25 Years Of Commercial Leasing: What A Long, Strange, Cyclical Trip It Has Been

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I. INTRODUCTION

The 10 years preceding the birth of the Real Property Law Section of the State Bar of California saw commercial leases expand from a typical six-page office lease, manually typed with carbon paper, to a 30-page lease with a dramatically increased focus on detail and an attempt to alleviate the unknowns and "what ifs." During this time, real estate attorneys focusing on leasing were a novelty. Nevertheless, as land values rose and capital was invested into increasingly larger real estate projects, landlords became more sophisticated in how they operated their real estate holdings, including committing more resources into finding quality tenants and documenting their leases. As more landlords retained attorneys to draft their leases, corporate departments of law firms became corporate/real estate departments and attorneys were hired to specialize in commercial leasing. As the attorney's role in the lease preparation process grew, so did the length of the typical commercial office lease. However, it was the 1980s that saw the most dramatic increase in the complexity of the commercial office lease.

A. Leasing Practice in the Early 1980s

The 1980s saw a striking increase in investment capital coming into California to build office buildings, addressing demands by the entertainment, defense, financial, and computer technology industries, together with the professional firms supporting them. International money competed with domestic money as large-scale office buildings were developed in San Francisco, Los Angeles, and San Diego, with other city centers seeing multi-phase projects of much greater size and scope than had been in place in the previous decades. As the investments became more significant, legal documentation grew in complexity and length to match. Many real estate attorneys began devoting a substantial portion, if not all, of their practice to commercial leasing. The increasing amount of educational training available to lawyers and brokers dealing with the negotiation and drafting of office leases, coupled with the advent of computer technology, which made it easier to reflect the treatment of sophisticated leasing issues, caused leases to grow in size and complexity at a rapid pace. Some of the larger landlords even began developing in-house legal teams to draft and negotiate office leases. The in-house leasing attorneys were apt to repeatedly update their standard form leases to address specific issues that they encountered on a day-to-day basis. The end result was that leases grew exponentially to address these series of unending concerns and to reflect the history of the negotiations experienced by landlords.

B. Into the 1990s and Beyond

In the early 1990s, the specter of over-supply loomed and landlords found they had overbuilt in the 1980s, providing tenants with leverage in lease negotiations. As the economy progressed in the 1990s, a significant real estate recession took place, accentuated by the Federal Trade Commission taking over the management of savings and loans and banks, and then fire-selling the excess inventory. This led to such an over-supply of rental real estate that tenants were not only receiving significant concessions, they found themselves in complete control of the lease negotiations. These market conditions resulted in yet another wave of new lease language protecting the respective parties as the Tenant Bar Association—which had become much more knowledgeable in the preceding 10 years and understood there were many ways to draft lease provisions which would favor tenants—took advantage of the market conditions to request numerous concessions. A changing of the guard took place during this period: institutions foreclosed on developers, and real estate managers within such institutions, armed with business degrees but not much experience, took over massive quantities of office building product. As a result, many mistakes were made with regard to the disposition of foreclosed assets.

Eventually the economy turned and headed into the late 1990s with another wave of optimism and construction in major cities such as San Francisco and Los Angeles. Tremendous demand in technology-related industries, including bio-technology, and particularly in software and Internet industries, saw landlords once again in a position of power in lease negotiations. Landlords were not only able to get tenants to enter into leases with minimal lease negotiations, they were also able to bulk-up their leases with numerous landlord-friendly provisions (*e.g.*, limitations of landlord's liability, sublease profit sharing, limitations on tenants' remedies and rights to rent abatement and self-help, etc.). Tenants simply did not want to risk negotiating the landlord's standard form lease provisions for fear of losing the scarce space.

Even so, this new tenant class introduced a new set of lease issues for landlords to consider and attempt to guard against, such as minimal or no credit to back the lease obligations; cash flow problems; extensive, customized tenant build-outs for technology tenants; and high density in the leased premises as tenants expanded rapidly. Based on their continuing experience with these types of tenants, landlords modified their form leases accordingly. For instance, landlords began taking large letters of credit and other securities (*i.e.*, warrants and stock options) in lieu of cash to secure the tenant's obligations under the lease, and began restricting the amount of power and heating/ventilation services that a tenant could consume in its premises.

In reaction to this sudden and extensive demand toward the late 1990s, landlords again engaged in a new round of construction of new rental office space as they had done in the late 1980s. As we know all too well, this newfound demand disappeared as quickly as it arrived as a result of the dot-com meltdown of early 2000-2001. In certain submarkets, skyrocketing

vacancy rates were the rule of the day, which once again leveled the playing field between landlords and tenants. However, while landlords were willing to be very flexible on rental rates and other economic terms during this period, having learned from past experience, they were reluctant to over-negotiate their form leases.

The 25th anniversary of the Real Property Law Section of the State Bar of California finds the cycle continuing with the economy having strengthened and new buildings being constructed for office space once again. Job growth and expanding service firms are picking up a great deal of the rental real estate inventory, providing a new cure for oversupply of office space. In addition, in certain areas inventory is being further reduced due to the permanent removal of office space through conversion to condominium and rental housing. We, therefore, currently find ourselves in a healthy market for both landlords and tenants, where neither side is experiencing dominant position in the market.

Every provision in the typical commercial office lease has evolved dramatically over the last 25 years, and a comprehensive discussion of such issues would fill up a multi-volume treatise. The following is merely a summary of a handful of the major issues and terms of commercial leases that have evolved during that period, most of which have been covered in more depth by articles previously published in *California Real Property Journal*.

II. SELECTED LEASE PROVISIONS THAT HAVE SUBSTANTIALLY EVOLVED OVER THE LAST 25 YEARS

A. Assignment and Subletting

1. *General Background*

Over the last 25 years, assignment and subletting provisions have become one of the biggest hot buttons in commercial leasing. This is due in part to the fluctuating, yet cyclical, real estate market and attendant respective landlord and tenant interests. Prior to 1985, the law in California provided that, in the absence of a standard of consent for a landlord, the landlord could be as arbitrary as it wanted when reviewing a transfer request.[1] Most practitioners of the time then believed that lease transfer restrictions would be enforced in accordance with their express terms, whether that was a standard of reasonableness, or the landlord's sole and absolute discretion; however, this belief would soon be altered due in part to a falling demand for leased property and a need of tenants to alienate their leasehold interests.[2]

In 1985, following a string of similar appellate decisions,[3] the California Supreme Court decided *Kendall v. Ernest Pestana, Inc.*,[4] a case that would forever change the face of transfer provisions in commercial leases. *Kendall* held that, where a lease restricts tenant's transfer of the lease to an assignee or sublessee without the prior consent of the landlord, but does not provide for a standard of consent, the landlord may refuse consent only if there is a "commercially reasonable objection."[5] The Supreme Court based its decision in *Kendall* on two factors: (i) the long-standing California policy against unreasonable restraints on alienation, which is codified as Section 711 of the California Civil Code; and (ii) the duty of good faith and fair dealing, which is implied in every contract under California law.[6] The decision was further based on a remedy afforded to landlords in the event of a defaulting tenant—Section 1951.4 of the Civil Code. Section 1951.4 permits the landlord in a commercial lease to keep the lease in effect (even after tenant breach and tenant abandonment), and to sue for rent owing under the lease as it becomes due. This "lock-in" remedy, which pre-dates *Kendall*, is available only "if the lease permits the tenant to sublet, assign, or both, subject only to *reasonable* limitations."[7]

After *Kendall* it was clear that prior majority rule, interpreting silent transfer consent standards in landlords' favor, was replaced with an implied standard of reasonableness where the lease was otherwise silent as to the standard of consent required. In doing so, however, the decision in *Kendall* left some questions in the minds of landlords; specifically, could a landlord explicitly contract for a sole discretion standard in a transfer consent context?

