis determined that the lease in question was a long-term lease by determining that any reversionary value assigned to the landowner would be so minimal and speculative that it should be disregarded. *Id*. Therefore, *Metropolitan Life* should be read as setting forth the general concept that when a landlord cannot prove more than a minimal reversionary value beyond mere speculation, the landlord is not entitled to any portion of the condemnation award.

It should further be noted that the condemnation clause in *Metropolitan Life* received minimal attention, and nothing in the case contradicts the discussion in §12.4 above regarding the effect given to condemnation clauses in leases. The clause in *Metropolitan Life* stated that condemnation awards were to "be divided fairly and equitably between the fee simple estate and the leasehold estate" and did not set forth any specific division of condemnation awards. 192 N.E.2d at 609 – 610. Therefore, the court's decision regarding the distribution of the condemnation award gave effect to the clause requiring a fair and equitable distribution of the award.

Tenants should also be wary of a condemnor's right to abandon eminent domain proceedings at any point before the condemnor has taken possession of the property pursuant to the order of taking. 735 ILCS 30/20-5-40 (formerly 735 ILCS 5/7-110). In *Village of Bellwood v. American National Bank & Trust Company of Chicago,* 2011 IL App (1st) 093115, 952 N.E.2d 148, 351 Ill.Dec. 775, construing former 735 ILCS 5/7-110, the court arguably created a harsh result for the tenant. In *Bellwood,* the village sought to condemn property under the eminent domain statute. The village and the property owners eventually reached agreements, and an "Agreed Stipulation and Final Judgment Order" was filed that provided that the village would pay the compensation to the owners by a certain date and then be vested with fee simple title to the property. 2011 IL App (1st) 093115 at ¶5. Handschy Industries, Inc., was a tenant of one of the properties and had no input in these negotiations. The day before the village was to pay the compensation to the owners and take possession of the properties, the village abandoned the eminent domain proceeding. The Illinois appellate court reversed the trial court's order that the village could not abandon the proceeding, finding that the right to do so was statutory and none of the parties negotiated with the village to waive that right. In a specially concurring opinion, Justice Cunningham noted that the tenant suffered the most harm in this situation because it was forced to wind down and move its business, losing money in the process, and there is no remedy for this situation within the Eminent Domain Act. 2011 IL App (1st) 093115 at ¶¶39 – 41.

D. [12.9] Subtenant Issues

A subtenant has a potentially compensable interest, incident to an eminent domain acquisition. *Chef's No. 4, Inc. v. City of Chicago,* 117 Ill.App.3d 410, 453 N.E.2d 892, 73 Ill.Dec. 67 (1st Dist. 1983); *National Railroad Passenger Corp. v. Faber Enterprises, Inc.,* 931 F.2d 438 (7th Cir. 1991). It is also established in Illinois that a subtenant has no right in the demised premises not previously held by his or her immediate landlord, which is the original tenant. Thus, the subtenant possesses only the rights of the tenant and is charged with notice of all conditions and obligations contained in the original lease. 24 I.L.P. *Landlord and Tenant* §106 (1980).

III. CONDEMNATION PROCEEDING

A. [12.10] Complete Taking

In a complete taking, the entire leasehold interest is taken by the condemning authority. By operation of law, the leasehold estate is extinguished and all obligations between the tenant and landlord cease to exist. *Corrigan v. City of Chicago,* 144 Ill. 537, 33 N.E. 746 (1893). The Illinois Supreme Court in *Corrigan* held:

> **The measure of compensation for the estate of the tenant taken is the value of her leasehold estate, subject to the rent covenanted to be paid. If the value exceeds the rental she will be entitled to recover the excess. If it does not exceed the rent reserved, she will be entitled to nothing.** 33 N.E. at 749.

Notwithstanding whether the taking is complete, the tenant remains obligated to pay rent until the date of the condemnation judgment. *Bohne v. Bauer,* 21 Ill.App.2d 133, 157 N.E.2d 545 (2d Dist. 1959). Vesting of title in the condemnor, however, is conditioned on payment and deposit of the award. *Chicago Park Dist. v. Downey Coal Co.,* 1 Ill.2d 54, 115 N.E.2d 223 (1953); *Bohne, supra,* 157 N.E.2d at 546. Thus, the preliminary just compensation must be deposited in a quick-take action, which in turn permits entry of an order vesting title in the condemnor. See 735 ILCS 30/20-5-5, *et seq*.

In a complete taking, the primary issue is the leasehold's fair cash rental value as compared to the actual rent paid under the lease agreement. Thus, the tenant's damages can be measured by the fair cash market value of the leasehold, less the rental actually being paid. *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319 (1953); *Corrigan, supra; Yellow Cab Co. v. Howard,* 243 Ill.App. 263 (1st Dist. 1927); *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955).

To be entitled to any compensation for the taking, the lessee must have an interest in the property at the time of the award. A lessee may not share in the award under the following circumstances:

1. The lease expires by its terms after the complaint to condemn but before the final award is determined and there is no option to renew. *Schreiber v. Chicago & E.R. Co.,* 115 Ill. 340, 3 N.E. 427 (1885). The lessee is not entitled to compensation because, at the time the complaint to condemn was filed, the lessee had a right to possession for a certain term, which was fully exercised.

2. The lessee exercises its rights under a condemnation clause to terminate the lease due to the condemnation after the complaint to condemn but before final compensation is paid. *City of Lake Forest v. First National Bank of Lake Forest,* 52 Ill.App.3d 893, 368 N.E.2d 156, 10 Ill.Dec. 670 (2d Dist. 1977). The *Lake Forest* court found that the cancellation relieved the lessee of the burdens and benefits of the lease, and the cancellation was tantamount to a natural termination of a lease.

3. The lessee abandons the premises after failing to pay rent. *City of Chicago v. American National Bank,* 86 Ill.App.3d 960, 408 N.E.2d 379, 42 Ill.Dec. 1 (1st Dist. 1980). The *American National* lessee left the premises due to an alleged failure of a commercial lessor to repair the premises after the complaint to condemn, but before the entry of a final judgment order. This abandonment extinguished the lessee's right to share in the award.

B. [12.11] Partial Taking

In a partial taking, the condemnation clause will set forth the rights and obligations of the tenant. Absent an express condemnation clause, the partial taking of a leasehold that does not adversely affect the lease results in no compensation to the tenant, and the tenant continues to remain obligated under the terms of the lease. *Stubbings v. Village of Evanston,* 136 Ill. 37, 26 N.E. 577 (1891); *Corrigan v. City of Chicago,* 144 Ill. 537, 33 N.E. 746 (1893). Conversely, if the taking is of such magnitude that the tenant can no longer operate, then the result is essentially the same as a complete taking. *Yellow Cab Co. v. Stafford-Smith Co.,* 320 Ill. 294, 150 N.E. 670 (1926); *55 Jackson Acquisition, LLC v. Roti Restaurants, LLC,* 2022 IL App (1st) 210138, 202 N.E.3d 998, 461 Ill.Dec. 1. See Alan N. Polasky, *The Condemnation of Leasehold Interests,* 48 Va.L.Rev. 477 (1962); Julius L. Sackman, *Compensation Upon the Partial Taking of a Leasehold Interest,* Sw. Legal Foundation 3d Ann.Inst. on Eminent Domain 35 (1961). However, if a tenant loses the leasehold interest for only a temporary period of time, it has been held that the rent does not abate since the situation is similar to a partial taking. *Leonard v. Autocar Sales & Service Co.,* 392 Ill. 182, 64 N.E.2d 477 (1945).

Similar to a complete taking, the prevailing test in a partial condemnation of a tenant's leasehold is the fair rental value of the leasehold taken, less the rent actually paid. *Department of Public Works & Buildings of State of Illinois v. Blackberry Union Cemetery,* 32 Ill.App.3d 62, 335 N.E.2d 577 (2d Dist. 1975).

One commentator has noted the following hypothesis:

> **For example, a lessee pays $500 a month rent and has two years to go on his lease. He has constructed buildings which revert to landlord at termination of lease, so he has the use and enjoyment of buildings and land for two more years. Because of this the fair market value of the leasehold at the time of taking is $700 a month. After the partial taking, it is $200 a month. The lessee is entitled to $700 × 24 ($16,800) less $200 × 24 ($4,800) or $12,000, discounted for cash.**

> **This is actually the same as saying the lessee is entitled to the difference between the fair cash market value of the leasehold before and after the taking, the applicable test according to other authorities.** Frank S. Righeimer, Jr., EMINENT DOMAIN IN ILLINOIS §6.281, p. 214 (3d ed. 1986).

See also Village of Orland Park v. Orland Park Building Corp., 2015 IL App (1st) 130623-U.

In the landmark Illinois case *Corrigan, supra,* the court stated that the true way to measure compensation for the tenant in a partial taking is to place a value on the leasehold at the time of the filing of the complaint to condemn and subsequently to deduct the value of the use of the premises not taken. See §12.10 above. The Eminent Domain Act will have little effect on the valuation process, affecting only cases in which trials begin, or title to the property is taken, more than two years after the filing of the complaint to condemn. 735 ILCS 30/10-5-60. In these cases, the court has discretion to declare the valuation date no sooner than the date of filing the complaint to condemn and no later than the date of commencement of the trial or the date on which title to the property is taken. *Id*.

Finally, Illinois Pattern Jury Instructions — Civil No. 300.59 (I.P.I. — Civil) provides:

> **In deciding whether the tenant is entitled to a share of the compensation to be paid for the entire property, you must first determine the fair rental value of the tenant's leasehold. If the fair rental value of the leasehold exceeds the rent agreed upon in the lease, the tenant is entitled to the excess. But if the fair rental value of the leasehold does not exceed the rent, the tenant is not entitled to any share of the compensation.**

In *Department of Transportation ex rel. People v. 600 W. Dundee, LLC,* 2019 IL App (1st) 181699, ¶1, 129 N.E.3d 654, 432 Ill.Dec. 436, the defendant-appellant, Market Square Restaurant, Inc., appealed the trial court's finding that it was not entitled to any portion of a condemnation award that its landlord, 600 West Dundee, LLC, received relating to the Illinois Department of Transportation's partial taking of the leased premises.

The appellate court affirmed the trial court's finding that, under the plain language of the condemnation clause in the lease, Market Square was entitled to a rent adjustment relating to the portion of the premises partially taken, but not a portion of the condemnation award. In so doing, the appellate court noted that, "[a]lthough the Act generally provides interested parties with the authority to petition for withdrawal of all or part of a condemnation award according to the fair value of their legal or equitable interests (735 ILCS 30/10-5-90 (West 2016)), parties to a lease are free to include a provision governing their rights in the event of a condemnation proceeding." 2019 IL App (1st) 181699 at ¶7. Because the lease at issue included such a provision, that provision dictated Market Square's rights relating to the partial taking.

The appellate court went on to find that the lease agreed to and executed contained definite and precise language that a rent adjustment was Market Square's remedy in the event of a partial taking that did not result in the termination of the lease. 2019 IL App (1st) 181699 at ¶8. In this case, the fact that the lease was silent regarding the method of computing the rent adjustment had no bearing

on Market Square's agreed-to remedy in the event of a partial taking nor did it justify ignoring the rent adjustment remedy provided for in the condemnation clause. *Id.* The court also found it important that "the absence of the provision to compute the rent adjustment referenced in section 26(b) would have been equally obvious to Market Square and 600 West Dundee at the time the lease was executed." *Id.*

C. [12.12] Valuation of Leasehold — Two Methods

At trial, the condemnees can elect one of two methods for the apportionment of their leasehold damages. First, the landlord and the tenant can request the jury to apportion damages after the determination of the gross award. *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955). Alternatively, they can petition the court to hold a subsequent and separate proceeding following the trial. 735 ILCS 30/10-5-70. In a partial taking, the condemnees should file a cross-complaint. A sample form of a cross-complaint is found in §12.35 below. It is unnecessary to file a cross-complaint in a complete taking. If any dispute arises regarding which method is preferable, the parties should file a motion in limine to resolve the dispute outside the presence of the jury.

1. [12.13] Apportionment as Part of the Jury Trial

Apportionment as part of the jury trial is provided by statute and has long been recognized by the Illinois courts. See 735 ILCS 30/10-5-90. *See also Chicago, B. & Q. Ry. v. F. Reisch & Bros.,* 247 Ill. 350, 93 N.E. 383 (1910); *Lambert v. Giffin,* 257 Ill. 152, 100 N.E. 496, 499 (1912). This method of determining leasehold damages can be placed before the court by filing an appropriate motion. A sample form of a motion for a separate verdict is found in §12.36 below.

2. [12.14] Posttrial Apportionment Hearing

The condemnor will be required to deposit the condemnation proceeds with the county treasurer prior to title being vested in the condemning authority. 735 ILCS 30/20-5-15(a). If it is clear under the lease that only the landlord should recover the condemnation proceeds, then a waiver and consent can be obtained from the tenants. A sample form of a tenant's waiver of lease is found in §12.34 below. Otherwise, a motion can be filed by any one of the condemnees seeking posttrial apportionment of the proceeds. A sample form of a motion for apportionment of condemnation award is found in §12.37 below. A bifurcated proceeding has been held appropriate to apportion condemnation proceeds between the landlord and the tenant. *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955); *Department of Transportation v. White,* 264 Ill.App.3d 145, 636 N.E.2d 1204, 201 Ill.Dec. 772 (5th Dist. 1994).

D. Evidence — Valuation of Leasehold

1. [12.15] Burden of Proof

The burden of proof to value the leasehold estate lies with the condemning authority. *Chicago, B. & Q. Ry. v. F. Reisch & Bros.,* 247 Ill. 350, 93 N.E. 383 (1910); *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319 (1953).

2. [12.16] Options and Verbal Leases

An option to renew is valued and, thus, capable of expanding the lease term. In fact, there is a presumption that the tenant will exercise its option to renew. *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319 (1953). On the other hand, other states have recognized that a tenant's mere expectancy of continued lease renewals may not be a compensable property interest. *See State of Arizona ex rel. Miller v. Gannett Outdoor Company of Arizona, Inc.,* 164 Ariz. 578, 795 P.2d 221 (App. 1990). In *Texaco Refining & Marketing, Inc. v. Crown Plaza Group,* 845 S.W.2d 340 (Tex.App. 1992), the court held that as a matter of law the tenant had a right to share in a condemnation award and the tenant did not act in bad faith by tendering rent and exercising the option to renew the lease. In holding against a sign tenant, one court noted that the ground leases lacked renewal options and refused to recognize any value in the tenant's claimed "inchoate interest to renew the lease." *State of New Hampshire v. 3M National Advertising Co.,* 139 N.H. 360, 653 A.2d 1092, 1094 (1995).

A tenant's unexercised purchase option may be a compensable property interest. *State of New Jersey v. Jan-Mar, Inc.,* 236 N.J.Super. 28, 563 A.2d 1153 (1989). Similarly, the court in *City of Chicago v. Anthony,* 136 Ill.2d 169, 554 N.E.2d 1381, 144 Ill.Dec. 93 (1990), held that a proposal letter to lease a small portion of ground space for a sign, while not a formal lease, could be considered by a valuation witness in determining the highest and best use for the property; the amount of rent proposed in the letter was inadmissible to prove value. However, a verbal lease was held insufficient to support a condemnation award to a tenant. *Conness v. Indiana, I. & I. Ry.,* 193 Ill. 464, 62 N.E. 221 (1901).

3. [12.17] Permanent Improvements

Permanent improvements installed by a tenant must be considered in arriving at the fair cash rental value of a leasehold. *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319 (1953). It must be clear, however, that the improvements belong to the tenant. In *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955), a loading dock was installed by the tenant. Nevertheless, pursuant to the lease, the dock belonged to the landlord and not the tenant.

4. [12.18] Unit Rule for Improvements

The unit rule for improvements prohibits separate valuation of leasehold improvements. Rather, the test is whether the improvement enhances the leasehold's value. In *United States v. 1.357 Acres of Land,* 308 F.2d 200 (7th Cir. 1962), the lease contained a condemnation clause, but the court still considered whether the tenant was entitled to compensation for its improvements to the leasehold. Moreover, in *Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82, 84 (2d Dist. 1975), the court held:

> **In disputes between the landlord and tenant there is a presumption that the tenant, by annexing fixtures, did so for his own benefit and not to enrich the freehold, and the law accordingly construes the tenant's right to remove his annexations liberally, at least where removal may be effected without material injury to the freehold.**

In *Department of Transportation v. East Side Development, L.L.C.,* 384 Ill.App.3d 295, 892 N.E.2d 136, 322 Ill.Dec. 889 (3d Dist.), *appeal denied,* 229 Ill.2d 665 (2008), the Third District Illinois Appellate Court upheld the use of the unit rule for condemned properties with lawfully erected off-premises outdoor advertising signs or billboards. The defendant-billboard owner argued that 735 ILCS 30/10-5-5 provided for billboard owners to obtain a separate market value for their loss resulting from the condemnation. The court determined that the statutory language is clear and provides only that the owner has a compensable interest, not that the interest should be valued separately from the property as a whole. 892 N.E.2d at 140.

5. [12.19] Bonus Value

The bonus value of the leasehold belongs to the tenant. In a complete taking, the landlord would receive the present value of the agreed reserved rent for the remainder of the lease term. If the tenant had negotiated a below-market rental amount, he or she would then be entitled to the difference or "bonus" amount. *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607 (1st Dist. 1963). The phrase "bonus value" or "bargain value" is the difference between the rent reserved and the rental value of the premises. It also has been referred to as an "overplus" or "surplus." Alfred D. Jahr, LAW OF EMINENT DOMAIN: VALUATION AND PROCEDURE §131, p. 198 (1953).

In *Department of Transportation v. East Side Development, L.L.C.,* 384 Ill.App.3d 295, 892 N.E.2d 136, 322 Ill.Dec. 889 (3d Dist.), *appeal denied,* 229 Ill.2d 665 (2008), the Third District Appellate Court stated in dicta that bonus value may not be the only way to determine just compensation for a leasehold. The defendant-billboard owner argued that bonus value did not take into consideration the value of the billboard and the property's value for producing rental income. The court reiterated "that the measure of compensation for a leasehold interest is the value of the interest, subject to the rent covenanted to be paid." 892 N.E.2d at 141. While the Illinois Supreme Court has specifically rejected the proposal that profits derived from the property are a basis for determining just compensation, the Third District Appellate Court stated that bonus value may not be the only appropriate method for valuing a leasehold interest but did not give any examples of other methods that would be considered appropriate. 892 N.E.2d at 141 – 142. The Illinois Supreme Court denied certification on appeal; therefore, *East Side Development* leaves open the question of what other methods of valuation may be appropriate for determining just compensation.

A tenant must ensure that evidence of bonus value is put into the record. In a case involving the apportionment of condemnation proceeds between the landlord and the tenant, a Missouri appellate court reversed and held that no evidence regarding the bonus value of the leasehold was introduced at trial and, therefore, the landlord was entitled to 100 percent of the award. *St. Louis County v. Boatmen's Trust Co.,* 857 S.W.2d 453 (Mo.App. 1993). Similarly, a Florida court refused to permit a tenant to recover its bonus value because that would amount to an impermissible double recovery. *Bolduc v. Glendale Federal Bank,* 631 So.2d 1127 (Fla.App. 1994).

6. [12.20] Valuation Witnesses

Any person acquainted with the property can be a valuation witness in a leasehold case. *Department of Public Works & Buildings v. Bohne,* 415 Ill. 253, 113 N.E.2d 319, 325 (1953);

People ex rel. McDonough v. Goldberg, 354 Ill. 423, 188 N.E. 428 (1933); *Illinois Power & Light Corp. v. Talbott,* 321 Ill. 538, 152 N.E. 486 (1926). *But see Department of Public Works & Buildings of State of Illinois v. Blackberry Union Cemetery,* 32 Ill.App.3d 62, 335 N.E.2d 577 (2d Dist. 1975). A lease executed in good faith before commencement of condemnation proceedings is admissible in evidence on the issue of the rental value of the property. *Department of Public Works & Buildings v. Kirkendall,* 415 Ill. 214, 112 N.E.2d 611 (1953).

PRACTICE POINTER

✓ Based on *Bohne* and the flexibility under Illinois law in valuing a leasehold, the following items should be noted regarding leasehold valuation testimony:

a. The valuation witness should read the lease.

b. The witness must know the property, its use, and its value for the purposes to which it is being applied.

c. A witness may express an opinion of fair cash rental value even though not engaged in the business of leasing property or of real estate in general.

d. A witness who testifies to an opinion of fair cash rental value must be familiar with the terms and conditions of the lease and must have background, experience, or knowledge on which to predicate such an opinion of value.

e. A witness who testifies to the fair cash market value of the real estate subject to a lease must be familiar with the terms and provisions of the lease, the existence of options of renewal, provisions relating to improvements, and improvements made.

f. A witness who testifies to the fair cash market value of the real estate subject to a lease can properly consider the leased portions and any unleased portions as distinct elements in arriving at the value of the entire property.

For trial purposes, attorneys should note that the Illinois Rules of Evidence became effective January 1, 2011. In *Wilson v. Clark,* 84 Ill.2d 186, 417 N.E.2d 1322, 49 Ill.Dec. 308 (1981), the Illinois Supreme Court adopted Federal Rules of Evidence 703 and 705 and their application to the testimony of experts. In *City of Chicago v. Anthony,* 136 Ill.2d 169, 554 N.E.2d 1381, 144 Ill.Dec. 93 (1990), the Illinois Supreme Court held that these rules apply to real estate valuations. Practitioners should be aware that Illinois' rules of evidence related to expert testimony are now identical to the federal rules. *See Department of Transportation ex rel. People v. Raphael,* 2014 IL App (2d) 130029, 9 N.E.3d 1120, 381 Ill.Dec. 1.

