

Michigan Lease Drafting and Landlord-Tenant Law

Chapter 3: Drafting Commercial Leases: Definitions and Required Provisions

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I. Overview: Drafting Commercial Leases

A. In General

§3.1 The goal of chapters 3, 4, and 5 is to provide both a practical guide for the beginning lawyer and a useful reference tool for the more seasoned drafter. Chapter 3 outlines the basic requirements for a commercial lease. Chapter 4 discusses other provisions commonly found in commercial leases. Finally, chapter 5 reviews provisions included in commercial leases in anticipation of problems between the landlord and tenant.

Commercial leases must be drafted with their common-law context firmly in mind. As artfully stated by Justice Holmes and repeated by the Michigan Court of Appeals, “we do not write on a clean slate—the law as to leases is not a matter of logic *in vacuo*; it is a matter of history that has not forgotten Lord Coke.” *Plaza Inv Co v Abel*, 8 Mich App 19, 23, 153 NW2d 379 (1967) (quoting *Gardiner v William S Butler & Co*, 245 US 603, 605 (1917)). Because Michigan’s common law incorporates that history, it is important to have a strong understanding of the caselaw as a cornerstone for drafting. These materials are intended to be state-law specific, so there is little discussion of foreign caselaw and no discussion of majority rules or trends outside of Michigan. Instead, these chapters present the cases and statutes required to address most issues that will arise during the negotiation and drafting of a commercial lease for Michigan real estate.

Each chapter section begins with sample lease clauses. Although a variety of clauses will sometimes be provided to address a single issue, these chapters do not attempt to address every possible variation or situation. Shopping center leases, for example (and particularly those for space in large regional malls), often include provisions that are specifically drawn for that context and are drafted for use across all 50 states. Although retail-oriented clauses are included in these chapters, a student of the nationally oriented shopping center lease will need to supplement their reading. It is important to keep in mind that each sample

clause represents but one of many possible solutions to a drafting problem and obviously should not be followed slavishly. Care must also be taken because defined terms have been thoroughly integrated into the sample clauses. Defined terms are usually capitalized and are often actually defined in other sections of the lease. Many of the defined terms appear in section 1 (Definitions) of the lease forms (forms 3.1, 3.2, 3.3, and 3.4).

Commentary follows the sample lease clauses. The commentary for each section begins with a statement of Michigan's common law, along with any statutory modifications. The common-law rule will typically determine the rights of the parties absent an express agreement to the contrary. However, the common law is neither static nor without ambiguity. It is always best to address the issues directly and in writing, even when the common-law rule is consistent with the desired position. The second half of the commentary is designed to connect the legal context to the sample clauses that precede the commentary.

Finally, each section of the chapter ends with a checklist. The checklist provides a tool for quick reference. The section checklists are combined into an overall leasing checklist at the end of the chapter (form 3.5).

B. The Four Basic Requirements of a Commercial Lease

§3.2 The common-law requirements for a commercial lease (or an agreement to lease) are minimal. An agreement on four basic points is required: (1) the parties, (2) the property, (3) the amount of rent to be paid, and (4) the duration of the lease. *De Bruyn Produce Co v Romero*, 202 Mich App 92, 98–99, 508 NW2d 150 (1993); *Brodsky v Allen Hayosh Indus, Inc*, 1 Mich App 591, 137 NW2d 771 (1965).

If the duration of the lease is a year or less, the agreement need not be in writing. If the duration of the lease is more than a year, the statute of frauds requires that the material terms of the lease be evidenced in a document authenticated by the landlord—traditionally by signature. MCL 566.106. A similar rule applies to agreements to lease. MCL 566.108 states that “[e]very contract for the leasing for a longer period than 1 year” must also be evidenced by a written document. The technical distinctions between a lease and an agreement to lease are explained in John G. Cameron, Jr., *Michigan Real Property Law* §20.11 (ICLE 3d ed). The statute of frauds does not, however, always require the tenant to execute the lease for it to be enforceable. *Starr v Holck*, 318 Mich 452, 28 NW2d 289 (1947). The technical requirement of a writing can often be met with something less than a fully executed lease. See *Jim-Bob, Inc v Mehling*, 178 Mich App 71, 443 NW2d 451 (1989). The question of who must sign a multiyear lease for it to be enforceable was addressed in *Rutila Props, LLC v Thumb Cellular, LLC*, No 294907 (Mich Ct App Feb 10, 2011) (unpublished). The *Thumb* court held that a landlord who seeks to enforce a long-term lease must (1) proffer a lease executed by both landlord and tenant and (2) prove that the lease had been previously delivered to tenant, but a tenant is required only to proffer a copy signed by the landlord. See the discussion in §3.9.

An important distinction must be made between a *true lease* and a *capital lease*. A *capital lease* uses the traditional lease structure and format, but in economic reality the lease performs the function of a security agreement, conditional sales contract, or financing tool.

A bankruptcy court may refuse to extend the leasehold protections of the Bankruptcy Code to such leases. In connection with the application of 11 USC 365, in particular, the bankruptcy court will examine a number of factors, including the existence of an option to purchase, in what is essentially a form-over-substance examination to determine whether the relationship is that of a true lease. *In re Lansing Clarion*, 132 BR 845 (Bankr WD Mich 1991); *see also* Lisa Sommers Gretchko, *Effect of Bankruptcy on Non-Residential Real Estate Lease*, 19 Mich Real Prop Rev 157 (1992).

C. General Drafting Principles

§3.3 Under Michigan law, a commercial lease is both a contract and a document of conveyance. Because of its mixed nature, a commercial lease is affected by both contract and property law principles. The result is a unique and often misunderstood legal relationship. An excellent discussion of the general nature of this relationship is found in 1 Milton R. Friedman, *Friedman on Leases* §1.1 (4th ed 1997). An example of this distinction is provided by the court's opinion in *Barocas v THC, Inc*, 216 Mich App 447, 549 NW2d 86 (1996). In *Barocas*, the court held that the landlord had no obligation to mitigate in an action for rent, a distinct break from the contract-law damage rule. It is clear from *Barocas* that the distinction between contract and property law continues to be honored in the leasing context. Suffice it to say that thinking of a lease simply as a contract will get one into trouble—it is a hybrid and must be dealt with accordingly. In addition to the materials in this book, the chapter on landlord-tenant law in 2 John G. Cameron, Jr., *Michigan Real Property Law* ch 20 (ICLE 3d ed), is strongly recommended.

The parties to a commercial lease are accorded broad latitude in defining their rights and obligations. *See, e.g., Kokalis v Whitehurst*, 334 Mich 477, 54 NW2d 628 (1952) (lease controls on effect of accepting money following notice of termination); *Pendill v Union Mining Co*, 64 Mich 172, 31 NW 100 (1887) (lease controls on termination and waiver of notice); *Fera v Village Plaza, Inc*, 52 Mich App 532, 218 NW2d 155 (1974) (lease controls for waiver of jury trial), *rev'd on other grounds*, 396 Mich 639, 242 NW2d 372 (1976). Unlike residential leases, Michigan law imposes few limitations on drafting commercial leases. There are certainly no statutory limitations on drafting similar to those imposed on residential leases by the Truth in Renting Act, MCL 554.631 et seq., or the Landlord and Tenant Relationships Act, MCL 554.601 et seq. The only direct statutory limitation involves self-help, a limitation that applies both to residential and commercial leases and that may not be waived. MCL 600.2918. This does not mean, however, that the parties are entirely free of drafting constraints. For example, lease provisions that violate public policy may be stricken. *Sprick v Regents of Univ of Michigan*, 43 Mich App 178, 204 NW2d 62 (1972), *aff'd*, 390 Mich 84, 210 NW2d 332 (1973). Nonetheless, only “recognized traditional contract defenses” such as duress, waiver, estoppel, fraud, and unconscionability may be used to avoid the enforcement of commercial lease provisions. *Majestic Golf, LLC v Lake Walden Country Club, Inc*, 297 Mich App 305, 326, 823 NW2d 610 (2012), *rev'd on other grounds by order*, 495 Mich 909, 840 NW2d 305 (2013).

Although there are several drafting presumptions affecting commercial leases, one is particularly unique: commercial leases are construed against the landlord unless the tenant drafted the lease. *Cinderella Theatre Co v United Detroit Theatres Corp*, 367 Mich 424, 116

NW2d 825 (1962); *Carl A Schuberg, Inc v Kroger Co*, 113 Mich App 310, 317 NW2d 606 (1982). This rule is slightly different from the contract-law presumption, which typically requires the contract to be construed against the drafter. The lease rule acknowledges that the landlord usually controls the opening move, which can include the use of a “form” lease. The landlord cannot avoid the drafting presumption by adopting a lease form prepared by a local real estate board or property owners association. *Starr v Holck*, 318 Mich 452, 459, 28 NW2d 289 (1947) (“The parties used a printed form of lease The principle is firmly established, however, that ambiguous provisions in a lease of this character must be construed against the lessor or lessors.”). Caution should be used when using a form lease. Some of the provisions may not necessarily apply and could have unintended consequences.

D. Basic Drafting Tips

§3.4 As the joke goes, “this lease *had* to be long, it covered a lot of ground.” There are a lot of very long commercial lease forms in general use and many are simply too long to be easily navigated and too bogged-down in legalese. There are things that can be done to make a lengthy lease easier to read and therefore more effective.

A way to make a long lease easier to navigate is to include a table of contents. A table of contents helps the parties move around the lease and saves time. All standard word-processing programs include tools that generate tables of contents, so this tip is relatively simple to effectuate.

The best way to make a document easier to read is to write it in plain English. This sounds easy, but it is not. It is particularly hard for real estate lawyers because we have become accustomed to writing in archaic language. Where else but in a real estate case would you find the word *usufruct* used to explain *rent*? See *Detroit Tr Co v Detroit City Serv Co*, 262 Mich 14, 247 NW2d 76 (1933). Nonetheless, leases are often enforced by the uninitiated (jurors), who will only enforce what they can read and understand. This fact must always be kept in mind: the drafter is writing for jurors, not other real estate lawyers. See §1.1 for a discussion of plain English.

Another way to make a lease easier to read is to use defined terms. Although this tip is by no means new, its importance cannot be overstated. Define as many terms as possible at the beginning of the lease. The model leases included in this chapter demonstrate how the defined terms thread their way throughout the lease. In addition to providing basic definitions, the defined terms should also set forth the essential economic deal between the parties. Although much of a lease consists of boilerplate, certain key information will inevitably vary from lease to lease. It is typically this information that is the most important to the parties. It is best to gather this information and put it at the beginning of the lease to save everybody time in finding it later.

E. The Importance of Boilerplate

§3.5 The development of a legally sound, functional form is the only cost-effective way to practice law in this area. If the parties were required to handcraft every lease, the transaction costs would drive many properties and parties out of the market. The

development of a good set of working forms is a necessary component of the leasing industry.

Because forms are necessary, much of the lease must be boilerplate. It is interesting to consider what this means and how it is viewed. The *Dictionary of Finance and Investment Terms* defines *boilerplate* as

Standard legal language, often in fine print, used in most contracts, wills, indentures, prospectuses, and other legal documents. Although what the boilerplate says is important, it rarely is subject to change by the parties to the agreement, since it is the product of years of legal experience.

John Downes & Jordan Elliot Goodman, *Dictionary of Finance and Investment Terms* 58 (5th ed 1998). This definition positively acknowledges the fact that boilerplate is the product of years of legal experience. Less flattering is the definition previously provided by *Black's*:

Language which is used commonly in documents having a definite meaning in the same context without variation; used to describe standard language in a legal document that is identical in instruments of a like nature. [*In re Estate of Pfaff*, 41 Wis2d 159, 163 NW2d 140 (1969)]. See also Adhesion contract.

Black's Law Dictionary 175 (6th ed 1990). The cross-reference to “adhesion contract” hardly puts the concept in a positive light. Although the cross-reference was dropped in the seventh edition, the point remains. *Boilerplate* is the word a court uses when it is going to rule against a party, despite the plain language of the contract. See generally *Hayward v Postma*, 31 Mich App 720, 188 NW2d 31 (1971).

The fact is that the boilerplate in the typical commercial lease has been painstakingly developed over decades of trial and error by legions of attorneys. It is the only way commercial leasing can be carried out on a cost-effective basis, and it must be honored for the leasing industry to work effectively. There is no such thing as “mere boilerplate”; the language referred to as “boilerplate” is nothing less than the agreement of the parties, evidenced by their signatures at the end of the lease. If they had wanted different language, they could have negotiated it into the agreement or refused to sign it.

This issue was addressed in *UAW-GM Human Res Ctr v KSL Recreation Corp*, 228 Mich App 486, 496 n5, 579 NW2d 411 (1998):

Would it have made any difference if the parties had included language in the contract to the effect that the merger clause here “means what it says” or that the clause was “consciously” included in the agreement or that “it is not intended to be mere boilerplate”? What can parties to a contract do to ensure that they are held only to the terms explicitly agreed to in a written agreement?

The rhetorical questions posited by Justice Markman are critical to the practice of commercial leasing in the State of Michigan. Unless the courts honor the written

agreements, as written, drafting is a fool's art and the "agreement" simply one of several "arguments" to be made to the court.

The proper function for the courts was laid out by the Michigan Court of Appeals in *G&A Inc v Nahra*, 204 Mich App 329, 330, 514 NW2d 255 (1994): "If a contract's language is clear, its construction is a question of law for the court.... When presented with a dispute, a court must determine what the parties' agreement is and enforce it." As Justice Markman wrote in *Archambo v Lawyers Title Ins Corp*, 466 Mich 402, 414, 646 NW2d 170 (2002), referring back to his opinion in *UAW-GM Human Resource Ctr*, "The parties are bound by the contract because they have chosen to be so bound." The boilerplate is the contract, nothing less. As stated by the Michigan Supreme Court, unless the contract provision violates law or one of the traditional defenses to the enforceability of a contract applies, a court must construe and apply unambiguous contract provisions as written. *Rory v Continental Ins Co*, 473 Mich 457, 461, 703 NW2d 23 (2005). "[T]he judiciary is without authority to modify unambiguous contracts or rebalance the contractual equities struck by the contracting parties because fundamental principles of contract law preclude such subjective post hoc judicial determinations of 'reasonableness' as a basis upon which courts may refuse to enforce unambiguous contractual provisions." *Id.*

F. Checklist

§3.6

- Is the agreement a lease or an agreement to lease in the future?
- Does the agreement to lease include the four basic requirements for a commercial lease (parties, property, rent, and duration)?
- Has there been a present lease of the premises?
- Does the lease include the four basic requirements for a commercial lease (parties, property, rent, and duration)?

II. Definitions

A. In General

§3.7 This section addresses the basic definitions that will be used throughout the lease. It also sets forth the parties and the basic economic terms of the agreement. Many of the terms defined in this section will be addressed in more detail in later sections of this chapter.

Sample Clauses

Gross lease definitions (single-tenant building). The following defined terms will be used throughout this Lease:

- a. Lease Date means *[effective date of agreement]*.
- b. Landlord means *[name]* or *[its / his / her / their]* successors in interest.
- c. Landlord Notice Address means *[address or addresses to which legal notices are to be delivered]*.
- d. Tenant means *[name]*.

- e. Tenant Notice Address means *[address or addresses to which legal notices are to be delivered]*.
- f. Premises means the building and land located at *[description]*, including *[description of any facilities included with the Premises, such as parking lots]*.
- g. Term means *[number]* Lease Years.
- h. Lease Year means the period beginning on *[date]*, and ending on *[date]*, of the following calendar year.
- i. Commencement Date means *[date occupancy begins]*.
- j. Expiration Date means *[date payment of rent begins]*
- k. Expiration Date means *[date on which the lease will expire]*.
- l. Rent means the Annual Base Rent and each Monthly Installment of Base Rent.
- m. Annual Base Rent means *[\$amount]*.
- n. Monthly Installment of Base Rent means *[\$amount]*.
- o. Security Deposit means *[\$amount]*.
- p. Designated Use means *[describe use]*.
- q. Building Rules means the rules established by Landlord for the Premises, the current version of which is attached as exhibit *[number / letter]*.
- r. Applicable Laws means all statutes, codes, ordinances, administrative rules, regulations, and orders or directives of any governmental authority, including environmental laws.

Net lease definitions (single-tenant building). The following defined terms will be used throughout this Lease:

- a. Lease Date means *[effective date of agreement]*.
- b. Landlord means *[name]* or *[its / his / her / their]* successors in interest.
- c. Landlord Notice Address means *[address or addresses to which legal notices are to be delivered]*.
- d. Tenant means *[name]*.
- e. Tenant Notice Address means *[address or addresses to which legal notices are to be delivered]*.
- f. Premises means the building and all land located at *[street address]*, including *[description of any facilities included with the Premises, such as parking lots]*.
- g. Term means *[number]* Lease Years.
- h. Lease Year means the period beginning on *[date]*, and ending on *[date]*, of the following calendar year.
- i. Commencement Date means *[date that rent and occupancy begin]*.
- j. Expiration Date means *[date on which the lease is to expire]*.
- k. Rent means the Annual Base Rent, each Monthly Installment of Base Rent and Additional Rent.
- l. Annual Base Rent means *[\$amount]*.
- m. Monthly Installment of Base Rent means *[\$amount]*.
- n. Additional Rent means the reimbursement of all expenses paid or incurred by Landlord in connection with the *[Premises]*, including *[Real Estate Taxes /*

Operating Expenses / Insurance / Utilities] and all other charges that may become due under the terms of this Lease.

- o. Real Estate Taxes means (i) real estate taxes; (ii) ad valorem taxes; (iii) general, special, ordinary, or extraordinary assessments; (iv) water and sewer charges; (v) taxes based on the receipt of rent, other than federal, state, and local income taxes; and (vi) any other federal, state, or local charge that may now or later be imposed, levied, or assessed against the *[Premises]*.
- p. Insurance means all insurance expenses paid or incurred by Landlord in connection with the *[Premises]*, including commercial general liability, property, fire, casualty, extended coverage, worker's compensation, elevator, boiler and machinery, war risk, or any other insurance carried in good faith by Landlord or required by Landlord's mortgagee.
- q. Utilities means all utility expenses paid or incurred by Landlord in connection with the *[Premises]*, including charges for electricity, gas, steam, water, and sewer.
- r. Security Deposit means $\$[amount]$.
- s. Designated Use means *[use]*.
- t. Applicable Laws means all statutes, codes, ordinances, administrative rules, regulations, and orders or directives of any governmental authority, including environmental laws.