These questions and additional case law led to the adoption of Senate Bill 536 by the California legislature.[8] Senate Bill 536 created Sections 1995.010 through 1995.270 of the California Civil Code, which attempts to reach a compromise between the pro-landlord doctrines that had applied prior to the *Kendall* case, and the pro-tenant rules created by *Kendall*.[9] The statutory scheme rejects *Kendall* and embodies the principal that parties to a commercial lease should be able to strike their own bargain concerning the transfer of such commercial leases.

This scheme, combined with Section 1951.4, states, in so many words, that explicit restrictions on transfer in a commercial lease should be enforceable (notwithstanding the fact that certain remedies and rights may be forfeited). Specifically, the new laws provide, among other things, that: (i) a lease without any transfer provision would be held freely transferable;[10] (ii) a lease may absolutely prohibit transfer or make transfer subject to an express standard of consent;[11] and (iii) the *Kendall* holding would apply to all leases that provide for landlord consent, but do not give a standard for such consent, executed after September 23, 1983.

The foregoing expansion, explanation, and codification of *Kendall*, combined with the standard of reasonableness required for a landlord to utilize Section 1951.4 of the Civil Code, made for some interesting expansions to an already lengthy transfer provision in most commercial leases. If reasonableness is the express or, in most cases implied standard for landlord consent, then what is reasonable? What should happen in an upwardly mobile leasing market to "profits" from a transfer? Are there any alternatives to being reasonable?

2. *Grounds for Landlords' Withholding of Consent—What is Reasonable?*

Neither *Kendall*, nor Sections 1995.010 through 1995.340 of the California Civil Code, conclusively indicates which factors should be or will be considered in determining whether a landlord's consent is being withheld "reasonably," except to state that reasonableness is a question of fact for which the tenant (not the landlord) has the burden of proof.[12] *Kendall* set forth, in dicta, that some factors a court should consider are financial responsibility of the transferee (compared to that of the transferor), the legality and suitability of the proposed new use, the need for any alterations associated with the transfer, and the nature of the occupancy; however, none of these were codified by the

California legislature.[13] In addition, the following factors have also been accepted by the courts in California as "reasonable": (i) the landlord's desire to avoid competition from a transferee;[14] and (ii) the transferee's inability to generate the same percentage rent as the existing tenant.[15] Accordingly, whether a particular objection was reasonable or not depends on the objective facts and circumstances of each case.[16]

Rather than rely on such a tenuous standard, many landlords and tenants in today's leasing world explicitly set forth factors of reasonableness in the lease. The statutory scheme set forth in Section 1995.010, *et seq*. essentially states that "explicit restrictions are reasonable."[17] By setting forth explicit standards of reasonableness, the landlord benefits in several ways. First, it undercuts the tenant's ability to claim at the time of a proposed transfer that a particular standard is unreasonable for the landlord to consider. Second, if a dispute occurs as to the reasonableness of denial of consent, a court is more likely to determine that a factor is reasonable if the parties specifically bargained for it in the lease. Last, explicit standards are presumed to be reasonable for purposes of determining whether the landlord is entitled to exercise the remedy set forth in Section 1951.4 of the Civil Code.[18] Tenants also benefit by knowing that if their proposed transfer meets the criterion set forth in the lease, it will be approved or the landlord will be in breach.

Consequently, the prudent leasing professional will want to set forth, as explicitly (tenant) or as broadly (landlord) as possible, the standards for reasonableness in the lease. The cases cited above provide guidance as to the standards of reasonableness, but really any specific standard is plausible. Section 1951.4 provides that to be reasonable, a restriction must be reasonable "on paper" and at the time of the requested transfer in light of the facts at the time.[19]

3. The Right to Share in Transfer Premiums

Another question left in the "reasonableness" wake of *Kendall* and the California legislature's interpretation of the decision is the handling of profits (or "transfer premiums") generated by a transfer. In the most basic sense, transfer premiums are generated from a transfer when the rent charged to the transferee by the tenant exceeds the rent paid by the tenant to the landlord. This often occurs in a rising rental market, especially with a lease that is longer and did not have adequate rent increases.

From a tenant's perspective, these transfer premiums should go entirely to the tenant under the logic that the landlord must live with the bargain it made when it entered into the lease.[20] If the tenant were to transfer the lease at a rent lower than tenant's liability thereunder, the landlord would not be affected because tenant would remain liable under the lease and would carry the shortcoming, so the logic follows that the tenant should keep any increase as well.[21] At the same time, landlords are increasingly negotiating a portion of the transfer premium for themselves, which may be nothing more than a self-awarded justification for having to be reasonable in its consideration of proposed transfers, but are these "excess rents" clauses themselves "reasonable?" The *Kendall* decision specifically approved the use of excess rents clauses, as did Section 1995.240 of the new statutory scheme.[22]

The problem arises with respect to Section 1951.4 of the Civil Code, the landlord's so-called "lock-in" remedy. An attorney including such a provision in a lease, even though seemingly enforceable in a transfer context, may nonetheless forgo one of the landlord's most powerful remedies by its inclusion. This is complicated by the fact that the Law Revision Commission's comments to Section 1995.260 seem to suggest that some "excess rent" clauses, but not all are reasonable, yet no guidelines have been offered to suggest which.[23]

As a result, most landlords will often split a percentage of the transfer premiums with their tenants in an effort to make the provisions seem more "reasonable" for purposes of Section 1951.4. What ends up happening is that the parties dispute the percentages and what should be included and excluded from the "transfer premium." The general trend recently has been to split transfer premiums evenly in half, and define transfer premiums as those sums actually received by the tenant, over what is being paid as base rent in the lease.[24]

4. Landlord's Right of Recapture

Landlords have been typically requiring a right to recapture, that is, the right to terminate a lease in response to a tenant's request to transfer the same, in response the standard of reasonableness inflicted upon them with respect to lease transfers. This "right" of recapture was called into question in the late 1980s and early 1990s as an unreasonable restraint on alienation and transfer by the case of *Carma Developers (Cal.) Inc. v. Marathon Dev. Cal., Inc*.[25] The initial decision handed down by the California Court of Appeal held that such clauses were unreasonable restraints on alienation, a violation of the covenant of good faith and fair dealing, and void as a matter of law.[26] In making its decision, the Court of Appeal cited *Kendall* numerous times and precedent for abolishing this landlord right.