Ill.R.Evid. 703 states:

> **The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.**

Ill.R.Evid. 705 provides:

> **The expert may testify in terms of opinion or inference and give reasons therefor without first testifying to the underlying facts or data, unless the court requires otherwise. The expert may in any event be required to disclose the underlying facts or data on cross-examination.**

7. [12.21] Valuation Testimony in Separate Apportionment Proceeding

If the parties elect to proceed with a separate posttrial apportionment proceeding, the valuation testimony in this proceeding is similar to the testimony in a jury trial. However, the only issue is the fair cash rental value of the leasehold, and the court will not consider the fair cash market value of the whole. *City of Chicago v. American National Bank & Trust Co.,* 233 Ill.App.3d 1031, 599 N.E.2d 1126, 1129 – 1130, 175 Ill.Dec 112 (1st Dist. 1992); *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955); *Department of Public Works & Buildings v. Metropolitan Life Insurance Co.,* 42 Ill.App.2d 378, 192 N.E.2d 607 (1st Dist. 1963).

8. [12.22] Comparable Leasehold Valuation

Comparable leasehold valuation evidence is not generally as easy to obtain as comparable sales evidence. As stated by one commentator,

> **[**t**]he holding by the courts that leasehold interests are to be valued . . . according to their "market value" probably poses a problem which is just as complicated as the original problem. How are those interests to be valued by "market value"? Certainly there are very few sales of leases exactly in point. It is not like valuing a piece of real property where you may find sales of comparable properties in the vicinity. Each leasehold is *sui generis*. Nevertheless, the courts have said that market value is the measure of compensation to the lessee. The market value must be determined by qualified experts in the sale of leases. [**Footnote omitted.**]** Alfred D. Jahr, LAW OF EMINENT DOMAIN: VALUATION AND PROCEDURE §130, p. 194 (1953).

Often the best source of comparable leasehold estates will be commercial real estate brokers and leasing agents. The difficulty in obtaining convincing and admissible leasehold valuation testimony is demonstrated by several Illinois courts. *See, e.g., City of Chicago v. Lord,* 276 Ill. 544, 115 N.E. 8 (1916); *Commercial Delivery Service, Inc. v. Medema,* 7 Ill.App.2d 419, 129 N.E.2d 579 (1st Dist. 1955); *Department of Public Works & Buildings v. Lambert,* 411 Ill. 183, 103 N.E.2d 356 (1952); *Department of Public Works & Buildings of State of Illinois v. Blackberry Union Cemetery,* 32 Ill.App.3d 62, 335 N.E.2d 577 (2d Dist. 1975); *Sanitary Dist. of Chicago v. Boening,* 267 Ill. 118, 107 N.E. 810 (1915).

9. [12.23] Consequential Losses

The landlord's and the tenant's consequential losses (*i.e.,* loss of profits, relocation expenses, and damage to goodwill) are not recoverable. *United States v. Petty Motor Co.,* 327 U.S. 372, 90 L.Ed. 729, 66 S.Ct. 596 (1946); *National Railroad Passenger Corp. v. Faber Enterprises, Inc.,* 931 F.2d 438 (7th Cir. 1991); *United States v. Meyer,* 113 F.2d 387, 397 (7th Cir.) (income is generally too conjectural and inadmissible to prove value), *cert. denied,* 61 S.Ct. 174 (1940); *Kurth v. Iowa Department of Transportation,* 628 N.W.2d 1, 9 – 10 (Iowa 2001).

10. [12.24] Mortgagee's Interest

Just as compensation between a landlord and a tenant can be determined by an express contractual provision, so can interests involving lenders. *See Village of Palatine v. Palatine Associates, LLC,* 2012 IL App (1st) 102707, 966 N.E.2d 1174, 359 Ill.Dec. 486. Thus, owners of an interest in the property should be cognizant of the mortgagee's rights under the loan documents. In the nature of an equitable conversion, all interest in the property is transferred to the award of just compensation upon the vesting of the title in the condemnor, and the holder of a first mortgage on the property is entitled to priority of payment from the award to satisfy its lien. *City of Chicago v. Salinger,* 384 Ill. 515, 52 N.E.2d 184 (1943). This priority is superior to an attorney lien on behalf of the owner for fees and expert witness costs. *Village of Clarendon Hills v. Mulder,* 278 Ill.App.3d 727, 663 N.E.2d 435, 215 Ill.Dec. 424 (2d Dist. 1996). Thus, when the lessor and/or lessee petitions to withdraw funds, the lien of the mortgagee is paid first. If there is an excess of the award after satisfaction of the first mortgage interest but the excess is insufficient to satisfy a lessee's award of damages, Illinois law is uncertain as to whether the entire balance goes to the lessee or an apportionment on some basis is to be made between the lessor and the lessee. Accordingly, a condemnation provision dealing with this eventuality might be considered advisable by the parties.

IV. [12.25] EMINENT DOMAIN ACT AND ITS EFFECT ON LANDLORDS AND TENANTS

The Eminent Domain Act, which took effect January 1, 2007, applies only to complaints to condemn filed on or after the effective date of the Act. The Act replaces, and in some instances modifies, the former provisions of the Code of Civil Procedure, 735 ILCS 5/1-101, *et seq.,* for eminent domain proceedings. (Note that, in two instances, old eminent domain statutes still apply: (a) the O'Hare Modernization Act, 620 ILCS 65/1, *et seq*. (see 620 ILCS 65/15); and (b) tax-increment allocation redevelopment plans adopted prior to April 15, 2006. 735 ILCS 30/5-5-5(a-5), 30/5-5-5(a-10).) Although the Eminent Domain Act is extensive in its provisions, its effect on the landlord-tenant relationship is minimal. What changes the Act does have on the landlord-tenant relationship will be most evident when the court is determining the value of the property taken. The Act provides that the value of taken property shall be determined and ascertained as of the date of filing the complaint to condemn, except that

> **(i) in the case of property not being acquired under Article 20 (quick-take), if the trial commences more than 2 years after the date of filing the complaint to condemn, the court may, in the interest of justice and equity, declare a valuation date no sooner than the date of filing the complaint to condemn and no later than the date of commencement of the trial; and**

(ii) in the case of property that is being acquired under Article 20 (quick-take), if the trial commences more than 2 years after the date of filing the complaint to condemn, the court may, in the interest of justice and equity, declare a valuation date no sooner than the date of filing the complaint to condemn and no later than the date on which the condemning authority took title to the property. 735 ILCS 30/10-5-60.

This language appears to provide more protection to the landlord and the tenant when the trial to condemn takes place long after the filing of the complaint to condemn.

V. [12.26] CONCLUSION

The impact of a leasehold interest in a condemnation proceeding begins with the condemnation clause in the lease. Once the contractual rights between the landlord and the tenant are ascertained, the parties must look to the law of eminent domain to determine whether damages exist to the leasehold and how those damages should be measured.

VI. APPENDIX — SAMPLE FORMS

A. Automatic Termination Clauses

1. [12.27] Condemnation Clause

If, under the power of eminent domain, there shall be a permanent taking of the whole or any portion of the property so as to materially affect the permitted use of the property, this agreement shall cease as of (and the rent shall be apportioned to) the date that pursuant thereto title shall be taken by the appropriating authority. In the event of any taking of a portion of the property that does not materially affect the permitted use of the property, this agreement shall continue in full force and effect and the rent shall continue unabated.

2. [12.28] Compensation Clause

All compensation awarded for a taking under the power of eminent domain, whether for the whole or a portion of the property, shall be the property of the landlord, except any compensation for the tenant's moving expense, whether such damages shall be awarded as compensation for diminution in the value of or loss of the leasehold, for the diminution in the value of or loss of the fee of the property, or otherwise, and the tenant hereby assigns to the landlord all of the tenant's rights, title, and interest in and to any and all such compensation.

B. Condemnation Clauses

1. [12.29] Total Condemnation Clause

If, during the term of this lease or any extension or renewal thereof, all of the premises should be taken for any public or quasi-public use under any law, ordinance, or regulation or by right of eminent domain or should be sold to a condemning authority under threat of

condemnation, this lease shall terminate and the rent shall be abated during the unexpired portion of this lease, effective as of the date of the taking of the premises by the condemning authority.

2. [12.30] Partial Condemnation Clause

If, during the term of this lease or any extension or renewal thereof, less than all of the premises shall be taken for any public or quasi-public use under any law, ordinance, or regulation, or by right of eminent domain, or should be sold to a condemning authority under the threat of condemnation, the landlord shall have the option to (a) terminate this lease or (b) forthwith, at its sole expense, restore and reconstruct the building and other improvements situated on the premises, provided such restoration and reconstruction shall make them reasonably tenantable and suitable for the uses for which the premises are leased. The rent payable hereunder during the unexpired portion of this lease shall be adjusted equitably.

3. [12.31] Office Building Clause

Taking of Whole. **Notwithstanding any other provision of this Article ____, in the event the whole of the premises or any substantial part of the building is taken or condemned by any competent authority for any public use or purpose, or conveyed under threat of such condemnation, this lease shall terminate as of the date title vests in such authority and fixed minimum rent shall be apportioned as of that date.**

Taking of Substantial Part. **If more than 25 percent but less than 100 percent of the rentable area of the premises is taken or condemned by any competent authority for any public use or purpose, or conveyed under threat of such condemnation, or if by reason of any such taking or conveyance, regardless of the amount so taken, the remainder of the premises is not usable for the purposes for which the premises were leased, then either the landlord or the tenant shall have the right to terminate this lease as of the date the title vests in such authority by giving notice to the other in writing of such election within 60 days after the date of such vesting. In the event of such termination, both the landlord and the tenant shall thereupon be released from any liability thereafter accruing under this sublease.**

Taking of Part. **If any part of the premises but less than 100 percent of the premises is taken or condemned by any competent authority for any public use or purpose, or conveyed under threat of condemnation, and this lease is not terminated pursuant to §____ or §____, fixed minimum rent shall be reduced by an amount that bears the same ratio to fixed minimum rent then in effect as the number of square feet of rentable area in the premises so taken or condemned bears to the number of square feet of rentable area specified in §____. The landlord, upon receipt of and to the extent of the award in condemnation or proceeds of sale, shall make necessary repairs and restorations (exclusive of the tenant's work, its leasehold improvements, and personal property paid for or installed by the tenant) to restore the premises remaining to as near their former condition as circumstances will permit, and to the building to the extent necessary to constitute the portion of the building not so taken or condemned as a complete architectural and commercially viable unit. In the event of a**

partial taking or condemnation of the premises, the rentable area of the premises specified in §____ shall be reduced for all purposes under this lease by the number of square feet of rentable area of the premises so taken or condemned or rendered useless by such condemnation.

Compensation. **Whether or not this lease is terminated, the landlord shall be entitled to receive the entire price or award from any such sale, taking, or condemnation without any payment to the tenant, and the tenant hereby assigns to the landlord the tenant's interest, if any, in such award; provided, however, the tenant shall have the right to pursue separately against the condemning authority an award in respect of the loss, if any, to its trade fixtures and personal property and for the tenant's cost of relocation.**

4. [12.32] Shopping Center Clause

1. ***All of Premises Taken.*** **If the whole of the premises is taken by any authority under the power of eminent domain, this lease shall terminate as of the date possession is taken by such public authority, and the tenant shall pay rent up to that date with an appropriate refund by the landlord of such rent as may have been paid in advance for a period after the date of the taking.**

2. ***Less Than 25 Percent of Premises Taken.*** **If less than 25 percent of the gross leasable area of the premises is taken, this lease shall terminate only with respect to the part taken as of the date possession is taken by such public authority, and the tenant shall pay rent up to that date with an appropriate refund by the landlord of such rent as may have been paid in advance for a period after the date of the taking and, thereafter, the rent shall be equitably adjusted, and the landlord will, at its expense, make all necessary repairs or alterations to the basic building and exterior work so as to constitute the remainder of the premises a complete architectural unit.**

3. ***More Than 25 Percent of Premises Taken.*** **If more than 25 percent of the gross leasable area of the premises is taken, this lease shall terminate only with respect to the part so taken as of the date possession is taken by such public authority, and the tenant shall pay rent up to that date with an appropriate refund by the landlord of such rent as may have been paid in advance for a period after the date of the taking, and either party shall have the right to terminate this lease upon notice in writing to the other party given within 30 days from the date of such taking. If neither party elects to so terminate, all of the terms herein provided will continue in effect except that rent shall be equitably adjusted and the landlord will, at its expense, make all necessary repairs or alterations to the basic building and exterior work so as to constitute the remainder of the premises a complete architectural unit.**

4. ***More Than 50 Percent of Developer Parcel Taken.*** **If more than 50 percent of the gross leasable area of the mall stores or more than 50 percent of the parking area on the developer parcel is taken, this lease shall terminate only with respect to the areas so taken as of the date possession is taken by such public authority, and the tenant shall pay rent up to that date with an appropriate refund by the landlord of such rent as may have been paid in advance for a period after the date of the taking, and either party shall have the right to terminate this lease**

upon notice in writing to the other party given within 30 days from the date of such taking. If neither party elects to so terminate, all of the terms herein provided will continue in effect except that rent shall be equitably adjusted and the landlord will, at its expense, make all necessary repairs and alterations to the basic building and exterior work so as to constitute the remainder of the premises a complete architectural unit.

5. ***Landlord's Restoration Obligation.*** **In the event the landlord is obligated to restore the premises to a complete architectural unit pursuant to this Article ____, the landlord will not be required to spend for such work an amount in excess of the amount received by the landlord as damages for the part of the premises so taken, less any amount paid to the landlord's mortgagee from such award.**

The above notwithstanding, if 25 percent or less of the gross leasable area of the premises is taken and the tenant is unable to operate its business in that portion of the premises remaining, the tenant may terminate this lease upon 30 days' written notice, provided, however, that such notice must be given within 30 days of the taking.

6. ***Allocation of Award.*** **In the event the shopping center, the developer parcel, the premises, or any portions thereof are taken or condemned either permanently or temporarily for any public or quasi-public use or purpose by any competent authority in appropriation proceedings or by the exercise of any right of eminent domain, the entire compensation award therefor, including but not limited to all damages as compensation for diminution in value of the leasehold, reversion, and fee, shall belong to the landlord without any deduction therefrom for any present or future estate of the tenant, and the tenant hereby assigns to the landlord all its right, title, and interest to any such award. Although all damages in the event of any condemnation are to belong to the landlord, whether such damages are awarded as compensation for diminution in value of the leasehold, reversion, or fee of the premises, the tenant shall have the right to claim and recover from the condemning authority, but not from the landlord, such compensations as may be separately awarded or recoverable by the tenant in the tenant's own right on account of damage to the tenant's business by reason of the taking and for or on account of any cost or loss to which the tenant might be put in removing the tenant's merchandise, furniture, fixtures, improvements, and equipment.**

C. [12.33] 60-Day Letter

_____, 20__

Dear Landowner:

As you have been previously informed, the State of Illinois, Department of _____, proposes [description of project**]. This construction requires the acquisition of [**description of property**] consisting of ____ acres, which we find is owned by you.**

The amount of compensation for the taking of your property by the Illinois Department of _____ has been established at $_____. A copy of the basis for computing the compensation and offer to purchase is enclosed.

Pursuant to 735 ILCS 30/10-5-15, this Department is required to provide you with this certified letter at least 60 days before filing a petition with any Court to initiate an eminent domain action. It is our intent, however, to continue to seek a negotiated agreement with you within this 60-day period and to avoid litigation if at all possible.

We are also required to inform you that, in the absence of a negotiated agreement, it is the intention of this Department to initiate eminent domain proceedings.

Sincerely,

_____
[condemning authority]

D. [12.34] Tenant's Waiver of Lease

STATE OF ILLINOIS)
) ss.
COUNTY OF _____)

TENANT'S WAIVER OF LEASE

Know all men by these presents, that [I**] [**we**], tenant[**s**] of the County of _____ and State of Illinois, for and in consideration of One Dollar, and other good and valuable consideration, in hand paid, receipt of which is hereby acknowledged, do hereby remise, convey, relinquish, renounce, release, and quitclaim unto [**condemning authority**] of the County of _____ and State of Illinois all right, title, interest, claim, or demand whatsoever [**I**] [**we**] may have acquired under and by virtue of a certain lease duly executed by tenant[**s**] as Lessee[**s**] and _____ as Lessor. This lease was dated the ____ day of _____, 20__, and recorded in the Recorder's Office of _____ County in the State of Illinois, in Book ____ on Page ____, demising premises described as follows:**

[legal description]

Given under my hand and notarial seal this ____ day of _____, 20__.

_____ (SEAL)

_____ (SEAL)

Signed and sworn to before me on _____, 20__.

_____
Notary Public

E. [12.35] Cross-Complaint

[Caption]

CROSS-COMPLAINT

NOW COME Defendants, by their attorney _____ of _____, pursuant to 735 ILCS 30/10-5-10, as owners of the real property being condemned and of the remaining real property, including the leasehold interest, and for their Cross-Complaint hereby state as follows:

1. Plaintiff has filed a Complaint for Condemnation as follows:

[insert legal description of whole tract]

2. The tract of real property being condemned by Plaintiff includes a leasehold estate described as follows:

[describe]

3. The taking of the real property by Plaintiff will result in damages to the remainder of the real property not taken and specifically to the leasehold interest, which will be adversely affected as follows:

[describe]

WHEREFORE, for all the reasons set forth herein, Defendants, being the tenants of the leasehold estate, pray that their damages to the leasehold estate be assessed in these proceedings against Plaintiff and that a judgment for damages, expenses, and costs of this suit be entered against Plaintiff and in favor of Defendants.

By: _____
Attorney for Defendants

[attorney information]

F. [12.36] Motion for Separate Verdict

[Caption]

MOTION FOR SEPARATE VERDICT

NOW COMES Defendant, by its attorney _____ of _____, and moves this Court for a separate verdict as to its leasehold damage arising from the acquisition of the property herein and in support states as follows:

1. Defendant is vested with a leasehold interest in and to the property herein under a lease dated _____, 20__, from the record titleholder of the property. (A copy of said lease is attached hereto as Exhibit A.)

2. By virtue of Defendant's leasehold interest, Defendant has a compensable leasehold interest in and to the property and is entitled to have its leasehold damage herein established by a separate verdict.

WHEREFORE, for all the foregoing reasons, Defendant respectfully requests that the jury impaneled herein return a separate verdict as to the leasehold damage sustained by Defendant incident to this acquisition.

By: _____
Attorney for Defendant

[attorney information**]**

G. [12.37] Motion for Apportionment of Condemnation Award

[Caption**]**

MOTION FOR APPORTIONMENT OF CONDEMNATION AWARD

NOW COMES Defendant, by its attorney _____ of _____, and respectfully represents:

1. Defendant is a party in the above-captioned condemnation action.

2. On _____, 20__, a judgment was entered in this action setting the amount of just compensation for the taking of the fee-simple title to the property as described in the Complaint To Condemn at $_____.

3. On _____, 20__, the award of just compensation was deposited with the County Treasurer of _____ County for the benefit of the owners and parties interested in said property.

4. Defendant is the lessee of the said premises condemned, holding its leasehold interest pursuant to a lease dated _____, 20__, and executed by _____. A true and accurate copy of the lease is attached hereto as Exhibit ____.

5. Defendant as lessee of the subject property is entitled to an apportionment of the condemnation award for the value of its interest in the property condemned pursuant to 735 ILCS 30/10-5-90.

WHEREFORE, for all the foregoing reasons, it is respectfully requested that this Motion for Apportionment be set for Hearing and that the Court enter an Order awarding Defendant the amount of its leasehold damage sustained by virtue of the acquisition of the property.

By: _____
Attorney for Defendant

[attorney information**]**

13 Mechanics Liens on Leased Property

JENNIFER L. JOHNSON
Zanck, Coen, Wright & Saladin, P.C.
Crystal Lake

IICLE® gratefully acknowledges Kevin V. Hunt, who provided this chapter for previous editions and on whose material this edition is based.

I. [13.1] SCOPE OF CHAPTER

The Mechanics Lien Act, 770 ILCS 60/0.01, *et seq.,* attempts to balance the interests of contractors, owners, tenants, subcontractors, lenders, material suppliers, and third-party purchasers relative to construction work performed on real property. The Mechanics Lien Act is remedial in nature and permits a lien on premises when a benefit has been received by the owner and when the value or condition of property has been increased or improved by reason of the furnishing of labor and materials. *Prior v. First Bank & Trust Co. of Mt. Vernon, Illinois,* 231 Ill.App.3d 331, 596 N.E.2d 891, 173 Ill.Dec. 267 (5th Dist. 1992). This chapter discusses the rights and obligations of contractors who furnish labor and materials pursuant to an oral, written, or implied contract with a tenant vis-á-vis the rights and obligations of the tenant and the owner.

II. BASIS OF A MECHANICS LIEN CLAIM

A. [13.2] Statutory Basis of a Mechanics Lien Claim

Section 1 of the Mechanics Lien Act states in pertinent part:

> **Any person who shall by any contract or contracts, express or implied, or partly expressed or implied, with the owner of a lot or tract of land, or *with one whom the owner has authorized or knowingly permitted to contract, to improve the lot or tract of land* or for the purpose of improving the tract of land . . . is known under this Act as a contractor and has a lien upon the whole of such lot or tract of land . . . and in case the contract relates to 2 or more buildings, on 2 or more lots or tracts of land, upon all such lots and tracts of land and improvements thereon for the amount due to him or her for the material, fixtures, apparatus, machinery, services or labor, and interest at the rate of 10% per annum from the date the same is due. [**Emphasis added.**]** 770 ILCS 60/1(a).