Commentary

Common law and statutes. Absent defined terms within the lease, contractual language in a lease is given its ordinary, plain meaning. *G&A Inc v Nahra*, 204 Mich App 329, 514 NW2d 255 (1994). Technical or constrained constructions are avoided. *Id.* If terms are not defined in the agreement, they will be interpreted in accordance with their common usage. *Meridian Mut Ins Co v Wypij*, 226 Mich App 276, 573 NW2d 320 (1997).

With respect to industry or trade terms, even when usage is well established, the trade definitions are not controlling if only one party had reason to know of their meaning. *Schroeder v Terra Energy*, 223 Mich App 176, 565 NW2d 887 (1997) (oil and gas lease).

A general principle of contract law is that, even where such usage or custom is well established, it is not controlling if only one party meant the usage or custom to be operative and the other party had no reason to know of this interpretation. 3 Corbin, *Contracts*, § 555, p 238. The law imposes no requirement that the terms and provisions of a contract shall be the same as, or similar to, those that neighbors and trade associates of the contracting parties are accustomed to agree upon. *Id.*, § 556, p 242. Before a usage or custom of trade, otherwise affirmatively proved to exist, can be invoked to construe a contract, it first must be shown that the party against whom it is asserted knew of the usage and had reason to know that the other party assented to the words of the contract in accordance with it, or that, if the party against whom it is asserted did not know of the usage, an ordinary person in that party's position would have known of it.

Id. at 183.

Terms that are defined in an agreement will be construed as defined, regardless of their common or trade usage. *Farm Bureau Mut Ins Co v Nikkel*, 460 Mich 558, 567, 596 NW2d 915 (1999) (“we decline defendants’ invitation to discern ambiguity solely because an insured might interpret a term differently than the express definition provided in a contract”). The use of a definition section to set forth some of the basic terms of the agreement is neither deceptive nor confusing. *Id.* at 568. (“We reject the ... conclusion that placing the clause in the definition section of the policy is deceptive and confusing.”).

Tips, traps, and thoughts. The primary goals in the definition section are to eliminate ambiguities and to provide one-stop shopping for all the basic economic terms of the lease. The sample clauses establish the defined terms, include the basic economic agreement, and set forth the essential terms that are required to establish a lease (parties, property, rent, and duration). Most of the terms that are defined in this section are further refined (and others added), but the basic information is laid out in the definition section for quick reference. It may be helpful to refer to the model leases (forms 3.1, 3.2, 3.3, and 3.4) to understand how the definition section integrates into the rest of the lease.

The sample clauses draw a distinction between gross and net leases. Leases are often distinguished based on the method by which rent is determined. In a gross lease, the rent is a fixed amount. In a net lease, the tenant pays some or all the landlord’s expenses in addition to the fixed rent.

This section of commentary focuses on the following defined terms: Landlord, Landlord Notice Address, Tenant, Tenant Notice Address, and Lease Date. The other defined terms are discussed in subsequent sections of this chapter. The Premises and Rentable Area are addressed in §§3.11–3.18. Commencement Date, Lease Year, Term, and Expiration Date are addressed in §3.19. Annual Base Rent, Monthly Installments of Base Rent, Proportionate Share, Base Year, Percentage Rent, Percentage, and Gross Sales are addressed in §3.25. Security Deposit is addressed in §5.15. Designated Use and Rules and Regulations are addressed in §4.7 and §4.10.

Because identification of the parties is one of the four basic requirements of a lease, it is important to start out by identifying Landlord and Tenant. Remember that the landlord’s managing agent is not the landlord. Make sure the building owner (not the managing agent) is identified as the landlord. If the landlord or the tenant is an entity rather than an individual, make sure the lease reflects that fact. There is no reason, however, that a managing agent cannot be identified or that the managing agent’s business address cannot be used as the Landlord Notice Address, if that is where notices should be delivered.

The Landlord Notice Address and the Tenant Notice Address are the addresses to which legal notices, such as default notices or notices to quit, should be delivered. Although this information is often set forth near the end of the lease, placing the information at the beginning makes it easier to find and use. More importantly, it makes this information difficult to overlook. Given today’s technological advancements, consider using email as a form of notice. It is true that email can sometimes be sent but received by the recipient in a “junk” folder (which means it won’t be read). Consider adding an obligation to

acknowledge an email in good faith. At a minimum, it may be worthwhile to add an obligation to also send a copy by email to a party (and be sure to include email addresses as part of the notice addresses).

The Lease Date establishes the date on which the lease is signed. There is usually a lag between the Lease Date and the date on which the tenancy or rent payments begin. In the sample clauses, Commencement Date (rather than Lease Date) is used to identify the date on which occupancy begins. Rent Commencement Date is used to identify the date rent payments begin, if it is different from the Commencement Date. The Lease Date is also traditionally used for identification purposes. Leases are routinely referred to as “the Lease dated [date].” Make sure a date is inserted so that the parties will have a full name for the lease.

B. Checklist

§3.8

- Does the lease properly identify the landlord and tenant?
- If the landlord or tenant is a legal entity (corporation, partnership, limited liability company, etc.), is it properly identified as such?
- Does the lease clearly identify the addresses to which legal notices should be sent?
- Does the lease state a lease date (the effective date of the agreement)?

III. The Parties

A. In General

§3.9 This section addresses the first of the common-law requirements for a commercial lease: the parties. For a list of sample clauses that define the parties to a commercial lease, see §3.7.

Commentary

Common law and statutes. Proper identification of the parties is one of the four fundamental requirements for the creation of a lease. *De Bruyn Produce Co v Romero*, 202 Mich App 92, 98–99, 508 NW2d 150 (1993) (“In order for an agreement to be a valid lease, it must contain the names of the parties, an adequate description of the leased premises, the length of the lease term, and the amount of the rent.”); *Brodsky v Allen Hayosh Indus, Inc*, 1 Mich App 591, 137 NW2d 771 (1965).

Even where a lease identifies the parties, issues remain concerning the proper party to execute a lease. The question of who must sign a multiyear lease for it to be enforceable was addressed in *Rutila Props, LLC v Thumb Cellular, LLC*, No 294907 (Mich Ct App Feb 10, 2011) (unpublished). The *Thumb* court examined three statutes of frauds: (1) MCL 566.132, which establishes the general rule that any agreement that cannot be performed within one year must be signed by the “party to be charged”; (2) MCL 566.106, which states that no interest in lands, other than a lease for a term not exceeding one year, may be created, granted, assigned, surrendered or declared, unless in writing, signed by the party creating, granting, assigning, surrendering or declaring the same; and (3) MCL 566.108, which states

that every contract for leasing, for a longer period than one year, is void unless the contract, or some note or memorandum thereof, is in writing and signed by the party by whom it was made. According to *Thumb*, the statutory interplay affects the parties differently. If a landlord seeks to enforce a long-term lease, it must *both* proffer a lease executed by both landlord and tenant *and* prove that the lease had been previously delivered to tenant. However, if a tenant seeks to enforce such a lease, it need only proffer a copy signed by the landlord.

If the premises are owned by tenants in common, all the co-owners must be identified and sign the lease; one tenant in common cannot make a valid lease of the entire premises. *Lee v Livingston*, 143 Mich 203, 206, 106 NW 713 (1906). Moreover, a lease of such property is not “binding on the lessors except upon condition it was signed by all,” *Hagan v Moch*, 249 Mich 511, 516, 229 NW 629 (1930). Real property held by a married couple as tenants in the entireties cannot be separately alienated by lease. *Eadus v Hunter*, 249 Mich 190, 192, 228 NW 782 (1930). In the leasing context, there is no presumption of agency of a husband for a wife, and “while his agency and authority may be implied from circumstances, his authority is no more extensive in scope or longer in duration than that of any agent similarly constituted.” *Id.* at 195. However, where a spouse “admittedly knew nothing about the business and acquiesced in all of her husband’s business decisions,” the husband can be determined to have acted as the “general agent” of his spouse and therefore legally authorized to convey a leasehold without his wife’s signature on the lease. *Wentworth v Process Installations, Inc*, 122 Mich App 452, 462, 333 NW2d 78 (1983).

Tips, traps and thoughts. Because proper identification of the parties is one of the four basic requirements of a lease, it is important to start out by properly identifying the landlord and tenant. Remember that the landlord’s managing agent is not the landlord. Make sure the property owner (not the managing agent) is identified as the landlord. If a property is jointly owned, all the co-owners must execute the lease. If the landlord or the tenant is an entity rather than an individual, make sure the lease reflects that fact. Be sure to check the legal status of the entity on the Department of Licensing and Regulatory Affairs’ Business Entity Search website.

B. Checklist

§3.10 For checklist items concerning parties, see §3.8.

IV. The Premises and Common Areas

A. In General

§3.11 The first substantive challenge in every lease is to determine exactly what property is being conveyed to the tenant. This section deals with provisions of the lease that address (1) the location and size of the premises, (2) the condition of the premises, and (3) the use of the related common areas outside the premises.

B. Location and Size of the Premises

§3.12

Sample Clauses

Basic single-tenant premises. Landlord leases the Premises to Tenant. Premises means the building and land located at *[street address]*, including the parking lot located on the land.

Basic multitenant office building premises. Landlord leases the Premises to Tenant. Premises means suite *[number]* of the Building, specifically the cross-hatched area on the floor plan attached as exhibit *[number / letter]*.

Basic multitenant shopping center premises. Landlord leases the Premises to Tenant. Premises means unit *[number]* of the Shopping Center, specifically the cross-hatched area on the site plan attached as exhibit *[number / letter]*.

Premises with license for related areas. Landlord leases the Premises to Tenant. Premises means unit *[number]* of the Shopping Center, specifically the cross-hatched area on the site plan attached as exhibit *[number / letter]*. The lease of the Premises includes a nonexclusive license for reasonable use of the *[Common Areas / Parking Area / Parking Garage]*.

Exclusion from the premises (general). The exterior walls, the roof, and *[the basement / the area beneath the floor of the Premises]* are excluded from the Premises.

Exclusions from premises (restrictive). The areas beyond the interior wall surface, finished ceiling, and floor covering are excluded from the Premises. Landlord reserves the use of these areas to locate, install, maintain, repair, and replace pipes, utility lines, ducts, conduits, flues, refrigerant lines, drains, sprinkler mains and valves, access panels, wires, and structural elements. Landlord also reserves an easement through the Premises for general access to these areas.

Landlord's use of roof and walls. Landlord will have the exclusive right to use the roof of the Premises for any purpose, including (a) the erection of additional stories or other structures over the Premises; (b) the erection of temporary scaffolds and other aids to construction on the exterior of the Premises; (c) the installation, maintenance, use, or repair of pipes, ducts, conduits, wires, and all other mechanical equipment serving other parts of the *[Building / Shopping Center]*; and (d) the installation, maintenance, use, or repair of satellite and telecommunication equipment. Landlord may make any use it desires of the side or rear walls of the Premises or other structural elements of the Premises, including freestanding columns and footings for all columns, provided that such use does not encroach on the interior of the Premises.

Rentable area determined by lease. The Premises will be deemed to include the Rentable Area set forth in the Basic Lease Definitions. In no event will Tenant have

the right to challenge or request any change to this Lease as the result of any claimed or actual error in the Rentable Area or the calculation of the Proportionate Share.

Rentable area determined by measurement. The Premises described in section [number / letter] is depicted on the Space Plan attached as exhibit [number / letter]. Within [number] days after the date the demising walls of the Premises are installed, Landlord's architect will calculate and certify in writing to Landlord and Tenant the "Rentable Area" of the Premises, measured in accordance with [examples: the methods specified in the BOMA publication ANSI Z65.1 1996 / 2010 BOMA Office Building Standard, Method A / 2010 BOMA Office Building Standard, Method B / other standard]. The certification, if not objected to by Tenant within [number] days after the later to occur of (a) Tenant's receipt of the certification, or (b) the Commencement Date, will be conclusive of the Rentable Area of the Premises for all purposes. The Rentable Area of the [Building / Shopping Center] means the number of square feet of floor area at each level or story of the [Building / Shopping Center], including mezzanines, bounded by the outside surfaces of exterior walls and the center lines of party walls. The following areas will not be included in any such calculations: [outside sales areas / the upper levels of any deck or platform areas used for storage of merchandise / loading docks / areas covered by exterior canopies or overhangs].

Resolution of disputes over size of rentable area. If Tenant objects to Landlord's architect's measurement of the Premises, Tenant will specify the size of the Rentable Area which Tenant's architect believes the Premises contain. The parties will give reasonable efforts to resolve their differences. If, within [number] days after Tenant's objection, the parties have not resolved their differences, Landlord's and Tenant's architects will name a third architect, who will, within [number] days, measure the Premises. The measurement of the third architect will be averaged with either Landlord's or Tenant's architect's measurement, whichever is closer, which averaged amount will be deemed the correct Rentable Area of the Premises. The party whose measurement was not averaged with that of the third architect will pay the fees and expenses of the third architect, and each party will pay the fees and expenses of its own architect.

Commentary

Common law and statutes. Identification of the premises is a fundamental requirement for the creation of a lease. *De Bruyn Produce Co v Romero*, 202 Mich App 92, 98–99, 508 NW2d 150 (1993) ("In order for an agreement to be a valid lease, it must contain the names of the parties, an adequate description of the leased premises, the length of the lease term, and the amount of the rent."); *Brodsky v Allen Hayosh Indus, Inc*, 1 Mich App 591, 137 NW2d 771 (1965). If the location of the premises is not specifically designated, the agreement will be considered at most a license, rather than a lease. *United Coin Meter Co v Gibson*, 109 Mich App 652, 311 NW2d 442 (1981).

The premises can be identified simply as a building having a specified street address. *Meredith v McCormick*, 208 Mich 563, 175 NW 280 (1919); *Nowicki v Kapelczak*, 195 Mich 678, 162 NW 266 (1917); *Kuschinsky v Flanigan*, 170 Mich 245, 136 NW 362 (1912). When a street address is used, the premises will include only “so much of the lot upon which the building [is] situate as [is] necessary to the complete enjoyment of the building for the purpose for which it was let, and nothing more.” *Id.* at 249 (citation omitted).

The lease of a building, or of one floor or story of a building, conveys to the tenant the absolute dominion over the premises, including the outer as well as the inner walls. *Forbes v Gorman*, 159 Mich 291, 123 NW 1089 (1909). The tenant obtains the right, in the absence of restrictions, to use the premises, including the walls, for all purposes consistent with the lease. *Id.* at 294. The tenant acquires the right to use the outer walls and may put any sign or signs on them that cause no injury to the freehold. *Id.* The landlord in such a lease retains no right to permit signs or advertisements of other parties to be placed on the outside walls of the leased building. *Id.* at 295. Premises described as the “first floor” and basement of a multistory building do not include water pipes above the ceiling or drainpipes along the outside wall of the building when the second floor is leased to another tenant. *Nederlander v Cadillac Clay Co*, 264 Mich 434, 250 NW 281 (1933).

The general rules of construction apply to interpretation of the description of the premises. Contractual language is given its ordinary, plain meaning; technical or constrained constructions are to be avoided. *G&A Inc v Nahra*, 204 Mich App 329, 514 NW2d 255 (1994). If terms are not defined in the agreement, they will be interpreted in accord with their common usage. *Meridian Mut Ins Co v Wypij*, 226 Mich App 276, 573 NW2d 320 (1997). Defined terms in an agreement will be construed as defined, regardless of their common or trade usage. *Farm Bureau Mut Ins Co v Nikkel*, 460 Mich 558, 567, 596 NW2d 915 (1999) (ambiguity will not be found solely because insured might interpret term differently than express definition in contract).

Tips, traps, and thoughts. The problems that can arise by using a street address are illustrated by the decisions in *Meredith* (premises in rooming house included use of backyard and walkway) and *Kuschinsky* (premises included use of backyard but not barn). Because of the potential for confusion, a street address should be used only for single-tenant facilities and only when the landlord does not retain any portion of the property for its own use. Otherwise, a great deal more care should be devoted to describing what is and is not included as part of the premises. If there are common areas, the right to use them should be separately stated and should be referred to as a license rather than as a part of the premises. Additional provisions regarding the common areas are set forth in §3.17. If the lease also includes an option to purchase, it is important to precisely describe the property that is included within the scope of the option, and a street address should be used only in the case of single-tenant properties. *See Nowicki* (dispute over scope of option to purchase included within lease).

Whenever the premises are part of a multitenant building, as in the case of a shopping center or office building, the description should refer to a suite number or floor or site plan. The primary goal here is to avoid ambiguity. The use of a graphic representation of the premises, drawn to scale and attached as an exhibit, can greatly enhance the written word.

A general discussion of the problems and issues can be found in Annotation, *Specificity of Description of Premises as Affecting Enforceability of Lease*, 73 ALR4th 236.

Defining the Rentable Area requires an understanding of the trade distinction between rentable and usable space. Generally, rental rates for commercial properties are quoted on a dollar-per-square-foot basis. For example, a broker will tell a prospective tenant that the office space is available for \$20.75 a foot. The tenant must understand the difference between rentable and usable square footage so it can make an apples-to-apples assessment. The usable space is the area actually located within the four walls of the premises. The rentable space, on the other hand, typically includes a portion of the common areas. The Dictionary of Real Estate Appraisal 253 (2d ed 1989) defines *rentable area* as “[t]he amount of space on which the rent is based; calculated according to local practice.” For example in *New Places, Inc v Communications Workers of America, Inc*, 619 A2d 73 (DC App 1993), the court held that a lease of “1,588-square-foot premises” did not misrepresent the size of the premises, which included only 1,344 square feet of usable space, because an add-on for a portion of the common area was customary in that market. In Michigan, the term rentable space includes an upward adjustment to allocate a portion of the common areas to the premises for the purpose of computing factors like base rent and common area maintenance charges. An office containing 1,000 square feet of usable space will almost always be bigger than an office containing 1,000 square feet of rentable space. There is nothing wrong or misleading about using rentable area to determine the rent and other economic factors, but the tenant should understand what it means. In southeastern Michigan, the most commonly employed standard for measuring office building space is the one established by the Building Owners and Managers Association (BOMA). See 2010 BOMA Office Building Standard, Method A and 2010 BOMA Office Building Standard, Method B, published by American National Standards Institute/BOMA International. Regardless of the standard employed, the only way to get a precise handle on the per-square-foot cost is to hire an architect or a space planner. This solution is obviously not practical for smaller tenants, who typically will have to rely on their own perceptions after touring different offerings.