Nevertheless, in 1992 the California Supreme Court overturned the Court of Appeal in *Carma Developers*, and ruled that a commercial lease may provide expressly that the landlord has the right to terminate the lease upon any assignment, sublease or other transfer of the lease and this absolute "prohibition" is enforceable, may be exercised without commercially reasonable justification, and is not an unreasonable restraint on alienation.[27] Moreover, the *Carma Developers* decision held that the landlord's termination of the lease for financial gain was not a breach of the covenant of good faith and fair dealing because it had been negotiated by the parties and expressly set forth in the lease as permissible.[28]

B. Management and Allocation of Risk Provisions

1. General Background

Like lease transfer provisions over the last 25 years, the portions of the typical commercial office lease addressing insurance, indemnification and exculpation have gone from a couple of paragraphs to a large portion of the lease. The increasingly litigious atmosphere in the United States (and particularly in California) over the last 25 years, coupled with some very significant casualty events (the Loma Prieta and Northridge earthquakes and the terrorist attacks of September 11, 2001), has had a significant impact on the risk management policies of many landlords and tenants. As landlords and tenants have

become more sophisticated in their risk management policies for their respective businesses, these policies have been reflected in their leases.

The common goal for sophisticated landlords and tenants in risk management has been tri-fold. First, the parties want to eliminate, or at least minimize liabilities. Next, the parties must allocate risk. Finally, the parties must agree on what insurance coverages will be carried to cover assumed risks.

2. Minimizing Liabilities—Use Restrictions, Exculpation, and Similar Provisions

California's statutory scheme[29] and case law have exposed landlords to liability to third parties for conditions at their buildings, even if those conditions were not the result of the landlord's actions. Over the last 25 years, landlords have been found increasingly liable to non-tenant third parties for dangerous conditions at their property created by their tenants where courts have determined that the landlord *should* have known that the dangerous condition existed.[30] As a result, landlords have attempted to retain a certain level of control over what occurs in a tenant's leased premises by adding a number restrictions and reserved rights in their form leases.

In order to minimize the probability of accidents resulting from dangerous conditions within a tenant's premises, the standard use provisions of leases have been lengthened to not only discuss what types of businesses the tenants may conduct within the premises, but also to detail what activities a tenant may not perform at its premises (*e.g.* activities that involve an above average risk for property damage or bodily injury).[31] In addition to protecting the landlord from potential liability for dangerous conditions at the building, restrictive use provisions also ensure that the insurance premiums of a typical office building landlord will not increase as the result of a tenant engaging in a "high risk" type activity in the premises (*e.g.*, a use that involves numerous third party invitees entering the premises, such as for training or retail purposes).

Another way that landlords have retained the right to restrict activities within the building and a tenant's premises is by developing detailed (and often exhaustive) "rules and regulations," which are often attached as exhibits to the leases, making the leases even longer. The rules and regulations will typically delve into the minutia of every aspect of using the premises, from establishment of building hours to the types of food that may be cooked in the tenant's cafeteria. While many attorneys may view the rules and regulations as unnecessary boilerplate that is not worthy of review, landlords can often find detailed rules and regulations a valuable tool (especially in a multi-tenant setting) for having a smoothly-run building. As an added benefit, the reserved right of the landlord to change the rules and regulations following lease execution allows the landlord to essentially modify a tenant's lease to take into account circumstances that change during the term of the lease.

In addition to claims from non-tenant third parties, landlords have increasingly found themselves defending lawsuits from their tenants when a casualty or accident occurs at the property, even in instances where it is not readily apparent that the landlord's acts or omissions directly caused the damage or injury. In order to protect themselves from this liability, landlords have developed elaborate exculpation and limitation of liability provisions in their leases. In many cases, landlords have been a bit overzealous in crafting their exculpation provisions to the point that the scope of the exculpation provision extends beyond what is allowed under California law. For instance, many commercial leases exculpate a landlord for everything other than damages resulting from the landlord's gross negligence or willful misconduct. However, California Civil Code Section 1668 provides: "All contracts which have for their object, directly or indirectly, to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law."[32]

Therefore, if the damage is the result of a condition that is in violation of an applicable law, even if the landlord was not negligent at all, a court may invalidate the exculpatory clause. For instance, recently the court in *Capri v. L.A. Fitness Int'l, LLC*,[33] found an exculpation provision invalid because the subject injury was the result of mildew accumulation surrounding a pool drain, which was in violation of an obscure provision of the California Health and Safety Code. Still, as a general rule, exculpatory clauses will be upheld in California (so long, of course, as they don't violate Civil Code Section 1668). That being said, landlords should at least entertain a tenant's comments with respect to exculpatory provisions for fear that a court will view such provisions as a contract of adhesion.

In the wake of the September 11, 2001, terrorist attacks, landlords have also begun to address limiting their responsibility for providing security at the building and increasing (or at least more specifically addressing) the obligations of the tenants to secure their premises and keep track of those entering the premises. In their form leases, most landlords have specifically stated that they are not responsible for security breaches at the property. At the same time, landlords have instituted numerous additional security measures post-9/11 to restrict access to the building, including the use of card keys to access both the building lobby areas and the tenant's premises. Tenants are, in turn, charged with keeping an accurate list of the personnel to whom access cards are provided.[34]

The final way that landlords have attempted to minimize their risk in commercial office leases is to limit their liability even in situations where they have not been exculpated, which is accomplished in three ways. First, landlords have increasingly limited the types of damages that a tenant may seek. For instance, consequential damages and claims with respect to lost profits or business opportunities are routinely waived in commercial office leases. One should ensure, though, that these waivers are absolute (as opposed to being conditioned landlord's negligence or some other standard of care). Second, landlords have added provisions clarifying that in no instance is any constituent shareholder, member or limited partner of the landlord liable for any matter under the lease. Finally, landlords have added provisions to their leases limiting their liability to their interests in the subject building.[35] However, given that most buildings in this day and age are held in single asset entities (as required by their securitized loans), this last protection may no longer be of much utility to many landlords.

3. *Allocation of Risk Through Indemnities*

In most office leases, risks are allocated among the landlord and tenant through the use of indemnification provisions. Most office leases provide that the tenant must indemnify the landlord for any damage or injury occurring within the leased premises from any cause whatsoever (unless such damage or injury was the result of the landlord's negligence) or occurring at the portions of the property other than the premises as a result of the tenant's negligence. Depending on the market, tenants have also been able to receive indemnities from landlords with respect to damages occurring at the property as a result of the landlord's negligence. Due to California cases that have been decided over the years spreading liability on to certain other designated parties, these indemnification provisions have grown to include a laundry list of indemnitees such as property managers,[36] lenders, constituent owners, and agents.

