3

Drafting Commercial Leases

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I. Overview

A. In General

§3.1 The goal of this chapter is to provide both a practical guide for the beginning lawyer and a useful reference tool for more seasoned drafters. The chapter is intended to be state specific; there is little discussion of foreign case law and no discussion of majority rules or trends outside of Michigan. Instead, this chapter presents the basic lease clauses, common law, and statutes required to address the majority of issues that will arise during the negotiation and drafting of a commercial lease for Michigan land.

Although a variety of clauses will sometimes be provided to address a single issue, this chapter does not attempt to address every possible variation or situation. Shopping center leases, for example, 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 this chapter, a student of the nationally oriented shopping center lease will need to supplement his or her reading. There are a number of excellent form books designed to provide sample clauses and drafting advice for use in the preparation of shopping center leases.

Most leases, even most commercial leases, are initially drafted by the landlord's attorney. As a result, this chapter will speak more directly to those lawyers who are in the business, albeit occasional, of representing landlords. In addition, because the author falls within that category, this chapter will inevitably have a landlord bias when it comes to drafting. Nonetheless, effort has been made to also address many issues from the tenant's perspective.

Commercial leases must be drafted with their common-law context firmly in mind. As 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). Because the common law of Michigan incorporates that history, it is important to have a strong understanding of the case law as a cornerstone for drafting.

Each section of the chapter begins with sample clauses that address the section topic, followed by commentary and then a checklist. The commentary for each section begins with a state-

ment 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 your desired position. The second half of the commentary is designed to connect the legal context to the sample clauses that precede the commentary.

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 capitalized and are often 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).

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 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 (usually by signature) by the landlord. 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 2005 & Supp). The statute of frauds does not require the tenant to execute the lease. *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).

Another basic distinction that can be very important in the bankruptcy context is the difference 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* Gretchko, *Effect of Bankruptcy on Non-Residential Real Estate Lease,* 19 Mich Real Prop Review 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 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, thinking of a lease simply as a contract will get you 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 written by Janet P. Knaus in 2 John G. Cameron, Jr., *Michigan Real Property Law* ch 20 (ICLE 3d ed 2005 & Supp), 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 wavier 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 with 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. As with contracts, lease provisions that violate public policy may be stricken, *Sprik v Regents of Univ of Michigan*, 43 Mich App 178, 204 NW2d 62 (1972), *aff'd,* 390 Mich 84, 210 NW2d 332 (1973), and penalties will not be enforced, *see Lesatz v Standard Green Meadows*, 164 Mich App 122, 416 NW2d 334 (1987); *Rothenberg v Follman*, 19 Mich App 383, 172 NW2d 845 (1969). An analysis of the public policy limitation was recently undertaken by the Michigan Supreme Court in *Rory v Continental Ins Co*, 473 Mich 457, 470–471, 703 NW2d 23 (2005) (to determine parameters of public policy, courts must look to policies that have been adopted by public through various legal processes and are reflected in state and federal constitutions, statutes, and common law.)

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 rule, 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.").

D. Basic Drafting Tips

§3.4 As the joke goes, "this lease *had* to be long, it covered a lot of ground." Threadbare jokes aside, there are a lot of very long commercial lease forms in the marketplace. Many forms are simply too long and have become bogged down in legalese. There are three things that can be done to make a lengthy lease easier to read and therefore more effective.

The first and foremost way to make a lease easier to read is to write it in plain English. This sounds easy but is not. It is particularly hard for real estate lawyers, because we have become accustomed to talking in archaic language. Where else but in a real estate case would you find the word *usufruct* used to explain *rent? See Detroit Trust 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.

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

A final way to make a long 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, there is certain key information that 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. *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 a 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 Pfaff's Estate*, 41 Wis2d 159, 163 NW2d 140. *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. The author would propose adding the following definition:

> Boilerplate: When used by a party to litigation, the word "boilerplate" means the party would like to weasel out of its agreement. Similarly, the phrase "mere boilerplate" means that the party is without any legitimate grounds for weaseling out of the agreement.

Boilerplate is also the word the court uses when it is going to rule against the landlord despite the plain language of the contract. *See generally Miller Indus, Inc v Cadillac State Bank*, 40 Mich App 52, 198 NW2d 433 (1972); *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 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 by Judge (now Justice) Markman in *UAW-GM Human Resource 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 Judge 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 our 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). The 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)?
- If the agreement to lease is for more than a year, is it evidenced by a written memorandum?
- If the agreement to lease is for more than a year, has the written memorandum been executed or authenticated by the party against whom the agreement will be enforced?
- 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)?
- If the term of the lease is for more than a year, is it evidenced by a written lease or another document?