More discussion of matters relating to the measurement of the premises can be found in §§4.17–4.18.

C. Relocation of the Premises

§3.13

Sample Clauses

Broad relocation right. Landlord may relocate Tenant to other comparable space within the *[Building / Shopping Center]* on not less than *[number]* days’ prior notice to Tenant. Landlord will pay the expenses of moving Tenant to the relocated Premises.

Limited relocation right. Landlord may relocate Tenant to other comparable space within the *[Building / Shopping Center]* on not less than *[number]* days’ prior notice to Tenant. The comparable space must *[be located on the [direction] side of*

the Building / be located on or above the [number] floor / be at least the same size as the original Premises / be built out at Landlord's expense using comparable finishes and space configurations]. If the relocated Premises are larger than the original Premises, the Rent *[will / will not]* be increased after relocation.

Identification of expenses associated with move. Landlord must pay all reasonable expenses associated with Tenant's move to the relocated Premises including (a) the hiring of professional movers, (b) the acquisition of new stationery and business cards, (c) the relocation of phone lines and Internet service, and (d) the printing and mailing costs of announcements reflecting the relocation of tenant's business.

Relocation clause with termination right. Landlord may relocate Tenant to other comparable space within the *[Building / Shopping Center]* on not less than *[number]* days' prior notice to Tenant (Relocation Notice). Landlord will pay the cost of moving Tenant to the relocated Premises. If Tenant does not wish to accept relocation, Tenant may object by notice to Landlord within *[number]* days after receiving the Relocation Notice from Landlord. If Tenant fails to object within the *[number]*-day period, Tenant is deemed to have accepted the relocation. If Tenant objects, Landlord must rescind or reaffirm the Relocation Notice within *[number]* days. If Landlord rescinds the Relocation Notice, Tenant must remain in the Premises through the duration of the Term. If Landlord reaffirms the Relocation Notice, Tenant may terminate this Lease by notice to Landlord within *[number]* days after the reaffirmation of the Relocation Notice by Landlord. If Tenant fails to notify Landlord of its termination within the *[number]*-day period, it is deemed to have accepted the relocation. If Tenant terminates this Lease pursuant to this section, Tenant must vacate the Premises within *[number]* days following Tenant's notice to Landlord of the termination.

Commentary

Common law and statutes. Under common law, a lease is considered the equivalent of a sale of the premises for the duration of the lease. *McCurtis v Detroit Hilton*, 68 Mich App 253, 242 NW2d 541 (1976). Because the tenant owns a specific parcel of real property during the term of the lease, the landlord has no right to relocate the tenant. Moreover, any effort by the landlord to reenter the premises and move the tenant is "unlawful interference" under Michigan law. MCL 600.2918.

If the location of the premises is too fluid, the agreement will be considered a license, rather than a lease. *United Coin Meter Co v Gibson*, 109 Mich App 652, 311 NW2d 442 (1981). In *United Coin Meter*, the court addressed the legal status of a document entitled a "lease" that conveyed the right to use space in an apartment complex to install and service coin-operated laundry equipment:

The controlling issue is whether the contracts between [grantee] and [grantor] are leases or licenses. A license is a permission to do some act or series of acts on the land of the licensor without having any permanent interest in the land.

A lease, on the other hand, gives the tenant possession of the property leased and exclusive use or occupation of it for all purposes not prohibited by the terms of the lease. To be a valid lease, the contract must contain the names of the parties, an adequate description of the leased premises, the length of the lease term and the amount of the rent.

....

These agreements ... were not specific enough to be leases.... [T]he agreements in this case allowed [grantor's] predecessors in title to choose the area designated as laundry areas. Furthermore, the description of the laundry area was too indefinite. In one of the apartment complexes covered by the agreements, the laundry area consisted of three different rooms on three separate floors. Paragraph 1 of the agreement did not contemplate that the laundry area would be contained in three separate areas. The agreements were also vague because they failed to specify the number of machines which would be placed in the different laundry areas. Finally, the agreements did not give exclusive possession or control of the areas to [grantee] since the [grantor's] predecessors in title were required to clean and maintain the laundry area.

109 Mich App at 655–658 (citations omitted). The *United Coin Meter* court noted a number of factors that may have affected its decision, so it is impossible to determine exactly how far the law will allow the parties to go with relocation before it recharacterizes their relationship as a license. Suffice it to say that the more restrictions that are placed on the right, the more likely the relationship will be viewed as a tenancy rather than a license.

Tips, traps, and thoughts. Small tenants often present problems for the landlord of a larger multitenant property. When the premises are part of a larger property, such as an office building or a shopping center, the landlord often wants to retain as much flexibility as possible concerning relocation so it can accommodate anchor tenants or other desirable prospects. Because there is no common-law right to relocate a tenant, any right the landlord acquires must be established in the lease. In addition, the landlord will want to place as few restrictions as possible on the exercise of that right.

The tenant wants to lease a specific piece of property and does not want to be moved around at the whim of the landlord. The tenant will usually try to negotiate out of any relocation obligation and, if it cannot do so, place as many limitations on that right as possible. Assuming that the tenant is willing to live with relocation, there are several issues to address, such as (1) when the tenant may be relocated, (2) how much notice is required before relocation, (3) where the tenant may be relocated, (4) whether the tenant has the right to terminate the lease instead of relocating, (5) who pays the costs associated with the relocation, and (6) if the landlord is paying, for what and how much.

The sample clauses present a number of ways to address the issue of relocation. Although provisions similar to the “broad relocation right” clause are often used, it is important to read and consider *United Coin Meter* before using such a broadly drafted clause. If a relocation right is too vague or fluid, it might result in the agreement being deemed a license rather than a lease, which may have a substantial impact on the parties’ rights. In

addition, you should check with the landlord's mortgagee before giving any tenant a termination right. Because lenders typically do not like termination rights (which can interfere with cash flow), caution in their use is advised. Nonetheless, in the proper circumstances, such a right can be very useful.

D. Expansion

§3.14

Sample Clauses

Simple expansion option. Tenant has the option (Expansion Option) to lease the contiguous space cross-hatched on exhibit *[number / letter]* (Option Space). Tenant must exercise its Expansion Option by notice to Landlord. If Tenant leases the Option Space under this section, all of the terms of the Lease apply to the Option Space except that (a) possession of the Option Space will be delivered "as is," without any requirement for Landlord to perform Landlord Work or any other finish-out work; (b) the commencement date of the Lease for the Option Space will be *[number]* days after the Option Space is delivered to Tenant broom clean, free of tenants and other occupants, and in reasonably good condition; and (c) the Rent will be *[revised amounts or formulas]*.

Detailed expansion option. On the *[number]* anniversary of the Commencement Date, subject to availability and the existing rights of other tenants in the Building, Tenant has the option (Expansion Option) to lease contiguous space, not to exceed *[number]* rentable square feet, in the area that is cross-hatched on exhibit *[number / letter]* and located on the *[number]* floor of the Building (Option Space). The Expansion Option does not apply to any portion of the Option Space that has been re-leased to any other tenant by renewal, extension, or renegotiation, or that is subject to an expansion right held by any other tenant in the Building. The Expansion Option is conditioned on the following: (a) the Lease must be in full force and effect, (b) Tenant must not be in default, and (c) Tenant's then-current financial condition, as reflected in its most recent financial statements, must demonstrate that Tenant's net worth is at least equal to its net worth on the Commencement Date.

Tenant must give Landlord notice of Tenant's desire to lease the Option Space (Expansion Notice) at least *[number]* months before the *[number]* anniversary of the Commencement Date. On receipt of the Expansion Notice, Landlord has *[number]* days to provide Tenant with notice of the portion of Option Space that Landlord anticipates will be available (Available Expansion Space). Tenant has *[number]* days to accept all of the Available Expansion Space by notice to Landlord. Tenant's failure to provide notice within *[number]* days will indicate its decision to decline to lease the Available Expansion Space. If Tenant delivers to Landlord notice of Tenant's election to lease the Available Expansion Space, the Available Expansion Space will be leased by Tenant on the terms and conditions set forth in this section.

If Tenant leases Available Expansion Space under this section, all of the terms of the Lease apply to the Available Expansion Space except that (a) possession of the Available Expansion Space will be delivered “as is”, without any requirement for Landlord to perform Landlord Work or any other finish-out work; (b) the commencement date of the Lease for the Available Expansion Space will be *[number]* days after the Available Expansion Space is delivered to Tenant broom clean, free of tenants and other occupants, and in reasonably good condition; (c) the Rent will be *[revised amounts or formulas]*; and (d) as of the commencement date for the Available Expansion Space, Tenant’s Proportionate Share will be increased to an amount computed by dividing the total of the rentable square footage of the Premises plus all Available Expansion Space leased by Tenant (the numerator) by the rentable square footage of the Building (the denominator) and expressing the fraction as a percentage.

Confirmation of expansion. Within *[number]* days after Tenant adds any *[Option Space / Available Expansion Space]*, Landlord and Tenant must confirm in writing (a) the commencement date for the *[Option Space / Available Expansion Space]*, (b) the *[Option Space / Available Expansion Space]* that was leased, (c) the Rent to be paid for the *[Option Space / Available Expansion Space]*, (d) the increased Proportionate Share allocated to the *[Option Space / Available Expansion Space]*, and (e) any other terms related to the *[Option Space / Available Expansion Space]* or this Lease that either party reasonably requests to be confirmed.

Detailed right of first offer. Within *[number]* years of the Commencement Date, subject to availability and the rights of other tenants in the Building, Tenant has the right of first offer (Right of First Offer) to lease any contiguous space located on the *[number]* floor of the Building (Offer Space). During the term of this Right of First Offer, Landlord must not enter into a lease of the Offer Space with any third party without first offering Tenant the right to lease that space. This Right of First Offer does not apply to any space that is (a) assigned or subleased by the current tenant of the space; (b) re-leased by the current tenant of the space by renewal, extension, or renegotiation; or (c) subject to an expansion right held by another tenant in the Building.

Landlord will not execute any lease with any third party regarding the Offer Space until Landlord has first notified Tenant (First Offer Leasing Notice) that Landlord intends to offer the Offer Space to third parties and until a period of *[number]* business days has elapsed. The First Offer Leasing Notice must (a) describe the amount and location of the First Offer Space that has or will become available (Available First Offer Space) and have attached a floor plan showing the Available First Offer Space cross-hatched, (b) advise Tenant that Landlord intends to offer the Available First Offer Space for lease, and (c) state the date on which the Available First Offer Space will be available for leasing by Tenant.

If Tenant delivers notice of its desire to lease all of the Available First Offer Space within the *[number]*-day period following the First Offer Leasing Notice, the

Available First Offer Space will be leased by Tenant on the terms and conditions set forth in this section.

If Tenant declines or fails to effectively exercise the Right of First Offer, the right terminates. Landlord is then free to offer the Available First Offer Space on the open market and to lease some or all of that Available First Offer Space at any time without regard to the restrictions in this section and on whatever terms Landlord decides in its sole discretion.

If Tenant leases Available First Offer Space under this section, all of the terms of the Lease apply to the Available First Offer Space except that (a) possession of the Available First Offer Space will be delivered “as is,” without any requirement for Landlord to perform Landlord Work or any other finish-out work; (b) the commencement date of the Lease for the Available First Offer Space will be *[number]* days after the Available First Offer Space is delivered to Tenant broom clean, free of tenants and other occupants, and in reasonably good condition; (c) as of the commencement date for the Available First Offer Space, the Rent will be *[revised amounts or formulas]*; and (d) as of the commencement date for the Available First Offer Space, Tenant’s Proportionate Share will be increased to an amount computed by dividing the total of the rentable square footage of the Premises plus all Available First Offer Space leased by Tenant (the numerator) by the rentable square footage of the Building (the denominator) and expressing the fraction as a percentage.

Within *[number]* days after Tenant adds any Available First Offer Space, Landlord and Tenant must confirm in writing (a) the commencement date for the Available First Offer Space, (b) the Available First Offer Space that was leased, (c) the additional Rent to be paid for the Available First Offer Space, (d) the increased Proportionate Share allocated to the Available First Offer Space, and (e) any other terms related to the Available First Offer Space or this lease that either party reasonably requests to be confirmed.

Commentary

Common law and statutes. The tenant has no common-law right to expand into contiguous space within the landlord’s building. Moreover, MCL 565.5 states that “[n]o covenant shall be implied in any conveyance of real estate, *except* oil and gas leases, whether such conveyance contain special covenants or not” (emphasis added). Because a commercial lease is considered a conveyance of real estate, there are no implied terms. *Walker & Co v Davis*, 257 Mich 316, 318, 241 NW 169 (1932) (“an adjoining owner, notwithstanding he also owns the premises demised, can only be held to the obligations sought to be imposed by the tenant here upon an express stipulation in the lease to be so bound”) (quoting *Kingsway Realty & Mortg Corp v Kingsway Repair Corp*, 223 AD 281, 285, 228 NYS 265 (1928)).

Nonetheless, the landlord may grant the tenant an option to expand onto contiguous space. Under Michigan law, options within a written lease are treated as “mere offer[s].” *Mathieu v Wubbe*, 330 Mich 408, 412, 47 NW2d 670 (1951). Because options are offers, acceptance must strictly comply with the terms of the option, regarding both the exact thing offered and the time specified; otherwise, the right is lost. *Id.* Substantial compliance with the terms of an option is generally not sufficient. *Id.*

The tenant’s right to make a first offer on contiguous space differs from an option to lease. *Czapp v Cox*, 179 Mich App 216, 220, 445 NW2d 218 (1989) (“the word ‘first’ does have a meaning which can be given a definite effect”). A right of first offer is a conditional option. Such a right is also frequently referred to as a “right of first refusal.” *Id.* at 223 (“It is clear from the above cases that the term ‘first option’ means a conditional option or right of first refusal, unless it is not possible to reconcile that meaning with other portions of the instrument creating the option when read as a whole.”). Rights of first refusal and options are governed by the contract terms the parties established. *Phillips v Homer (In re Smith Tr)*, 480 Mich 19, 28, 745 NW2d 754 (2008). If the landlord wants to lease the space, it must first offer the space to the holder of the right. Alternatively, the landlord can simply decide to keep the property off the market, in which case the right never becomes effective.

Tips, traps, and thoughts. The “simple expansion” clause above represents a basic format for an expansion option and may be entirely adequate to address a small amount of contiguous space. With larger, more expensive space, the issue should be approached more carefully and in far greater detail. If the space is not delivered “as is,” the details of the build-out will have to be spelled out in the same degree of detail as the original landlord’s work. Similarly, the determination of the adjusted rent may involve a considerable amount of negotiation and drafting, which is not undertaken in the sample clauses because it will vary from lease to lease. The sample clauses assume that the landlord has defined the Premises, the Landlord’s Work, and the Commencement Date in the definitions section at the beginning of the lease.

Generally speaking, landlords dislike both expansion options and rights of first offer. Expansion options tie up the landlord’s property without providing any guarantee that they will ever be exercised. Although a right of first offer is typically considered less burdensome, it can still impede the landlord’s ability to quickly lease to a new tenant. If the landlord is going to grant such rights, it will seek to draft the option in the most restrictive way possible. The landlord will also want some mechanism to force the tenant to make its decision in a timely manner.

It is common practice to condition the exercise of an expansion option or right of first offer on the tenant’s faithful performance of all of the lease covenants. This can be handled in a variety of ways. Typically, language such as “provided Tenant is not in default” is added to the beginning of the clause to condition exercise of the right. Similarly, “provided Tenant has not defaulted in the performance of any of its obligations under this Lease” conditions the option but includes *any* prior default as effectively precluding exercise. A middle position is found in language such as “provided that no default exists under this Lease and no default has existed within [number] years before exercise of the option,” which narrows the compliance condition period. The tenant will want to condition the condition on its

prior receipt of some sort of written notice of the default, so that it is not blindsided by an alleged default when it acts to exercise its option.

Tenants like expansion options. If the tenant anticipates future growth, an expansion option is an excellent way to transfer the market risk and holding costs to the landlord. When reviewing or drafting an expansion option, it is important to remember that strict compliance will be required for the tenant to exercise the option. The clause should clearly state how and when the option must be exercised. In addition, the tenant must take particular care in keeping track of the trigger date for notifying the landlord that the tenant is exercising its option. Should the trigger date accidentally pass before the notice is given, the tenant will have forfeited its hard-won right to expand.

E. Contraction

§3.15

Sample Clause

Contraction option. Tenant has the option to terminate (Partial Termination Option) that portion of the Premises located *[description of area]* and reflected on the cross-hatched area of the *[floor plan / site plan]* attached as exhibit *[number / letter]* (Termination Space) effective *[date]* (Termination Effective Date), by paying a termination fee of *[\$amount]* (Termination Fee). Tenant must provide notice to Landlord of Tenant's intent to terminate on or before *[date]*, and pay the Termination Fee when the notice is given. If Tenant (a) does not exercise the Partial Termination Option within the required period, (b) fails to provide Landlord with the required notice, or (c) fails to pay the Termination Fee when the notice is given, this Partial Termination Option automatically terminates and has no further force or effect. This Partial Termination Option is personal to Tenant and may not be transferred or assigned. Within *[time period]* after notice of Tenant's intent to terminate has been given, Tenant must surrender the Termination Space to Landlord. After the Termination Effective Date, each party is released from any further obligations or liability for the Termination Space under this Lease, with the following exceptions: (a) Tenant must surrender the Termination Space in accord with this Lease and (b) all Rent accruing through the Termination Effective Date must be paid in full. If this Partial Termination Option is exercised, then after the Termination Effective Date, the Definitions in section 1 of this Lease will be modified as follows:

- Rentable Area means approximately *[number]* rentable square feet and includes an allocated percentage of the common areas;
- Annual Base Rent means *[\$amount]*;
- Monthly Installments of Base Rent means *[\$amount]*; and
- Proportionate Share means *[percentage]*.