4. *Insurance*

The final step in the risk allocation process is carrying insurance to cover the risks assumed by each party in order to shift any losses to the insurance carriers for the parties. As the insurance industry has evolved over the last 25 years to include many new types of insurance coverages and landlords have retained risk management experts to advise them on which coverages to carry and also which coverages that their tenants should carry, the insurance provisions of most standard, form office leases have become incredibly detailed. Even for experienced real estate lawyers, these provisions can sometimes be extremely confusing as the provisions include insurance industry terms of art that require an extensive knowledge technical insurance issues to understand. As a result, many attorneys and their clients give little consideration to analyzing and negotiating the insurance provisions of the lease, and this can be a big mistake since the insurance provisions have a far reaching effect on the rest of the lease (*e.g.*, insurance issues shape the use clause, the operating expense clause, the indemnity and exculpation provisions, and the casualty provisions, among others).

Landlords have a vested interest in ensuring that their tenant carry adequate insurance not only to insulate the landlord from risk of suit from a tenant, but also to ensure that in the event of an accident or casualty, their tenants will not go out of business. One of the main problems with many form leases is that, in an abundance of caution on the part of the landlord wishing to ensure that a tenant is carrying every conceivable type of insurance (as drafted in many form leases), the landlord and tenant often carry duplicative insurance. Due to the complexity of the typical insurance provisions in sophisticated commercial office leases, the requirement in many form leases for duplicative insurance is inadvertently overlooked by many practitioners. For instance, many form leases require a tenant to carry insurance on all leasehold improvements within the premises. Nevertheless, as part of their property insurance for the building, landlords often also carry insurance on the leasehold improvements (especially improvements that either the landlord has performed to prepare the premises for occupancy or for which the landlord has provided an allowance). The end result is that the tenant is paying for the same coverage twice (directly to its own carrier and through its payment of a portion of the landlord's insurance premiums through operating expenses).

Another recent trend surrounding insurance clauses in commercial leases is that, in reaction to the Northridge and Loma Prieta earthquakes, the 9/11 terrorist attacks, and recent flooding in New Orleans, many landlords have become increasingly concerned with providing rent abatements, providing indemnities to tenants, or waiving claims against tenants for property damage or injury where the tenant was at fault. While in theory a landlord that tightens up its lease may be viewed as simply protecting itself from occurrences beyond its control and shifting risk of accident or injury to its tenants, this approach is misguided. The first goal of the insurance provisions of the lease should be to provide an adequate, but non-duplicative, insurance program for the landlord and tenant. When dealing with a large, sophisticated tenant, the landlord should be willing to take a tenant's existing insurance program into account when negotiating the lease's insurance provisions so as to avoid duplication. The other main goal of the insurance provisions of the lease should be to shift risk, to the extent possible, to the respective insurance carriers rather than to the tenant.

This means landlords should always waive claims against their tenants with respect to property damage to the extent such damage is insured (this is typically accomplished in the waiver of subrogation provision), even where the tenant is arguably at fault for the damage (*e.g.*, the tenant caused a fire that burned down the building). In addition, landlords should not be hesitant to provide tenants with rent abatement rights to the extent of rental loss insurance that is recovered by the landlord. This not only applies to casualties occurring at the building, but as landlords are increasingly carrying insurance for off-premises services coverage in the wake of 9/11, this should also apply to interruptions in services under the utilities provision of the lease.

By including insurance as the final step of the risk allocation process described in this section, the authors are by no means encouraging practitioners to treat the insurance provisions of the commercial office lease as an afterthought. In today's current market, with the wide array of insurance coverages that are available (and are often carried by both the landlord and the tenant) and the multitude of risks faced by landlords and tenants, the insurance provisions of all commercial office leases require and deserve a great amount of attention.[37]

C. Compliance with Laws

In addition to the repair provisions typically contained in commercial leases with respect to the leased premises, virtually every commercial lease prepared today also contains a "compliance with laws" provision. These provisions usually address the tenant's obligation to perform what could be substantial and expensive replacements, alterations or improvements of the leased premises in order to comply with governmental codes and laws relating to its use and occupancy.[38] Over the past 25 years, the allocation of the costs for such compliance has become increasingly critical as additional natural and man-made health and safety hazards are discovered and improvements in design and construction are revealed.[39] The difficulty with such provisions is that, without more specific language, a tenant's covenant

to "comply with all laws and applicable orders" does not obligate a tenant for structural or substantial repair.[40]

With the passage of the Americans with Disabilities Act of 1990 ("ADA"), the strong push for removal of asbestos and similar hazardous building materials from public buildings, and new earthquake retrofitting laws were enacted, the compliance with laws provisions grew substantially in size and substantially more complex. In response to these new considerations, all of which could be extremely costly in terms of their compliance, the California Supreme Court attempted to clear up the responsibilities of landlords and tenants in terms of compliance with laws provisions. Unfortunately, in two cases decided contemporaneously, on similar facts and similar lease provisions, the Court reached two different conclusions and in doing so, further complicated the drafting of compliance provisions and the allocation of responsibilities thereunder.[41]

1. Pre-1994—The Sewell Case.

Prior to 1994, the California Supreme Court had essentially established a two-tiered process for interpreting which party, landlord or tenant, would bear financial responsibility for making the leased premises compliant with relevant codes and applicable laws.[42] The general rule, put forth in *Glenn R. Sewell Sheet Metal, Inc. v. Loverde,*[43] was that a common covenant by the tenant to "comply with laws" did not, absent something more, obligate a tenant for structural or "substantial" work. There were however, two exceptions to the *Sewell* general rule whereby tenants would be responsible for structural or significant work. First, a tenant who voluntarily subjects the leased premises to a different use than that contemplated in the lease documents shall be required to comply with all laws applicable to that use, regardless of whether or not said compliance requires structural or "substantial" work.[44] Second, a tenant who, pursuant to the express terms of the lease, obligates itself to make such structural or "substantial" repairs/changes to the leased premises to comply with any and all applicable laws.[45]

The latter of these exceptions has given rise to lengthy compliance with laws provisions in order to shift the burden from landlord to tenant. This is especially so in that the *Sewell* case held that tenant could assume the obligation for structural or significant repairs to the leased premises even if the particular compliance with laws provision did not mention "substantial" or "structural" work as a requirement. In rendering its opinion, the Court in *Sewell* casually discussed a six-part "intent of the parties" test that courts in California often used when determining whether or not parties had assumed certain risks, though the test was never applied by the *Sewell* court because it determined that the tenant in *Sewell* had changed the use of the premises from that contemplated at the time of the lease and was therefore obligated to make the requested repairs under the first exception to the "general rule" set forth above.[46] The six factors were converted to an actual "test" by the California Supreme Court in 1994 and are discussed in the following subsection.

Up until 1994, California courts had applied the *Sewell* two-tiered approach, considering the six factors set forth above when it appeared that the tenant had undertaken to comply with all laws, including those requiring significant and/or structural repairs and alterations. With the discovery of asbestos, the enforcement of the ADA, and earthquake retrofitting in California, these allocations of cost drafted under *Sewell* were starting to be litigated as the costs for such repairs were elevating on an exponential basis. Finally in 1994, two such cases (one dealing with asbestos removal and the other with earthquake retrofitting) would reach the California Supreme Court. However, the results were anything but consistent.