Pursuant to the statute, a contractor, subcontractor, or material supplier who enters into a contract with a tenant of a building for the improvement of the property may be entitled to a lien against the fee interest of the landlord and the tenant's leasehold interest. The operative statutory language is "with one whom the owner has authorized or knowingly permitted to contract, to improve the lot or tract of land." *Id.* When a contractor enters into a contract with a tenant, the contractor's mechanics lien is enforceable against the owner of the property if the owner knowingly authorized or permitted the tenant to contract for improvements. *Norman A. Koglin Associates v. Valenz Oro, Inc.,* 176 Ill.2d 385, 680 N.E.2d 283, 223 Ill.Dec. 550 (1997). "The words 'knowingly permit' are to be understood in the general sense of being aware of and consenting to the initiation of such improvements." *Abbott Electrical Construction Co. v. Ladin,* 144 Ill.App.3d 974, 494 N.E.2d 1251, 1254, 98 Ill.Dec. 924 (2d Dist. 1986). A contractor may also have a lien against the leasehold interest. This lien may be essentially worthless, however, if the landlord terminates the lease or the tenant defaults on the lease. See §13.17 below.

In *Rasmussen v. Harper,* 287 Ill.App. 404, 5 N.E.2d 257, 260 (1st Dist. 1936), the court stated the basic theory on which the lien against the fee interest is allowed:

> **The theory underlying, in the cases holding an owner liable for work done pursuant to the order of his tenant, is that it would be unjust to permit the owner to knowingly obtain additions and improvements to his real estate and not be liable for the same, as it would be an unjust enrichment.**

In *E.R. Darlington Lumber Co. v. Burton,* 156 Ill.App. 82, 86 (3d Dist. 1910), the court further discussed the underlying basis for allowing the lien:

> **The theory upon which the mechanic's lien laws are based, is that the owner of the fee is benefited by buildings and improvements erected on the premises, they becoming a part of the realty, and that he in right and justice should pay for this accruing benefit, when it was induced or encouraged by his acts. It is founded upon the equitable doctrine that as the land is enhanced in value, the owner of the fee should pay for the improvements when he encouraged them.**

Note, however, that an original contractor is deemed to be neither an agent of the owner nor one knowingly permitted or authorized to contract for work on behalf of the owner. *Philip S. Lindner & Co. v. Edwards,* 13 Ill.App.3d 365, 300 N.E.2d 283 (3d Dist. 1973).

> **If the owner of real estate has let out the entire work to an original contractor, then he may not be deemed to have "knowingly permitted" or "authorized" any subcontractor of the original contractor to furnish any service or material, since the owner is justified in assuming that such subcontractor is doing the work and furnishing materials for the original contractor, and not the owner.** 300 N.E.2d at 287.

A contractor or subcontractor asserting a lien claim pursuant to a contract with a tenant must ensure that it strictly complies with the statutory requirements of the Mechanics Lien Act, including the notice provisions, as "such liens are valid 'only if each of the statutory requirements is scrupulously observed.' " *Seasons-4, Inc. v. Hertz Corp.,* 338 Ill.App.3d 565, 788 N.E.2d 179, 183, 272 Ill.Dec. 875 (1st Dist. 2003), quoting *First Federal Savings & Loan Association of Chicago v. Connelly,* 97 Ill.2d 242, 454 N.E.2d 314, 316, 73 Ill.Dec. 454 (1983). However, once the lien claimant has satisfied the statutory requirements, the Mechanics Lien Act should be liberally construed to fulfill its remedial purpose. *Seasons-4, supra,* 788 N.E.2d at 183. This purpose is to protect, through imposition of an enforceable lien, a party who improves the value or condition of property by furnishing labor or materials. *Id.*

B. [13.3] Enactment of "The Clause" and Its Constitutionality

The Mechanics Lien Act provides lien rights for contractors who enter into contracts "with one whom the owner has authorized or knowingly permitted to contract." 770 ILCS 60/1(a). This clause was first inserted in the Mechanics Lien Act of 1895. Prior to this revision, to be entitled to a lien, a claimant had to contract with the owner or with his or her authorized agent. *Hough v. Collins,* 176 Ill. 188, 52 N.E. 847 (1898), *aff'g* 70 Ill.App. 661 (1st Dist. 1897); *Walsh v. Murphy,* 167 Ill.

228, 47 N.E. 354 (1897); *Campbell v. Jacobson,* 145 Ill. 389, 34 N.E. 39 (1893), *aff'g* 46 Ill.App. 287 (1st Dist. 1892); *Burns v. Lane,* 23 Ill.App. 504 (4th Dist. 1887); *Dawson v. Harrington,* 12 Ill. 300 (1850). The constitutionality of the "authorized or knowingly permitted" clause was upheld in *Boyer v. Keller,* 258 Ill. 106, 101 N.E. 237, 239 (1913). Most of the cases arising under the present statute (Mechanics Lien Act of 1903) involve the mechanics lien claimant's seeking a lien against the owner's interest under a contract made by a general contractor with the tenant to improve the premises of the owner.

III. FACTORS TO DETERMINE THE VALIDITY OF A MECHANICS LIEN CLAIM ON LEASED PROPERTY

A. [13.4] Factual Considerations — Authorized or Knowingly Permitted

When determining whether the owner has authorized or knowingly permitted the tenant to enter into a contract for the purpose of improving the owner's property, one should consider

1. whether the facts demonstrate that the owner authorized the improvements by the tenant under the terms of a lease;

2. whether the owner had knowledge that the improvements were being made by the tenant and did nothing to stop the work; or

3. whether the owner or the landlord imposed conditions on the tenant that must be performed prior to the tenant's making the improvements that were not waived by the landlord's actions or inactions.

In *Miller v. Reed,* 13 Ill.App.3d 1074, 302 N.E.2d 131 (5th Dist. 1973), the circuit court awarded the contractor a lien when there was an oral contract between a tenant at sufferance and the contractor for electrical work. The court held that the tenant had sufficient interest in the property to contract to improve the property and that the owner knew of and approved of the work. The court foreclosed the lien against the owner and the tenant. On appeal, the court stated:

> **[**T**]he Act now requires only that the contract be with the owner or with one whom such owner has authorized or 'knowingly permitted' to contract for the improvement of or to improve the land. . . . The owner is assumed to have 'knowingly permitted' the improvements *where he knew and failed to protest or accepted the benefits* of the improvements. . . . Here the record clearly shows *that the owner knowingly permitted the tenant to contract for the improvements.* Under our statute, this is sufficient to give rise to a mechanics' lien upon the owner's property. [**Emphasis added.**] [**Citations omitted.**]** 302 N.E.2d at 133.

In *Abbott Electrical Construction Co. v. Ladin,* 144 Ill.App.3d 974, 494 N.E.2d 1251, 98 Ill.Dec. 924 (2d Dist. 1986), the court considered the definition of "knowingly permit." In *Abbott,* the contractor performed electrical work ordered by a tenant of the building. The building was owned by a land trust. The beneficiaries of the trust were Larry and Elaine Klairmont, and their son, Alfred, managed the property. The tenant was a corporation operating a restaurant. Alfred was an officer of the corporation.

Abbott filed a claim for lien and brought suit to foreclose its lien. The Klairmonts claimed the lien was invalid because Abbott had failed to supply the beneficial owners with a contractor's affidavit pursuant to §5 of the Mechanics Lien Act. The court held that the lien was valid:

> **Section 1 of the Act grants a lien to anyone who contracts "with one whom the owner has authorized or knowingly permitted to contract" (Ill.Rev.Stat. 1983, ch. 82, par. 1) for the provision of labor, services and material for the improvement of the owner's property. The words "knowingly permit" are to be understood in the general sense of being aware of and consenting to the initiation of such improvements. . . . [**Alfred**] testified that he visited his father's properties on a regular basis and saw workmen on the restaurant premises when he was there. As noted by the trial court, the elder Klairmont "knew or should have known there was electrical work" being done. On these facts we conclude that the Klairmonts knowingly permitted Ladin to contract with Abbott for electrical work to be performed in the Highland Park building owned by them.**
>
> **By knowingly allowing the work to be done, the Klairmonts recognized a benefit to their building. They cannot now defeat Abbott's claim merely on the basis that demand for payment was made on their lessee rather than directly upon them. It was incumbent upon the Klairmonts to request a contractor's affidavit from Abbott if they wanted such an affidavit for their own protection. [**Citation omitted.**]** 494 N.E.2d at 1254.

In *Christopher B. Burke Engineering, Ltd., v. Heritage Bank of Central Illinois,* 2015 IL 118955, 43 N.E.3d 963, 398 Ill.Dec. 53, the Illinois Supreme Court analyzed the meaning of "knowingly permitted," albeit not in the context of a landlord-tenant matter. In *Burke Engineering*, a contract purchaser engaged an engineering company prior to purchasing a plot of land. The bank holding the mortgage contested the lien claim, arguing, among other things, that the owner of the land at the time of the contract did not authorize the work. The Illinois Supreme Court determined that it was not contingent upon the owner receiving a benefit from the work performed for the contract purchaser, but whether she permitted the work. The Illinois Supreme Court remanded the case to the circuit court to determine whether the owner knew the work had begun before the date of the closing, whether she knew what the lien claimant was supposed to do under the contract, or whether she had any meaningful opportunity to object to the contract.

1. [13.5] Work Performed by Tenant Without Knowledge of Owner or Authorization by Terms of Lease

A tenant is not entitled to a lien against the fee interest of a property when the owner neither has knowledge of the work being performed by the tenant nor has authorized the work by lease or by contract. *Hacken v. Isenberg,* 288 Ill. 589, 124 N.E. 306 (1919); *Sorg v. Crandall,* 233 Ill. 79, 84 N.E. 181 (1908); *Crandall v. Sorg,* 198 Ill. 48, 64 N.E. 769 (1902); *Williams v. Vanderbilt,* 145 Ill. 238, 34 N.E. 476 (1893); *Edward Solomon, Inc. v. Padorr,* 282 Ill.App. 269 (1st Dist. 1935); *McRae v. Murdoch Campbell Co.,* 94 Ill.App. 105 (1st Dist. 1900). To prove entitlement to a lien, the tenant must present competent evidence that the owner knew of the work being done. *Donkle*

& Webber Lumber Co. v. Rehrmann, 310 Ill.App. 17, 33 N.E.2d 709 (3d Dist. 1941). Further, "[t]o knowingly permit property to be improved is to know that material is bring procured for that purpose and the work being done and not objection to it." *Bermingham v. Gill,* 164 Ill.App. 536, 538 (2d Dist. 1911).

2. [13.6] Work Performed with Knowledge of Owner, Who Permits It To Be Done

In the context of the lessor-lessee relationship, Illinois courts have held that an owner's interest is subject to a mechanics lien by a contractor when the owner has had notice that work was being done on the property and the owner made no objection to the work. *Bingaman v. Dahm,* 307 Ill.App. 432, 30 N.E.2d 509 (4th Dist. 1940); *Young v. Bergner,* 243 Ill.App. 473 (4th Dist. 1927); *Matot v. Barnheisel,* 212 Ill.App. 489 (1st Dist. 1918); *Mutual Construction Co. v. Baker,* 237 Ill.App. 596 (1st Dist. 1925); *Wertz v. Mulloy,* 144 Ill.App. 329 (2d Dist. 1908). The statement of the court in *McRae v. Murdoch Campbell Co.,* 94 Ill.App. 105, 110 (1st Dist. 1900), must be considered:

> **It would be a most onerous rule to adopt, as the meaning of the statute, that whoever lets his store, and sees the tenant putting in an improvement, must forbid the work being done, or expressly disclaim all responsibility for it, or else run the risk of having the fee to his land swept from him by a mechanic's lien. We can not subscribe to such a construction of the statute.**

In *Loeff v. Meyer,* 209 Ill.App. 382 (1st Dist. 1918), the court referred to *McRae* and distinguished it on the sole ground that in the case before it the lease provided for the alterations, while in *McRae* there was no such provision. *Goldstein v. McAlonan,* 297 Ill.App. 643, 17 N.E.2d 993 (1st Dist. 1938) (abst.); *Friebele v. Schwartz,* 164 Ill.App. 504 (2d Dist. 1911).

In *Wertz, supra,* the court stated:

> **He knowingly permits a thing to be done who, knowing that it is being done, and being present when he can object, and who has an interest to object, does not object; and still more has he knowingly permitted it to be done if he takes part in doing it.** 144 Ill.App. at 334.

For discussion of *Wertz, see Philip S. Lindner & Co. v. Edwards,* 13 Ill.App.3d 365, 300 N.E.2d 283, 287 (3d Dist. 1973). See also Paul Bernstein, *The Lessee's Contractor — Perfection of Mechanics Liens against the Lessor,* 57 Ill.B.J. 996 (1969). An owner who has knowledge of the character of the work being done and does not object to it cannot defend on the ground that the work was not necessary or did not increase the value of the premises (*Young, supra*) or that the cost was excessive or the improvements undesirable. *Westphal v. Berthold,* 273 Ill.App. 266 (2d Dist. 1934); *R. Haas Electric & Mfg. Co. v. Springfield Amusement Park Co.,* 236 Ill. 452, 86 N.E. 248 (1908); *Fehr Const. Co. v. Postl System of Health Building,* 288 Ill. 634, 124 N.E. 315 (1919). In *R. Haas Electric,* the court said:

> **The owner, no doubt, might have specified the character of improvements to be placed on his land and [**might**] have limited the cost thereof, but in the case at bar the owner did not see proper to place any limitations whatever upon the power of the park company in this regard, and he will therefore not be heard to complain that the cost is excessive or the character of the improvements undesirable.** 86 N.E. at 251.

An owner who had knowledge of the improvements but who did not have knowledge of the particular contract between the tenant and the lien claimant cannot contend that such knowledge was necessary before it could be held to have authorized or knowingly permitted the contract to improve the lot or tract of land, etc. *Young, supra; Cooper v. Palais Royal Theatre Co.,* 242 Ill.App. 184 (1st Dist. 1926).

A tenant is entitled to a mechanics lien when the tenant performs work at the request of the owner, even when the lease prohibits the placement of mechanics liens on the property. *Leveyfilm, Inc. v. Cosmopolitan Bank & Trust,* 274 Ill.App.3d 348, 653 N.E.2d 875, 210 Ill.Dec. 680 (1st Dist. 1995).

3. [13.7] Work Authorized by Owner Under Terms of Lease

A lien claimant is entitled to a lien on the property when the owner has authorized the work to be done under the terms of the lease between the tenant and the owner. *Armco Steel Corp. v. LaSalle National Bank,* 31 Ill.App.3d 695, 335 N.E.2d 93 (2d Dist. 1975); *McKeown Bros. v. Ogden Kennel Club,* 269 Ill.App. 622 (1st Dist. 1933); *Edward Hines Lumber Co. v. Great Lakes Chemical Works, Inc.,* 237 Ill.App. 246 (2d Dist. 1925); *Boyer v. Keller,* 258 Ill. 106, 101 N.E. 237 (1913); *E.R. Darlington Lumber Co. v. Burton,* 156 Ill.App. 82 (3d Dist. 1910); *R. Haas Electric & Mfg. Co. v. Springfield Amusement Park Co.,* 236 Ill. 452, 86 N.E. 248 (1908); *Crandall v. Sorg,* 198 Ill. 48, 64 N.E. 769 (1902); *Carey-Lombard Lumber Co. v. Jones,* 187 Ill. 203, 58 N.E. 347 (1900).

Whether the work is authorized may depend on whether the lease contains conditions precedent and whether the tenant meets such conditions. *Rasmussen v. Harper,* 287 Ill.App. 404, 5 N.E.2d 257 (1st Dist. 1936); *Edward Solomon, Inc. v. Padorr,* 282 Ill.App. 269 (1st Dist. 1935). Note, however, that an owner may be considered to have waived a condition precedent if the owner allows the work to proceed knowing the condition has not been met. *Armco, supra; Loeff v. Meyer,* 209 Ill.App. 382 (1st Dist. 1918).

In some instances, the courts have held that the lease between the owner and the tenant, by its very terms and by the conditions surrounding the transactions between the parties, shows the improvement to be the joint enterprise of the owner and the tenant. *Boyer, supra; Crandall, supra. See F.K. Ketler Co. v. County Fair Grounds Corp.,* 301 Ill.App. 117, 21 N.E.2d 779 (1st Dist. 1939), holding that the determination of rental by fixing a proportion of gross receipts of the lessee does not evidence a joint enterprise.

When the lease between the lessor and lessee provides for certain improvements therein set forth, the interest of the other cannot be subjected to a lien for other improvements in the absence of any showing of authorization or of consent to the additional work. *Sorg v. Crandall,* 233 Ill. 79, 84 N.E. 181 (1908); *Bermingham v. Gill,* 164 Ill.App. 536 (2d Dist. 1911).

4. [13.8] Work Authorized Under Terms of Lease and Performed by Tenant with Knowledge of Owner

If the owner both authorized the work to be done by express provisions in the lease and had knowledge that the work was being performed, the mechanics lien claimant is allowed a lien. *Loeff*

v. Meyer, 209 Ill.App. 382 (1st Dist.), *aff'd,* 284 Ill. 114 (1918); *Henry v. Miller,* 145 Ill.App. 628 (3d Dist. 1908); *R. Haas Electric & Mfg. Co. v. Springfield Amusement Park Co.,* 236 Ill. 452, 86 N.E. 248 (1908); *Friebele v. Schwartz,* 164 Ill.App. 504 (2d Dist. 1911) (lease authorized repairs); *Brokaw v. Tyler & Hippach,* 91 Ill.App. 148 (3d Dist. 1900).

5. [13.9] Work Performed with Knowledge of Agent of Owner

An owner will be held to have knowingly permitted work to be done when an agent of the owner has notice or knowledge of the work and the agent is in general charge of the property. Even though the agent might not have authority broad enough to permit him or her to make a contract for the work that would be binding on the owner in the absence of specific approval by the owner, the agent will be held to have knowingly permitted the work to be performed. The scope of the agent's authority is such that, when notice or knowledge of the work comes to him or her, it becomes the agent's duty to communicate that knowledge to the principal. *Mutual Construction Co. v. Baker,* 237 Ill.App. 596 (1st Dist. 1925), *followed in Johns-Manville Corporation of Delaware v. La Tour D'Argent Corp.,* 277 Ill.App. 503 (1st Dist. 1934).

In *Johns-Manville,* the court held that building managers knowingly permitted work ordered by a tenant, and the managers' knowledge was binding on the owner, notwithstanding that the agents were restricted to contract for similar work to a lesser amount. *See also Wanzer v. Smorgas-Brickan Developers, Inc.,* 130 Ill.App.2d 378, 264 N.E.2d 435 (2d Dist. 1970). In *Martinez v. Knochel,* 123 Ill.App.3d 555, 462 N.E.2d 1281, 78 Ill.Dec. 927 (4th Dist. 1984), the court held that owners of a one-half interest in improved property were bound by the other owner's acts as their agent.

In *Fettes, Love & Sieben, Inc. v. Simon,* 46 Ill.App.2d 232, 196 N.E.2d 700 (1st Dist. 1964), the court held, when the property was owned by the wife, that there is no presumption that a husband has authority to act for his wife. Since she performed no acts that would indicate that she gave authority to her husband to act as her agent, who saw improvements in progress, she could not be said to have knowingly permitted alterations to be made on the premises.

B. [13.10] Factual Considerations — Safeguards in Lease

If a lease authorizes the tenant to make improvements, but only upon the performance of certain conditions precedent, such as the consent of the lessor in writing, the deposit of money to cover the cost of the work contemplated, the deposit of waivers of mechanics and material suppliers' liens, or other provisions designed to safeguard the lessor from mechanics liens, the cases fall into three categories: (1) when the owner has protected itself by adequate safeguards in the lease and does not waive those safeguards; (2) when the owner has protected itself by adequate safeguards in the lease but has permitted the work to be done without compliance by the tenant with the conditions set forth in the lease; and (3) when the provisions prohibit the attachment of liens. See §§13.11 – 13.13 below.

1. [13.11] Lease Containing Safeguards: Conditions Not Waived by Lessor

In *Rasmussen v. Harper,* 287 Ill.App. 404, 5 N.E.2d 257, 261 – 262 (1st Dist. 1936), the court stated the theory on which the interest of the lessor in these safeguard cases is protected:

> **[**W**]here a plaintiff shows by his evidence that he relies upon a lease containing language which is the basis for a mechanic's lien against the lessor for work done for the sublessee, then, and in that event, the conditions of the lease, requiring the consent of the landlord in writing, is a condition precedent to his recovery and his nonproduction of such a consent in writing prevents him from recovering. Certainly the owner of the property has the right to protect himself by putting clauses in his lease which may afford him protection, and no inference or construction should be drawn in a mechanic's lien case which will obviate the necessity of complying with the known terms of the lease as entered into by the parties.**

Rasmussen followed *Edward Solomon, Inc. v. Padorr,* 282 Ill.App. 269 (1st Dist. 1935), in which the court denied a lien to a contractor employed by a sublessee to lay a cement floor and do other work on the building. The ground lease and the sublease required the deposit of the cost of making the improvements and the delivery of waivers of mechanics liens.