All other terms of this Lease will remain in full force and effect.

Commentary

Common law and statutes. When the lease has a fixed term, the tenant remains liable for rent regardless of whether it uses or abandons the premises. *Pyle v Orzell*, 350 Mich 298, 86 NW2d 163 (1957). Agreements for early termination are enforceable, but their exercise must be in writing to comply with the statute of frauds. *Barth v Women’s City Club*, 254 Mich 270, 236 NW 778 (1931).

An option is treated as a continuing offer by the landlord. *Maas Bros v Weitzman*, 288 Mich 625, 286 NW 104 (1939). When accepted by the tenant, the option becomes a binding contract. *Id.* Because an option within a lease is considered merely an offer, acceptance must strictly comply with the terms proposed by the option, regarding both the exact thing offered and the time specified; otherwise, the right is lost. *Gurunian v Grossman*, 331 Mich 412, 49 NW2d 354 (1951); *Mathieu v Wubbe*, 330 Mich 408, 47 NW2d 670 (1951). Substantial compliance with the terms of the option is not sufficient. *Gurunian*. *But see Tel-Towne Props Grp v Toys “R” Us–Delaware, Inc*, 630 F Supp 2d 766 (ED Mich 2007) (equitable relief); *King-Blair Co v Schloss*, 253 Mich 243, 234 NW 481 (1931).

Tips, traps, and thoughts. Landlords disfavor termination options. A tenant’s ability to terminate the lease for a portion of the premises before the expiration of the initial lease term essentially reduces the true term of the lease for that portion of the premises. Lenders and potential purchasers of the landlord’s interest will view the duration similarly, which is likely to have a negative effect on valuation. A tenant must have a great deal of leverage to negotiate such a provision into a lease. At a minimum, the landlord is likely to require the payment of a substantial termination fee, which is often related to the unamortized transaction costs relating to the lease.

F. Condition of the Premises

§3.16

Sample Clauses

Condition satisfactory without improvements. Tenant has inspected the Premises and is satisfied with their condition. Tenant accepts the Premises “as is” and will make all repairs and alterations necessary to conduct its business on the Premises at its expense.

Condition Satisfactory subject to improvements. Tenant has inspected the Premises and is satisfied with their condition. Tenant accepts the Premises and will make all repairs and alterations necessary to conduct its business on the Premises at its expense, with the sole exception of the Landlord Work identified on exhibit *[number / letter]*, which must be substantially completed before the Commencement Date.

Turnkey Clause. Landlord Work is identified on exhibit *[number / letter]*. The Premises must be delivered to Tenant on the Commencement Date with the Landlord Work substantially completed. The Landlord Work will be performed by

Landlord at its expense. The Premises must be delivered in good repair, fit for the Designated Use, and in full compliance with all Applicable Laws.

Broad waiver of any defects in condition. Tenant's taking possession of the Premises will be conclusive evidence of Tenant's acceptance of the Premises in good order and satisfactory condition and "as is," including patent and latent defects. No representations about the condition of the Premises, nor any promises to decorate, alter, repair, or improve the Premises, have been made to Tenant. Tenant also agrees that no representations have been made to Tenant that any other tenants will lease space in the [Building / Shopping Center]. Tenant waives any implied warranties, including any warranties of fitness, suitability, or habitability.

Commentary

Common law and statutes. A lease is considered the equivalent of a sale of the premises for the duration of the lease term. *McCurtis v Detroit Hilton*, 68 Mich App 253, 242 NW2d 541 (1976). Because a commercial lease is considered a conveyance of real estate, there are no implied terms regarding its condition. *Id.* Although there are limited exceptions for tort liability, the landlord is generally not responsible for the condition of the premises, and the tenant takes the property with all its faults. *Id.* The general rule undoubtedly is that, in the absence of fraud, there is no implied covenant that premises are fit for the purpose for which they are leased. *Sill v O'Rourke*, 352 Mich 318, 323, 89 NW2d 463 (1958) (landlord had no implied obligation to provide water for use in tenant's business).

In this area, commercial leases are radically different from residential leases. In the residential lease context the common law has been modified by statute to include covenants regarding condition. MCL 554.139(1) states that in every lease of residential premises, the landlord covenants that the premises and all common areas are fit for the use intended by the parties. MCL 554.139 also requires that the landlord keep the premises in reasonable repair and in accord with all applicable health and safety laws. These statutes apply only to residential leases. *See generally Rome v Walker*, 38 Mich App 458, 196 NW2d 850 (1972).

When a lease calls for the performance of a build-out by the landlord before the commencement of the lease (defined in the clauses as Landlord Work), substantial performance becomes an important consideration. In the absence of an agreement to the contrary, rent begins to accrue on substantial performance by the landlord. *Gordon v Great Lakes Bowling Corp*, 18 Mich App 358, 171 NW2d 225 (1969) (substantial performance found). Substantial performance requires a good-faith attempt to perform the build-out in accord with the agreement. "Substantial performance means not doing the exact thing promised, but doing something else that is just as good, or good enough for both obligor and obligee. It requires a good-faith attempt to perform without intentional or material departures." *Rogers Plaza, Inc v SS Kresge Co*, 32 Mich App 724, 745, 189 NW2d 346 (1971) (quoting 17A CJS *Contracts* §508) (landlord failed to substantially perform build-out required by lease).

Tips, traps, and thoughts. When it comes to the initial condition of the premises, the landlord benefits from the common-law view that a lease is a conveyance. The landlord's drafting goal is to simply reinforce the common-law rule. The landlord seeks to further buttress the rule by having the tenant acknowledge in the lease that it has inspected the premises and is satisfied with their condition and size. Such an acknowledgment undermines any allegation of fraud in the inducement.

The common-law rule provides no help for the tenant. Whatever rights the tenant obtains concerning the initial condition of the premises must come through negotiation and drafting. This is generally done through an agreement that the landlord will perform certain improvements to the premises before occupancy, which is usually reduced to a work letter and attached as an exhibit to the lease. The sample clauses use the defined term *Landlord Work* to refer to the obligations undertaken in the work letter. Because some landlords attempt to add qualifications or limitations in the work letter, the tenant must pay careful attention to it.

When the landlord undertakes an obligation to make improvements, it should be sure that those obligations are laid out with precision and are limited. Work letters identifying the Landlord Work are usually attached to the lease for that purpose. Form 3.6 is an example of a landlord's work letter. The landlord will want to tie performance to the common-law standard of *substantial* rather than *exact* compliance to avoid unduly delaying the commencement of rent based on minor deviation from the agreed-on performance. A more detailed discussion concerning construction and delivery of improvements to the premises is in §§4.17–4.18.

G. Use of Related Areas Outside the Premises

§3.17

Sample Clauses

Definition of common areas (shopping center). Common Areas means all areas, inside or outside of the *[Building / Shopping Center]*, furnished and designated by Landlord as common areas for the general nonexclusive use and convenience of the tenants of the *[Building / Shopping Center]* and their respective agents and invitees. Common Areas may include parking areas, access roads, driveways, loading areas, retaining walls, service corridors, public rest rooms, pedestrian sidewalks, stairways, plazas, foundations, exterior walls, demising walls, roofs, curbs, escalators, elevators, courts, ramps, walls, landscaped areas, and appurtenances and systems to provide gas, water, electricity, sewage, heating, ventilation, air-conditioning, lighting, music, intercom, fire suppression, and warning for the *[Building / Shopping Center]*.

Maintenance of common areas. Landlord will operate and maintain the Common Areas in a manner deemed by Landlord to be reasonable and appropriate given the location and market conditions of the *[Building / Shopping Center]*. Tenant must pay its Proportionate Share of the costs Landlord incurs in operating and maintaining the Common Areas. If repairs or replacements are occasioned

through the acts or omissions of Tenant or its agents or invitees, Tenant must pay Landlord the costs of such repairs and replacements.

Use of common areas. Landlord grants Tenant and its agents and invitees a nonexclusive license to use, in common with others, the Common Areas. Tenant's use of the Common Areas is subject to whatever rules Landlord may establish from time to time. Landlord may temporarily close or prohibit use of any Common Area. Landlord may make changes to the Common Areas, including parking areas, parking spaces, location of exits, or the direction of traffic flow. Landlord may increase or decrease the number of parking spaces or change the size and configuration of parking areas or parking spaces. Landlord may increase or decrease the land size of the *[Building / Shopping Center]*. All land added to the *[Building / Shopping Center]* is subject to the terms of this Lease, and all land excluded is thereafter excluded from the terms of this Lease. Landlord may, from time to time, construct additional buildings and structures in the Common Areas or remove buildings (except the Premises) from the *[Building / Shopping Center]* to create, reduce, enlarge, or restructure the Common Areas. Landlord's rights under this section may be exercised in its sole discretion.

Restrictions on the use of common areas. Tenant will not use or permit its employees to use the common areas for the purpose of overnight or weekend storage of any automobiles, trucks, or other vehicles owned or used by Tenant or its employees, except as Landlord approves in writing. Landlord reserves the right to designate specific parking areas for employee parking.

Reservation of rights (shopping center). Landlord reserves the right to alter, add to, and build additional stories on the building in which the Premises are located and to build adjoining it. Landlord also reserves the right (a) to construct other buildings and improvements in the Shopping Center, (b) to enlarge or reduce the Shopping Center, (c) to alter or add to the Shopping Center, (d) to build additional stories on any building or buildings within the Shopping Center, (e) to build adjoining to it and to construct decks or elevated parking facilities, (f) to sell or lease any part of the land comprising the Shopping Center, and (g) to purchase any land adjacent to the Shopping Center and add that land to the Shopping Center. The purpose of the attached site plan is to show the approximate location of the Premises within the Shopping Center. Landlord reserves the right, at any time, to relocate, enlarge, reduce, or reconfigure the various buildings, parking areas, and other common areas shown on that site plan. Landlord has the right, at its sole option, to reduce the common areas and change the site plan in any manner it deems fit to accommodate new buildings and improvements without notice to or the consent of Tenant. The attached site plan creates no easement rights in the common areas shown on it, but only a license to use those areas in common with all other tenants and occupants of the Shopping Center, as these areas may exist from time to time during the term of this Lease. If Landlord subsequently constructs additional buildings in the Shopping Center, each such building may be included in or excluded from the Shopping Center at Landlord's option. If those buildings are included in the

Shopping Center, the floor area of those buildings will be used, as appropriate, in determining Tenant's Proportionate Share pursuant to section *[number]*.

Common area parking lot. Landlord grants Tenant, its employees, and invitees a license to reasonable nonexclusive use of the common area parking lot. Use is subject to rules Landlord may: establish and modify from time to time. Landlord may (a) temporarily close or prohibit the use of the common area parking lot; (b) make changes to the common area parking lot, including creating or closing exits or changing parking spaces, parking areas, or the direction of traffic flow; (c) increase or decrease the number of parking spaces; (d) change the size or configuration of the parking areas; and (e) construct additional buildings and structures on the common area parking lot or remove buildings, except the Premises, in order to create, reduce, enlarge, or restructure the common area parking lot.

Employee parking areas. Tenant and its employees will park their cars only in such areas designated for that purpose by Landlord. Upon request by Landlord, Tenant will furnish Landlord with the license plate numbers for Tenant and its employees' vehicles. Tenant will thereafter notify Landlord of any changes in such information within *[number]* days after such change occurs. If Tenant or its employees fail to park their vehicles in the designated parking areas, then, without limiting any other remedy that Landlord may have in the event of default, Landlord, after giving notice to Tenant, will have the right to charge Tenant, as Additional Rental, the sum of \$*[amount]* per day per vehicle parked in violation.

Enforcement of restrictions regarding employee parking areas. Landlord may tow unauthorized vehicles of Tenant or Tenant's employees (a) from no-parking areas established by Landlord from time to time and (b) from areas that have not been designated for Tenant or employee parking. Towing is at Tenant's expense. Tenant agrees to indemnify and hold Landlord harmless from any damages caused while towing vehicles.

Parking garage. Landlord will provide Tenant parking in the Building's parking garage for one vehicle for each *[number]* square feet of Rentable Area of the Premises. Tenant is not required to take all the allotted spaces but may take all or any number of them on *[number]* days' notice to Landlord. All except *[number]* of Tenant's allotted parking spaces will be unreserved spaces and will not be assigned to designated parking stalls. Tenant may use whatever unreserved stalls are available on a first-come, first-served basis. The remaining *[number]* parking spaces furnished to Tenant will be reserved spaces. Landlord will designate the location of the reserved spaces and may change their location from time to time in its sole discretion.

Parking garage: parking fee. During the first *[time period]* (Initial License Term), all parking spaces will be furnished to Tenant at the rate of \$*[amount]* per parking space. After the Initial License Term, Tenant will pay a monthly license fee for each parking space at a monthly rate established by Landlord. The license fee

may be adjusted from time to time in accordance with changes in the scheduled rate for similar parking in the Garage. Tenant must pay the monthly license fee in advance to Landlord together with the Monthly Installments of Base Rent. If Tenant defaults in the payment of the monthly license fee, Landlord may immediately revoke this Parking License. If this Parking License is revoked, Tenant has no further right to park in the Garage. If Landlord fails or is unable to provide parking spaces to Tenant due to casualty, condemnation, or any other similar cause, that failure or inability is not deemed a default by Landlord, but Tenant's obligation to pay the license fee for any parking space that is not available abates, unless Landlord provides replacement parking, for so long as Tenant does not have the use of the parking space.

Parking garage: duration of license. The term of the parking license will commence on the Commencement Date and will continue until the earlier of (a) the Expiration Date, (b) termination of the Lease, or (c) termination of this Agreement. Landlord may immediately revoke this parking license (a) for nonpayment of the license fee, (b) for the violation of any rule concerning the parking garage, (c) on the termination or expiration of the Lease, or (d) on the eviction of Tenant from the Premises. On the termination or revocation of the parking license, Tenant has no further right to park in the Building's parking garage.

Parking garage: applicable law and building rules. Tenant and its employees must at all times comply with all Applicable Laws regarding use of the Garage. Landlord reserves the right to adopt, modify, and enforce reasonable Building Parking Rules governing the use of the Garage. The Building Parking Rules currently in effect are attached. Landlord may refuse to permit any person who violates such Building Parking Rules to park in the Garage, and any violation of the Building Parking Rules will subject the car to removal from the Garage. Parking attendants are not authorized to make or allow any exceptions to the Building Parking Rules.

Parking garage: waiver of liability. Except for its intentional acts or gross negligence, Landlord has no liability whatsoever for (a) any damage to any vehicle or property located in the Garage, (b) theft or vandalism to any vehicle or property located in the Garage, or (c) any bodily injury or death arising out of any matter relating to the Garage, and in all events, Tenant and its employees agree to look to their insurance carriers for payment of any losses sustained in connection with any use of the Garage. Tenant's insurance obligations under the Lease include coverage for its use of the Garage and any of Tenant's vehicles and property while located in the Garage.

Parking garage: reservation of rights. Landlord reserves the right to close all or any portion of the Garage in order to make repairs or perform maintenance services, or to alter, modify, re-stripe, or renovate the Garage, or if required by casualty, strike, condemnation, act of God, governmental law, or requirement, or for any reason beyond Landlord's reasonable control.

Commentary

Common law and statutes. Although a lease gives the tenant exclusive use and occupation of a property for all purposes not prohibited by the terms of the lease, a license does not. *Macke Laundry Serv Co v Overgaard*, 173 Mich App 250, 253–254, 433 NW2d 813 (1988); *United Coin Meter Co v Gibson*, 109 Mich App 652, 655–656, 311 NW2d 442 (1981). Although a lease may, by implication, include a license for a right of way of necessity across other property owned by the landlord, such license is restricted in scope. *Powers v Harlow*, 53 Mich 507, 513, 19 NW 257 (1984). Moreover, unless the license is strictly necessary for access to the premises, it will probably be deemed revocable at will. *Forge v Smith*, 458 Mich 198, 210, 580 NW2d 876 (1998) (involving dispute over tenant parking area). Even where a license has been expressly extended for the use of common areas, the landlord may retain the right to modify common areas. *Hess's Dep't Stores, Inc v Ernest W Hahn, Inc*, 901 F2d 552 (6th Cir 1990). Although a license need not be in writing to be enforceable, it typically needs to be in writing if it is to be irrevocable during the term of its related lease. *Forge*, 458 Mich at 210.

Tips, traps, and thoughts. Most multitenant buildings have common areas or parking areas for the use of tenants and their invitees. In an office building, the common areas may consist solely of entries and hallways. In a regional shopping center, the common areas may consist of an entire network of shared facilities, including acres of parking lots. In downtown buildings, access to an attached parking garage can make or break a proposed deal. When the premises are tied to a facility with shared use with other tenants, it is important to define the tenant's right to use the common areas and parking facilities.

Access to common areas and the use of parking facilities are usually very important amenities to the tenant. Unless the terms of the agreement regarding access and use are reduced to writing and incorporated into the lease, they are unlikely to be binding on the landlord, who is entitled to revoke such rights at its discretion.

The landlord will want to ensure that it can control and alter common areas and parking facilities that are subject to the license. The sample clauses above define the common areas, impose maintenance obligations on the landlord, and establish the rights of the parties regarding use and modifications. When referring to the tenant's interest in such areas, it is best from the landlord's perspective to use the term *license*, which extends only limited rights to the area.

H. Checklist

§3.18

Location of the premises

- Does the lease identify a specific location for the premises? (If not, the lease is probably not enforceable.)
- If the premises consist of a building identified by street address, does the lease specify what areas of the surrounding real property are included with the building?
- Are the premises part of a larger multitenant property?