2. 1994—The Brown and Hadian Cases

In 1994 the California Supreme Court decided the companion cases of *Brown v. Green* and *Hadian v. Schwartz*.[47] The *Brown* case involved the question of whether or not the tenant was required to complete and pay for asbestos abatement, whereas the *Hadian* case involved a similar question related to earthquake retrofitting of the subject building. In both cases, the courts of appeal had applied the six factors considered in *Sewell* and determined that the respective tenant therein had voluntarily intended to undertake the asbestos/earthquake compliance.

The Supreme Court objected to the automatic application of Sewell in each instance of a compliance with laws determination stating that its opinion in that case was "apt to be misinterpreted."[48] The Supreme Court argued instead for a case-by-case inquiry into the facts and intentions of the parties when preparing the lease.[49] In both *Brown* and *Hadian*, the Supreme Court found ambiguities in the responsible party with respect to compliance with law obligations.[50] In both *Brown* and *Hadian*, the tenants' use of the leased property was outside the literal scope of the compliance with laws clause, and therefore, to the Court, it was unclear how the parties intended to allocate the risk of compliance with respect to government orders arising from property conditions unrelated to a particular use by the tenant.[51] To resolve the ambiguity, the Court applied the six factors for determining allocation of risk that it had previously set forth in a footnote in *Sewell*, calling the factors and method of determination "bedrock law."

The *Brown* six-factor "intent test" consists of the following considerations: (i) the relationship of the cost of the repair/alteration to the amount of rent paid by the tenant (the more the cost of rent, the more it appears that the parties intended to allocate cost to the tenant); (ii) the term of the lease (the longer the term, the more likely compliance was allocated to tenant); (iii) the comparison of benefit of the repair/alteration to the tenant versus the landlord (*i.e.*, who will receive the most benefit for the longest period of time—if tenant, most likely the costs of compliance were allocated to tenant); (iv) whether or not the repair or alteration is structural in nature (the more structural in nature, the more likely allocated to landlord unless tenant is a single tenant in control of the entire structure); (v) the degree to which the repair/alteration will interfere with or enhance the tenant's enjoyment of the leased premises (the more likely to interfere, the more likely the parties would allocate such cost to the landlord); and (vi) the likelihood that the parties contemplated the particular law or code for which the repair/alteration was necessary.[52]

The Court in *Brown* went on to conclude that, with regard to the lease at issue therein, and given the terms of the lease in light of the six-factor "intent test," the parties intended that the tenant would assume the burden of compliance with the abatement order. Nevertheless, in *Hadian*, the Supreme Court found for the landlord on albeit similar compliance with laws provi-

sions. The court of appeal therein had determined that tenant was required to comply and pay for necessary earthquake retrofitting because of a covenant in the lease which obligated the tenant to assume the duty of keeping the building in repair and comply with all applicable laws.[53] Based on the *Brown* six-factor intent test, the Supreme Court reversed citing a three-year lease (the Brown lease was fifteen) and a smaller monthly rent than that in *Brown*.[54] Aware of its distinct decision, the Court stated, "[t]he means by which we reach such a diametrically opposite conclusion illuminates the process by which courts ferret out the likely intent of the parties and arrive at a reasonable construction of their agreement in cases such as this."[55]

3. So Where Are We Now?

In the wake of *Brown* and *Hadian,* one thing is clear: there is no black-and-white answer for the question of which party will bear the financial responsibility for compliance with law provisions in a commercial lease. The best the parties can do is attempt to negotiate their respective obligations under the lease and to accurately set forth those obligations in the lease document in hopes that, if there is an unexpected ordinance or code that requires an expensive compliance, which neither of the parties is willing to undertake, the courts will be able to ferret out which party undertook the obligation at the time of bargaining. The *Brown* six-factor intent test should be in the mind of every leasing practitioner when negotiating such a provision.

D. Letters of Credit as Security

The tech boom of the late 1990s had many interesting impacts on how leases were structured.[56] For instance, landlords were taking equity interests in their tenants in the form of warrants (in order to provide cash-strapped tenants with alternate means to paying rent consideration other than cash) and tenant improvement allowances were structured as loans from the landlord to the tenant (in order to avoid the landlord's cap on lease damages in bankruptcy). However, the main trend that emerged from this era was landlords taking letters of credit as security for a tenant's obligations under the lease, which provided advantages to both tenants and landlords. Unfortunately though, due to changes in case law and the market, many of the advantages of letters of credit have deteriorated in recent years.

The popularity of the letter of credit for use in leases with Internet, software, and other technology-based tenants was the result of certain advantages the letter of credit provided to both the tenant and the landlord. Many high-tech tenants that entered the lease market in the late 1990s had little, if any, track record or cash on hand. As a result, landlords were demanding fairly substantial security deposits from these tenants. Of course, this requirement exacerbated the tenant's cash flow crunch. By having a bank issue the letter of credit, the tenant could post a security deposit without actually losing the use of a substantial amount of its cash on hand. For landlords, the use of the letter of credit provided advantages in the context of circumventing the landlord's cap of lease rejection claims in bankruptcy under Section 502(b)(6) of the Bankruptcy Code.[57] Section 502(b)(6) essentially limits a landlord's damages in bankruptcy to one year's rent (although, if the term of the lease is seven years or longer, depending on the court's application and interpretation of Section 502(b)(6), the damages may exceed one year's rent).[58] However, under the theory that the obligation to pay under the letter of credit is the obligation of the issuing bank rather than the obligation of the tenant, courts did not view amounts recovered by a landlord under a letter of credit as being applied to the capped amount that could be received by the landlord under Section 502(b)(6). Therefore, if the amount of the security deposit exceeded one year's rent, the letter of credit afforded the landlord a substantial benefit. In addition to circumventing the cap, the use of the letter of credit allows the landlord to collect on its security without going to the bankruptcy court and getting relief from the automatic stay.

When the dot-com bust occurred, many landlords drew on the letters of credit, resulting in financial distress for many banks. As a result, most banks began requiring (if they had not already) that tenant's post security with the banks for the issuance of the letter of credit, sometimes up to the full amount of the letter of credit. Therefore, for certain tenants (usually the ones with the least financial wherewithal), the letter of credit is now actually less favorable than a cash security deposit, because they have to post the full amount of cash with bank plus pay the bank a fee to issue the letter of credit. Similarly, for landlords the letter of credit lost some of its appeal as a result of recent case law holding that where a letter of credit is secured by the assets of a tenant's bankruptcy estate, draws on a letter of credit would reduce the allowed claim under Section 502(b)(6).[59] That being said, this area of the law is still in flux, so it is unclear right now whether letters of credit will be able to maintain their desirability vis-à-vis cash security deposits in the coming years.