In *Ketler Co. v. County Fair Grounds Corp.,* 301 Ill.App. 117, 21 N.E.2d 779 (1st Dist. 1939), the lease provided that there should be inserted in all contracts a clause waiving all rights to mechanics liens and a statement that all contractors were familiar with the provisions of the lease with reference to liens and that waivers should be furnished within five days after contracts were made. This clause was not complied with, but the owner, after visiting the work, notified the contractor by letter of its provisions. The court held that by this letter the contractor had notice of the lease and of the provision calling for waiver of liens, and, therefore, this knowledge was sufficient to put the plaintiff lien claimant on notice.

In *Faerber Electrical Co. v. International Telephone & Telegraph Corp.,* 123 Ill.App.3d 704, 463 N.E.2d 820, 79 Ill.Dec. 266 (1st Dist. 1984), ITT, the tenant, entered into a contract with the general contractor to repair and remodel the Field Annex Building in Chicago. The contract provided that the general contractor waived any right to record a mechanics lien and required the general contractor to obtain similar waivers from its subcontractors. The general contractor entered into a contract with the plaintiff to do electrical work. Between May 1, 1980, and August 25, 1980, the contractor issued to the plaintiff purchase orders that had "no lien" clauses. In July 1980, the lessee took over control of the project and directed the plaintiff to do extra work. The lessee agreed to pay for the extras. When the lessee refused to pay, the plaintiff filed suit to foreclose a mechanics lien. The lower court dismissed the foreclosure action. The appellate court affirmed, stating: "Since the lien against ITT arises out of a contract in existence at the date the waivers in the purchase orders were given, the lien waivers are a complete defense to plaintiff's right of lien." 463 N.E.2d at 824.

Compare *Faerber,* however, to §1 of the Mechanics Lien Act. This section states:

> **An agreement to waive any right to enforce or claim any lien under this Act, or an agreement to subordinate the lien, where the agreement is in anticipation of and in consideration for the awarding of a contract or subcontract, either express or implied, to perform work or supply materials for an improvement upon real property is against public policy and unenforceable. This Section does not prohibit release of lien under subsection (b) of Section 35 of this Act [**770 ILCS 60/35**], nor does it prohibit**

> **an agreement to subordinate a mechanics lien to a mortgage lien that secures a construction loan if that agreement is made after more than 50% of the loan has been disbursed to fund improvements to the property.** 770 ILCS 60/1(d).

The Supreme Court upheld the constitutionality of what was formerly §1.1 of the Mechanics Lien Act in *R.W. Dunteman Co. v. C/G Enterprises, Inc.,* 181 Ill.2d 153, 692 N.E.2d 306, 229 Ill.Dec. 533 (1998). In *Brown & Kerr, Inc. v. American Stores Properties, Inc.,* 306 Ill.App.3d 1023, 715 N.E.2d 804, 240 Ill.Dec. 117 (1st Dist. 1999), the court held that the language of former §1.1 prohibits agreements to waive any right to enforce or claim a lien whether express or implied as consideration for the contract. The court found that waivers of lien rights are permitted as long as they are not given in consideration for obtaining a contract. Although *Brown & Kerr* did not involve a lease, it is questionable whether a no-lien provision in a lease would be upheld.

2. [13.12] Lease Containing Safeguards: Conditions Held Waived by Lessor

In *Armco Steel Corp. v. LaSalle National Bank,* 31 Ill.App.3d 695, 335 N.E.2d 93 (2d Dist. 1975), the court distinguished *Rasmussen v. Harper,* 287 Ill.App. 404, 5 N.E.2d 257 (1st Dist. 1936), and *Edward Solomon, Inc. v. Padorr,* 282 Ill.App. 269 (1st Dist. 1935), by stating that in these cases the owner had no knowledge that the work was being done until after the claims for lien were filed. In *Armco,* the lessor knew that improvements to the racetrack were being made, although the lessee did not perform some of the covenants of the lease. The court said that

> **the lessor was negligent in permitting the work to continue and supplies to be ordered without the safeguards he had specified being complied with. Moreover, he did not see to it that the lease was recorded. In this situation there is no doubt the Mechanics' Lien Statute is intended to protect the contractor or supplier who, without notice of any lease provisions, adds an improvement to the land through his labor or materials.** 335 N.E.2d at 97.

Armco cites *Cooper v. Palais Royal Theatre Co.,* 242 Ill.App. 184 (1st Dist. 1926), as containing similar circumstances. Cases in which the lessor made no objections when it saw the work being done notwithstanding the safeguards in the lease are *Loeff v. Meyer,* 284 Ill. 114, 119 N.E. 908, *aff'g* 209 Ill.App. 382 (1st Dist. 1918), and *Overhead Door Co. of Illinois v. Bernstein,* 285 Ill.App. 587, 3 N.E.2d 169 (1st Dist. 1936) (abst.).

Similarly, the owners did not record articles of agreement for a deed in *Wanzer v. Smorgas-Brickan Developers, Inc.,* 130 Ill.App.2d 378, 264 N.E.2d 435 (2d Dist. 1970). The articles provided that the buyer would not permit any mechanics lien. The court held that, as the contractors had no knowledge of the agreement provision, it was void as to them. 264 N.E.2d at 436.

3. [13.13] Lease Containing Safeguards: Provision That No Mechanics Liens Shall Attach

A provision in a lease that the owner's interest shall be exempt from liens is not binding on lien claimants (*Brokaw v. Tyler & Hippach,* 91 Ill.App. 148 (3d Dist. 1900); *Carey-Lombard Lumber Co. v. Jones,* 187 Ill. 203, 58 N.E. 347 (1900); *Friebele v. Schwartz,* 164 Ill.App. 504 (2d Dist.

1911); *Crandall v. Sorg,* 198 Ill. 48, 64 N.E. 769 (1902); *Boyer v. Keller,* 258 Ill. 106, 101 N.E. 237 (1913); *Loeff v. Meyer,* 209 Ill.App. 382 (1st Dist.), *aff'd,* 284 Ill. 114 (1918); *Provost v. Shirk,* 223 Ill. 468, 79 N.E. 178 (1906)) even if the claimants have notice of the existence of the provision (*Loeff, supra*).

The fact that the owner informed the claimant that he or she would have to look to the tenants for pay will not divest the claimant of his or her lien rights. *Mutual Construction Co. v. Baker,* 237 Ill.App. 596 (1st Dist. 1925). The owner must protect itself by giving written notice to the tenant's contractor to deliver waivers of mechanics liens.

In *Carey-Lombard Lumber, supra,* the lease provided that the lessee "shall permit no mechanics' liens to attach to said premises." 58 N.E.2d at 350. The court stated:

> **The clause, taken as a whole, does contemplate that a contract may be made which would be binding between a mechanic or material man and the owner authorizing a lien, but requires, as between himself and the lessees, that they shall not permit the lien to attach; that is, that they shall pay off the liabilities and thereby prevent the enforcement of a lien. The latter part of the clause clearly shows that the owner anticipated that that part of the agreement might not be performed by them, and he therefore protected himself from loss by reserving the right to declare a forfeiture and take the property. It seems to us very clear that, under the terms of this lease, the rights of the petitioner must be held to be the same, in every respect, as though the contract for the building material had been made directly with appellee Jones. In this view the lien attaches to the whole of the property, the owner's title. It is his contract, not that of the lessees, and he gets the full benefit of it.** *Id.*

A provision in a lease exempting the owner's interest from liens in favor of the tenant's contractor was held not effective and could not be upheld in *Crandall, supra.* The lease provided that "notice is hereby given, that no . . . mechanic's . . . lien shall in any manner or degree affect the claim of the lessor in said building and his rights in said premises." 64 N.E. at 775. The court held the above provision did not apply to the tenant's contractor. The court took the position that such a provision would be void as an attempt to set aside the law of the land. On that point, the court said:

> **[T]his provision in the lease can only be regarded as a declaration on the part of persons engaged in the construction of a building, under circumstances which subject their property to the mechanic's lien laws of the state, that such laws shall not have operation against their property or the property of one of such persons.** *Id.*

See also R. Haas Electric & Mfg. Co. v. Springfield Amusement Park Co., 236 Ill. 452, 86 N.E. 248 (1908), citing the above cases and holding that such clauses did not prevent the lien from attaching.

A notice that no lien should attach, served by the owner after a contract has been made and after a great part of the material has been delivered, is of no effect. *Westphal v. Berthold,* 273 Ill.App. 266 (2d Dist. 1934). See also 770 ILCS 60/1; *Brown & Kerr, Inc. v. American Stores Properties, Inc.,* 306 Ill.App.3d 1023, 715 N.E.2d 804, 240 Ill.Dec. 117 (1st Dist. 1999).

C. Factual Considerations — Type of Work Performed

1. [13.14] Repairs Distinguished from Alterations

An authorization in a lease to repair cannot be construed to authorize the making of alterations or additions by the lessee. "Repair" is restoration after decay, waste, injury, or partial destruction, supply of loss, or reparation. It does not include alterations or additions. *Hacken v. Isenberg,* 288 Ill. 589, 124 N.E. 306 (1919), *rev'g* 210 Ill.App. 120 (1st Dist. 1918).

In *Hacken,* the lease provided that the tenant was obligated to make repairs, but his contractor was denied a lien against the landlord's interest when the contractor installed a sewer that was considered an alteration or improvement. The lease also provided that all alterations were to remain the property of the landlord, but the Supreme Court ruled that this provision did not, of itself, constitute authority to make improvements, and, since the landlord had not knowingly permitted the alteration, the contractor was denied a lien.

The question then arises as to what type of lien the contractor can have for making repairs. A contractor can also have a lien against the landlord's interest if the landlord knowingly permitted the repairs. *Henry DeCicco & Co. v. Drucker,* 101 Ill.App.2d 340, 243 N.E.2d 456 (1st Dist. 1968). However, if the contractor cannot show that the landlord knowingly permitted the work, it is doubtful whether the contractor can obtain a lien against the landlord's interest. In *Zimmerman v. Garafolo,* 306 Ill.App. 504, 29 N.E.2d 121 (2d Dist. 1940) (abst.), the court denied a lien for repairs that were done subsequent to the performance of the work under the original contract with the tenant for plumbing and heating.

Of course, if the contractor contracted with the owner directly, the contractor could have a lien against the owner's property (*Henry DeCicco, supra*) and would not have to prove enhancement since it is necessary to prove enhancement only over the claim of a mortgagee or other third party. *See D.M. Foley Co. v. North West Federal Savings & Loan Ass'n,* 122 Ill.App.3d 411, 461 N.E.2d 500, 77 Ill.Dec. 877 (1st Dist. 1984). Furthermore, the contractor (or a subcontractor who dealt directly with the owner) can have a money judgment against the owner even if the contractor did not perfect a lien. *Swansea Concrete Products, Inc. v. Distler,* 126 Ill.App.3d 927, 467 N.E.2d 388, 81 Ill.Dec. 688 (5th Dist. 1984).

2. [13.15] Trade Fixtures and Improvements of Temporary Kind and Removable by Tenant

Under the Mechanics Lien Act, contractors are entitled to liens for permanent improvements. *Southern Illinois Contracting Co. v. Launtz,* 169 Ill.App. 87 (4th Dist. 1912). A contractor is entitled to a lien against the owner's interest if the owner knowingly permitted the installation of permanent fixtures and the contractor was not paid for the work. The central inquiry in determining if work performed constitutes an improvement is whether the work performed enhanced the value of the land. *Safari Circuits, Inc. v. Chicago School Reform Board of Trustees,* 474 F.Supp.2d 993 (N.D.Ill. 2007); *First Bank of Roscoe v. Rinaldi,* 262 Ill.App.3d 179, 634 N.E.2d 1204, 199 Ill.Dec. 850 (2d Dist. 1994). Trade fixtures and improvements of a temporary kind that are removable by the tenant at the expiration of the lease are not considered improvements that would subject the

owner's interest to a claim for lien even though the owner had knowledge of their installation by the tenant's contractor. *Hacken v. Isenberg,* 288 Ill. 589, 124 N.E. 306 (1919); *Fehr Const. Co. v. Postl System of Health Building,* 288 Ill. 634, 124 N.E. 315 (1919). In *R. Haas Electric & Mfg. Co. v. Springfield Amusement Park Co.,* 236 Ill. 452, 86 N.E. 248 (1908), it was held that certain items furnished by the claimant were not lienable without proof showing in what manner, if at all, the items were connected with the real estate. *Alexander Lumber Co. v. Swindlehurst,* 309 Ill.App. 433, 32 N.E.2d 637 (3d Dist. 1941) (abst.); *Rasmussen v. Harper,* 287 Ill.App. 404, 5 N.E.2d 257 (1st Dist. 1936); *E.R. Darlington Lumber Co. v. Burton,* 156 Ill.App. 82 (3d Dist. 1910); *Schmeling v. Rockford Amusement Co.,* 154 Ill.App. 308 (2d Dist. 1910); *Joseph Lumber Co. v. Tree,* 315 Ill.App. 212, 42 N.E.2d 885 (1st Dist. 1942) (abst.); *Johns-Manville Corporation of Delaware v. La Tour D'Argent Corp.,* 277 Ill.App. 503 (1st Dist. 1934); *Southern Illinois Contracting, supra; Westphal v. Berthold,* 273 Ill.App. 266 (2d Dist. 1934).

Whether a fixture is permanent is a question of fact. In *Fehr, supra,* the Illinois Supreme Court listed three prerequisites for a fixture to be permanent and thus lienable:

a. The fixture must be permanently attached to the realty.

b. The fixture must be adapted to and necessary for the purpose to which the leased premises are devoted and for which they are leased.

c. The parties to the lease must have intended that the fixture become part of the realty. 124 N.E. at 318.

When an owner makes payments for an item installed by the tenants, a fair presumption arises that, as between the landlord and tenant, the parties intend a permanent fixture. *Crane Erectors & Riggers, Inc. v. LaSalle National Bank,* 125 Ill.App.3d 658, 466 N.E.2d 397, 80 Ill.Dec. 945 (2d Dist. 1984); *Miller v. Reed,* 13 Ill.App.3d 1074, 302 N.E.2d 131 (5th Dist. 1973).

In *AUI Construction Group, LLC v Vaessen,* 2016 IL App (2d) 160009, 67 N.E.3d 500, 409 Ill.Dec. 288, the court ruled that a lease provision allowing the dismantling and removal of a wind energy tower supported a finding that it was a trade fixture not subject to a mechanics lien, regardless of the fact that it would have been difficult and expensive to remove.

In *Griffiths v. Office of State Fire Marshall,* 301 Ill.App.3d 658, 704 N.E.2d 934, 235 Ill.Dec. 361 (2d Dist. 1998), the appellate court reversed and remanded the trial court's decision that the underground storage tanks located on the property were trade fixtures that became part of the property. The court held that "an article may generally be regarded as a trade fixture if it is annexed for the purpose of aiding in the conduct by the tenant of a calling exercised on the leased premises for the purposes of pecuniary profit." 704 N.E.2d at 936, quoting *Empire Building Corp. v. Orput & Associates, Inc.,* 32 Ill.App.3d 839, 336 N.E.2d 82, 84 – 85 (2d Dist. 1975). The court went on to say that "[w]e have also applied a three-part test that looks at (1) the means by which the item has been annexed to the real estate; (2) whether it is adapted to and necessary for the purpose to which the premises is devoted; and (3) the intent of the parties. . . . The most important of these factors is the parties' intent." [Citation omitted.] 704 N.E.2d at 936.

The *Griffiths* court's ruling was based on the idea that

> **[**i**]n disputes between the landlord and tenant there is a presumption that the tenant, by annexing fixtures, did so for his own benefit and not to enrich the freehold, and the law accordingly construes the tenant's right to remove his annexations liberally, at least where removal may be effected without material injury to the freehold. . . .**
>
> **Articles annexed to the realty by a tenant for the purpose of carrying on a trade are ordinarily removable by him during his term . . . unless the removal would substantially injure the freehold. [**Citations omitted by *Griffiths* court.**]** 704 N.E.2d at 936, quoting *Empire Building, supra,* 336 N.E.2d at 84.

In *Babiak v. Strum,* 20 Ill.App.2d 191, 155 N.E.2d 332 (3d Dist. 1959) (abst.), the court held that the electrical wiring system with conduits attached when possible to walls, fluorescent lighting fixtures attached to the ceiling, and outlets placed both in walls and the floor constituted a permanent improvement and not a trade fixture. Accordingly, the court held that the work was lienable against the landlord's interest.

In *Crowley Bros. v. Ward,* 322 Ill.App. 687, 54 N.E.2d 753 (2d Dist. 1944), a lessee occupied the first story of a two-story building and contracted with the plaintiff to perform plumbing and heating work necessary to equip a restaurant. The defendant owner authorized the plaintiff to perform the work and knowingly permitted the work to be done without objection. The court allowed the lien as to this equipment and work. The court held, however, that the lien did not extend to labor and materials used in installing trade fixtures because there was no showing that these items were intended by the parties to become part of the premises. *See also B. Kreisman & Co. v. First Arlington National Bank of Arlington Heights,* 91 Ill.App.3d 847, 415 N.E.2d 1070, 47 Ill.Dec. 757 (2d Dist. 1980); *Miller, supra; Dual Temp Installations, Inc. v. Chicago Title & Trust Co.,* 41 Ill.App.3d 415, 354 N.E.2d 131 (1st Dist. 1976).

In *California Steel Co. v. Dodds (In re California Steel Co.),* 21 B.R. 383 (Bankr. N.D.Ill. 1982), in which the lessee of a steel mill had filed a petition in bankruptcy and a contractor had furnished engineering services for an electrical system for the modernization of the mill, the court applied two of the criteria set forth in *Fehr, supra,* and found that the electrical system was attached to the realty and was adapted to the purpose for which the leased premises were used, and, therefore, a lien against the debtor's leasehold interest was allowed.

In *Crane Erectors & Riggers, supra,* the court ruled that because the landlord made payments to an erection company for assembling an overhead crane, which work was ordered by the tenant, there was a fair presumption that as between the landlord and the tenant, the parties intended that the crane was a permanent "fixture" and, therefore, lienable.

In *Southwest Bank of St. Louis v. Poulokefalos,* 401 Ill.App.3d 884, 931 N.E.2d 285, 341 Ill.Dec. 677 (1st Dist. 2010), the court considered whether improvements were fixtures or trade fixtures in the context of a replevin suit. The court affirmed the ruling of the trial court that the silos and machinery within the building were fixtures because they could not be removed without causing substantial damage to the infrastructure of the building.

In *Flader Plumbing & Heating Co. v. Callas,* 171 Ill.App.3d 74, 524 N.E.2d 1097, 121 Ill.Dec. 49 (1st Dist. 1988), the plaintiff entered into an oral contract with the tenants to install plumbing, bathroom fixtures, and a sprinkler system. The plaintiff sought a lien against the building. The court set forth a definition to determine the difference between a trade fixture, on which there cannot be a lien, and a permanent fixture, which is lienable. The court said:

> **[**T**]hree factors must be considered in determining whether the equipment installed has become a permanent fixture and, therefore, lienable: (1) whether the parties intend these fixtures and alterations should be considered as part of the realty; (2) whether the fixtures are firmly attached to the realty; and (3) whether they are adapted to and necessary for the purposes for which the premises leased are now devoted.** 524 N.E.2d at 1100.

Kupferschmid, Inc. v. Rodeghero, 139 Ill.App.3d 975, 488 N.E.2d 305, 94 Ill.Dec. 479 (3d Dist. 1986), dealt with a situation in which a contract purchaser of a farm entered into a contract with the plaintiff to install various items of equipment in a dairy barn on the contract seller's property. The plaintiff sued to foreclose a mechanics lien on the property. The defendant claimed that the items purchased were business fixtures not subject to the Mechanics Lien Act. The case, while not strictly a landlord-tenant situation, is enlightening in determining the differences between trade fixtures and permanent fixtures in the modern world:

> **In determining whether the items furnished . . . constitute "material" as opposed to "fixtures", the proper inquiry is whether the items were by their inherent characteristics integral parts of the structure and were intended to remain permanently in the barn. It is clear from the record that the items furnished by the plaintiff, though not fabricated at the construction site, were of this nature and are more properly classified as "material" as opposed to "fixtures, apparatus or machinery." It was not necessary therefore for these items to have been actually installed to enable the plaintiff to have a valid claim for lien. . . . The Illinois Mechanics' Lien Act must be interpreted in light of modern construction methods and materials in characterizing items furnished by a contractor as either "materials, fixtures, apparatus or machinery." [**Citation omitted.**]** 488 N.E.2d at 307.

Conversely, in *Nokomis Quarry Co. v. Dietl,* 333 Ill.App.3d 480, 775 N.E.2d 669, 266 Ill.Dec. 829 (5th Dist. 2002), in the context of a mortgage foreclosure case, fixtures that included storage buildings, fencing, and silo machinery were deemed fixtures to a farm because they were in place before the farmland was leased and the intent was that they were to stay with the land.

D. [13.16] Notice by Lessor to Contractor To Furnish Waivers of Liens

If the lease allows the tenant to improve the premises or if the owner has knowledge that improvements are contemplated or are in progress by the tenant, the owner may give the tenant's contractor a written notice that it is not to furnish labor or material to the premises without first delivering a waiver of mechanics lien to the owner. *Ketler Co. v. County Fair Grounds Corp.,* 301 Ill.App. 117, 21 N.E.2d 779 (1st Dist. 1939); *Westphal v. Berthold,* 273 Ill.App. 266 (2d Dist. 1934). A form of such notice is set forth below.