- Does the lease provide a graphic depiction of the location of the premises within the larger multitenant property?

Relocation of the premises

- Does the lease allow the landlord to relocate the tenant? (If not, no right exists.)
- What are the restrictions on relocation? Notice? Payment? Comparable space?
- Does the lease expressly address what constitutes comparable space? Finishes? Location? Size?
- If the landlord has agreed to pay the costs associated with relocation, what is included? Movers? Announcements? Stationery? Cards? Phone lines?
- May the tenant terminate rather than relocate?

Expansion of the premises

- Does the lease expressly grant the tenant an option to expand its premises? (If not, no right exists.)
- Does the lease give the tenant the right to make a first offer on contiguous space that becomes available? (If not, no right exists.)
- If any expansion rights exist, what are the requirements regarding notice?
- Is there any obligation for the landlord to build-out the expanded area?

Reduction of the premises

- Does the lease expressly grant the tenant an option to reduce the size of the premises? (If not, no right exists.)
- If any reduction right exists, what are the requirements regarding notice?
- What are the conditions for reduction?

Condition of the premises

- Are the premises conveyed as is?
- Does the lease provide that the tenant has inspected the premises and is satisfied with their condition?
- Who is responsible for build-out work?
- Is the build-out work clearly identified in the lease or an attached work letter?
- Is substantial completion sufficient?
- Has the landlord undertaken any express commitments regarding the quality of the build-out, fitness for use, or compliance with laws?

Related areas

- Does the lease define what is included in the common areas?
- Does the lease impose an obligation on the landlord to maintain the common areas?
- What standard, if any, does the lease impose on the landlord concerning maintenance of the common areas?
- Who pays for maintenance of the common areas?
- What are the tenant's rights with respect to use of the common areas?
- What are the landlord's rights with respect to changing common areas?
- How important is parking to the tenant?

- Is there an associated parking garage or surface lot?
- Does the lease address parking?
- How many parking spaces are included?
- Is there a charge imposed for the use of parking, and how is it determined?
- May the charge be increased and under what circumstances?
- Is there designated reserve parking available?
- May the landlord change the parking situation by reconfiguring the structure or lot?

V. The Term and Holdover

A. In General

§3.19 This section examines those clauses that address the duration of the tenancy but that are not based on early termination for reasons such as default, casualty, or eminent domain. This includes clauses that (1) establish the initial term, (2) create options to extend or renew, (3) establish options for early termination, and (4) determine rights with respect to holdover. For other clauses that affect the term, see §5.4 for terminations based on default, §5.40 for casualty, and §5.41 for eminent domain.

B. Establishing the Initial Term

§3.20

Sample Clauses

Describing the initial term. The Term means *[number]* Lease Years. The Term commences on the Commencement Date and expires on the Expiration Date, unless otherwise terminated or extended as provided in this Lease.

Delay in the delivery of possession. Landlord must make reasonable efforts to deliver possession of the Premises on the Commencement Date. Landlord is not liable for damages for failure to deliver possession on the Commencement Date, and the validity of the Lease will not be impaired by such a failure.

Rent abatement during delay in delivery. If Landlord fails to deliver possession on the Commencement Date, the Rent will abate until Landlord gives Tenant notice that the Premises are ready for occupancy. The abatement does not apply to any period of delay attributable to any action or inaction by Tenant.

Rent abatement and holdover payments during delay in delivery. If Landlord fails to deliver possession on the Commencement Date, the Rent must be abated until Landlord gives notice that the Premises are ready for occupancy. In addition, Landlord must reimburse Tenant for any holdover rent paid to Tenant's prior landlord as the result of the delay, but only to the extent that the holdover rent exceeds an amount equal to the Monthly Installment of Base Rent under this Lease. The abatement and reimbursement do not apply to any period of delay attributable to any action or inaction by Tenant.

Termination based on delay in delivery. If Landlord (a) fails to deliver possession of the Premises to Tenant within *[period]* after the Commencement Date and (b) Landlord's failure to deliver possession is not attributable to any action or inaction by Tenant, Tenant may terminate this Lease on *[number]* days' notice to Landlord (Termination Option). If Tenant terminates the Lease under this section, Landlord must immediately refund the Security Deposit, and the parties have no further obligations under this Lease. If Tenant (a) does not exercise the Termination Option on or before *[date]* or (b) fails to provide Landlord with the required notice, this Termination Option automatically expires and has no further force or effect.

Floating commencement date. The term of this Lease is *[number]* Lease Years, commencing on the date (Commencement Date) that is the earlier of (a) *[number]* days after the delivery of the Premises to Tenant "ready for occupancy" (Delivery Date) or (b) the date Tenant opens for business. Landlord must make reasonable efforts to deliver possession of the Premises to Tenant on or before *[date]* (Target Delivery Date). The period between the Delivery Date and the Commencement Date is the Tenant's Construction Period. During the Tenant's Construction Period, this Lease applies and is in full force and effect, except that Tenant has no obligation to pay Rent until the Commencement Date. Landlord is not liable for damages for failure to deliver possession on the Target Delivery Date, and the validity of the Lease is not impaired by such a failure. Before occupying the Premises, Tenant must execute and deliver to Landlord a Commencement Memorandum in the form attached as exhibit *[number / letter]*, acknowledging the Commencement Date and the Expiration Date.

Commencement date letter. Tenant will furnish Landlord, before occupying the Premises, a letter addressed to Landlord stating that (a) Tenant has examined the Premises and is satisfied with their condition, (b) the Landlord Work has been completed to the satisfaction of Tenant, (c) the Commencement Date and Expiration Date, and (d) any other information that either Landlord or the mortgagee of the *[Premises / Building / Shopping Center]* requests.

Commentary

Common law and statutes. The court of appeals analyzed the word *term* in *Stancroff v Brown*, 76 Mich App 589, 594–595, 257 NW2d 179 (1977). The court noted that the word can mean either a period of time or a covenant within an agreement. The court also noted that the word often refers to a manner of payment. As used here, the word *term* refers solely to duration.

An agreement concerning the duration of the lease is a fundamental requirement for the creation of a lease. *De Bruyn Produce Co v Romero*, 202 Mich App 92, 98–99, 508 NW2d 150 (1993) ("In order for an agreement to be a valid lease, it must contain the names of the parties, an adequate description of the leased premises, the length of the lease term, and the amount of the rent."); *Brodsky v Allen Hayosh Indus, Inc*, 1 Mich App 591, 137 NW2d 771 (1965). A "lease for years" has a term of two years absent an express agreement for a

longer duration. *Starr v Holck*, 318 Mich 452, 460, 28 NW2d 289 (1947) (“If a man makes a lease for years, without saying how many, this shall be a good lease for two years certain, because for more there is no certainty, and for less there can be no sense in the words.”) (citation omitted). When the lease calls for specified annual rent but does not establish a definite term, the lease is for one year. *Benfey v Congdon*, 40 Mich 283 (1879). If there is no express agreement concerning duration, the tenancy will be considered at will. *Hilsendegen v Scheich*, 55 Mich 468, 21 NW 894 (1885). The Michigan legislature has established that a tenancy at will may be terminated on one-month’s notice to quit. MCL 554.134(1). A year-to-year tenancy may be terminated on one-year’s notice to quit. MCL 554.134(3). A landlord seeking the repossession of premises on the expiration of a fixed term does not terminate the tenancy by notice to quit but merely seeks repossession pursuant to the lease expiration that has otherwise taken place. *Frenchtown Villa v Meadors*, 117 Mich App 683, 324 NW2d 133 (1982).

Tips, traps, and thoughts. A real estate lease is a four-dimensional construct. Although all real estate documents have a temporal aspect, time is a key component in leasing. Duration is, after all, one of the four basic elements of a lease (parties, property, rent, and duration). Time also represents one of the four physical boundaries of the premises (height, width, breadth, and time). With respect to leases, time truly is of the essence.

If no specific term is identified, the lease will probably be viewed as an at-will tenancy. Such a tenancy provides little protection for the tenant, whose estate may be terminated on relatively short notice. Certain benefits, however, can be derived from short-term commitments. If the tenancy or lease is determined to be at will, it can be terminated on one-month’s notice. Practically speaking, the tenant can usually stay an extra month or two based on delays in the eviction process but may be liable to the landlord for the damages caused by the delay.

The phrase *Commencement Date* is typically used to delineate the beginning of the tenancy. It is generally the date on which the landlord is to deliver possession to the tenant and the tenant is to start paying rent. It is sometimes necessary, however, to establish two separate dates, particularly when there is a negotiated delay between the commencement of occupancy and the commencement of rent payments. Such delays are often referred to as “free rent” periods, though in point of fact they are just periods of deferral.

Problems arise when the landlord is unable to deliver possession of the premises on the agreed date. Delays may occur because a prior tenant has refused to vacate the premises or because the construction of the tenant improvements has taken longer than anticipated. The primary concern for the landlord is to ensure that any delay in delivering possession does not undermine the validity of the lease. The landlord may have invested a considerable amount of money into tenant improvements and, at a minimum, does not want the tenant to walk away from the lease before the landlord has had an opportunity to recover its investment.

The tenant, on the other hand, wants to make sure that the premises are ready for occupancy on the agreed date. Although the tenant may be able to holdover at its existing location, its previous landlord may want to extract concessions to allow the holdover. There is little economic incentive for the prior landlord to maintain the relationship after the

tenant has announced that it is moving out. In addition, the prior landlord may simply demand possession on the expiration date of the old lease, in which case the tenant may find itself without a place to conduct business. In either case, the tenant can find itself in a precarious position with little or no leverage.

The sample clauses present several ways to tackle the issues, depending on which party has the most leverage. Rent abatements and holdover reimbursements are common concessions. A termination option is a bitter pill that many landlords will simply refuse to swallow. A termination option gives the tenant considerable leverage to ensure the build-out is completed by a specific deadline. If a termination option is used, a sunset date should be established, so the option does not continue throughout the entire term of the lease, an unacceptable position for the landlord.

When the premises are the subject of an extensive build-out, it is often difficult or even impossible to determine a commencement date with any degree of certainty. In such circumstances, a floating date may often be necessary. If a floating commencement date is used, the lease should require the tenant to confirm the commencement date in writing before it takes possession of the premises. Form 3.7 is an example of a commencement date memorandum.

When the lease anticipates a build-out, it is important for the landlord to control the potential for tenant-generated delay. The tenant can delay construction in several ways, but most problems involve the preparation or approval of construction plans. When the lease contemplates the construction of tenant improvements, it is useful either to attach the approved plans to the lease as an exhibit or to establish a timetable for preparation and approval within the lease. At a minimum, if rent is to be abated or other concessions extended to the tenant based on delay, the landlord will want to preclude their application when the delay is attributable to the tenant's action or inaction.

The primary drafting goal for both parties is to avoid ambiguity. With the exception of the floating-commencement-date clause, the sample clauses assume that the landlord has defined the Commencement Date and Expiration Date using specific dates in the definition section at the beginning of the lease. By defining the Commencement Date and the Expiration Date at the beginning of the lease, specific dates are incorporated by reference throughout the lease.

Specific dates should be used whenever possible to avoid confusion and misunderstanding. There is, however, a downside to using specific dates in a lease. When one or both parties procrastinate or delay in the execution of the lease, the lease may need to be modified or amended before the ink is dry. Delay is not always intentional, particularly when one of the parties is a large institution with a highly bureaucratic approval process. Some leases require a floating commencement date simply because the parties are unable to determine how long the execution process will take. Ultimately, the format employed must correspond to the speed by which the parties can execute the lease once it is prepared.

C. Extending the Term

§3.21

Sample Clauses

Simple extension option. If Tenant is not in default, Tenant has the option to extend the Term for an additional *[number]* Lease Years. This Lease will continue to apply during the extended Term, except that (a) the Annual Base Rent will increase to *[\$amount]*, (b) each Monthly Installment of Base Rent will increase to *[\$amount]*, and (c) Tenant will not be entitled to any further extensions of the Term. Tenant's option to extend must be exercised by giving notice of the extension not less than *[number]* months before the Expiration Date.

Option with fair market rent. Tenant has the option to extend the Term (Extension Option) for one additional *[number]*-year period beginning *[date]*, and ending *[date]* (Extended Term). This Extension Option must be exercised by notice from Tenant to Landlord on or before *[date]*. If the Extension Option is exercised, this Lease will continue to apply during the Extended Term, except that (a) Tenant is not entitled to any further extensions of the Term and (b) the Annual Base Rent will be increased to the greater of (i) the then-prevailing fair market rent or (ii) the Annual Base Rent during the final Lease Year of the initial Term. Each Monthly Installment of Base Rent will be adjusted accordingly during the Extended Term.

Appraisers to determine rent. The Annual Base Rent payable during the Extended Term will be adjusted to the then-prevailing fair market rent for similar properties in *[area]* (Comparison Area), as mutually determined by Landlord and Tenant. If within *[number]* days following Tenant's exercise of the Extension Option, the parties cannot agree on the prevailing fair market rent, the rental rate must be determined by arbitration in the following manner:

- a. Within *[number]* days, Landlord and Tenant must each appoint one arbitrator, who must be a MAI-designated appraiser active in the appraisal of commercial and industrial properties in the Comparison Area.
- b. Within *[number]* days after that, the two arbitrators must appoint a third arbitrator with the same qualifications.
- c. Within *[number]* days after that, the three arbitrators must reach a decision and notify Landlord and Tenant.
- d. The decision of the majority of the three arbitrators is binding on Landlord and Tenant. If the majority of the arbitrators fail to reach an agreement, the prevailing fair market rent will be determined by averaging the appraisal of each arbitrator, ignoring for the purpose of that averaging any appraisal that is more than 10 percent in excess of or less than the middle appraisal.
- e. If either Landlord or Tenant fails to appoint an arbitrator within the time period designated, the arbitrator appointed by the other must decide, and that arbitrator's decision is binding on Landlord and Tenant.
- f. If the two arbitrators fail to agree on and appoint a third arbitrator, both arbitrators must be dismissed and the matter submitted to arbitration under the provisions of the American Arbitration Association.
- g. Landlord and Tenant must pay the costs of arbitration equally.

On the request of either party, the circuit court may render a judgment on the arbitration award and enter whatever additional orders and equitable relief may be necessary to enforce the award.

American Arbitration Association to determine rent. The Annual Base Rent payable during the Extended Term will be adjusted to the then prevailing fair market rent for similar properties in *[area]* (Comparison Area) as mutually determined by Landlord and Tenant. If within *[number]* days following Tenant's exercise of the Extension Option the parties cannot agree on the prevailing fair market rent, the rental rate must be determined by the American Arbitration Association in accordance with its then prevailing rules. A judgment on the award may be entered in any court that has jurisdiction. The arbitrators will have no power to change any of the provisions of this Lease in any respect, and the jurisdiction of the arbitrators is expressly limited accordingly. The arbitration must be by a panel of *[one / two / three]* arbitrators.

Perpetual renewal (based on *Petition of Mackie*). At the end of the Term of this Lease, the Lease will be automatically renewed for a further period of *[number]* years at the same Annual Rent, payable as described above, unless Tenant gives Landlord written notice *[number]* days before the expiration of the Lease that Tenant does not intend to exercise this privilege of renewal. This provision for automatic renewal is operative on each and every renewal lease.

Commentary

Common law and statutes. It is Michigan's public policy to construe leases as not granting a right of renewal or extension. *Briarwood v Faber's Fabrics, Inc*, 163 Mich App 784, 415 NW2d 310 (1987). There is no implied right to extend or renew a lease. *Id.* As noted in *Walker & Co v Davis*, 257 Mich 316, 317, 241 NW 169 (1932), MCL 565.5 provides that "[n]o covenant shall be implied in any conveyance of real estate, except oil and gas leases, whether such conveyance contain special covenants or not." There is no right to extend or renew a lease absent specific language to that effect. *Briarwood*.

Although it is possible to enter into a "perpetual" lease, clear language establishing such a right is required. *Department of Nat Res v Board of Trs of Westminster Church of Detroit*, 114 Mich App 99, 318 NW2d 830 (1982); *Petition of Mackie*, 372 Mich 104, 109, 125 NW2d 482 (1963). In *Mackie*, the Michigan Supreme Court held that language like that in the perpetual-renewal sample clause "clearly expresses the intent of the parties to the lease that the lease should continue in effect until such time as the lessee, or its successors and/or assigns, signified an intent to terminate the lease." *Id.*

If the lease provides for an extension but does not identify the duration of the extension, the extension is for the same period as the initial term. *Starr v Holck*, 318 Mich 452, 461, 28 NW2d 289 (1947) ("It is definitely settled by authority, however, that an agreement for an extension or renewal of a lease, without designation of the added period, is to be considered as contemplating an extension or renewal for a period equal to the original term.").

There is a long-standing common-law distinction between *renewals* and *extensions*. Renewals contemplate the execution of a new lease document, but extensions do not. *Delashman v Berry*, 20 Mich 292 (1870). Although this distinction is now largely academic, use of the term renewal to mean extension can create problems. *Stancroff v Brown*, 76 Mich App 589, 596, 257 NW2d 179 (1977) (“The use of the word “renewal” alone in a lease provision is not enough to prevent such a provision from being construed as an extension where the latter result is shown by the circumstances to have been intended by the parties” (quoting *Mutual Paper Co v Hoague-Sprague Corp*, 297 Mass 294, 8 NE2d 802 (1937))); accord *Darling v Hoban*, 53 Mich 599, 19 NW 545 (1884). A general discussion of the law surrounding this distinction is set forth in John G. Cameron, Jr., *Michigan Real Property Law* §20.23 (ICLE 3d ed).