E. Common Area Maintenance Charges

As rents have risen dramatically over the last 25 years, the costs incurred by companies with respect to their space leases have become a significant portion of their overall budget. In addition, many of the office leases over the last 25 years shifted to a net lease, where operating expense exclusions became evermore important to negotiate. This has led to increasing scrutiny with respect to those portions of the lease that subject tenants to additional rent obligations, most obviously the common area maintenance charges (or operating expenses) that tenants pay on a monthly basis. There are two central issues surrounding these provisions in the present standard day commercial office lease: (i) what items are either specifically included or excluded from the definition of operating expenses; and (ii) what audit rights, if any, are provided to the tenant so that the tenant can confirm that the additional rent bill it is paying accurately reflects the agreed upon provisions of the lease.

The most dramatic areas of growth in the additional rent arena involved detailed descriptions of operating expense inclusions and very lengthy lists of operating expense exclusions. For scholarly debate, nothing has given leasing attorneys more fertile ground for argument than the issue of which kinds of capital expenditures, if any, could be expensed in a single lease year. The language has now settled down, and now basically two kinds of capital expenditures are being accepted by tenants for pass-through—the amortization of the cost of: (i) capital equipment, which would, by its efficiency, result in a savings equal to the cost of the equipment; and (ii) responding to changes in the law, following the date of execution of the lease, requiring

capital expenditures, with such amortization being at reasonable interest rates and over its useful life.

In addition to battles over which types of capital expenditures can be passed through, many large, sophisticated tenants have developed multi-page inserts that include dozens of operating expense exclusions, many of which are very obscure exclusions that a landlord would not pass through in any event (*e.g.*, costs for political contributions). In many instances, the negotiations on these issues have taken a life of their own, to the point leaving a bad taste in the mouths of both landlords and tenants after having completed lease negotiations. The fights over common area maintenance charges are often ugly and leave landlords "offended" that tenants are implying they are crooks and tenants frustrated that landlords are not giving their otherwise reasonable operating expense exclusions proper consideration.

Along with the additional attention that has been paid to the operating expense inclusions and exclusions in commercial office leases, is the tenant's right to audit the landlord's records with respect to operating expenses. Over the last 25 years, tenants have really begun to focus on this right as being a primary concern. The rise of accounting firms and contingency-based auditing firms that will provide audit services for tenants at a reasonable price has given tenants an incentive to both negotiate then exercise audit rights. Landlords, in an attempt to protect themselves from excessive and costly audits, have added protections in their audit provisions concerning, among other things, whether auditors could be paid on a contingency basis, how long after the end of each year tenants may conduct their audits, which records tenants may review in their audits, and who pays for the audit (which is typically based on whether, and to the extent that, any inaccuracies are uncovered). Although there may be bigger fish to fry in the lease negotiation, given the tangible nature of the operating expense section, the pressure put on lease administrators within large companies to keep leasing costs down, and the watchful eyes of the accounting departments at large companies, it is likely that in the years to come more and more energy will be spent by landlords and tenants in negotiating and documenting the lease provisions concerning additional rent.[60]

F. Hazardous Substances

Although not necessarily "new" in the last 25 years, the treatment of hazardous substances in the commercial lease has grown substantially. The Comprehensive Environmental Response Compensation and Liability Act of 1980 ("CERCLA")[61] and its interpretation have fueled this increased awareness in commercial leasing. CERCLA imposes joint and several liability without fault for the costs of investigating and cleaning up hazardous substances that have been released into soil or groundwater underlying the subject parcel of property.[62] Obviously, such costs and liabilities can be astronomical in amount, and it is therefore of utmost importance that parties to a real estate transaction think about and properly delegate the party that will bear the responsibility for hazardous substance clean-up/remediation.

Both landlords and tenants are potentially responsible for hazardous substances remediation under CERCLA—the landlord as the owner and the tenant as the operator of the property.[63] As such, both are responsible for the associated costs of such remediation; however, either may avail itself of three possible defenses as "responsible parties." If either landlord or tenant can show that the release of the subject hazardous substance was an act of God, an act of war, or caused by a third party, then the landlord or tenant can avoid liability and the cost of remediation under CERCLA.[64]

Of major significance in the past 25 years has been the broadening of the most utilized third-party defense in 1986 to include the so-called "innocent landlord" or "innocent purchaser" defense.[65] For a landlord to take advantage of this defense, it must show that the release of the hazardous substance in question was caused by a third party, that the landlord acquired the property after the hazardous substance in question had already been released onto the property, and that the landlord was unaware and had no reason to know at the time of acquisition that the property was contaminated.[66] This defense can be used against a past owner, past tenant, or present tenant responsible for releasing the hazardous substance prior to the landlord's acquisition of the property.

As the owner of a commercial property, the costs of hazardous materials remediation could be high if CERCLA is triggered—that is because as a present owner, unless absolved of liability under one of the defenses set forth above, all of which are construed very narrowly, the landlord will be liable for the remediation and response costs, regardless of its proportion of fault. The CERCLA defines hazardous substances very broadly, including many commonly used chemicals (including common office products like toner for copy machines). Accordingly, it is imperative for landlords in today's leasing market to minimize the risk of future contamination and shifting of the liability to those actually responsible for the release.[67] Thus, over the past 25 years, leases have become significantly more complex in risk/cost allocation for release of hazardous substances.

Because of the direct contractual relationship between a landlord and its tenant, the third-party defense cannot be utilized by a landlord against its tenant, or by a tenant against its landlord, to escape liability.[68] Nevertheless, private parties can allocate liability under CERCLA amongst themselves by contract.[69] Such contracts typically take the form of environmental indemnity agreements (often seen in commercial lending) and "hazardous substances" clauses in commercial leases. To sufficiently protect themselves, landlords must (i) ensure the proper tenant is leasing space from it, and (ii) make sure that the lease explicitly establishes the legal obligations on the part of the tenant, should a release of hazardous substance occur.

In addition to the standard "hazardous substance" clause that typically appears in most commercial leases today, landlords are also advised to look at several other sections of their form commercial leases to ensure adequate protection. Those sections include, without limitation, the definition of tenant's use of the leased premises, tenant's representations and warranties, landlord's representations and warranties, compliance with laws, indemnity (general and that relating specifically to hazardous substances), assignment, default, and limitation of liability.[70] Within these provisions, especially that of the general "hazardous substances (indemnity)" provisions, landlords should use care to state as explicitly as possible the express declaration to transfer liability for environmental contamination to the tenant.[71]

G. Work Letters and Alteration

Work Letters, the agreements typically governing the build-out of the premises and attached as exhibits to the lease ("Work Letter"), grew in the last 25 years proportionately more than any other section of a commercial lease, as base building definitions expanded and as tenants came to appreciate that a landlord allowance could be dramatically reduced by the application of the funds to elements of the improvement work which tenants reasonably believed were the obligation of the landlord. The expansion of the Work Letter was both reasonable and necessary, as practitioners focused on the fact that this portion of the lease would be reviewed not only by the representatives of the landlord and tenant, but also by the construction manager, the architect/design team, the contractors and the lenders; it is a high-profile report card on the negotiation and drafting efforts of counsel for the respective parties. Standards for determining whether the tenant caused a delay in the completion of the work of improvement evolved, and bidding requirements were injected to try to stretch the tenant improvement dollar. Every fee imaginable was tested and some survived, more with some landlords than with others.