**NOTICE FROM LANDLORD OR VENDOR
TO CONTRACTOR OF TENANT OR VENDEE**

As [landlord**] [**vendor**] of _____, who [**occupies**] [**is purchasing**] the premises at _____, in _____ County, State of Illinois, as my [**tenant**] [**vendee**], I hereby notify you that you are not to furnish any material, fixtures, apparatus, or machinery or perform any labor or services in connection with any repairs, alterations, additions, or improvements in, to, or about the said premises without first delivering to me a waiver or release of mechanics lien as against my interest in the premises, with respect to such repairs, alterations, additions, or improvements. If you furnish any material, fixtures, apparatus, or machinery or perform any labor or services in disregard of this notice, you will be doing so at your own risk, without acquiring any right to subject my interest in the premises to any lien therefor, and I shall be compelled to attempt to stop you from proceeding therewith.**

It is unlikely, however, that such a provision would be binding on a lien claimant. Section 21 of the Mechanics Lien Act provides that if "the legal effect of a provision in any contract between the owner and contractor or contractor and subcontractor is that no lien or claim may be filed or maintained, or that such contractor's lien shall be subordinated to the interests of any other party, and the provision is not prohibited by this Act, such provision shall be binding if made as part of an agreement not prohibited by this Act." 770 ILCS 60/21(b). The courts in *Ellman v. Ianni,* 21 Ill.App.2d 353, 157 N.E.2d 807 (2d Dist. 1959), and *Dunlop v. McAtee,* 31 Ill.App.3d 56, 333 N.E.2d 76 (2d Dist. 1975), held that such no-lien contracts are binding in situations in which the owner itself enters into a contract with the contractor.

E. [13.17] Forfeiture or Surrender of Lessee's Interest

Mechanics liens may be maintained against the interest of the lessee. Section 1 of the Mechanics Lien Act provides:

> **This lien extends to an estate in fee, for life, for years, or any other estate or any right of redemption or other interest that the owner may have in the lot or tract of land at the time of making such contract or may subsequently acquire and this lien attaches as of the date of the contract.** 770 ILCS 60/1(a).

See Matot v. Barnheisel, 212 Ill.App. 489 (1st Dist. 1918), in which a lien was allowed against a lessee under a 99-year lease when the lessee had consented to the improvements. *See also California Steel Co. v. Dodds (In re California Steel Co.),* 21 B.R. 383 (Bankr. N.D.Ill. 1982), in which a lien against a lessee was allowed as a secured claim against the lessee in the lessee's bankruptcy proceeding.

In most cases, however, the lien against the leasehold interest is worthless, especially in short-term lease situations and in cases in which the leasehold has been forfeited and the owner goes into possession. Consequently, the claimant seeks a lien against the interest of the lessor, the owner of the fee, either by claiming that the lessor authorized or knowingly permitted the improvements or that it was a joint undertaking by the lessor and the lessee.

A lien that attaches to a leasehold is subject to the conditions of the lease and may be defeated by a forfeiture. In *Williams v. Vanderbilt,* 145 Ill. 238, 34 N.E. 476 (1893), the court held that if the lease has been forfeited, the holder of the mechanics lien must pay all arrears of rent to the lessor before he or she can acquire the rights of the lessee thereunder. *Kelley v. Springer,* 235 Ill. 493, 85 N.E. 593 (1908); *Ketler Co. v. County Fair Grounds Corp.,* 301 Ill.App. 117, 21 N.E.2d 779 (1st Dist. 1939) (following *Williams, supra*).

In *Ketler,* the lease provided that the lessee had the right to remove fixtures within the term fixed in the lease, and the lessee did not remove the fixtures within the term. Therefore, the right to remove the fixtures was lost, and the contractor's lien did not attach to the right of removal so as to permit the contractor to remove the fixtures.

If, however, the evidence disclosed a voluntary surrender of the leasehold to the owner of the fee, the lien on the estate of the lessee that attached while he or she was in possession is not affected. After surrender, the estate would still be subject to the burdens that rested on it. The merger of the estate of the lessee with that of the lessor would not destroy the previous lien. *Dobschuetz v. Holliday,* 82 Ill. 371 (1876).

Compare this with an easement, which is not subject to a mechanics lien claim. In *AUI Construction Group, LLC v. Vaessen,* 2016 IL App (2d) 160009, ¶52, 67 N.E.3d 500, 409 Ill.Dec. 288, the court rejected the lien claimant's attempt to recharacterize the easement as a lease because an easement provides use rights as opposed to ownership rights. Furthermore, the nature of the agreement was determined not to be a long-term leasehold interest because it could be terminated in as little as three months. *Id.*

F. [13.18] Quasi-Contract or Equitable Relief

In certain situations, when neither a mechanics lien claim nor other contractual relief is possible, the lien claimant may be entitled to other relief. The theories of quasi-contractual relief were extended in *C. Szabo Contracting, Inc. v. Lorig Construction Co.,* 2014 IL App (2d) 131328, 19 N.E.3d 638, 385 Ill.Dec. 706, in which the appellate court addressed whether a party to a contract may pursue quasi-contractual relief against a nonparty to the contract on the basis that the nonparty requested and received a benefit but has paid no one for it. The appellate court weighed considerations for and against permitting relief in this situation. 2014 IL App (2d) 131328 at ¶38. The court concluded that the lien claimant was entitled to an unjust-enrichment claim against the general contractor because the general contractor knew that the subcontractor contracted for the work with the lien claimant, the work was done properly for an appropriate price, and the general contractor was paid under its own contract with the owner. 2014 IL App (2d) 131328 at ¶42. Similarly, an owner that requests improvements and approves of the work may be bound by its tenant's contract with the contractor under a theory of unjust enrichment.

However, in *Hayes Mechanical, Inc. v. First Industrial, L.P.,* 351 Ill.App.3d 1, 812 N.E.2d 419, 285 Ill.Dec. 599 (1st Dist. 2004), the appellate court affirmed the trial court's denial of the contractor's request for leave to amend its mechanics lien complaint to allege unjust-enrichment and quantum meruit claims against the landlord. The appellate court found that Hayes failed to allege any facts to state a quasi-contractual claim and distinguished the situation at hand from

instances in which a landlord knowingly induced a contractor, who contracted with a tenant, to perform work. 812 N.E.2d at 429. The appellate court stated that "we are not foreclosing the possibility that a contractor could state claims for *quantum meruit* or unjust enrichment against a landlord after a tenant fails to pay the contractor for agreed upon improvements to the property." 812 N.E.2d at 430. The appellate court noted that there were only limited circumstances in which a party could claim quasi-contractual relief against a party without demonstrating wrongdoing by the party against whom restitution is sought. *Id.*

IV. [13.19] PROCESSING OF THE CLAIM

An attorney representing a lien claimant who has furnished or installed equipment pursuant to a contract with the tenant should be extremely cautious about determining who the landlord, the owner, and the lender are at the time the contract was entered and at the time the notice is to be served or the claim for lien is to be filed.

In *Edward Electric Co. v. Automation, Inc.,* 164 Ill.App.3d 547, 518 N.E.2d 172, 115 Ill.Dec. 647 (1st Dist. 1987), the owner of the building leased the property. The tenant hired a contractor who hired the plaintiff as a subcontractor. The owner transferred title before the plaintiff served the notice on the party that owned the property at the time the plaintiff's contract was entered into. The court held that the plaintiff did not have a lien because it should have served notice on the party that owned the property at the time the notice was served.

V. [13.20] CONCLUSION

The underlying theory of the Mechanics Lien Act is that an owner that has benefited from improvements to its real property should pay for the benefit. It has been argued that when the tenant, not the owner, contracts for these improvements, the owner should not be obligated to pay for the improvements and the owner's interest in the real property should not be subject to a lien. The Mechanics Lien Act and the caselaw demonstrate, however, that when the owner has knowingly permitted or authorized the improvements, the owner's interest is subject to the lien inasmuch as the owner allowed the work and enjoys the benefit to the real property.

14 Environmental Issues in the Landlord-Tenant Relationship

JOSEPH R. PODLEWSKI, JR.
Podlewski & Hanson P.C.
Western Springs

IV. [14.30] Remedies

A. Statutory Remedies
   1. [14.31] Cost Recovery Under the Comprehensive Environmental Response, Compensation, and Liability Act of 1990
   2. [14.32] Citizen Suit Under the Resource Conservation and Recovery Act of 1976
   3. [14.33] Citizen Enforcement Action Before Illinois Pollution Control Board

B. [14.34] Contractual Remedies

V. [14.35] Sample Lease Provisions

I. [14.1] INTRODUCTION

Environmental issues are inherently complex, both technically and legally. They also tend to be costly to address. Few attorneys with a commercial leasing practice have not heard at least one environmental horror story in which an unsuspecting landlord was presented with a polluting tenant's six-figure cleanup bill. As a consequence, the proper management of environmental issues arising in connection with a commercial lease is of considerable importance to both the landlord and the tenant.

The goal of this chapter is to provide attorneys with guidance for dealing with common environmental issues that arise in commercial leasing. As this chapter demonstrates, traditional risk recognition, assessment, and allocation techniques can be used successfully by both the landlord and the tenant to manage troublesome environmental issues.

II. [14.2] ADDRESSING ENVIRONMENTAL ASPECTS OF LEASE

Successful management of environmental issues under a commercial lease necessarily begins at lease inception. It is a three-part exercise for both the landlord and the tenant.

First is *risk recognition.* Both parties to the lease — but particularly the landlord — must recognize the potential risks created by the tenancy under applicable environmental laws.

Second is *risk assessment.* Although the tenancy may have the potential to result in the imposition of liability under applicable environmental laws, the risk that such liabilities will ever be imposed must be assessed.

Last is *risk allocation.* Once the environmental liabilities associated with the tenancy are sufficiently established and evaluated, the lease must be fashioned to allocate those risks between the parties.

Each of these steps is discussed more fully in §§14.3 – 14.25 below.

A. [14.3] Recognition of Risk

Generally, both a landlord and a tenant face exposure to liability under federal and state environmental laws for activities conducted at the leased premises because many environmental statutes impose liability on both owners and operators of a site. Some of the more significant environmental laws affecting the landlord-tenant relationship are briefly discussed in §§14.4 – 14.10 below.

1. [14.4] Comprehensive Environmental Response, Compensation, and Liability Act of 1990 and Its Illinois Analog

Perhaps the best-known environmental law among real estate attorneys is the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub.L. No. 96-510, 94 Stat. 2767, codified at 42 U.S.C. §9601, *et seq.* CERCLA and its state analog

(found in §22.2(f) of the Illinois Environmental Protection Act (Illinois Act), 415 ILCS 5/1, *et seq.*) impose liability on the owner and operator of a facility for costs incurred by the government to address a release, or threatened release, of a hazardous substance. (Private parties also have a cause of action under CERCLA to recover their costs of response. However, the Illinois statute imposes liability only for costs incurred by the state or a unit of local government.)

It is generally well settled that CERCLA liability is strict, joint, and several. *United States v. NCR Corp.,* 688 F.3d 833 (7th Cir. 2012). Accordingly, if a tenant — as "operator" — engages in activities that result in a release, or threatened release, of hazardous substances at the leased premises, the landlord — as "owner" — is jointly, strictly, and severally liable for the costs incurred by the government or a third party to respond. *See, e.g., South Florida Water Management District v. Montalvo,* No. 88-8038-CIV-DAVIS, 1989 WL 260215 (S.D.Fla. Feb. 15, 1989), *aff'd,* 84 F.3d 402 (11th Cir. 1996).

An exception to this common-law rule is found, and CERCLA liability may be apportioned among responsible parties, when the environmental harm is divisible and "there is a reasonable basis for determining the contribution of each cause to a single harm." *Burlington Northern & Santa Fe Ry. v. United States,* 556 U.S. 599, 173 L.Ed.2d 812, 129 S.Ct. 1870, 1881 (2009), quoting RESTATEMENT (SECOND) OF TORTS §433A(1)(b) (1965). In *Burlington Northern & Santa Fe,* the Supreme Court upheld the district court's apportionment finding that the property owners-lessors (whose only basis for CERCLA liability was their status as "owner" under §107(a)(1), 42 U.S.C §9607(a)(1)) were liable for only nine percent of the governments' response costs. In so holding, the Supreme Court observed "that it was reasonable for the [district] court to use the size of the leased parcel and the duration of the lease as the starting point for its [apportionment] analysis." 129 S.Ct. at 1883. Accordingly, under *Burlington Northern & Santa Fe,* a landlord who faces CERCLA owner liability for contamination caused by a polluting tenant may reduce its exposure by establishing that a reasonable basis exists for apportionment of response costs. Based on *Burlington Northern & Santa Fe,* the standard for determining the reasonableness of a liability apportionment would appear to be quite low. *See, e.g., In re Methyl Tertiary Butyl Ether (MTBE) Products Liability Litigation,* 643 F.Supp.2d 461, 467 – 471 (S.D.N.Y. 2009) (relying on *Burlington Northern & Santa Fe,* court determined that apportionment of liability among joint tortfeasors may be established by "available evidence"); *NCR Corp., supra,* 688 F.3d at 841 – 842 (noting that, although CERCLA liability apportionment is fact-intensive exercise, "there is not necessarily one universal way that we should approach apportionment in pollution cases" and that "apportionment calculations need not be precise"). *Accord PCS Nitrogen, Inc. v. Ashley II of Charleston, LLC,* 714 F.3d 161 (4th Cir.), *cert. denied,* 134 S.Ct. 514 (2013). "[W]hile 'cleanup costs, on their own, are not exactly equal to harm,' . . . they 'may sometimes be a relevant factor for courts to use to determine the level of contamination, and thus the level of harm, caused by each polluter.' " *United States v. P.H. Glatfelter Co. & NCR Corp.,* 768 F.3d 662, 676 (7th Cir. 2014), quoting *NCR Corp., supra,* 688 F.3d at 840 – 841.

Some cases suggest that a tenant who leases contaminated property may be liable under CERCLA for the costs to clean up the leased premises based solely on its status as the facility operator regardless of whether it contributed in any way to the contamination (*see, e.g., United States v. 175 Inwood Associates LLP,* 330 F.Supp.2d 213 (E.D.N.Y. 2004)) despite the "well-settled rule" that CERCLA "operator" liability attaches only if the there is some nexus between the

contamination and the person against whom liability is sought (*Exxon Mobil Corp. v. United States,* 108 F.Supp.3d 486, 520 (S.D.Tex. 2015), quoting *Geraghty & Miller, Inc. v. Conoco, Inc.,* 234 F.3d 917, 928 (5th Cir. 2000), *abrogated on other grounds as recognized by Vine Street LLC v. Borg Warner Corp.,* 776 F.3d 312, 317 (5th Cir. 2015)). However, under the Illinois proportionate share liability statute, 415 ILCS 5/58.9, no liability is imposed on either a landlord or a tenant for costs to clean up contamination that the party did not cause or contribute to in any material respect. See also 35 Ill.Admin. Code pt. 741. In addition, there is a specific liability exemption under the Illinois proportionate share liability statute for a landlord that "did not know, and could not have reasonably known, of the acts or omissions of a tenant that caused or contributed to, or were likely to have caused or contributed to, a release of regulated substances that resulted in the performance of remedial action at the site." 415 ILCS 5/58.9(a)(2)(B).

Under certain circumstances, a tenant may also qualify as a CERCLA owner. It has been held that a tenant that subleases property may be liable under CERCLA as an owner if the tenant possesses sufficient indicia of ownership. *Commander Oil Corp. v. Barlo Equipment Corp.,* 215 F.3d 321 (2d Cir.), *cert. denied,* 121 S.Ct. 427 (2000). In *Next Millennium Realty, LLC v. Adchem Corp.,* 690 Fed.Appx. 710 (2d Cir. 2017) (summary order), it was held that a passive "sandwich" lessee is neither a "owner" nor "operator" under CERCLA.

A tenant facing potential liability as either an owner or an operator may be able to avail itself of statutory liability protections provided by CERCLA. A tenant who conducts a Phase I environmental site assessment consistent with CERCLA's "all appropriate inquiries" standard (40 C.F.R. pt. 312) prior to the commencement of the lease may be an "innocent purchaser" and insulated from CERCLA liability if, on the basis of the Phase I environmental site assessment, it did not know, nor had any reason to know, of the presence of hazardous substances at the leasehold. 42 U.S.C §§9601(35)(A)(i), 9601(35)(B). Even if the Phase I environmental site assessment reveals hazardous substances to be present at the leasehold, the tenant could still be insulated from CERCLA liability as a "bona fide prospective purchaser" (BFPP). 42 U.S.C. §9601(40). The Brownfields Utilization, Investment and Local Development Act of 2018 (BUILD Act), Pub.L. No. 115-141, Div. N, 132 Stat. 1046, enacted as part of the Consolidated Appropriations Act, 2018, Pub.L. No. 115-141, 132 Stat. 348, clarified the availability of the CERCLA BFPP defense to lessees through amendments to §101(40) of CERCLA. Under the amendments, a lessee acquiring a leasehold interest after January 11, 2002, who establishes by a preponderance of the evidence that the lease is not designed to avoid CERCLA liability can avail itself of BFPP status if any of the following apply:

a. The lessor is a BFPP.

b. The lessor was a BFPP at the time the leasehold interest was acquired but no longer qualifies as a BFPP due to circumstances unrelated to the lessee.

c. The lessee completes a Phase I environmental site assessment that reveals that disposal of hazardous substances at the leasehold occurred prior to the commencement of the lease; legally required notices of the presence of hazardous substances are provided; and the lessee exercises appropriate care with respect to hazardous substances found at the facility by taking reasonable steps to (1) stop any continuing release, (2) prevent any threatened future release, and (3) prevent

or limit human, environmental, or natural resource exposure to any previously released hazardous substance. 42 U.S.C. §§9601(40)(B)(i) – 9601(40)(B)(iv). (Additional requirements to secure BFPP status are found at 42 U.S.C. §§9601(40)(B)(v)) – 9601(40)(B)(viii).)

In addition to imposing liability on facility owners and operators, §107(a) of CERCLA also imposes liability on those who arrange for the disposal of hazardous substances. 42 U.S.C. §9607(a)(3). In *Burlington Northern & Santa Fe, supra,* the Supreme Court held that imposition of CERCLA arranger liability under §107(a)(3) requires a showing that the defendant took "intentional steps to dispose of a hazardous substance." 129 S.Ct. at 1879. The failure to allege the requisite intent resulted in the dismissal of a CERCLA action brought by current and former owners of properties leased to dry cleaners against the manufacturers of the dry-cleaning machines. *Hinds Investments, L.P. v. Team Enterprises, Inc.,* No. CV F 07-0703 LJO GSA, 2010 WL 922416 (E.D.Cal. Mar. 12, 2010), *aff'd sub nom. Hinds Investments, L.P. v. Angioli,* 654 F.3d 846 (9th Cir. 2011); *Team Enterprises, LLC v. Western Investment Real Estate Trust,* 647 F.3d 901 (9th Cir. 2011) (dry-cleaning machine manufacturers' instructions to direct solvent-contaminated wastewater into open drain was not tantamount to intentional disposal).

Although the property owner-plaintiffs in *Hinds, supra,* were unable to state a claim against the dry-cleaning machine manufacturers under §107(a)(3), lack of requisite intent is not necessarily fatal to a CERCLA §107(a) claim. In *United States v. Saporito,* 684 F.Supp.2d 1043, 1057 (N.D.Ill. 2010), the court found that a lessor of machinery used in metals plating was liable for the government's costs of response at the plating facility as an "owner" under §107(a)(1):

> **The plating line is no less a facility than the land on which it operated. 42 U.S.C. §9601(9)(A). Thus, an owner of equipment necessary to the operation of the plating line is no less an "owner" than a part-owner of land. . . . Just as CERCLA extends liability to a landowner who may not even be aware of pollution-producing activities by a lessee . . . it also extends liability to an equipment owner like Defendant whose lessee is using the equipment in a similar manner. In fact, the equipment owner is arguably more culpable: a landowner might not inquire into how her land is being used, but an equipment owner is likely to know exactly what her equipment can do. [**Citations omitted.**]**

2. [14.5] Resource Conservation and Recovery Act of 1976 and Its Illinois Analog

The federal Resource Conservation and Recovery Act of 1976 (RCRA), Pub.L. No. 94-580, 90 Stat. 2795, codified at 42 U.S.C. §6901, *et seq.,* and its Illinois counterpart (found at 35 Ill.Admin. Code pts. 720 – 729) regulate the generation, treatment, storage, and disposal of hazardous waste. In the landlord-tenant context, RCRA compliance is an issue — if the tenant generates, or otherwise manages, hazardous waste — for two main reasons. First, the landlord may find itself subject to RCRA if the tenant abandons hazardous waste at the leased premises; it is all too common for a landlord to find drums of hazardous waste left behind by a departing tenant. Second, §7002(a)(1)(B) of RCRA (the citizen suit provision) provides that any person may commence a civil action against any person

> **including any . . . past or present owner or operator of a treatment, storage, or disposal facility, who has contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment.** 42 U.S.C. §6972(a)(1)(B).

It has been observed that RCRA liability may be imposed on a landlord under §7002(a)(1)(B) for gasoline contamination of its property without regard to fault. *Sachs v. Exxon Company, U.S.A.,* 9 Cal.App.4th 1491, 12 Cal.Rptr.2d 237 (1992).

Underground storage tanks (USTs) are regulated under RCRA at both the federal and state levels. 42 U.S.C. §6991; 40 C.F.R. pt. 280; 415 ILCS 5/57, *et seq.;* 35 Ill.Admin. Code pts. 731, 734. Once again, liabilities are imposed on owners and operators:

a. In the case of an UST in use on November 8, 1984, or brought into use after that date, the "owner" is the person who owns the UST.

b. In the case of an UST no longer in use on November 8, 1984, the "owner" is the person who owned the UST immediately before the discontinuation of its use.

c. An "operator" is any person in control of, or having responsibility for, the daily operation of the UST. 35 Ill.Admin. Code §734.115.