Options are governed by the contract terms established by the parties. *Phillips v Homer (In re Smith Tr)*, 480 Mich 19, 28, 745 NW2d 754 (2008). An option to extend or renew is treated as a continuing offer by the landlord. *Maas Bros v Weitzman*, 288 Mich 625, 286 NW 104 (1939). When accepted by the tenant, the option becomes a binding contract to lease during the extended period. *Id.* Because an option within a lease is considered merely an offer, acceptance must strictly comply with the terms proposed by the option, regarding both the exact thing offered and the time specified; otherwise, the right is lost. *Gurunian v Grossman*, 331 Mich 412, 49 NW2d 354 (1951); *Mathieu v Wubbe*, 330 Mich 408, 47 NW2d 670 (1951). Substantial compliance with the terms of the option is not generally sufficient. *Gurunian*. But see *Tel-Towne Props Grp v Toys “R” Us–Delaware, Inc*, 630 F Supp 2d 766 (ED Mich 2007) (equitable relief given); *King-Blair Co v Schloss*, 253 Mich 243, 234 NW 481 (1931).

It is presumed that the renewal is to be continued on the same terms and conditions, unless some other intention is expressed. *Maas Bros*. The exception to this presumption is the right of further renewal or extension. *Metzgar Register Co v Thomas Canning Co*, 220 Mich 435, 190 NW 245 (1922); *Gould v Harley*, 215 Mich 234, 238, 183 NW 705 (1921). As summarized by the *Gould* court:

“It is the universally recognized rule that where the provision is in general terms for a renewal, the lessee is only entitled to a single renewal, and it is held that a provision that the renewal lease shall contain similar covenants, terms, etc., as contained in the original lease, does not require the insertion in the renewal lease of the covenant to renew; otherwise a perpetuity is provided for, and in such a case even an agreement for a second renewal will not be inferred and the lessee is entitled to one renewal only”

Id. (citations omitted). Although agreements for perpetual extensions are permissible, they are neither favored nor presumed.

The common law has repeatedly addressed how an extension or renewal option must be exercised. Options are governed by the contract terms the parties established. *Phillips v Homer (In re Smith Tr)*, 480 Mich 19, 28, 745 NW2d 754 (2008). If the lease does not specify how the option is to be exercised, it may be exercised orally or by possession. In *Kern v Pawlega*, 5 Mich App 384, 146 NW2d 689 (1966), the court of appeals upheld the oral exercise of a renewal option. As the *Kern* court stated, in the absence of an express

requirement in the lease about how it must be exercised, “[a]ll that is required is that the tenant inform the landlord with reasonable certitude, in terms that cannot fairly be misunderstood, of her exercise of the option given her by the lease.” *Id.* at 388–398 (quoting *Boden v Trumpour*, 344 Mich 133, 136, 73 NW2d 462 (1955)). The tenant’s continued possession may be sufficient to exercise an extension option unless the tenant has expressed an intention to the contrary. *Delashman*. Possession, however, may not be sufficient to exercise a renewal option. See John G. Cameron, Jr., *Michigan Real Property Law* §20.25 (ICLE 3d ed). If the lease requires written notice, continued possession is not sufficient to exercise the option. *Beller v Robinson*, 50 Mich 264, 15 NW 448 (1883). Moreover, if the option requires written notice, the notice must generally be received by the landlord before the expiration of the deadline. *Starr*, 318 Mich at 457–458 (“Where a contract requires notice, but does not specify the manner in which the notice is to be given, mere mailing of the notice is not sufficient unless it is received, in the absence of express provisions in the contract to the contrary, and if the notice is mailed in proper time, but is not received until after the time fixed for giving notice, it is ineffective.”).

A number of cases address how rent may be determined during the extended term. It is not uncommon for the parties to leave some of the provisions of the option, particularly rent, to be determined in the future. Such terms can be fixed by judicial determination, arbitration, or appraisal. *Maas Bros.*

“Speaking generally, chancery will enforce such a contract if the agreement is to submit certain factual questions, such as price, value, quantity, quality, et cetera, to selected persons for determination, and is not of the essence of the principal contract, but is merely subsidiary or auxiliary to its main purpose and scope. A court of equity may determine the subsidiary question of fact itself, or by its master in chancery or by appraisers or arbitrators of its own selection, and may enforce specific performance of the principal contract.”

In a lease with option for renewal upon rental terms to be fixed by arbitrators, a court of equity on refusal of one of the parties to arbitrate may determine the question of a fair and reasonable rental and when such terms are so fixed by the court, such option is enforceable. In renewal leases, the tenant has a quasi proprietorship lacking merely a valuation, and gross inequity would result should he lose his rights through a failure upon the part of arbitrators provided by the contract to fix a valuation. In such a case, a court of equity will determine terms of reasonable rental and thereafter enforce specific performance of the contract upon such terms.

288 Mich at 632–633 (citations omitted). If the landlord is to determine the rent during the extension, the amount must be reasonable. *Bird v Couchois*, 214 Mich 607, 613, 183 NW 36 (1921) (“While the word ‘reasonable’ is not used in the lease, we think it may be clearly implied.”). *But see* MCL 565.5; *Walker & Co*, 257 Mich at 317. If the lease calls for the rent to be tagged at the “prevailing” rate, this does not mean the highest market rent, just the most predominant. *Schroeder v Terra Energy*, 223 Mich App 176, 194, 565 NW2d 887 (1997) (“‘Prevailing’ has been defined as ‘predominant’.”).

Michigan courts distinguish *statutory arbitration* from *common-law arbitration*. *Wold Architects & Eng'rs v Strat*, 474 Mich 223, 231, 713 NW2d 750, 755 (2006). The Michigan Uniform Arbitration Act provides that an agreement to arbitrate is valid, enforceable, and irrevocable except on a ground that exists at law or in equity for the revocation of a contract. MCL 691.1686(1). Parties wishing to conform an agreement to the arbitration statute must put it in writing and require that a circuit court may render judgment on the award made pursuant to the agreement; otherwise, it will be treated as an agreement for common-law arbitration. *Wold Architects & Eng'rs*, 474 Mich at 231. Common-law arbitration agreements are, however, revocable at the will of either party. *Id.* (“What characterizes common-law arbitration is its unilateral revocation rule.”). Arbitration agreements must include the required statutory language to be irrevocable.

Tips, traps, and thoughts. An extension or renewal option is one of the most commonly requested add-ons to a commercial lease. The distinction between *extensions* and *renewals* is widely ignored, but perilously so. The sample clauses all use the term *extension*, which is what is usually meant. Unless the parties actually anticipate executing a new lease, the proper term is *extension*, so use that specific word to avoid problems. The following discussion will focus on extensions, though most points will apply equally to renewals.

It is common practice to condition the exercise of an extension option on the tenant's faithful performance of all of the lease covenants. This can be handled in a variety of ways. The phrase “if Tenant is not in default” is commonly used to condition the exercise of the option. Similarly, “provided Tenant has not defaulted in the performance of any of its obligations under this Lease” conditions the option but includes *any* prior default as effectively precluding the exercise. A middle position is found in the language “provided that no default exists under this Lease and no default has existed within [number] years before the exercise of the option,” which narrows the period.

Typically the extension will be on the same terms and conditions as the original lease term, except for the rent. Before discussing rent, however, it is worth considering the effect of an extension on the extension clause itself. As noted above, an extension on the same terms and conditions typically does not include the reinstatement of the extension option during the extended term. Even though this is the common-law rule, it is wise to expressly state the rule within the extension clause to discourage disputes.

Determination of rent during the extended term is a primary area of concern for the parties. The most straightforward method for dealing with this issue is to agree on the amount in advance. When the parties select an actual amount and insert it into the lease, there is little room for confusion or dispute. The longer the initial lease term, however, the greater the risk that market fluctuations will result in an amount that is either too high or too low when the option is to be exercised. The risk here is on the landlord. If the option rate is too high, the tenant will simply ignore the option and negotiate market rent as the lease draws to a conclusion. If, however, the rent is substantially below market, the tenant will exercise the option and leave its landlord to stew over the loss of market rent. Because options are a one-way street, landlords are often reluctant to commit to a rental rate 10 or 20 years in the future.

Several methods have been developed to deal with this issue. The most landlord-oriented method is to allow the landlord to determine the rent based on its reasonable discretion. Such a provision, though enforceable, gives scant comfort to the tenant. Another solution is to simply provide that the rent will be based on the “then prevailing market rent” for the premises. Such a provision allows the court to determine the rent if the parties are unable to do so. It is, obviously, an imperfect solution, in that it is an invitation for litigation, which can be both costly and divisive. Provisions of this nature often include an arbitration clause to reduce the overall cost and to increase the speed of the determination. If arbitration is the solution, be careful to use language to require binding statutory arbitration, as opposed to revocable common-law arbitration.

Finally, it is important for the parties to specifically agree on how the option is to be exercised. The best mechanism is through written notice delivered in a specified manner before a specific date. Tenants must be extremely careful to comply with all the requirements of the lease, particularly in light of the substantial body of caselaw requiring strict compliance with the terms of an option. The tenant must never take the exercise of an option for granted.

D. Early Termination

§3.22

Sample Clauses

Co-Tenancy right to terminate. If less than *[percentage]* of the rentable space in the *[Building / Shopping Center]* is occupied by tenants for any consecutive *[number]*-month period commencing *[number]* months after the Commencement Date, Tenant will have, as its sole and exclusive remedy, the right to terminate this Lease on *[number]* days’ written notice to Landlord at any time prior to the date upon which *[percentage]* or more of the rentable space in the *[Building / Shopping Center]* is occupied by tenants. If this Lease is terminated pursuant to this Section, Landlord and Tenant will be released from all obligations other than those that accrued prior to the termination of this Lease.

Co-Tenancy (anchor) right to terminate. If *[anchor tenant]* ceases operations at the *[Building / Shopping Center]*, Tenant will have, as its sole and exclusive remedy, the right to terminate this Lease on *[number]* days’ written notice to Landlord. If this Lease is terminated pursuant to this Section, Landlord and Tenant will be released from all obligations other than those that accrued prior to the termination of this Lease.

Termination option. Tenant has the option to terminate this Lease (Early Termination Option) effective *[date]*, by paying a termination fee of \$*[amount]* (Termination Fee). To exercise this Early Termination Option, Tenant must provide notice of Tenant’s intent to terminate this Lease on or before *[date]*, and pay the Termination Fee at the time the notice is given. If Tenant (a) does not exercise the Early Termination Option within the required period, (b) fails to provide Landlord

with the required notice, or (c) fails to pay the Termination Fee at the time the notice is given, this Termination Option automatically terminates and has no further force or effect. This Termination Option is personal to Tenant and may not be transferred or assigned.

Alternative termination option. If Tenant is not in default, Tenant has the option to terminate this Lease at the end of the [number] Lease Year. To exercise its early termination option, Tenant must give notice [number] months before the end of the [number] Lease Year and pay a termination payment equal to (a) [number] months' base rent, (b) whatever common area maintenance estimates would be in effect during the first [number] months of the [number] Lease Year, (c) the unamortized straight line costs of the tenant improvements, and (d) all leasing commissions paid by Landlord in connection with the Lease.

Commentary

Common law and statutes. If the lease has a fixed term, the tenant remains liable for rent regardless of whether it uses or abandons the premises. *Pyle v Orzell*, 350 Mich 298, 86 NW2d 163 (1957). Agreements for early termination are enforceable, but they must be in writing to comply with the statute of frauds. *Barth v Women's City Club*, 254 Mich 270, 236 NW 778 (1931).

Options are governed by the contract terms the parties established. *Phillips v Homer (In re Smith Tr)*, 480 Mich 19, 28, 745 NW2d 754 (2008). An option is treated as a continuing offer by the landlord. *Maas Bros v Weitzman*, 288 Mich 625, 286 NW 104 (1939). When accepted by the tenant, the option becomes a binding contract. *Id.* Because an option within a lease is considered merely an offer, acceptance must strictly comply with the terms proposed by the option; otherwise, the right is lost. *Gurunian v Grossman*, 331 Mich 412, 49 NW2d 354 (1951); *Mathieu v Wubbe*, 330 Mich 408, 47 NW2d 670 (1951). Substantial compliance with the terms of the option is generally not sufficient. *Gurunian*. *But see Tel-Towne Props Grp v Toys "R" Us-Delaware, Inc*, 630 F Supp 2d 766 (ED Mich 2007) (equitable relief); *King-Blair Co v Schloss*, 253 Mich 243, 234 NW 481 (1931).

Tips, traps, and thoughts. Landlords dislike termination options. The tenant's ability to terminate the lease before the expiration of the initial lease term essentially reduces the true term of the lease. Lenders and potential purchasers of the landlord's interest will view the duration accordingly, which is likely to have a negative effect on valuation. At a minimum, the landlord is likely to require the payment of a substantial termination fee, which is often related to the unamortized transaction costs relating to the lease. It is common practice to condition the termination option on the tenant's faithful performance of all of the lease covenants. Various potential qualifications of the right are discussed in §3.21.

Co-tenancy termination rights can be very important to a retail tenant. Since the anchor stores and other retail tenants provide "draw" for both the shopping center and their own store, the loss of an anchor or of a significant number of co-tenants can significantly impact most retailer's sales.

It is also important that the parties specifically agree on how the option is to be exercised. The best mechanism is through written notice delivered in a specified manner before a specific date. Tenants must be careful to comply with all the requirements of the lease, particularly in light of the substantial body of caselaw requiring strict compliance. The tenant must never take the exercise of an option for granted.

E. Holdover

§3.23

Sample Clauses

Basic holdover. If Tenant remains in possession of the Premises after the Expiration Date with the consent of Landlord, it will occupy the Premises as a holdover tenant on a month-to-month basis. Landlord may withhold its consent to the holdover in its sole discretion. If Landlord consents to the holdover, Tenant is subject to all the covenants of this Lease to the extent they can be applied to a month-to-month tenancy, except that the Monthly Installment of Base Rent for each month of the holdover will be [125 / 150 / 200] percent of the Monthly Installment of Base Rent payable during the last month of the Term. This covenant does not preclude Landlord from recovering damages if Tenant fails to timely deliver possession of the Premises after termination of the holdover, nor does it establish any right to extend or renew the Term.

Consequential damages. If Tenant holds over after the expiration of the Term without Landlord's consent, Tenant is liable for all damages resulting from the holdover. It is expressly within the contemplation of the parties that such damages may include (a) the reasonable rental value of the Premises; (b) any damages arising from the loss of any sale, lease, or refinancing of the [Premises / Building / Shopping Center]; (c) any lost profits incurred by Landlord; and (d) any treble, double, or statutory damages allowed under the Applicable Laws.

Commentary

Common law and statutes. The tenant has no common-law right to holdover after the conclusion of the lease term. *Deroshia v Union Terminal Piers*, 151 Mich App 715, 391 NW2d 458 (1986). The landlord has the absolute right either to accept the tenant's proposed holdover or to treat the former tenant as a trespasser. *Auto Parts v Jack Smith Beverages*, 309 Mich 735, 742, 16 NW2d 141 (1944); *Rice v Atkinson-Deacon-Elliott Co*, 215 Mich 371, 183 NW 762 (1921); *Scott v Beecher*, 91 Mich 590, 52 NW 20 (1892). There is no implied right to extend the lease. *Briarwood v Faber's Fabrics, Inc*, 163 Mich App 784, 415 NW2d 310 (1987); see also *Walker & Co v Davis*, 257 Mich 316, 317, 241 NW 169 (1932). Nonetheless, the landlord is not entitled to exercise self-help to remove the ex-tenant from the premises. *Deroshia*.

A consensual holdover clause providing that the tenancy during the holdover is on a month-to-month basis is enforceable under Michigan law. *Wagner v Regency Inn Corp*,

186 Mich App 158, 463 NW2d 450 (1990). Moreover, the lease may impose its general obligations on the tenant during the holdover period. *Id.* at 168 (“the trial court correctly found that the provisions of the parties’ lease continued during the holdover period”). Absent an agreement, the parties are presumed to have agreed that the terms of the lease will apply during the holdover. *Glocksine v Malleck*, 372 Mich 115, 125 NW2d 298 (1963). This presumption does not, however, extend to options to purchase the premises. *Id.*; *Cox v McGregor*, 330 Mich 260, 47 NW2d 87 (1951).

The landlord is entitled to treble damages if it is denied possession by force:

Any person who is ejected or put out of any lands or tenements in a forcible and unlawful manner, or being out is afterwards held and kept out, by force, if he prevails, is entitled to recover 3 times the amount of his actual damages or \$200.00, whichever is greater, in addition to recovering possession.

MCL 600.2918(1). Moreover, “the refusal to leave peaceably, thus requiring removal by force, constitutes a holding by force.” *De Bruyn Produce Co v Romero*, 202 Mich App 92, 106, 508 NW2d 150 (1993). In addition, the landlord is entitled to special damages including lost profits as the result of a wrongful holdover by the tenant. *McCullagh v Goodyear Tire & Rubber Co*, 342 Mich 244, 69 NW2d 731 (1955); *Pasieczny v Bonkowski*, 260 Mich 107, 244 NW 248 (1932).

Tips, traps, and thoughts. It is not uncommon for a tenant to remain on the premises after the lease expires. The tenant may find it useful to holdover for a number of reasons. The tenant might be waiting for its new landlord to complete a build-out at its future place of business. The tenant might be going out of business and simply need a few more months to finish the process. Even if the tenant is not closing up shop, its business may be so marginal that it cannot justify the additional financial commitment of a long-term lease. Whatever the reason, the tenancy is a fragile one that can usually be terminated on one-month’s notice.

When the tenant is holding over, it is good practice to enter into a formal holdover agreement so that there are no misunderstandings concerning the rights of the parties. Form 3.8 is a model holdover agreement. For the most part, the agreement simply reinforces the common-law rules with respect to holdover but reduces the potential for dispute.

F. Checklist

§3.24

The initial term

- Does the lease establish an express term? (If not, typically the tenancy is month to month.)
- Does the lease relieve the landlord from any liability for failure to deliver the premises on the agreed date?
- Does the lease remain in effect despite the landlord’s failure to deliver the premises on the agreed date?