As tenant improvement allowances grew throughout the last several decades, larger tenants, together with smaller tenants with multiple offices, ran increasingly sophisticated analyses to determine whether or not the tenant should step up and request the right to control the construction of the tenant improvements.[72]

Surrender requirements were brought into the Work Letter framework, so tenants became more and more concerned with what they could leave in the space at the end of the term and what they had to remove, with the result that the parties have come to agree on such removal requirements in advance, particularly in the alterations and surrender provisions of the modern lease.

Landlords in the late 1990s experienced a sharp upward curve in the cost and sophistication of tenant improvements as the dot-com boom entered its full stride. The dot-com bust taught landlords a significant lesson with regard to how they should structure the disbursement of a tenant improvement allowance, which has evolved into today's custom and practice of landlords requiring that tenants' contractors provide partial lien releases and ultimately full lien releases as disbursements of tenant improvement allowances, much in the tradition of the conservative construction lender, which is what a landlord is when taking into consideration the delivery of significant tenant improvement dollars. As the dot-com boom ended, however, it became clear to the landlord bar that disbursements of tenant improvement allowance dollars should be securitized, perhaps through an additional letter of credit, or perhaps with elaborate completion bond structures.

Due to an ever accelerating pace of new technical breakthroughs in telecommunications and data cabling, rendering existing telecommunications and data cabling outmoded and useless, even after a one- or two-year period, landlords began to require that tenants remove all data cabling from buildings' riser systems, and tenants responded by demanding a credit for dollars expended by a new tenant in removing the outmoded cabling of the prior tenant from the risers. No tenant wants to pay for the initial stripping of the risers of useless telecommunications and data cabling, only to find it is required by the terms of its lease to remove its own cabling at the end of its term.

III. CONCLUSION

A. Summary

As we approach 2007, it is clear that in the last 25 years, certain elements of the lease have evolved dramatically, and have grown exponentially (both in terms of the amount and quality of the provisions therein). Where commercial leasing grew the most was in the assignment and subletting provisions, where case and statutory law kept pace with expanding language; the operating expense areas where common-area maintenance charges were defined and redefined—both as to long lists of exclusions and as to sophisticated treatment of issues such as the expenditure of capital and passing-through of capital expenditures; and in the Work Letter, where commencement date and tenant improvement issues coincide, with Work Letters expanding to thirty pages or more (taking into account exhibits). The final area of most dramatic expansion has been provisions regarding hazardous substances, more with respect to industrial leases than with office leases.

B. Where Is Leasing Practice Headed in the Next 25 Years?

As case law and legislation have done for years with other commercial industries, the leasing industry will continue to evolve as statutes are passed, cases are decided interpreting those statutes, and new concerns arise. The cost of dealing with extra security due to threats of terrorism will be passed through to tenants or absorbed by landlords, although it's not clear today what the relative burdens will be as we experience further incidents of terrorism. Language has been proposed to deal with the concerns raised by the Patriot Act and language will evolve in the future to address the maturity of Sarbanes Oxley and the auditing requirements that it generates. As new areas of liability for landlords develop as a result of class action litigation and changes in statutory law (such as liability for mold related injuries[73]), landlords will continue to modify the risk management provisions of their leases, most certainly making leases longer and more landlord-favorable.

One thing is for sure: it will never be dull in the world of commercial leasing.

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ENDNOTES

[1] *Richard v. Degan & Brody, Inc.*, 181 Cal. App. 2d 289 (1960).

[2] Kenneth J. Stipanov, *Assignment and Subletting of Commercial Leases Under the New Statutory Scheme*, CAL. REAL PROP. J., Vol. 8, No. 4, 1990, at 18.

[3] *See, e.g.*, *Schweiso v. Williams*, 150 Cal. App. 3d 883 (1984); *Cohen v. Ratinoff*, 147 Cal. App. 3d 321 (1983).

[4] *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488 (1985).

[5] *See* Wiliam G. Coskran, *Lease Transfer Restraints: Must Consenting Adults be Reasonable*, CAL. REAL PROP. J., Vol. 4, No. 2, 1986, at 15.

[6] *Id.*

[7] For a thorough interpretation of *Kendall* and its ramifications, see Coskran, *supra* note 5.

[8] Stats. 1989, ch. 982 (SB 536-Beverly).

[9] *See* Stipanov, *supra* note 2, at 19-21.

[10] *Id.*

[11] *Id.*

[12] Cal. Civ. Code § 1995.260.

[13] Coskran, *supra* note 5, at 18-19; *Kendall*, 40 Cal. 3d at 502; *see also Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 330 (1983).

[14] *See Pay 'N Pak Stores, Inc. v. Superior Court*, 210 Cal. App. 3d 1404, 1409 (1989).

[15] *See John Hogan Enter. v. Kellogg*, 187 Cal. App. 3d 589, 592 (1986).

[16] Cal. Civ. Code § 1995.260.

[17] *See* Stipanov, supra note 2, at 20.

[18] OFFICE LEASING: DRAFTING & NEGOTIATING THE LEASE, *Assignment & Subletting* §§ 24.6, 24.7 (C.E.B. 2005).

[19] Stipanov, *supra* note 2, at 21

[20] OFFICE LEASING, *supra* note 17 § 24.28.

[21] *Id.*

[22] *Kendall*, 40 Cal. 3d at 505, n. 17.

[23] Stipanov, *supra* note 2, at 22.

[24] OFFICE LEASING, *supra* note 17 § 24.30.

[25] 2 Cal. 4th 342 (1992).

[26] *Carma Developers (Cal.), Inc. v. Marathon Dev. California, Inc.*, 211 Cal. App. 3d 1360 (1989).

[27] *Carma Developers*, 2 Cal. 4th at 356.

[28] OFFICE LEASING, *supra* note 17 § 24.37.

[29] *See* Cal. Civ. Code § 1714.

[30] *See Portillo v. Aiassa,* 27 Cal. App. 4th 1128 (1994) and *Lopez v. Superior Court,* 45 Cal. App. 4th 705 (1996).

[31] For a detailed analysis of permissible restrictions on use, see Timothy S. Williams & Michael P. Fink, *California's New Legislation Regarding Use Restrictions in Commercial Leases: Can Commercial Landlords Just Say No?*, CAL. REAL PROP. J., Vol. 10, No. 3, 1992, at 10.

[32] California Civil Code Section 1668.

[33] *Capri v. L.A. Fitness Int'l, LLC*, 136 Cal. App. 4th 1078 (2006).

[34] For a more thorough analysis on post-9/11 security measures that are being instituted by commercial landlords, *see* Richard C. Mallory, Anton N. Natsis, & Benjamin M. Birnie, *Addressing Post 9-11 Building Safety Issues in Commercial Office Leases*, CAL. REAL PROP. J., Vol. 21, No. 3, 2003, at 16.