Accordingly, although often a tenant is both the owner and operator of an UST, it is not uncommon for a landlord to own an UST that is operated by the tenant and, therefore, be equally responsible for compliance with federal and state operating and corrective action requirements.

3. [14.6] Clean Air Act and Asbestos National Emission Standards for Hazardous Air Pollutants

A tenant conducting operations that result in air pollution emissions may well be regulated under the Clean Air Act (CAA), ch. 360, 69 Stat. 322 (1955), codified at 42 U.S.C. §7401, *et seq.,* and regulations adopted by the Illinois Pollution Control Board (IPCB) under the Illinois Environmental Protection Act at 35 Ill.Admin. Code pt. 201. See 415 ILCS 5/9. Generally, a landlord is not responsible for a tenant's failure to comply with the CAA or regulations promulgated thereunder. However, there is a notable exception to this general rule in connection with asbestos abatements.

Regulations adopted by the United State Environmental Protection Agency (USEPA) under the CAA establish work practice standards for asbestos abatement in conjunction with certain building renovation or demolition activities. These regulations — known as the "asbestos NESHAP" (an acronym for the National Emission Standards for Hazardous Air Pollutants, which for asbestos are found at 40 C.F.R. pt. 61, subpart M) — impose compliance obligations on owners and operators. At a demolition or renovation, an "owner" or "operator" is any person who owns, leases, operates, controls, or supervises the facility being demolished or renovated; any person who owns, leases, operates, controls, or supervises the demolition or renovation operation; or both. 40 C.F.R. §61.141.

As a consequence, a tenant engaging in renovation activities that implicate the asbestos NESHAP exposes the landlord to liability for any violations of the asbestos NESHAP that may occur. *See, e.g., United States v. B & W Investment Properties,* 38 F.3d 362 (7th Cir. 1994), *cert. denied,* 115 S.Ct. 1998 (1995).

The asbestos NESHAP is enforceable not only by the USEPA, but also by the Illinois Environmental Protection Agency (IEPA) as a matter of state law.

4. [14.7] Clean Water Act and Other Federal Environmental Laws

There are several other federal environmental laws that have the potential to affect a commercial tenant. For example, a tenant with process wastewater or stormwater discharges may be regulated under the Federal Water Pollution Control Act (Clean Water Act), ch. 758, 62 Stat. 1155 (1948), codified at 33 U.S.C. §1251, *et seq.,* and require a National Pollution Discharge Elimination System (NPDES) permit from the Illinois Environmental Protection Agency. Tenants storing certain quantities of petroleum at the leasehold may be obligated to prepare spill prevention, control, and countermeasure (SPCC) plans under the Oil Pollution Act of 1990, Pub.L. No. 101-380, 104 Stat. 484, codified at 33 U.S.C §2701, *et seq*. 40 C.F.R. pt. 112. Tenants required to prepare and have available safety data sheets for hazardous chemicals under the Occupational Safety and Health Act of 1970, Pub.L. No. 91-596, 84 Stat. 1590, codified at 29 U.S.C. §651, *et seq.,* may be required to notify certain state and local agencies of the identities, quantities, and locations of hazardous chemicals on hand on an annual basis under the Emergency Planning and Community Right-To-Know Act of 1986, Pub.L. No. 99-499, 100 Stat. 1728, codified at 42 U.S.C. §11001, *et seq*. Although a landlord is generally not responsible for a tenant's failure to comply with these laws, noncompliance may impact the leased property (as well as the tenant's finances) and, therefore, should be a matter of concern to the lessor.

5. [14.8] Illinois Environmental Protection Act

The Illinois Environmental Protection Act proscribes certain activities that adversely impact the environment. For example:

a. 415 ILCS 5/9(a) provides, inter alia, that no person shall "[c]ause or threaten or allow the discharge or emission of any contaminant into the environment in any State so as to cause or tend to cause air pollution in Illinois."

b. 415 ILCS 5/12(a) provides, inter alia, that no person shall "[c]ause or threaten or allow the discharge of any contaminants into the environment in any State so as to cause or tend to cause water pollution in Illinois."

c. 415 ILCS 5/21(a) provides, inter alia, that no person shall "[c]ause or allow the open dumping of any waste."

A landlord who permits a tenant to engage in polluting activities may be alleged to be in violation of the Illinois Act by "allowing" the proscribed activity. However, under the Illinois proportionate share liability statute, a landlord will not be liable for cleanup costs to the extent the tenant's activities occur without the landlord's knowledge. 415 ILCS 5/58.9(a)(2)(B).

6. [14.9] Metropolitan Water Reclamation District Act, Etc.

Laws governing sanitary districts in Illinois also have the potential to affect the landlord-tenant relationship. For example, the Metropolitan Water Reclamation District Act, 70 ILCS 2605/1, *et seq.,* provides that delinquent user charges, industrial waste surcharges, or industrial cost recovery charges "shall be liens against the real estate which receives the service or benefit for which the charges are being imposed." 70 ILCS 2605/7. Accordingly, a landlord with a commercial tenant served by the Metropolitan Water Reclamation District of Greater Chicago (MWRDGC) runs the risk of having its property encumbered by a lien for its tenant's unpaid user charges. A lien may also arise if civil penalties assessed by the MWRDGC for violations of its Sewage and Waste Control Ordinance are not paid. 70 ILCS 2605/7a(d)(11); MWRDGC Sewage and Waste Control Ordinance, art. VI, §3 (as amended Dec. 15, 2022), https://mwrd.org/sites/default/files/documents/SWCO%20Signed%20-%202023.pdf (case sensitive). However, unlike the lien imposed for unpaid user charges, the lien for unpaid civil penalties attaches only to the property of the violator.

7. [14.10] Trespass and Nuisance

Whereas liability under statutory schemes usually is to the government (with certain notable exceptions, such as private cost recovery/contribution actions under the Comprehensive Environmental Response, Compensation, and Liability Act and citizen suits brought under various federal statutes and the Illinois Environmental Protection Act), the liability of a landlord and/or tenant under common law usually arises in the context of an action brought by a third party to address pollution emanating from the leased premises. The traditional common-law theories of trespass and nuisance have been used successfully by third parties who have suffered injury as a result of pollution emanating from nearby properties. *Schwartzman, Inc. v. Atchison, Topeka & Santa Fe Ry.,* 857 F.Supp. 838 (D.N.M. 1994) (migration of contaminated groundwater onto adjacent property constitutes trespass); *Crosstex North Texas Pipeline, L.P. v. Gardiner,* 505 S.W.3d 580 (Tex. 2016) (noise as nuisance); *O'Neill v. Carolina Freight Carriers Corp.,* 156 Conn. 613, 244 A.2d 372 (1968) (noise as nuisance); *Ramik v. Darling International, Inc.,* 60 F.Supp.2d 680 (E.D.Mich. 1999) (odor as nuisance). In Illinois, maintaining a nuisance may also constitute a violation of the Illinois Act. See the definitions of "air pollution" and "water pollution" found at 415 ILCS 5/3.115 and 5/3.545, respectively.

B. [14.11] Assessment of Risk

Clearly, under federal and Illinois environmental laws, both the landlord and the tenant may face potential liability to the government and third parties for the environmental impact of the tenant's operations and for the condition of the leased premises. Once the potential risks and liabilities associated with the tenancy have been recognized, it becomes necessary for the parties to the lease to assess those risks. See §§14.12 and 14.13 below.

1. [14.12] Environmental Site Assessments

Performance of an environmental site assessment may prove useful to create a baseline for the environmental condition of the property prior to the commencement of the lease. It may also be advantageous for the tenant to conduct an environmental assessment of the property at the end of the lease to establish its environmental condition at that time.

Environmental site assessments are becoming increasingly common for tenants with long-term ground leases. If the purpose of the environmental site assessment is merely to establish baseline environmental conditions, an environmental assessment short of a Phase I environmental site assessment under the federal "all appropriate inquiries" standard (40 C.F.R. pt. 312) or ASTM International's *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process,* E1527-21, may be adequate. An environmental assessment performed for the landlord or its lender may also suffice if it is current or otherwise updated to reflect environmental conditions at the commencement of the lease.

2. [14.13] Evaluation of Prospective Tenant Operations

For the commercial landlord, having some idea of the possible environmental impact of a prospective tenant's business before the lease is signed is essential. Although the environmental risks associated with some businesses (such as gas stations and dry cleaners) are obvious, many are not. Therefore, some initial investigation into the environmental aspects of the tenant's operations should be conducted. Methods for obtaining this environmental information may include the tenant's completion of a compliance questionnaire and a review of readily available federal and state computerized databases. Although these efforts may yield useful information about the regulatory and compliance status of the tenant, the landlord must be cognizant of the limitations inherent in these approaches. However some information, no matter how meager, is preferable to no information at all. At the very least, it may identify an area for further inquiry.

In addition to knowing the potential environmental impact of the prospective tenant's operations, it is also useful for the prospective landlord to know whether the tenant has any significant off-site Superfund liability. A tenant with a spotless environmental record may nonetheless be liable as an "arranger" for costs to investigate and remediate a site where its wastes were disposed. Liability under the Comprehensive Environmental Response, Compensation, and Liability Act and its state analog that is not subject to insurance coverage or a reserve may be significant and impair the tenant's ability to maintain environmental compliance or satisfy other lease covenants.

C. [14.14] Allocation of Risk

Once the environmental risks associated with the proposed tenancy are recognized and satisfactorily assessed, the next task is to allocate those risks between the landlord and the tenant in the lease. Although the nature and scope of provisions allocating environmental risk will vary from lease to lease, some general observations can be made. See §§14.15 – 14.25 below.

1. [14.15] Warranties and Representations

At a minimum, the landlord should require the tenant to represent and warrant that its operations at the leased premises will not adversely impact the environmental condition of the property and that all operations conducted at the property shall comply with all applicable federal, state, and local environmental laws. Any material breach of these representations and warranties should constitute an event of default. The tenant should require the landlord to represent and warrant that no "hazardous materials" (or other similar term, as defined in the lease) have been disposed of at the property prior to the tenancy and that the operations of its previous tenants have complied with all applicable environmental laws.

For the tenant, the fewer representations, the better. The tenant should beware of the use of environmental terms of art. For example, "hazardous substances" under the Comprehensive Environmental Response, Compensation, and Liability Act, "hazardous wastes" under the Resource Conservation and Recovery Act, and "hazardous chemicals" under the Occupational Safety and Health Act mean different things. The tenant should be particularly wary of making a blanket warranty that it will not "use," "store," or "handle" hazardous substances at the property because this may effectively prohibit it from conducting its business.

2. [14.16] Indemnifications

The goal should be for both of the parties to the lease to indemnify the other for claims arising in connection with the use of the leased premises. Accordingly, the landlord should require the tenant to defend and indemnify it from and against any and all claims, expenses, and losses incurred in connection with the tenant's use of the property during its tenancy, and the landlord should indemnify the tenant from and against any and all claims, expenses, and losses incurred that are unrelated to the tenant's use of the property. For example, if a third-party claim is brought against a tenant based on events at the property that transpired before the tenancy, the landlord should indemnify the tenant from and against any liability associated with that third-party claim. However, for such an indemnification to be effective it is imperative that the environmental condition of the leased property prior to the commencement of the lease be established. Without an "environmental baseline," allocation of risk using a temporal concept may be difficult, particularly if the tenant intends to use the same chemicals in its business as did a prior occupant.

Indemnifications relating to environmental liabilities should be expressly stated to reflect the parties' clear and unequivocal intent to transfer such liabilities. There are some cases that hold that a general indemnity that does not make express reference to environmental liabilities is ineffective to transfer them.

The parties to the lease should also be aware that courts have found attempts to shift liability arising under certain environmental statutes through contractual indemnities to be contrary to public policy and void. *See United States v. J & D Enterprises of Duluth,* 955 F.Supp. 1153 (D.Minn. 1997) (public policy prohibits indemnification of penalties for violations of asbestos National Emission Standards for Hazardous Air Pollutants).

3. [14.17] Financial Assurance

The most artfully crafted risk allocation provisions are worthless unless the party undertaking the risk has the financial ability to do so. Some of the more common mechanisms for financing environmental liabilities are discussed in §§14.18 – 14.25 below.

a. [14.18] Illinois Underground Storage Tank Fund

The Illinois Underground Storage Tank Fund (UST Fund), 415 ILCS 5/57.8, *et seq.,* was established to satisfy financial assurance requirements imposed on UST owners and operators by federal Resource Conservation and Recovery Act regulations (40 C.F.R. pt. 280). The UST Fund provides financing (in excess of an applicable deductible) for certain corrective action costs

incurred by an UST owner and operator in connection with a confirmed release of specific petroleum-type substances. Although a detailed discussion of the permutations of the Illinois UST program and the operation of the UST Fund by the Illinois Environmental Protection Agency is beyond the scope of this chapter, certain aspects of the program are worth noting:

1. Not all USTs are covered by the UST Fund. Nonpetroleum USTs are excluded, as are USTs containing petroleum-type substances not listed in the statute. See 415 ILCS 5/57.9(a)(3).

2. Deductibles for releases prior to June 8, 2010, are established by the date the tank was registered. Deductibles for releases prior to June 8, 2010, range from $10,000 to $100,000. If none of the USTs at the site were timely registered, the deductible is $100,000. Deductibles for releases reported on and after June 8, 2010, are $5,000 per incident. 415 ILCS 5/57.9(b).

3. Only "eligible" corrective action costs are reimbursable. 35 Ill.Admin. Code §734.625 (for costs incurred prior to issuance of a no further remediation (NFR) letter). For example, costs to remove an UST are not reimbursable from the UST Fund unless the UST was removed as part of corrective action taken in response to a reported petroleum release. Under 2010 amendments to the Illinois Environmental Protection Act, certain corrective action costs incurred after issuance of an NFR letter are now reimbursable from the UST Fund. 415 ILCS 5/57.19; 35 Ill.Admin. Code §734.632. This is a significant departure from prior law, under which corrective action costs incurred after the issuance of an NFR letter were not reimbursable.

4. Normally, only the owner or operator of the UST is eligible to access the UST Fund. However, a landlord that is neither an owner nor an operator of a tenant's UST may elect to take over the tenant's ongoing remediation project, obtain an NFR letter from the IEPA, and obtain reimbursement from the UST Fund for its eligible corrective action costs. 415 ILCS 5/57.2. By electing to proceed in this fashion, the landlord steps into the tenant's shoes and becomes the UST owner in the eyes of the IEPA.

Any situation involving reimbursement from the Illinois UST Fund requires handling by an experienced environmental professional because the program contains many traps for the unwary. If a lease implicates UST issues, neither party should blithely assume that the state UST Fund will provide a source of financing for UST removal and corrective action costs.

b. [14.19] Drycleaner Environmental Response Trust Fund

Historically, dry-cleaning establishments have been a source of chlorinated solvent contamination. It is not uncommon to find chlorinated solvents — particularly perchloroethylene and its degradation compounds — in the soil and groundwater in the vicinity of active or former dry cleaners. The cost to remediate contamination in soil and groundwater at such facilities may be significant. To assist owners and operators with the costs of investigating and remediating such sites, Illinois established the Drycleaner Environmental Response Trust Fund. The Drycleaner Environmental Response Trust Fund Act, 415 ILCS 135/1, *et seq.,* creates two accounts that may be accessed to finance the investigation and cleanup of dry-cleaning sites in Illinois — the remedial action account (to address past releases) and the insurance account (to address future releases). See §§14.20 and 14.21 below. The fee and tax provisions of the Act (415 ILCS 135/60, 135/65) are scheduled to expire on January 1, 2030. 415 ILCS 135/85.

(1) [14.20] Remedial action account

The remedial action account provides funds to finance the investigation and cleanup of dry-cleaning sites where releases of dry-cleaning solvents were discovered on or after July 1, 1997, but before July 1, 2006. 415 ILCS 135/40(c)(7). Maximum reimbursement amounts and site deductibles vary, depending on the operating status of the dry-cleaning facility (active or inactive) and the nature of the costs incurred:

Type of Facility	Investigative Cost Deductible	Cleanup Cost Deductible	Maximum Reimbursement Amounts
Active	$5,000	$10,000	$300,000
Inactive	$10,000	$10,000	$50,000

See 415 ILCS 135/40(e), 135/40(f). Remedial action fund eligibility requirements are extensive. See 415 ILCS 135/40(c).

Effective January 1, 2008, the cleanup cost deductible for both active and inactive sites was increased to $15,000, unless an applicant had a focused Site Investigation Report approved by the Illinois Environmental Protection Agency and submitted a Remedial Action Plan to the IEPA by January 1, 2008. 415 ILCS 135/40(e)(1), 135/40(e)(2); 35 Ill.Admin. Code §§1500.40(d), 1500.40(e).

(2) [14.21] Insurance account

The insurance account provides up to $500,000 in insurance coverage for owners and operators of dry-cleaning facilities. 415 ILCS 135/45(c). Coverage is limited to remedial action costs (including third-party claims) associated with soil and groundwater contamination resulting from a release of dry-cleaning solvents occurring after the date of coverage. To purchase insurance from this account, the prospective insured must conduct a site investigation to identify whether a release of dry-cleaning solvents to the environment has occurred and meet all other statutory requirements. 415 ILCS 135/45(c), 135/45(d). Yearly premiums are actuarially established. Beginning July 1, 2020, the actuarially established premium is $1,500 per facility. 415 ILCS 135/45(e)(6). The deductible is $10,000 per incident. 415 ILCS 135/45(g).

Prior to July 1, 2020, the trust fund was administered by the Illinois Drycleaner Environmental Trust Fund Council. On July 1, 2020, administrative functions were transferred to the Illinois Environmental Protection Agency. 415 ILCS 135/12(a). All council rules (former 35 Ill.Admin. Code §§1500.10 – 1500.70) were repealed and replaced by new Illinois Pollution Control Board rules effective January 17, 2023. 35 Ill.Admin. Code pt. 1501.

c. [14.22] Environmental Insurance

One factor that must be considered in determining whether the party undertaking the environmental risk has the financial wherewithal to do so is whether coverage may be available under conventional insurance policies. Although an extensive discussion of environmental claims coverage is beyond the scope of this chapter, certain observations may be made. See §§14.23 and 14.24 below.

(1) [14.23] Older commercial general liability policies

The first question that must be answered in determining whether insurance coverage may be available for an environmental claim is whether coverage is being sought under an older policy containing a pollution exclusion. Most commercial general liability (CGL) policies issued from the mid-1970s through the mid-to-late 1980s contain a pollution exclusion that excludes coverage for claims relating to pollution unless the pollution is "sudden and accidental." Because many coverage claims relate to contamination that occurred gradually, the "sudden and accidental" exception to the pollution exclusion engendered a tremendous amount of litigation nationwide. Some courts ascribed a temporal meaning to the term "sudden and accidental," effectively precluding policyholder claims for coverage in cases involving pollution-causing events that occurred over time. Other courts, however, interpreted the term "sudden and accidental" to mean "unexpected and unintended," an interpretation more favorable to insureds. This is the interpretation given to the "sudden and accidental" exception to the pollution exclusion by the Illinois Supreme Court in *Outboard Marine Corp. v. Liberty Mutual Insurance Co.,* 154 Ill.2d 90, 607 N.E.2d 1204, 180 Ill.Dec. 691 (1992). *See also Fruit of the Loom, Inc. v. Travelers Indemnity Co.,* 284 Ill.App.3d 485, 672 N.E.2d 278, 219 Ill.Dec. 770 (1st Dist. 1996); *Rogers Cartage Co. v. Travelers Indemnity Co.,* 2018 IL App (5th) 160098, 103 N.E.3d 504, 422 Ill.Dec. 372.

Because of the unfavorable interpretation given by some courts to the "sudden and accidental" pollution exclusion exception, by 1987 the insurance industry began to replace the existing pollution exclusion with the "absolute pollution exclusion." By eliminating the "sudden and accidental" exception, the insurance industry hoped that the new absolute pollution exclusion would eliminate any controversy over coverage for environmental claims. However, the insurance industry has found the results of litigation over the scope of the absolute pollution exclusion to be mixed. In Illinois, for example, courts have found the absolute pollution exclusion to apply only to claims involving "traditional" environmental pollution. *See, e.g., Village of Crestwood v. Ironshore Specialty Insurance Co.,* 2013 IL App (1st) 120122, 986 N.E.2d 678, 369 Ill.Dec. 365; *Kim v. State Farm Fire & Casualty Co.,* 312 Ill.App.3d 770, 728 N.E.2d 530, 245 Ill.Dec. 448 (1st Dist. 2000). It does not bar coverage for claims relating to lead-based paint (*Insurance Company of Illinois v. Stringfield,* 292 Ill.App.3d 471, 685 N.E.2d 980, 226 Ill.Dec. 525 (1st Dist. 1997)), nuisance claims arising from odors from hog confinement facilities (*Country Mutual Insurance Co. v. Hilltop View, LLC,* 2013 IL App (4th) 130124, 998 N.E.2d 950, 376 Ill.Dec. 240; *Country Mutual Insurance Co. v. Bible Pork, Inc.,* 2015 Il App (5th) 140211, 42 N.E.2d 958, 397 Ill.Dec. 712), or bodily injury claims relating to carbon monoxide poisoning (*American States Insurance Co. v. Koloms,* 177 Ill.2d 473, 687 N.E.2d 72, 227 Ill.Dec. 149 (1997)). *See also Erie Insurance Exchange v. Imperial Marble Corp.,* 2011 IL App (3d) 100380, ¶22, 957 N.E.2d 1214, 354 Ill.Dec. 421 (because policy's pollution exclusion was "arguably ambiguous," question whether emission of contaminants within limits allowed by Illinois Environmental Protection Agency permit constituted "pollution" was interpreted favorably to insured and triggered insurer's duty to defend).