- Does the lease provide for rent abatement in the event of delay?
- Does the lease compensate the tenant for costs incurred as the result of a delay in the delivery of the premises?
- Does the lease compensate the tenant for holdover rent incurred as the result of the delay?
- Does the lease preclude abatement or compensation if the tenant causes the delay?
- May the tenant terminate the lease if the delay exceeds a specified duration?
- Does the option to terminate have a sunset date?
- Does the lease employ a floating commencement date?
- If the lease uses a floating commencement date, does it provide that the tenant must confirm the actual date in writing once the lease has in fact commenced?

Extending and renewing the term

- Does the lease provide the tenant with the right to extend or renew the term? (If not, no right exists.)
- How is the right to be exercised?
- What is the duration of the extension?
- Is the tenant entitled to additional extensions?
- How is rent to be determined during the extended term?
- If there is a dispute over the determination of rent during the extended term, what are the mechanisms for resolution? Appraisal? Arbitration? Litigation?
- If the rent during the extended term is to be determined by arbitration, does the lease employ the statutory language required to establish binding statutory arbitration rather than revocable common-law arbitration?

Early termination

- Does the lease give the tenant a right of early termination? (If not, no right exists.)
- What are the requirements to exercise the option?

Holdover

- Does the lease expressly address the rights and obligations of the parties in the event of a holdover?
- Does the lease impose the general obligations of the lease on the tenant during the holdover?
- Does the lease adjust or otherwise address the issue of the rent due during the holdover?

VI. Rent

A. In General

§3.25 It can be said boldly, and without fear of contradiction, that it is the rent provision that is most near and dear to the heart of the landlord. Because of its importance, there are a great variety of clauses that are directed to the obligation to pay rent. This creates a challenge for their presentation and analysis. This section will break the clauses into two broad groups: (1) gross and net leases and (2) percentage rent leases. The first section

(gross and net leases) will further break down into three subsections: (1) clauses establishing definitions for use in gross and net leases, (2) clauses generally dealing with the tenant's payment of base rent, and (3) clauses involving the tenant's payment of taxes and expenses. In order to retain a sense of context, the reader is invited to examine the form leases to see how the components fit together in a final product.

B. Gross and Net Rent Leases

§3.26

Establishing definitions for use in gross and net leases

Sample Clauses

Definition of Rent (gross lease). Rent means the Annual Base Rent and each Monthly Installment of Base Rent.

Definition of Rent (net lease). Rent means the Annual Base Rent, each Monthly Installment of Base Rent, and Additional Rent.

Definition of Additional Rent (net lease with expenses narrowly defined). Additional Rent means the reimbursement of the following expenses paid or incurred by Landlord in connection with the Premises: *[Real Estate Taxes / Operating Expenses / Insurance / Utilities / other specific charges that may become due under the terms of this Lease]*.

Definition of Additional Rent (net lease with expenses broadly defined). Additional Rent means the reimbursement of all expenses paid or incurred by Landlord in connection with the Premises, including *[Real Estate Taxes / Operating Expenses / Insurance / Utilities]* and all other charges that may become due under the terms of this Lease.

Definition of Real Estate Taxes (net lease with taxes broadly defined). Real Estate Taxes means (a) real estate taxes; (b) ad valorem taxes; (c) general, special, ordinary, or extraordinary assessments; (d) water and sewer charges; (e) taxes based on the receipt of rent, other than federal, state, and local income taxes; and (f) any other federal, state, or local charge that may now or later be imposed, levied, or assessed against the *[Premises / Building / Shopping Center]*.

Exclusions from definitions of Real Estate Taxes (net lease). Notwithstanding anything to the contrary, Real Estate Taxes will not include any of the following: (a) any assessments for highway, street or traffic control improvements, sanitary or storm sewers, utilities, or for other off-site improvements of any nature whatsoever made in connection with the development of the *[Building / Shopping Center]*; (b) any franchise, gift, estate, inheritance, conveyance, transfer, capital investment, or other tax assessed against Landlord or Landlord's heirs, successors or assigns; (c) any income, excess profits or other tax, assessment, charge,

or levy on the rent payable by Tenant under this Lease, (d) any interest, fine, or penalty for late payment or nonpayment by Landlord of any Real Estate Taxes; or (e) any increased assessments that result and are permissible by law solely as a result of transfers in ownership.

Definition of Operating Expenses (net lease with expenses broadly defined). Operating Expenses means all expenses paid or incurred by Landlord in connection with the *[Premises / Building / Shopping Center]*. Operating Expenses include (a) all utility charges, including charges for electricity, gas, steam, water, and sewer; (b) all services performed by Landlord, including maintenance, repair, window cleaning, security, and janitorial services; (c) all insurance, including commercial general liability, property, fire, casualty, extended coverage, worker's compensation, elevator, boiler and machinery, war risk, or any other insurance carried in good faith by Landlord or required by Landlord's mortgagee; (d) all management fees; (e) all wages, salaries, and fringe benefits paid to all persons engaged in performing services in connection with the *[Premises / Building / Shopping Center]*; (f) the cost of depreciation and maintenance for movable equipment and personal property; (g) all capital expenditures that reduce the Operating Expenses; (h) all repairs or other activities arising out of the presence of hazardous substances; (i) all charges of any independent contractor who, under contract with Landlord or its representatives, performs work in connection with the *[Premises / Building / Shopping Center]*; (j) all legal and accounting expenses, including the cost of seeking reductions and refunds of Real Estate Taxes; and (k) any other expense, whether or not previously mentioned, that, in accordance with sound accounting and management principles, would be considered an expense of the *[Premises / Building / Shopping Center]*.

Exclusions from definition of Operating Expenses (net lease).

Notwithstanding anything to the contrary, Operating Expenses will not include any of the following: (a) principal or interest payments on loans or other debts; (b) leasing commissions; (c) the cost of tenant improvements or build-outs incurred in connection with preparing, altering, or improving space for any tenant; (d) salaries or fringe benefits of personnel above the level of general manager; (e) costs incurred in connection with repairs that are the obligation of another tenant of the *[Building / Shopping Center]*; (f) expenses incurred in connection with the restoration of the *[Building / Shopping Center]* due to casualty, destruction, or condemnation; (g) costs incurred by Landlord as a result of Landlord's breach of this Lease or any other lease with a tenant of the *[Building / Shopping Center]*; (h) capital expenditures; (i) reserves for future expenses; (j) reserves for bad debts or rent loss; (k) costs reimbursed by another tenant other than pursuant to this section or a similar section of the tenant's lease; (l) costs reimbursed by insurance.

Definition of Insurance (net lease). Insurance means all insurance expenses paid or incurred by Landlord in connection with the *[Premises / Building / Shopping Center]*, including commercial general liability, property, fire, casualty, extended coverage, worker's compensation, elevator, boiler and machinery, war risk,

or any other insurance carried in good faith by Landlord or required by Landlord's mortgagee.

Definition of Utilities (net lease). Utilities means all utility expenses paid or incurred by Landlord in connection with the *[Premises / Building / Shopping Center]*, including charges for electricity, gas, steam, water, and sewer.

Clauses generally dealing with the tenant's payment of base rent

Sample Clauses

Payment of Rent (gross or net lease). Beginning on the Commencement Date, Tenant will pay Landlord the Rent. The Rent will be paid to the order of Landlord, in advance, on the first day of each calendar month.

Instructions regarding payment (gross or net lease). Rent must be paid to Landlord in lawful money of the United States, at Landlord's office, or at any other place Landlord designates in writing. All Rent must be paid without notice, demand, setoff, deduction, counterclaim, recoupment, abatement, or adjustment whatsoever. No payment of any amount less than the full Rent due will be deemed other than on account, and Landlord may accept any check or payment without prejudice to Landlord's right to recover the balance due or to pursue any other remedy available to Landlord. Landlord will have the right to apply any payment made by Tenant to the satisfaction of any debt or obligation according to Landlord's sole discretion and notwithstanding any instructions as to application of any such payment, whether such instructions be endorsed upon Tenant's check or otherwise given. The acceptance of a check or checks drawn by parties other than Tenant will not affect Tenant's liability under this Lease, nor will it be deemed an approval of any assignment of this Lease. Landlord shall not be required to accept the check of any person other than Tenant. Tenant assumes the risk of lateness or failure of delivery of mails, and no lateness or failure of mails excuses Tenant from its obligation to have made the payment as required under this Lease.

Interest due on late payment (gross or net lease). Rent that is not received within *[number]* days after its due date will bear interest at *[percentage]* until paid in full.

Administrative charge for late or dishonored payment (gross or net lease). Rent that is not received within *[number]* days after its due date will incur an administrative charge of *[percentage]* of the amount delinquent. Landlord will not be obligated to accept any late payment if the administrative charge is not also paid. If Tenant makes payment by a check which is not honored or is returned unpaid for any reason, Landlord may require that Tenant pay Rent by certified check, cashier's check, or money order. In addition, Tenant will be liable for an administrative charge of $\$[amount]$ for each check that is not honored or returned unpaid for any reason. Landlord and Tenant recognize that the damage which

Landlord will suffer as a result of Tenant's failure to properly pay Rent is difficult to ascertain, the administrative charges being the best estimate of the damage which Landlord will suffer in the event of Tenant's late payment or dishonored check. This provision will not relieve Tenant of Tenant's obligation to pay Rent at the time and in the manner otherwise required.

Proration of payment for partial month (gross or net lease). If the Commencement Date or the Expiration Date is other than on the first or last day of a calendar month, the Monthly Installment of Annual Base Rent for such partial calendar month will be prorated on a daily basis. The prorated Rent for the first month of the Term will be paid on the Commencement Date.

Clauses regarding Tenant's payment of taxes and expenses (net lease)

Sample Clauses

General net rent provision (net lease). With each Monthly Installment of Base Rent, Tenant will also pay Additional Rent by depositing with Landlord an amount equal to 1/12th of the estimated Additional Rent for each Lease Year, as reasonably determined by Landlord. If the funds deposited with Landlord are insufficient to pay the Additional Rent in full, Tenant will, immediately on demand by Landlord, deposit with Landlord any additional funds required to reimburse Landlord for all expenses paid or incurred in connection with the Premises, including Real Estate Taxes, Insurance, Utilities, and any other charge imposed by this Lease. If the funds deposited with Landlord exceed the amount required for the payment of Additional Rent, Landlord will credit the excess to the payment of future Additional Rent.

Payment of Real Estate Taxes (net lease proportionate share with base year). Tenant will pay as Additional Rent its Proportionate Share of any increase in Real Estate Taxes, which will be computed by subtracting the Real Estate Taxes for the Base Year from the Real Estate Taxes for each calendar year of the Term. Tenant will pay its Proportionate Share of any increase in Real Estate Taxes by depositing with Landlord, on the 1st day of each month, an amount equal to 1/12th of the estimated increase in Real Estate Taxes, as reasonably determined by Landlord. Landlord reserves the right to adjust these estimates whenever Landlord deems appropriate. If the funds deposited with Landlord are insufficient to pay Tenant's Proportionate Share of the increase in Real Estate Taxes in full at least *[number]* days before the date they become due, Tenant must, immediately on demand by Landlord, deposit with Landlord whatever Additional Rent Landlord requires to enable it to make the payment. If the funds deposited with Landlord exceed the amount required for the payment of Tenant's Proportionate Share of the increase in Real Estate Taxes, Landlord will credit the excess to the subsequent deposits required to be made by Tenant to pay future increases in Real Estate Taxes. On request, Landlord must furnish Tenant with copies of bills for the Real Estate Taxes. During the calendar years in which the Term commences and terminates, Tenant's liability for its Proportionate Share of any increase in Real Estate Taxes for those

years is subject to a pro rata adjustment based on the total number of days in the calendar year falling within the Term.

Payment of Operating Expenses (net lease proportionate share with base year). Tenant will pay as Additional Rent its Proportionate Share of any increase in Operating Expenses, which will be computed by subtracting the Operating Expenses for the Base Year from the Operating Expenses for each calendar year of the Term. Tenant will pay its Proportionate Share of the increase in Operating Expenses by depositing with Landlord, on the 1st day of each month, an amount equal to 1/12th of the estimated increase in Operating Expenses, as reasonably determined by Landlord. If the funds deposited with Landlord are insufficient to pay Tenant's Proportionate Share of the increase in Operating Expenses in full, Tenant must, immediately on demand by Landlord, deposit with Landlord whatever Additional Rent Landlord requires to enable it to make the payment. If the funds deposited with Landlord exceed the amount required for the payment of Tenant's Proportionate Share of the increase in Operating Expenses, Landlord will credit the excess to the subsequent deposits Tenant must make to pay future Operating Expenses. During the calendar years in which the Term commences and terminates, Tenant's liability for its Proportionate Share of any increase in Operating Expenses for those years is subject to a pro rata adjustment based on the total number of days in the calendar year falling within the Term.

Landlord's verification of charges (net lease). As soon as reasonable after the expiration of each Lease Year, Landlord will furnish Tenant a statement showing the following: (a) [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*] and other expenses for the expired Lease Year and (b) the estimated increase, if any, for those items during the new Lease Year.

Landlord's verification of adjustments (net lease). At the time of any adjustment, Landlord must furnish Tenant evidence of the increase in [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*] sufficient in Landlord's opinion to sustain the adjustment. If Tenant is not satisfied with Landlord's determination of the amount of Additional Rent, Tenant must pay the Additional Rent, but Tenant has the right to require Landlord to furnish at [*no additional / Tenant's*] expense a detailed statement of the basis for the increase. As soon as reasonable after the end of each calendar year, Landlord must give Tenant a statement showing the following: (a) [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*] for the expired calendar year, (b) [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*], and (c) the estimated increase in [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*] during the new calendar year.

Tenant audit rights (net lease). Not more than once every calendar year, Tenant will have the right to audit Landlord's books and records with respect to [*Real Estate Taxes / Operating Expenses / Insurance / Utilities*]. Tenant is entitled, at any reasonable time during regular business hours, after giving at least [*number*] business days' notice to Landlord, to audit Landlord's books and records at the site

of their location, using its own staff auditor or an independent auditor selected by Tenant. The scope of the audit is limited to the determination the accuracy of the amounts billed to Tenant for the prior *[number]* calendar years immediately preceding the year during which the notice is given. Landlord may make copies of the relevant books and records if requested by Tenant, at Tenant's expense.

Overcharges (net lease). If the audit discloses that Tenant's actual liability for *[Real Estate Taxes / Operating Expenses / Insurance / Utilities]* is less than the amount paid by Tenant, Landlord must refund the difference to Tenant within *[number]* days. If the audit reveals that Tenant was overcharged by more than *[percentage]*, Landlord must refund the overcharges and bear all reasonable costs of the audit.

Right to contest taxes (net lease). Landlord will, within *[number]* days of receiving notification, send to Tenant notice of any increase in the assessment for Real Estate Taxes. If Tenant requests Landlord to contest the assessment, and Landlord fails to contest the amount or validity of specific Real Estate Taxes which are payable by Tenant, Tenant will have the right, at Tenant's expense, to contest the amount or validity of Real Estate Taxes by appropriate administrative and legal proceedings brought either in Tenant's name, Landlord's name, or jointly with Landlord, as Tenant may deem appropriate. Counsel will be selected and engaged by Tenant, but Landlord will execute and deliver to Tenant whatever documents may be necessary or proper to permit Tenant to contest Real Estate Taxes, or which may be necessary to secure payment of any refund that may result from any such proceedings. Any refund resulting from a proceeding will be applied first to reimburse the party or parties who brought the proceeding for expenses incurred in connection with the proceeding, including reasonable attorney fees, and then to reimburse Tenant for the difference between the amount Tenant paid for Real Estate Taxes for each tax fiscal year involved in the proceeding and the amount Tenant would have been required to pay if the Real Estate Taxes had been assessed in accordance with the decision rendered in the proceeding, together with interest on the amount of such difference at the annual rate allowed by the court on the overpayment of Real Estate Taxes. Any remaining balance will be paid to Landlord.

Personal property taxes (net lease). In addition to the payment of Real Estate Taxes, Tenant must pay in full to the appropriate taxing authority, before delinquent, all municipal, county, and state taxes assessed, levied, or imposed on Tenant's leasehold interest and all personal property of any kind located on or used in connection with the Premises or its operation.

Operating expense multi-year allocation (net lease). If any expenses relating to the *[Premises / Building / Shopping Center]*, though paid in one year, relate to more than one calendar year, at the option of Landlord, such expenses may be proportionately allocated among the related calendar years.

Operating expense “gross up” (net lease). If the [*Building / Shopping Center*] is not fully rented during all or a portion of any calendar year, Landlord may elect to make an appropriate adjustment of the Operating Expenses for that calendar year, employing sound accounting and management principles to determine the amount of Operating Expenses that would have been paid or incurred by Landlord had the [*Building / Shopping Center*] been fully occupied. The amount so determined is deemed to have been the amount of Operating Expenses for that year.

Commentary

Common law and statutes. An agreement concerning rent is one of the four basic requirements for a lease. *Brodsky v Allen Hayosh Indus, Inc*, 1 Mich App 591, 137 NW2d 771 (1965). “In order for an agreement to be a valid lease, it must contain the names of the parties, an adequate description of the leased premises, the length of the lease term, and the amount of the rent.” *De Bruyn Produce Co v Romero*, 202 Mich App 92, 98–99, 508 NW2d 150 (1993). The covenant to pay rent runs with the land. *Riverbend Inv’rs v Progressive Surface Preparation, LLC*, 255 Mich App 327, 660 NW2d 373 (2003).

Rent is the compensation paid for the occupancy and use of the premises. *Munson v County of Menominee*, 371 Mich 507, 124 NW2d 246 (1963). Generally speaking, “[r]ent, as an obligation, differs from the usual contractual obligation.” 1 Milton R. Friedman, *Friedman on Leases* §5.101 (4th ed 1997); see also *SS Kresge Co v Twelve Seventy-Five Woodward Ave Corp*, 270 Mich 218, 221, 258 NW 252 (1935) (“Technically, rent is something which a tenant renders out of the profits of the land which he enjoys.” (quoting *Otis v Conway*, 114 NY 13, 16, 20 NE 628 (1889))). Because rent is tied to the temporal use and productivity of land, liability does not accrue until the applicable time period has passed. *Erb-Kidder Co v Levy*, 262 Mich 62, 247 NW 107 (1933).