[35] See Brad H. Nielsen & Gregory A. Clark, *Miscellaneous Lease Provisions—What You Don't Know Can Hurt You*, CAL. REAL PROP. J., Vol. 21, No. 4, 2003, at 3 (contains a discussion of the current law surrounding provisions limiting a landlord's liability in its lease).

[36] *See Burnett v. Chimney Sweep*, 123 Cal. App. 4th 1057 (2004).

[37] For a more detailed analysis on the types of coverages typically carried by commercial landlords and tenants as well as a discussion of how those coverages work, *see* John S. Worden & Joanna V. Stromberg, *What Every Real Estate Lawyer Should Know About Insurance Coverage*, CAL. REAL PROP. J., Vol. 23, No. 4, 2005, at 15. Also, for a discussion on insurance coverage in the context of constructive eviction proceedings, *see* Randy G. Gerchick, *READER ALERT: Insurance Coverage for Constructive Eviction*, CAL. REAL PROP. J., Vol. 21, No. 3, 2003, at 22-23.

[38] OFFICE LEASING, *supra* note 17 § 15.1

[39] *Id.*

[40] *See Glenn R. Sewell Sheet Metal, Inc. v. Loverde*, 70 Cal. 2d 666 (1969).

[41] *See Brown v. Green*, 8 Cal. 4th 812 (1994) and *Hadian v. Schwartz*, 8 Cal. 4th 836 (1994).

[42] *Glenn R. Sewell Sheet Metal, Inc. v. Loverde*, 70 Cal. 2d 666 (1969).

[43] 70 Cal. 2d 666 (1969).

[44] Manuel M. Fishman, *Compliance with Laws Provisions in Brown v. Green: California Supreme Court Breathes New Life Into Old Test*, CAL. REAL PROP. J, Vol. 12, No. 4, 1994, at 38.

[45] *Id.* ("The courts occasionally indicate the factors that offer insight into the probable intent of the parties such as: (1) the relationship of the cost of the curative action to the rent reserved, (2) the term for which the lease was made, (3) the relationship of the benefit to the lessee to that of the reversioner, (4) whether the curative action is structural

or non-structural in nature, (5) the degree to which the lessee's enjoyment of the premises will be interfered with while the curative action is being undertaken, and (6) [in cases involving compliance with laws or orders] the likelihood that the parties contemplated the application of the particular law or order involved.")

46 *Sewell Sheet Metal*, 70 Cal. 2d at 674, n. 10.

47 *Brown v. Green*, 8 Cal. 4th 812 (1994) and *Hadian v. Schwartz*, 8 Cal. 4th 836 (1994).

48 *Brown*, 8 Cal. 4th at 825 ("[O]ur opinion in *Sewell* is apt to be misinterpreted as one which, in the search for the parties' intent, exalts a text-bound logic over a close consideration not only of the terms of the lease but of the circumstances surrounding its making.")

49 *Id*. at 816 ("Disputes between landlords and tenants. . . do require a court presented with such a controversy not only to construe the relevant lease terms—terms that presumptively reflect the parties' intent—but to assess the result yielded by that analysis in light of established, judicially developed criteria designed to confirm the text-based conclusion that the parties agreed that the lessee would assume certain (often substantial) risks.")

50 *Id*., *see also Hadian*, 8 Cal. 4th at 845-847.

51 *Brown*, 8 Cal. 4th at 825.

52 *Id*. at 830-834.

53 *Hadian*, 8 Cal. 4th at 845-846.

54 *Id*. at 846-847.

55 *Id*. at 845.

56 For a summary on the ways deals were structured to address the unique issues presented by "dot com" tenants, *see* Anton N. Natsis, Joseph M. Davidson, & Michael S. Greger, *Structuring Deals with High-Tech Tenants: "The Good, The Bad, and The Ugly,"* Cal. Real Prop. J., Vol. 18, No. 3, 2000, at 4.

57 *See* Howard J. Weg, *Lease Rejection Claims in Bankruptcy*, Cal. Real Prop. J., Vol. 19, No. 1, 2001, at 13, and Alain M. R'bibo, *Calculating and Recovering 502(b)(6) Commercial Lease Rejection Damages in a California Bankruptcy*, 22 Cal. Real Prop. J., Vol. 22, No. 4, 2004, at 24.

58 Section 502(b)(6) of the Bankruptcy Code provides in relevant part that a landlord's claim for damages is capped at "(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."

59 *See* Jamie C. Uziel & Robert J. Sheppard, *READER ALERT: Recent Changes in California Landlord-Tenant Law*, Cal. Real Prop. J., Vol. 23, No. 3, 2005, at 25.

60 For a thorough discussion of operating expense audit issues, *see* Anton N. Natsis & Cheryl S. Prell, *The CAM Audit: Winning the Battle Without Starting a War*, Cal. Real Prop. J., Vol. 17, No. 3, 1999, at 1.

61 42 U.S.C. § 9601 *et seq*.

62 Susan M. Reid & Thomas D. Trapp, *Liability for Release of Hazardous Substances under the CERCLA: Landlord and Tenant Issues*, Cal. Real Prop. J., Vol. 6, No. 2, 1988, at 23.

63 42 U.S.C. §§ 9601(20)(A), 9607(a)(1).

64 Reid & Trapp, *supra* note 60, at 23.

65 42 U.S.C. § 9601(35)(A)(B).

66 *Id*.; *see also* Reid & Trapp, *supra* note 60, at 23.

67 *See* Reid & Trapp, *supra* note 60, at 23.

68 *See United States v. Northernaire Plating Co*., 670 F. Supp. 742, 748 (W.D. Mich. 1987); *see also* Thomas D. Trapp & Mary J. Decker, *Landlord-Tenant Liability under CERCLA: What's New?*, Cal. Real Prop. J., Vol. 14, No. 3, 1996, at 25.

69 *See e.g*., *Mobay Corp. v. Alliced Signal, Inc*., 761 F. Supp. 345, 355 (D. N.J. 1991); *Mardan Corp. v. C.G.C. Music, Ltd*., 804 F.2d 1454 (9th Cir. 1986); *see also* Trapp & Decker, *supra* note 66, at 27.

70 *See* Reid & Trapp, *supra* note 60, at 23-27 for a discussion on drafting these various provisions in light of CERCLA.

71 *See* Trapp & Decker, *supra* note 66, at 27-28.

72 For a detailed analysis of the issues to be weighed by a tenant when determining whether or not to negotiate for a tenant-build work letter, *see* Richard C. Mallory, *Controlling the Construction of Tenant Improvements in Office Leases: a Tenant's Perspective*, Cal. Real Prop. J., Vol. 16, No. 2, 1998, at 23.

73 For a thorough discussion on mold liability, *see* Robert McCormick, *The Toxic Mold Protection Act—When Will It Be Implemented?*, Cal. Real Prop. J., Vol. 20, No. 3, 2002, at 24.