In short, although Illinois decisions generally favor policyholders, neither party to a lease should assume that coverage for an environmental claim will be available under an older CGL policy. Coverage for an environmental claim under an older CGL policy is dependent on a wide variety of factors, including the nature of the exclusion contained in the policy, the nature of the claim, and the forum in which any coverage dispute will be litigated. *See, e.g., Central Illinois*

Light Co. v. Home Insurance Co., 213 Ill.2d 141, 821 N.E.2d 206, 290 Ill.Dec. 155 (2004) (insurer required to indemnify insured for cleanup costs under policy providing excess coverage for claims insured was legally obligated to pay when insured undertook cleanup in response to tacit threat by IEPA to bring enforcement action); *Keystone Consolidated Industries, Inc. v. Employers Insurance Company of Wausau,* 456 F.3d 758 (7th Cir. 2006) (extending *Central Illinois Light* holding to indemnification under primary policy). *But see Zurich Insurance Co. v. Carus Corp.,* 293 Ill.App.3d 906, 689 N.E.2d 130, 228 Ill.Dec. 258 (1st Dist. 1997) (holding that because there is no duty to defend under primary policy in absence of lawsuit (*Lapham-Hickey Steel Corp. v. Protection Mutual Insurance Co.,* 166 Ill.2d 520, 655 N.E.2d 842, 211 Ill.Dec. 459 (1995)), and duty to defend is broader than duty to indemnify, no duty to indemnify under primary policy exists in absence of lawsuit against insured). *Contra Selective Insurance Company of South Carolina v. Cherrytree Cos.,* 2013 IL App (3d) 120959, 998 N.E.2d 701, 376 Ill.Dec. 159.

(2) [14.24] Pollution legal liability policies

NOTE: This section was prepared with the help of Max West, Managing Director of Aon Risk Services Central, Inc. The author thanks Max for his assistance.

Until about 1995, few carriers offered any products specifically insuring against environmental risks, and the premiums charged for such coverage were expensive. However, the marketplace has changed, and a number of large insurance companies now offer policies providing coverage for environmental claims. As of this writing, the following insurance companies are active in the environmental insurance market:

a. Sirius International Insurance;

b. AXA XL Insurance;

c. Chubb;

d. Liberty Mutual Insurance Company;

e. Tokio Marine Insurance;

f. Navigators;

g. Allied World Assurance Company;

h. Freberg Environmental Insurance;

i. Aspen;

j. Great American Insurance Group;

k. Beazley;

l. Hamilton; and

m. Markel.

One type of policy offered by all these carriers is called a pollution legal liability (PLL) policy. Although PLL policy terms are site-specific, some common PLL policy coverages include

a. cleanup costs incurred as a result of both on-site and off-site pollution conditions;

b. third-party bodily injury claims (including mental anguish and emotional distress) arising from pollution conditions;

c. third-party property damage claims arising from on-site and off-site pollution conditions, including third-party business interruption and property devaluation claims;

d. costs of defense;

e. first-party business interruption losses;

f. first-party claims of diminution in property value;

g. natural resources damages; and

h. coverage for liability arising from nonowned disposal sites.

Cleanup costs coverage insures against remediation costs associated with contamination at the property, including contamination that has migrated onto the property from an off-site source. The PLL policy may afford coverage for both known and unknown site conditions. However, the scope of coverage provided by a particular policy depends on a variety of site-specific factors, including the nature of the contamination, the degree to which the property has been investigated, the previous use of the property, and the surrounding area. The experience of the insurance broker also plays a role. Due to an unanticipated number of claims, insurers' PLL underwriting practices have become more conservative, especially with respect to known contamination. In commercial leasing situations, underwriters today are looking not only at the environmental data, but also at the indemnity provisions contained in the lease.

In addition, the PLL policies have adapted over time to cover not only traditional soil and groundwater pollution risks, but also risks arising from mold, asbestos, Legionnaire's disease, and electromagnetic fields. However, most insurers are beginning to exclude coverage for claims arising from per- and polyfluoroalkyl substance (PFAS) contamination. Limited coverage for PFAS-related claims remains available if the prospective insured demonstrates that PFAS contamination poses a low risk.

Coverage under PLL policies has been underwritten for up to $250 million. Deductibles can be as low as $5,000 per incident. Coverage is generally available on a claims-made basis only. The policy term is generally one to ten years, although longer terms are available.

d. [14.25] Other Mechanisms

Other financial assurance mechanisms that may be used to provide a source of funding for environmental costs include personal guarantees and letters of credit. Establishment of an environmental escrow is also worth considering, although its use in connection with a commercial lease is not common.

III. SOME RECURRING ISSUES THAT REQUIRE SPECIAL ATTENTION

A. [14.26] Underground Storage Tanks

The presence of underground storage tanks at the leased premises requires special attention by both the landlord and the tenant. Ideally, if an UST located at the premises is no longer in use or will not be used by the tenant, it should be removed or abandoned in place prior to the commencement of the tenancy. UST removal requirements are contained in the regulations of the Office of the Illinois State Fire Marshal (OSFM) at 41 Ill.Admin. Code pt. 175, subpart H. In the City of Chicago, OSFM tank removal/abandonment regulations are enforced by the Chicago Department of Public Health (CDPH). All UST removal and abandonment activities require a permit issued by either the OSFM or the CDPH.

The key word in the foregoing paragraph is "ideally." Not all out-of-service USTs are required to be removed. In particular, USTs used to store heating oil for use on-site and tanks taken out of service before January 2, 1974 (known as "pre-74" tanks) need not be removed in the absence of a written removal order from the OSFM (or in Chicago, from the CDPH). 41 Ill.Admin. Code §§176.460(a), 176.460(b). However, simply because the law does not require the removal or abandonment of an out-of-service UST does not mean that removal or abandonment may not be prudent.

Before anyone applies for a permit to remove or abandon an UST, legal responsibility for the UST should be determined. As discussed in §14.5 above, state and federal UST laws impose obligations on the owner and the operator of the UST. The current owner of the property and the owner of the UST under state and federal UST laws may not be the same. If the UST has been out of service since November 8, 1984, the owner of the UST is the person who owned it immediately before the discontinuation of its use. See 42 U.S.C. §6991(4)(B). Ownership of an UST under state and federal UST laws is governed not by the mere fact of an UST's existence, but rather by whether one falls within the statutory definitions of "owner" and "operator." Although circumstances may dictate that the owner of the property undertake UST activities even though it is not the owner of the UST, this point should not be overlooked.

It is worth noting that with respect to USTs in use on, or brought into use after, November 8, 1984, the OSFM takes the position that USTs are real estate fixtures and, therefore, the owner of the real estate where a UST is located also owns the tank, unless there is documentation (such as a lease) to the contrary. *See A & A Market, Inc. v. Pekin Insurance Co.,* 306 Ill.App.3d 485, 713 N.E.2d 1199, 239 Ill.Dec. 349 (1st Dist. 1999).

Although the statutory definition of an UST "owner" — in the case of an UST in use on, or brought into use after, November 8, 1984, "any person who owns an underground storage tank used for the storage, use, or dispensing of regulated substances" (42 U.S.C. §6991(4)(A); see also 415 ILCS 5/57.2) — would seem to refer to only the current owner, at least one Illinois court has held that previous UST owners are also liable under §57.12(a) of the Illinois Environmental Protection Act for corrective action costs. 415 ILCS 5/57.12(a); *State Oil Co. v. People,* 352 Ill.App.3d 813, 822 N.E.2d 876, 291 Ill.Dec. 1 (2d Dist. 2004).

Along the same lines, if a prior tenant operated an UST during its tenancy, the responsibility for the removal of that UST under state and federal environmental laws rests with the tenant as the operator, even if the lease is silent on the issue. Inclusion of a specific lease provision obligating the tenant to remove the UST upon expiration of the lease term, however, should be considered.

The existence of a "reportable release" of regulated substances from the UST creates its own set of issues, not the least of which is responsibility for undertaking corrective action. Once again, under state and federal UST laws, the responsibility rests on the tank owner and operator. However, special attention needs to be given to heating oil and pre-74 tanks because of the unique treatment afforded them under Illinois law. In a nutshell, Illinois law imposes no obligation on an UST owner or operator to undertake any corrective action in response to a reportable release from a heating oil or pre-74 tank. Accordingly, in situations involving a tenant as owner or operator of a heating oil or pre-74 UST, a lease provision that imposes an obligation on the tenant to remove the UST at the expiration of the lease term and to undertake such corrective action as the law requires obligates the tenant to do nothing more than remove the tank. The landlord that wants the tenant to do more than simply remove the tank must be more specific in drafting the lease terms.

To avoid disputes over the extent of the tenant's cleanup obligations, it behooves both the landlord and the tenant to strive for specificity in describing the corrective action obligations of the tenant as the tank operator upon expiration of the lease. Simply requiring the tenant to conduct such corrective action as is required to secure a no further remediation letter for the property from the Illinois Environmental Protection Agency may not be adequate because the IEPA will issue NFR letters for property despite the presence of significant soil and groundwater contamination. Unless the landlord is willing to allow restrictions on the future use of the property that would allow for significant contamination to remain, the landlord should require the tenant to obtain an NFR letter based on a demonstration that contaminant levels at the property do not exceed the most stringent cleanup objectives for residential property under the Illinois Pollution Control Board's Tiered Approach to Corrective Action Objectives (TACO) rules at 35 Ill.Admin. Code pt. 742.

B. [14.27] Asbestos-Containing Materials

If the leased premises contain asbestos (and under the Occupational Safety and Health Act's occupational asbestos exposure regulations, thermal system insulation, surfacing materials, and resilient flooring installed before 1980 are presumed to contain asbestos), the landlord must notify the tenant of that fact prior to the commencement of any activities that would cause the asbestos-containing material (or presumed asbestos-containing material) to be disturbed. 29 C.F.R. §§1926.1101(k)(1)(i), 1926.1101(k)(2)(ii)(D). Although no obligation is imposed on commercial property owners to remove asbestos-containing materials, implementation of an operations and maintenance (O&M) program by the landlord to monitor the condition of asbestos-containing materials during the term of the lease should be considered.

Although an asbestos abatement can be performed in occupied spaces, it is not recommended absent exigent circumstances. Abatement must be conducted in accordance with work practice standards under the asbestos National Emission Standards for Hazardous Air Pollutants (40 C.F.R. pt. 61, subpart M) and Occupational Safety and Health Administration regulations (29 C.F.R. §1926.1101, *et seq.* (OSHA construction industry standard)). Because the Clean Air Act exposes the landlord to liability for any noncompliance with the asbestos NESHAP work practice standards by the tenant, or a contractor employed by the tenant, it is recommended that the landlord control any abatement performed during the lease term.

C. [14.28] Lead-Based Paint

In 1996, the United States Environmental Protection Agency and the U.S. Department of Housing and Urban Development issued joint regulations implementing the Residential Lead-Based Paint Hazard Reduction Act of 1992 (RLPHRA), Pub.L. No. 102-550, Title X, 106 Stat. 3897, codified at 42 U.S.C. §4851, *et seq.,* which are found at 24 C.F.R. pt. 35 and 40 C.F.R. pt. 745. Under these regulations, lessors of target housing must, to the extent of their actual knowledge, disclose to lessees the presence of any lead-based paint or lead-based paint hazards at the leased premises. "Target housing" includes any residential dwelling constructed before 1978, except housing for the elderly and persons with disabilities (unless a child under the age of six years resides, or is expected to reside, there) or any dwelling without a bedroom. See 24 C.F.R. §35.86. Also excluded from the disclosure requirements are residences certified by a certified inspector to be free of lead-based paint, property in foreclosure, and dwellings subject to short-term leases of 100 days or less, provided that no lease renewal or extension can occur. See 24 C.F.R. §35.82.

In addition to making the appropriate disclosure in the residential lease, the lessor must provide the lessee with any available information concerning the existence of lead-based paint or lead-based paint hazards at the property, as well as a copy of the USEPA pamphlet *Protect Your Family from Lead in Your Home.* 24 C.F.R. §35.88(a)(1); 40 C.F.R. §745.107(a)(1).

The federal disclosure requirements do not apply to nonresidential property. However, any repair or renovation activities (other than routine maintenance) that may disturb lead-based paint, whether at residential or commercial property, must comply with Occupational Safety and Health Administration construction industry lead exposure standards at 29 C.F.R. §1926.62. Routine maintenance activities are regulated by the general industry standard for lead at 29 C.F.R. §1910.1025. As is the case with asbestos, abatement of lead-based paint in occupied spaces should be avoided if at all possible.

On April 22, 2008, the USEPA issued a final rule requiring the use of lead-safe work practices when conducting certain building renovation, repair, and painting activities. 73 Fed.Reg. 21,692 (Apr. 22, 2008); 40 C.F.R. pt. 745.80, subpart E. Under the "renovation, repair, and painting rule," beginning April 22, 2010, contractors and building owners who perform renovation, repair, and painting projects that disturb lead-based paint in homes, childcare facilities, and schools built before 1978 must be certified and must follow specific work practices to prevent lead contamination. 40 C.F.R. §§745.81(a)(3), 745.81(a)(4). Property owners who renovate, repair, or prepare surfaces for painting in pre-1978 rental housing or space rented by childcare facilities must provide tenants with

a copy of the USEPA's lead hazard information pamphlet *Renovate Right: Important Lead Hazard Information for Families, Child Care Providers, and Schools* before beginning work. The pamphlet is available at www2.epa.gov/lead/renovate-right-important-lead-hazard-information-families-child-care-providers-and-schools. 40 C.F.R. §745.83.

On May 6, 2010, the USEPA gave advance notice of its intention to expand the renovation, repair, and painting rule to include the renovation, repair, and painting of public and commercial buildings. 75 Fed.Reg. 24,848 (May 6, 2010). The USEPA initiated proceedings to propose lead-safe work practices and other requirements for renovations on the exteriors of public and commercial buildings and to determine whether lead-based paint hazards are created by interior renovation, repair, and painting projects in such buildings. Although the USEPA agreed to either sign a proposed rule covering renovation, repair, and painting activities in public and commercial buildings, or to determine that these activities do not create lead-based paint hazards, by July 1, 2015 (78 Fed.Reg. 27,906 (May 13, 2013)), as of the date of this chapter no final action by the USEPA has been taken.

One issue that has arisen with respect to lead-based paint is whether a residential tenant has a private cause of action against a landlord for regulatory noncompliance. In *Abbasi v. Paraskevoulakos,* 187 Ill.2d 386, 718 N.E.2d 181, 240 Ill.Dec. 700 (1999), the Illinois Supreme Court found no private cause of action to exist under the Illinois Lead Poisoning Prevention Act, 410 ILCS 45/1, *et seq.* However, in *Price v. Hickory Point Bank & Trust, Trust No. 0192,* 362 Ill.App.3d 1211, 841 N.E.2d 1084, 299 Ill.Dec. 352 (4th Dist. 2006), a landlord's violations of a local ordinance and federal regulations implementing the RLPHRA were held to be prima facie evidence of negligence, notwithstanding the landlord's lack of knowledge of the existence of lead-based paint. *But cf. Garcia v. Jiminez,* 184 Ill.App.3d 107, 539 N.E.2d 1356, 132 Ill.Dec. 550 (2d Dist. 1989) (residential tenant obligated to establish landlord's actual or constructive knowledge of presence of lead-based paint to prevail on common-law negligence claim).

D. [14.29] Radon

Although sometimes discussed in Phase I environmental site assessments of commercial property, radon is generally not an issue in commercial leasing.

IV. [14.30] REMEDIES

The most common environmental scenario encountered by the lessor of commercial property is contamination of the property by the lessee during the tenancy. In the event the tenant's use of the property results in contamination, what are the remedies available to the landlord? As discussed in §§14.31 – 14.33 below, remedies are available under both federal and state environmental laws. Contractual remedies may also be available under the lease. See §14.34 below. The choice of remedy is usually determined by two factors: the identity of the party who is to perform the cleanup and the level of cleanup that the landlord desires to achieve.

A. Statutory Remedies

1. [14.31] Cost Recovery Under the Comprehensive Environmental Response, Compensation, and Liability Act of 1990

As a result of the U.S. Supreme Court's decision in *United States v. Atlantic Research Corp.,* 551 U.S. 128, 168 L.Ed.2d 28, 127 S.Ct. 2331 (2007), a landlord's status as a potentially responsible party (PRP) under the Comprehensive Environmental Response, Compensation, and Liability Act (as the owner of the property) does not prohibit it from maintaining a CERCLA cost recovery action under §107(a), 42 U.S.C. §9607. Accordingly, one option available to the landlord is to undertake a voluntary cleanup of the property and then bring a federal CERCLA action against the polluting tenant to recover its cleanup costs. However, a CERCLA cost recovery action contains a number of traps for the unwary, the most significant of which is that the response costs incurred by the plaintiff must be consistent with the National Oil and Hazardous Substances Pollution Contingency Plan (National Contingency Plan or NCP), 40 C.F.R. pt. 300. The NCP is a set of federal regulations that parties must follow in conducting response or removal activities under CERCLA. Unless a party can demonstrate that its response costs were incurred consistent with the NCP, it will be unable to recover those costs of response from the polluting party. *Public Service Company of Colorado v. Gates Rubber Co.,* 175 F.3d 1177 (10th Cir. 1999). However, initial investigative, assessment, and monitoring costs may be recoverable notwithstanding noncompliance with the NCP. *PMC, Inc. v. Sherwin-Williams Co.,* 151 F.3d 610 (7th Cir. 1998); *Continental Title Co. v. Peoples Gas Light & Coke Co.,* No. 96 C 3257, 1999 WL 753933 (N.D.Ill. Sept. 15, 1999); *CNH America, LLC v. Champion Environmental Services, Inc.,* 863 F.Supp.2d 793 (E.D.Wis. 2012). *But see Board of County Commissioners of County of La Plata v. Brown Group Retail, Inc.,* 768 F.Supp.2d 1092 (D.Colo. 2011)*; Angus Chemical Co. v. Mallinckrodt Group, Inc.,* No. 3:95-295, 1997 WL 280740 (W.D.La. Mar. 4, 1997); *Ambrogi v. Gould, Inc.,* 750 F.Supp. 1233 (M.D.Pa. 1990).

Another bar to the landlord's maintenance of a CERCLA cost recovery action is the petroleum exclusion. The response costs for which cost recovery is sought must relate to a release, or threatened release, of a hazardous substance. "Hazardous substance" is a defined term that specifically excludes petroleum. 42 U.S.C. §9601(14). Consequently, if the contaminant at issue is petroleum, CERCLA does not afford a basis for recovery.

Attorneys' fees are not recoverable in a CERCLA §107 action. *Key Tronic Corp. v. United States,* 511 U.S. 809, 128 L.Ed.2d 797, 114 S.Ct. 1960 (1994).

2. [14.32] Citizen Suit Under the Resource Conservation and Recovery Act of 1976

If the landlord has not incurred any response costs (or prefers not to) and wants the tenant to undertake the remediation, the Resource Conservation and Recovery Act may afford an appropriate remedy. RCRA provides two bases for initiation of a citizen suit:

a. under §7002(a)(1)(A) (42 U.S.C. §6972(a)(1)(A)), for a "violation of any permit, standard, regulation, condition, requirement, prohibition, or order" under RCRA; or

b. under §7002(a)(1)(B) (42 U.S.C. §6972(a)(1)(B)), against any "past or present owner or operator of a treatment, storage, or disposal facility, who has contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment."

A citizen suit under RCRA has several advantages over a CERCLA cost recovery action. The plaintiff need not expend any response costs, and compliance with the National Contingency Plan need not be shown. Also, because RCRA does not contain a petroleum exclusion, petroleum contamination may be the subject of a RCRA suit. Attorneys' fees are also recoverable. 42 U.S.C. §6972(e).

The RCRA citizen suit provisions contain mandatory prefiling notice requirements. Notice of intent to file suit is to be given to appropriate state and federal environmental officials as well as the prospective defendant. See 42 U.S.C. §§6972(b)(1)(A), 6972(b)(2)(A). Failure to give the required notice is grounds for dismissal. *Hallstrom v. Tillamook County,* 493 U.S. 20, 107 L.Ed.2d 237, 110 S.Ct. 304 (1989). If the government is already diligently prosecuting the violations, no private action may be maintained. *See Supporters to Oppose Pollution, Inc. v. Heritage Group,* 973 F.2d 1320 (7th Cir. 1992).

Only injunctive relief is available through a RCRA citizen suit. *Meghrig v. KFC Western, Inc.,* 516 U.S. 479, 134 L.Ed.2d 121, 116 S.Ct. 1251 (1996). Cleanup costs incurred after a RCRA suit is commenced are not recoverable. *Avondale Federal Savings Bank v. Amoco Oil Co.,* 170 F.3d 692 (7th Cir. 1999).