The fundamental tie between the use of land and the temporal nature of that use has two ramifications on any claim for rent. First, the claim for rent accrues with the passage of time. *Erb-Kidder*. Therefore, in the absence of an agreement requiring payment at the beginning of the period (like the first of the month), rent is not due until the end of that period. *Bushman v Faltis*, 184 Mich 172, 177, 150 NW 848 (1915) (“Taking the contract standing alone, it providing that the rent shall be a certain amount ‘per year,’ under the authorities the amount would be due at the end of the period with reference to which rent is computed, which in the instant case would be at the end of the year.”). Second, if this use and occupation should end, the rent would never become due.

Unless otherwise provided in the lease, the tenant has no obligation to pay real estate taxes, which are the obligation of the landlord. *Wycoff v Gavrilloff Motors, Inc*, 362 Mich 582, 107 NW2d 820 (1961). The tenant may agree to pay real estate taxes. *Blake v Metropolitan Chain Stores*, 247 Mich 73, 225 NW 587 (1929). If made, such an agreement runs with the land. *Id.* The tenant’s agreement to pay real estate taxes does not include an obligation to pay special assessments. *G&A Inc v Nahra*, 204 Mich App 329, 332, 514 NW2d 255 (1994) (“While plaintiff was responsible for all real property taxes under the lease agreement, it was not responsible for special assessments.”).

Unless expressly agreed, the tenant has no obligation to insure the premises against casualty. *New Hampshire Ins Grp v Labombard*, 155 Mich App 369, 399 NW2d 527 (1986). The parties may agree that the tenant will insure the premises or that the tenant will reimburse the landlord for insuring the premises. *See Milbrand Co v Lumbermens Mut Ins Co*, 175 Mich App 392, 438 NW2d 285 (1989); *Stefani v Capital Tire, Inc*, 169 Mich App 32, 425 NW2d 500 (1988).

Several other points merit noting. The obligation to pay rent is an independent covenant. *Reaume v Wayne Circuit Judge*, 299 Mich 305, 300 NW 97 (1941). A breach of lease by the landlord generally does not justify the suspension of rent payments by the tenant. *See* Lawrence R. Shoffner, *Commercial Leases: Effect of Landlord's Breach on Tenant's Obligation to Pay Rent*, 17 Mich Real Prop Rev 75 (1990). When a lease requires the landlord to complete a build-out of tenant improvements before the commencement of the lease, substantial completion of construction by the landlord is sufficient to start the accrual of rent. *Gordon v Great Lakes Bowling Corp*, 18 Mich App 358, 171 NW2d 225 (1969).

Tips, traps, and thoughts. Commercial leases fall into three types, based on how the rent is to be determined—gross leases, net leases, and percentage rent leases. These types can and do overlap. There is no reason, for example, why a fully net lease cannot also require the payment of percentage rent. Similarly, a percentage rent lease may impose certain expense obligations on the tenant. These terms do, however, provide a general description about how rent payments will be determined.

Of the three lease types, gross leases are the simplest when it comes to determining rent. In a gross lease, the rent is a specific amount and no other payments are generally expected. The landlord retains the obligation to pay real estate taxes and to obtain whatever insurance it desires. A net lease may transfer these, and potentially other, expenses of ownership to the tenant. Leases that transfer responsibility for all expenses to the tenant are sometimes referred to as “absolute-net leases.” This discussion simply refers to all leases that transfer expense obligations to the tenant as “net leases.” The third type, the percentage rent lease, is a lease that ties all or a portion of the rent to a percentage of the tenant’s gross sales. Conceptually, the arrangement harkens back to sharecropper leases, in which the landlord took a share of the produce generated from the soil. Percentage rent leases are found almost exclusively in the retail context and are particularly common for shopping centers.

Gross rent leases. The rent covenant in a gross lease is the easiest to draft. All that is required is a statement of the rent due, but a couple of basic refinements are suggested. First, even though lease covenants are independent, it is a good idea to expressly provide that the rent payments are not subject to setoff if that is the agreement. A discussion of this point is set forth in §5.23 and will not be repeated here. In addition, because rent payments are usually made on the first of the month, many landlords simply assume that is the law. In fact, the opposite is true. At common law, rent payments are not due until the end of the month. The common-law rule may be, and usually is, modified by agreement, but that agreement must be expressed in the lease to be enforced.

Net rent leases. At common law, a lease was treated as a conveyance of real property for a specified term. Because the lease was a conveyance, the landlord retained little involvement with the property, so there were only a few expenses to worry about, specifically taxes and insurance. The tenant had no common-law obligation to pay real estate taxes or to keep the landlord's property insured. The presumption was that the landlord would charge a gross rent sufficient to cover such expenses. Real estate taxes and insurance are, however, costs that can increase over the duration of the lease. To prevent inflation from reducing the landlord's return, landlords began shifting these costs directly to tenants. As commercial leases became more sophisticated and landlords began assuming more involvement in operating multitenant office buildings and shopping centers, the expenses became greater and the allocation mechanism more complex.

Multitenant properties such as shopping centers and office buildings present a complex situation for the drafter. First, a mechanism must be established to allocate the expenses among the various tenants. Second, the expenses in a multitenant building will include the cost of maintaining the common areas of the property and the cost of providing a variety of contractual services to the tenants. Modern multitenant leases are no longer bare conveyances. Retail leases, for example, often take on many aspects of a joint venture between the landlord and its tenants. Office leases can include a variety of services, including janitorial, security, and maintenance. As additional service costs are brought within the scope of the lease, the inflation risk correspondingly increases. Although landlords of multitenant properties are willing to provide a variety of services, they are typically unwilling to allow escalations in the costs of providing those services from reducing their desired returns.

The purpose of the net lease is to protect the landlord's return on investment. This can be done in two ways. The landlord can establish a base rent that reflects its desired return and simply transfer all the expenses to the tenant. Another way to accomplish the same goal is to calculate the rent based on two components: (1) the current year's expenses and (2) the desired return on investment. The combined amount is then established as the base rent. The current year's expenses are treated as the base amount for calculating increases, and the current year is treated as the base year for the calculation. Only those increases that exceed the expenses in the *base year* are billed to the tenant. This is generally referred to as an *escalator* or *cost escalation* provision.

Once the base year is established, the tenant is required to pay expenses (usually called *additional rent*) only to the extent they increase beyond the amount paid by the landlord in the base year. This allows the parties to come up with a realistic fixed number for the base rent but still transfers the inflation risk to the tenant. This style of net lease has traditionally been favored by commercial landlords in southeastern Michigan. There are many things to consider when negotiating and drafting a net lease. The first is to determine what expenses are included. This is solely a question of negotiation and leverage. The sample clauses above set forth some operating expense carveouts that the tenant can request. Once the items are agreed on, the goal is to identify them as clearly as possible, which is not always easy. The *G&A* court, for example, held that a provision calling for the payment of real estate taxes does not include any obligation to pay special assessments. *G&A Inc v Nahra*, 204 Mich App 329, 332, 514 NW2d 255 (1994). Because a lease is

typically construed against the landlord, it is incumbent on the landlord's attorney to make sure that its boilerplate provision is drawn as broadly as possible.

The last item to be examined concerning net leases is the problem of expense allocation among the various tenants in a multitenant building. This can be done in a variety of ways, but two are the most common. The easier of the two is simply separate metering. This works well for items such as utilities but is not particularly helpful for handling common-area expenses. The most widely accepted method of addressing the problem is by determining a proportionate share for each tenant, usually based on the proportion of the square footage of the respective premises to that of the entire property. The proportionate share concept allocates the total expenses among the tenants based on each tenant's percentage of occupancy of the building as a whole. Additional discussion of a related issue may be found at Michael E. Meyer, *Counseling the Client on Operating Expenses and Audit Rights (with Sample Clauses)*, *Prac Real Est Law*, Mar 1999, at 71, and Gary Goldman, *Tenant Triage: Operating on a Landlord's Operating Expense Clause*, *Prac Real Est Law*, Mar 2000, at 19. An operating expense gross-up clause is found in many commercial leases for multitenant buildings. The point of the clause is to allocate all the actual costs among the existing tenants. If the costs of a multitenant building are allocated based on percentage of occupancy alone, the landlord will be required to carry that portion of overall costs equal to the unleased space. This can become particularly painful to the landlord during hard times, since it is during periods of declining occupancy when the landlord needs cash most.

C. Percentage Rent Leases

§3.27

Sample Clauses

Definition of Percentage Rent. Percentage Rent means those amounts to be paid to Landlord, in addition to the Rent, which are to be calculated as a percentage of Gross Sales. Gross Sales means all sales of merchandise or services in any way related to the Premises and includes (a) all sales for cash, all sales on credit, all gift certificates honored, all deposits that are not refunded, and all carrying charges imposed on any sales; (b) all orders taken, services performed, and merchandise sold from the Premises, even those delivered or filled elsewhere; (c) all mail, Internet, and telephone orders received or filled on the Premises; and (d) sales by Tenant and any subtenants, licensees, or other occupants of the Premises.

Exclusions from definition of Gross Sales. Notwithstanding anything to the contrary, Gross Sales will not include any of the following: (a) returns and refunds to customers, (b) exchanges of merchandise, and (c) the amount of any sales tax collected by Tenant.

Payment of Percentage Rent. In addition to the Annual Base Rent and Additional Rent, Tenant agrees to pay Landlord the amount by which *[percentage]* of the Tenant's Gross Sales for a Lease Year exceeds the Annual Base Rent for that Lease Year (Percentage Rent). Within *[number]* days after the end of each calendar

month, Tenant will deliver to the Landlord a written statement, certified by an officer of Tenant to be correct, showing the Gross Sales on the Premises for the preceding calendar month. If the fixed percentage of Gross Sales for the preceding calendar month exceeds the Monthly Installment of Base Rent due that month, Tenant will pay the Landlord the excess with the statement. If the total Annual Base Rent and Percentage Rent paid by Tenant in a Lease Year exceeds the total Annual Base Rent and Percentage Rent required to be paid by Tenant during that Lease Year, Tenant will receive a credit for the excess, which Tenant will deduct from the next payments of Percentage Rent.

Reporting gross sales. Tenant must keep full and accurate books reflecting Gross Sales in accord with good accounting practices. On or before the *[date]* of each month, Tenant will furnish Landlord a true and accurate statement of the Gross Sales during the preceding month. On or before *[date]* of each year, Tenant will furnish a true and accurate statement of the Gross Sales during the preceding calendar year, *[verified / certified]* by an independent certified public accountant. Each month, Tenant will furnish Landlord a copy of its work sheet used to make the Michigan Sales Tax Return. Tenant grants Landlord permission to examine the sales tax records on file in the office of the Department of Treasury for the State of Michigan, or at any other place where such records are filed, for the sole purpose of verifying the correctness of the report of Gross Sales submitted.

Retention of Records. Tenant agrees to keep on the Premises for at least *[number]* years after the end of each Lease Year adequate records showing (a) inventories and receipts of merchandise at the Premises, (b) daily receipts from all sales and other transactions on the Premises, (c) records of gross income and sales, and (d) a copy of all sales tax records filed with the State of Michigan.

Radius restrictions. Tenant will not within a radius of *[distance]* miles from the outside boundary of the Shopping Center, directly or indirectly, operate, manage or have any interest in any other store or business which is similar to or in competition with the Designated Use during the Term.

Radius inclusion in gross sales. During the Term, if Tenant or any person or entity affiliated with Tenant directly or indirectly owns, operates, or becomes financially interested in any similar or competing business within a radius of *[distance]* miles from the outside boundary of the Shopping Center, the Gross Sales, as defined in this Lease, of any such business within that radius must be included in the Gross Sales made from the Premises, and the Percentage Rent must be computed on the aggregate of the Gross Sales made from the Premises and from the other business.

Auditing gross sales. Landlord may audit the books and records pertaining to the business of Tenant, its subtenants or licensees, or any other occupants of the Premises. The audit will be conducted by a certified public accountant selected by Landlord. If the audit shows that Tenant has correctly reported Gross Sales, the

expense of the audit will be borne by Landlord. If the audit shows that Tenant failed to report correct Gross Sales for any period, the expense of the audit must be paid by Tenant as Additional Rent during the month following the conclusion of the audit. If the audit discloses a deficiency in the amount of Percentage Rent payable by Tenant, the amount of the deficiency will be promptly paid to Landlord, together with interest at the rate of *[percentage]* from the date when the Percentage Rent was payable until the date of actual payment.

Alternative audit right. If either (a) Landlord, in its sole discretion, is dissatisfied with the submitted statements of Gross Sales or (b) Tenant fails to submit its Gross Sales statement or its annual statement of Gross Sales as provided in this Lease, Landlord may, on not less than *[number]* days' notice during the Term and for *[number]* years following the expiration of the Term, audit Tenant's books, records, documents, and instruments related to the sales of merchandise and all revenue derived from or attributable to business conducted on the Premises, whether or not included in the term Gross Sales. Landlord only has the right to inspect the books, records, accounts, and other such information of Tenant *[number]* times in any *[number]*-year period. If any audit of Tenant pursuant to this section discloses a discrepancy of *[percentage]* or more of Gross Sales, the preceding sentence limiting Landlord's right of inspection has no further force and effect. If Landlord performs an audit because Tenant has failed to submit its annual statement of Gross Sales certified by its independent certified public accountant or if an audit discloses a discrepancy of *[percentage]* or more of Gross Sales (comparing the Gross Sales reported by Tenant to the Gross Sales as calculated by Landlord, over the period audited by Landlord), Tenant must promptly pay to Landlord the greater of *[\$amount]* in liquidated damages, or Landlord's actual costs incurred in performing the audit, together with any Percentage Rent shown to be due to Landlord. In addition, if an audit discloses a discrepancy of *[percentage]* or more of Gross Sales, calculated in accordance with the preceding sentence, Landlord has the further remedy, on not less than *[number]* days' prior notice to Tenant, to declare this Lease terminated as of the date specified in the notice.

Commentary

Common law and statutes. Under Michigan law, the amount of rent may be tied to a percentage of the tenant's sales. *Bobenal Inv, Inc v Giant Super Mkts, Inc*, 79 Mich App 31, 260 NW2d 915 (1977). The primary functions of the percentage lease are to base the landlord's return on the productivity of the location and to automatically adjust the rent as the value of the dollar fluctuates in the swing of the business cycle. Note, *The Percentage Lease—Its Functions and Drafting Problems*, 61 Harv L Rev 317, 318 (1948). The percentage rent clause received its greatest development during the Great Depression. *Id.* The tenant could afford only low rent until business improved. The landlord, on the other hand, did not want to be saddled with low rents if and when the economy recovered. The percentage rent lease presented a perfect solution to the problem. *Id.*

The purpose of a percentage rent clause is to tie the rent to the tenant's gross sales from the premises. Such clauses are rarely employed outside retail leases and are usually only found in shopping center leases. Such an arrangement can be beneficial to both parties. The tenant's rent obligation is reduced when sales are slow and increased when sales are good, which fits well with the tenant's cash flow needs. The landlord benefits by sharing in the profits when things go well.

Since the rent under a percentage lease depends on the business done, the measure of that rent can be no more accurate than the tenant's records allow. *Id.* "The degree of landlord dependence on tenant conduct means that draftsmanship cannot provide a complete substitute for tenant integrity and skill." *Id.* at 325. Nonetheless, the landlord's primary drafting goal is to keep the tenant honest. This is done by using a broad definition of gross sales and ensuring access to the financial information necessary to confirm the tenant's representations. It is also helpful to have a provision that sanctions the tenant if it is caught cheating. This can range from imposing the cost of the audit on the tenant to termination of the lease, as reflected in the alternative landlord audit clause. Percentage rent provisions are particularly difficult for the landlord to enforce when dealing with small mom-and-pop retailers who may have very informal bookkeeping practices or who may be less than scrupulous. It is all but impossible to determine the gross receipts of a cash operation that is not required to maintain records for its home office.

More information on the issues surrounding percentage leases can be found in Annotation, *Calculation of Rental Under Commercial Percentage Lease*, 58 ALR3d 384.

D. Checklist

§3.28

- Is the lease a gross or net lease?
- Does the lease require that rent payments must be made in advance on the first day of each month? (If not, rent payments are not due until the end of the month.)
- Does the lease preclude setoffs against rent?
- If the lease is a net lease, what expense items does the tenant assume?
- If the lease is a net lease, what expense items have been expressly carved out by the parties?
- May the landlord "gross up" the expenses if vacancies arise?
- What is the procedure for estimating expenses?
- What is the verification process for expenses?
- What information regarding the expenses is the landlord required to give to the tenant?
- Can the tenant obtain copies of the original invoices and payment records?
- Does the tenant have the right to audit the landlord's books to verify expenses?
- What is the scope of the audit right?
- Does the lease have a percentage rent provision?
- What is the definition of *gross sales*?
- What items have been carved out of the definition of gross sales?
- What is the verification process for gross sales?
- What information is the tenant required to give to the landlord?

- Can the landlord obtain copies of the original sales records?
- Does the landlord have the right to audit to verify sales?
- What is the scope of the audit right?

Footnote

¹ ICLE and the authors acknowledge the contributions of Lawrence Shoffner to previous versions of this chapter. The authors would also like to express special thanks to the following people for assistance with material in chapters 3, 4, and 5: Jerome P. Pesick and Jason C. Long, for their contributions on condemnation issues; Michael P. Donnelly and Anita G. Fox, for their contributions on insurance issues; Mark P. Krysinski, for his contributions on construction issues; Arthur H. Siegal, for his contributions on environmental issues; and Jonathan S. Green, for his contribution on bankruptcy issues.

Forms and Exhibits

- Form 3.01 Gross Lease (Single-Tenant Building)
- Form 3.02 Net Lease (Single-Tenant Building)
- Form 3.03 Expense Escalation Lease, Multitenant Building
- Form 3.04 Percentage Rent Lease, Multitenant Building
- Form 3.05 Commercial Leasing Checklist
- Form 3.06 Landlord's Work Letter
- Form 3.07 Lease Commencement Memorandum
- Form 3.08 Temporary Holdover Agreement



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