3. [14.33] Citizen Enforcement Action Before Illinois Pollution Control Board

Instead of pursuing statutory remedies under the Comprehensive Environmental Response, Compensation, and Liability Act or the Resource Conservation and Recovery Act, the landlord could, alternatively, seek reimbursement of its corrective action costs in a citizen enforcement action before the Illinois Pollution Control Board. In a line of cases beginning with *Lake County Forest Preserve District v. Ostro,* PCB 92-80, 1994 WL 120267 (Mar. 31, 1994), the IPCB has recognized the right of a private party to recover cleanup costs incurred in response to violations of the Illinois Environmental Protection Act. *Herrin Security Bank v. Shell Oil Co.,* PCB 94-178, 1994 WL 487952 (Sept. 1, 1994); *Streit v. Oberweis Dairy, Inc.,* PCB 95-122, 1995 WL 545496 (Sept. 7, 1995); *Dayton Hudson Corp. v. Cardinal Industries, Inc.,* PCB 97-134, 1997 WL 530523 (Aug. 21, 1997); *Richey v. Texaco Refining & Marketing, Inc.,* PCB 97-148, 1997 WL 469802 (Aug. 7, 1997); *Malina v. Day,* PCB 98-54, 1998 WL 29953 (Jan. 22, 1998); *Union Oil Company of California v. Barge-Way Oil Co.,* PCB 98-169, 1999 WL 47292 (Jan. 7, 1999); *Kelly-Mac Partners v. Robertson-CECO Corp.,* PCB 99-162, 1999 WL 562212 (July 22, 1999); *MDI Limited Partnership #42 v. Regional Board of Trustees for Boone & Winnebago Counties,* PCB 00-181, 2002 WL 939586 (May 2, 2002); *Village of Park Forest v. Sears, Roebuck & Co.,* PCB 01-77, 2002 WL 1291796 (June 6, 2002); *McCarrell v. Air Distribution Associates, Inc.,* PCB 98-55, 2003 WL 1386319 (Mar. 6, 2003); *2222 Elston LLC v. Purex Industries, Inc.,* PCB 03-55, 2003 WL 21512768 (June 19, 2003); *Grand Pier Center LLC v. River East LLC,* PCB 05-157, 2005 WL 1255254 (May 19, 2005); *Elmhurst Medical Healthcare v. Chevron U.S.A. Inc.,* PCB 09-066, 2010

WL 2147432 (Mar. 18, 2010); *Caseyville Sport Choice, LLC v. Seiber,* PCB 08-030, 2011 WL 552466 (Feb. 3, 2011); *Johns-Manville v. Illinois Department of Transportation,* PCB 14-3, 2016 WL 7384358 (Dec. 15, 2016). *But see NBD Bank v. Krueger Ringier, Inc.,* 292 Ill.App.3d 691, 686 N.E.2d 704, 226 Ill.Dec. 921 (1st Dist. 1997).

One issue the IPCB has not directly addressed in the *Ostro* line of cases is whether the cleanup costs sought to be recovered are excessive under the IPCB's Tiered Approach to Corrective Action Objectives rules. The TACO rules (adopted in conjunction with the state's voluntary Site Remediation Program, 415 ILCS 5/58, *et seq.*) establish risk-based cleanup objectives for soil, soil gas, and groundwater contamination in Illinois. (Soil gas cleanup objectives address vapor intrusion concerns through the indoor and outdoor air inhalation exposure pathways.) The most stringent cleanup objectives are called "Tier 1" objectives and are largely determined by the exposure risks associated with the use of the property. See 415 ILCS 5/58.5. Accordingly, TACO Tier 1 cleanup objectives for residential property are more stringent than cleanup objectives for property that is industrial or commercial because the risk of exposure to contamination at residential property is greater.

Under the TACO rules, contamination at levels exceeding applicable cleanup objectives may remain if certain measures are implemented to reduce the risk of exposure to within acceptable limits. For example, if the existing contaminant levels in soil exceed applicable cleanup objectives determined by the risks associated with exposure through inhalation or ingestion, the soil contamination may remain if an engineered barrier (such as a building or pavement) is used to sufficiently reduce the risk of exposure. Institutional controls (such as a deed restriction) may also be required to ensure that the contaminant levels will not pose an unacceptable risk.

Suppose the landlord conducts a cleanup of the tenant's contamination at commercial property to achieve Tier 1 residential cleanup objectives under TACO and then seeks to recover its costs of cleanup from the polluting tenant in an action before the IPCB under *Ostro* and its progeny. Suppose further that the cost of cleanup to achieve Tier 1 residential cleanup objectives was $100,000 more than the cost to achieve cleanup levels appropriate for industrial or commercial property. Under these circumstances, the tenant may well argue that the landlord's cleanup costs were excessive and the very most that the landlord can recover are the costs to clean up the property to achieve cleanup objectives appropriate for the use of the property under TACO.

To date, the IPCB has not directly addressed this issue in a cost recovery action. The closest the IPCB has come is in *Village of Park Forest, supra,* a case in which a municipality sought to recover cleanup costs from a prior owner of the property. Believing that the costs the municipality incurred were excessive and not supported by §33(c) of the Illinois Environmental Protection Act, 415 ILCS 5/33(c), the prior owner moved for summary judgment. The IPCB denied the motion, finding insufficient evidence as to whether the costs incurred were economically unreasonable as a matter of law.

Although the IPCB in *Village of Park Forest* did not address the merits of the respondent's claim that the cleanup costs the complainant was seeking to recover were excessive, the IPCB's decision in *Matteson WHP Partnership v. Martin,* PCB 97-121, 2000 WL 890181 (June 22, 2000), does suggest that an owner may be able to recover from a polluting tenant all of its costs to

remediate the leased property to achieve the most stringent cleanup standard available under TACO. In *Matteson,* the commercial landlord filed a citizen enforcement case against a polluting dry-cleaner tenant, alleging various violations of the Illinois Act and the IPCB's water pollution control regulations in connection with perchloroethylene contamination at the property. The landlord sought an IPCB order requiring the tenant to clean up the perchloroethylene contamination at the property to within area background concentrations. The tenant argued that the appropriate level of cleanup of the property was determined by the TACO rules and, at most, the landlord was entitled to nothing more than a cleanup sufficient for commercial property. Although the IPCB agreed with the tenant that TACO applied, it rejected the tenant's argument that a cleanup to achieve commercial cleanup standards was all that was warranted and ordered a cleanup to achieve the most stringent cleanup objectives under TACO, *i.e.,* Tier 1 objectives for residential property. The IPCB's order requiring the tenant to clean up the soil to achieve residential cleanup objectives was affirmed by the appellate court in *Martin v. Illinois Pollution Control Board,* 323 Ill.App.3d 1145, 800 N.E.2d 884, 279 Ill.Dec. 596 (1st Dist. 2001) (Rule 23).

In several subsequent decisions, the IPCB has cited *Matteson* for the proposition that there are limits on the scope of the remediation it may order to address violations of the Illinois Act and IPCB rules. *Kapp, Inc. v. Carlton,* PCB 05-196, 2005 WL 1715702 (July 7, 2005); *Theodore Kosloff Trust v. A&B Wireform Corp.,* PCB 06-163, 2006 WL 2956155 (Oct. 5, 2006).

B. [14.34] Contractual Remedies

In addition to the remedies available under environmental laws, both the landlord and the tenant may have remedies under the lease. Depending on the nature of any warranties and representations given, a violation of a warranty or representation relating to environmental matters may constitute a breach of the lease and an event of default. It may also constitute a violation of the usual lease prohibition against waste.

Unlike statutory remedies, remedies available to the parties under the lease in the event of a breach can be tailored to fit the unique circumstances created by the tenancy. However, great care must be taken in drafting provisions imposing cleanup obligations. If, for example, the landlord wants the polluting tenant to clean up the property to meet residential standards and obtain a no further remediation letter from the Illinois Environmental Protection Agency, the desired standards for issuance of the NFR letter must be stated expressly. For example:

Tenant, at its sole cost and expense, shall obtain a no further remediation letter issued by the Illinois Environmental Protection Agency for the property based on a demonstration that contaminant levels do not exceed applicable Tier 1 cleanup objectives for residential property under the Illinois Pollution Control Board's Tiered Approach to Corrective Action Objectives Rules, 35 Ill.Admin. Code pt. 742, without the utilization of engineered barriers, institutional controls or building control technologies, with the exception of such institutional controls as may be existing at the property as of the commencement date of the Lease.

If the desired cleanup objectives cannot be reasonably achieved (*e.g.,* if residential cleanup objectives will be achieved only by removing a building), the lease can be written to require that the tenant is responsible for meeting the most stringent achievable objective. However, under such

circumstances, the landlord should be compensated for the contamination that remains. The landlord's compensation could be measured by the difference between the tenant's actual cleanup costs and the estimated cost to achieve the desired level of cleanup, or by the diminution in property value attributable to the remaining contamination.

Whether issuance of an NFR letter from the IEPA is to be sought in connection with cleanup conducted pursuant to the terms of a lease should be given serious consideration in the drafting of lease terms. In certain circumstances, involvement by the IEPA is a foregone conclusion. For example, releases from underground storage tanks regulated under the state's UST program will necessarily involve the IEPA to some degree. However, corrective action that is not mandated by a particular regulatory program but is undertaken voluntarily will trigger IEPA oversight only if requested. NFR letters issued by the state following successful participation in the Illinois voluntary Site Remediation Program provide certain valuable protections to the party obtaining the letter and to the other parties identified in the statute at 415 ILCS 5/58.10(d). For a variety of reasons, however, the parties to the lease may simply not want to get the government involved. A release of contaminants from the leased premises that has impacted off-site properties, if brought to the attention of the IEPA under the Site Remediation Program, may trigger the IEPA's notification obligations under the Illinois right-to-know statute, 415 ILCS 5/25d-1, *et seq.,* and result in the issuance of an administrative cleanup order by the IEPA. Under such circumstances the benefits of participation in the Site Remediation Program and issuance of an NFR letter may be outweighed by the burdens associated with the giving of the mandated off-site contamination notice.

For the tenant, remedies available in the event of a breach of an environmental condition by the landlord may include rent abatement and lease termination. Finally, a provision awarding attorneys' fees to the party successfully enforcing the environmental provisions of the lease (whether the landlord or the tenant) should be included.

V. [14.35] SAMPLE LEASE PROVISIONS

The following provisions may be useful as a guide in drafting lease terms. However, they are generally written from the perspective of the landlord and must be modified as necessary to fit the particular leasing situation.

ENVIRONMENTAL MATTERS

I. Definitions.

A. "Environmental Law or Laws" shall mean any and all federal, state, or local laws, regulations, ordinances, rules, orders, directions, requirements, or court decrees pertaining to health, industrial hygiene, or the environmental conditions on, under, or about the Premises, including, without limitation, the Resource Conservation and Recovery Act of 1976 (RCRA), 42 U.S.C. §6901, *et seq.,* as amended, and regulations promulgated thereunder; the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), 42 U.S.C. §9601, *et seq.,* as amended, and regulations promulgated thereunder; the Hazardous Materials Transportation Act, 49 U.S.C. §5101, *et seq.,* as amended, and

regulations promulgated thereunder; the Toxic Substances Control Act, 15 U.S.C. §2601, *et seq.,* as amended (including, but not limited to, by the Frank R. Lautenberg Chemical Safety for the 21st Century Act, Pub.L. No. 114, 182, 130 Stat. 448 (2016)), and regulations promulgated thereunder; the Federal Insecticide, Fungicide, and Rodenticide Act, 7 U.S.C. §136, *et seq.,* as amended, and regulations promulgated thereunder; the Federal Water Pollution Control Act (Clean Water Act), 33 U.S.C. §1251, *et seq.,* as amended, and regulations promulgated thereunder; the Safe Drinking Water Act of 1974, 42 U.S.C. §300f, *et seq.,* as amended, and regulations promulgated thereunder; the Oil Pollution Act of 1990, 33 U.S.C §2701, *et seq.;* as amended, and regulations promulgated thereunder; the Clean Air Act, 42 U.S.C. §7401, *et seq.,* as amended, and regulations promulgated thereunder; the Emergency Planning and Community Right-to-Know Act of 1986, 42 U.S.C. §11001, *et seq.,* as amended, and regulations promulgated thereunder; and all parallel, similar, or relevant Laws.

B. "Hazardous Materials" shall mean any (i) "hazardous waste" as defined in RCRA; (ii) "hazardous substance" as defined in CERCLA; (iii) petroleum or liquid petroleum or wastes; (iv) per- and polyfluoroalkyl substances; and (v) any other toxic or hazardous substances that may be regulated from time to time by applicable Environmental Laws.

C. "Environmental Conditions" shall mean any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing of Hazardous Materials on, from, or about the Premises other than in compliance with applicable Environmental Laws. The term "Environmental Conditions" includes, but is not limited to, the presence of Hazardous Materials on, from, or about the Premises attributable to the operation of any underground or above-ground storage tanks, oil/water separators, or in-ground hydraulic lifts or hoists and associated equipment.

D. "Environmental Costs" shall mean any and all judgments, damages, penalties, fines, costs, liabilities, obligations, losses, or expenses of whatever kind and nature (including, without limitation, diminution in value of the Property, damages for the loss or restriction on use of leasable space, damages arising from any adverse impact on marketing of space, sums paid in settlement of claims, attorneys' fees, consultants' fees, and experts' fees), arising from or incurred in connection with Environmental Conditions, including, but not limited to, those relating to the presence, investigation, or remediation of Hazardous Materials.

II. Representations, Warranties, and Covenants.

A. Tenant represents, warrants, and covenants to and with Landlord that

1. Tenant has the full right, power, and authority to carry out its environmental obligations hereunder.

2. Tenant is financially capable of performing and satisfying its environmental obligations hereunder.

3. Tenant is not now, and never has been, in violation of any applicable Environmental Law, including, but not limited to, any Environmental Law relating to the generation, handling, usage, transportation, treatment, storage, or disposal of Hazardous Materials, nor is it subject to any threatened, existing, or pending action by any governmental authority in connection therewith.

4. Tenant's generation, handling, usage, transportation, treatment, storage, or disposal of Hazardous Materials at the Premises shall at all times comply with applicable Environmental Laws and will not cause or allow any Environmental Condition to occur or exist.

5. Tenant, at its expense, shall comply with all Environmental Laws pertaining to the Premises or Tenant's use of the Premises, and with all directions of all public officers issued pursuant to any Environmental Law, which shall impose any duty on the owner or operator with respect to the use or occupancy of the Premises.

6. Tenant will not install, use, or operate any underground storage tank without the express written permission of Landlord, which permission may be withheld in Landlord's sole and arbitrary discretion.

B. Landlord represents, warrants, and covenants to and with Tenant that

1. Landlord has the full right, power, and authority to carry out its environmental obligations hereunder.

2. Landlord is financially capable of performing and satisfying its environmental obligations hereunder.

3. As of the commencement date of the Lease, neither Landlord, nor to the knowledge of Landlord, any of Landlord's current tenants, is now, or ever has been, in violation of any applicable Environmental Law, including, but not limited to, Environmental Laws relating to the generation, handling, usage, transportation, treatment, storage, or disposal of Hazardous Materials, at the Property, nor is Landlord, or to the knowledge of Landlord, any of Landlord's current tenants, subject to any threatened, existing, or pending action by any governmental authority in connection therewith.

4. As of the commencement date of the Lease, to the knowledge of Landlord, any generation, handling, usage, transportation, treatment, storage, or disposal of Hazardous Materials at the Property has complied with applicable Environmental Laws, and no Environmental Condition is known to have occurred or exist.

III. Notice.

Tenant shall give immediate written notice to Landlord of (a) any proceeding or inquiry by any governmental authority with respect to the presence of any Hazardous Materials on the Premises or the migration thereof from or to other areas; (b) all claims and potential

claims made, inquired about, or threatened by any third party against Tenant or the Premises relating to any loss or injury resulting from any Hazardous Materials; and (c) Tenant's discovery of any occurrence or condition on any property adjoining or in the vicinity of the Premises that could cause the Property or any part thereof to be subject to any restrictions on its ownership, occupancy, transferability, or use under any Environmental Law.

IV. Indemnifications.

A. Tenant shall defend, with counsel reasonably approved by Landlord, all actions against Landlord with respect to, and pay, protect, indemnify, and hold harmless, to the extent permitted by law, Landlord from and against any and all Environmental Costs of any nature arising out of, or claimed to be arising out of, any Environmental Conditions. Notwithstanding anything in this Lease to the contrary, Landlord agrees that Tenant shall not be responsible for Environmental Conditions to the extent that such Environmental Conditions (1) exist as of the commencement date of the Lease or (2) result from either the actions or omissions of Landlord or any breach of a representation or warranty made by Landlord herein.

B. Landlord shall defend, with counsel reasonably approved by Tenant, all actions against Tenant with respect to, and pay, protect, indemnify, and hold harmless, to the extent permitted by law, Tenant from and against any and all Environmental Costs of any nature arising out of, or claimed to be arising out of, any Environmental Conditions to the extent that such Environmental Conditions (1) exist as of the commencement date of the Lease or (2) result from either the actions or omissions of Landlord, or any breach of a representation or warranty made by Landlord herein. Tenant agrees that Landlord shall not be responsible for any Environmental Conditions to the extent that such Environmental Conditions result from the actions or omissions of Tenant, or Tenant's agents, employees, or invitees. Tenant further agrees that Landlord shall have no obligation to Tenant under this Lease for Environmental Conditions arising during the term of this Lease from the actions or omissions of any person or entity who or that is not an agent, employee, or invitee of Landlord.

C. The foregoing indemnities shall include, without limitation, Environmental Costs arising out of any violations of Environmental Laws, regardless of any real or alleged fault, negligence, willful misconduct, gross negligence, breach of warranty, or strict liability on the part of either party hereto. The foregoing indemnities shall also survive the end of the Lease term.

V. Tenant Disclosures.

Prior to the commencement date, and prior to January 1 of each year of the Lease term, including January 1 of the year immediately following the year during which the term ends, Tenant shall disclose to Landlord in writing the names and amounts of all Hazardous Materials or any combination thereof that were stored, used, or disposed of on the Premises or that Tenant intends to store, use, or dispose of on the Premises. Further, Tenant shall provide Landlord a copy of every document Tenant makes available to any governmental authority or to any person under any Environmental Law.

VI. Inspection.

Landlord shall have the right, but not the duty, to inspect the Premises at any time to determine whether Tenant is complying with the terms of this section. If Tenant is not in compliance, then Landlord shall have the right to immediately enter upon the Premises to remedy, at Tenant's expense, any Environmental Conditions caused by Tenant's failure to comply, notwithstanding any other provision of this Lease to the contrary. Such remedial measures shall be done in accordance with the recommendations of Landlord's environmental engineers and/or consultants and/or the requirements of any governmental authority having jurisdiction over such matters. Tenant shall pay to Landlord, as additional rent, all Environmental Costs incurred by Landlord in performing any such remedial measures within 30 days after Landlord's written request therefore. Landlord shall use reasonable efforts to minimize interference with Tenant's business operations, but Landlord shall not be liable for any interference caused thereby.

VII. Corrective Action.

A. If Tenant causes or allows any Environmental Conditions to exist at the Property that result in contamination of soil, soil gas, or groundwater at concentrations exceeding the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the Illinois Pollution Control Board (IPCB) under its Tiered Approach to Corrective Action Objectives Rules (TACO Rules), 35 Ill.Admin. Code pt. 742, then Tenant, at its expense, shall obtain a No Further Remediation (NFR) letter from the Illinois Environmental Protection Agency (IEPA) with respect to such Environmental Conditions. Tenant shall apply for issuance of an NFR letter by the IEPA only upon achieving the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the IPCB under the TACO Rules. The most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater shall be achieved by Tenant without the utilization of engineered barriers, institutional controls, or building control technologies, except for such institutional controls as may be existing at the Property as of the commencement date of the Lease.

B. Tenant shall use its best efforts to achieve the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the IPCB under the TACO Rules and to secure the issuance of an NFR letter from the IEPA for the Property on that basis, not later than two years after the end of the Term. If Tenant fails to secure an NFR letter prior to the expiration of said two-year period, then Landlord, at its option, may either (1) direct Tenant to continue with its efforts to achieve the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the IPCB under the TACO Rules and to secure the issuance of an NFR letter from the IEPA for the Property on that basis or (2) take over the project from Tenant and itself complete the project to Landlord's satisfaction, at Tenant's expense.

C. If the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the IPCB under the TACO Rules cannot be reasonably achieved by Tenant, then Tenant shall meet the most stringent achievable objectives. The determination whether any particular cleanup objective is reasonably achievable is within Landlord's sole

discretion; provided, however, that Landlord's determination as to the achievability of any particular cleanup objective shall be without prejudice to any rights Landlord may have against Tenant, at law or in equity, under this Lease or under applicable Environmental Laws, to compensation for any loss, including, but not limited to, diminution in fair market value of the Property attributable to the presence of contamination at the Property that exceeds the most stringent Tier 1 cleanup objectives for soil, soil gas, and groundwater established by the IPCB under the TACO Rules.

VIII. Tenant's Financial Assurance.

To ensure the availability of funds to satisfy Tenant's environmental obligations hereunder, on or before the execution of this Lease, Tenant, at its expense, at Landlord's discretion, shall either:

A. Maintain pollution legal liability insurance with minimum limits of $_____ with respect to the Premises, providing coverage for on-site and off-site cleanup costs and third-party bodily injury and property damage claims arising from on-site and off-site Environmental Conditions;

B. Obtain a bond or letter of credit in the amount of $_____, which shall provide for payment thereunder to be applied toward satisfying Tenant's environmental obligations under this Lease if Tenant fails to satisfy such obligations; or

C. Deposit funds in the amount of $_____ in an interest-bearing escrow account, with an escrowee satisfactory to Landlord, such escrowed funds to be used by Landlord to satisfy Tenant's environmental obligations under this Lease if Tenant fails to do so.

Index

References in this index are to section number.