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IN THE SPOTLIGHT

Shopping Center Declarations

By Consuelo Boyd

A commercial tenant contemplating a lease in a shopping center or adjacent outparcel has its work cut out for it in terms of due diligence required. In addition to inspecting the physical characteristics of the premises, which typically includes completion of a survey, environmental and soil testing, a thorough review of the landlord's title report and all corresponding matters of record also should be done as soon as possible after commencing lease negotiations. Some tenants prefer not to incur the expense of ordering and reviewing the title up front due to uncertainty as to whether the lease will come to fruition. However, the knowledge gained from an early title search will prove invaluable if completed sooner rather than later.

Shopping Center Declaration

Reviewing the status of the landlord's title will raise any red flags for potential problems that need to be addressed by the tenant early during lease negotiations. For example, the title report may reveal that ownership of the premises is reflected in an entity other than the landlord, or the existence of liens, conditions, restrictions, encumbrances or easements that may interfere with the tenant's proposed development and use of the premises. Of particular concern for purposes of this

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Landlords' Liens and Waivers

Competing Interests of Lenders and Landlords

By John G. Kelly

Commercial real estate landlords and the lenders for their tenants have competing interests with respect to the tenant's personal property located at the demised premises. The landlord is looking to secure the tenant's rental obligations by taking a lien against the tenant's fixtures, inventory, and equipment located in the space, which may be particularly valuable in the case of retail and restaurant tenants. The tenant's lender, which is providing premises fit-out and/or working capital financing, desires a security interest in the same property. The landlord's lien may be created either by contract under the terms of the lease or through operation of law, and allows the landlord to levy the property located at the demised premises of a tenant who has failed to pay rent.

While the tenant would rather not allow either party to maintain a lien against its personal property, the tenant's action in this regard is often dictated by the requirements of its lender. While national retailers with strong credit typically have the leverage to insist on the waiver or subordination of their landlord's lien rights, most smaller or regional tenants must navigate between their landlord's and lender's competing interests. This article discusses the varied interests of the landlord and the tenant's lender in the tenant's personal property, and offers suggested compromise solutions.

Landlord's Methods of Redress

Depending on the state, there are usually three ways that landlords obtain lien or other security interests in the tenant's personal property. The first method is not a lien, *per se*, but involves the exercise of the traditional common law rights of distress and distraint, which enable a landlord to seize and sell a tenant's personal property located at the premises in order to reimburse the landlord for the amount of unpaid rent and other liability. In Virginia, the landlord must file a sworn petition with the court that demonstrates the justifications for the attachment of the levy as set forth in the Code of Virginia. The landlord, however,

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must state that the tenant intends to flee, conceal itself from creditors or sell or destroy the property. If the court approves the petition, the sheriff will either take possession of the property or the tenant will be unable to sell, move, destroy or dispose of the property without facing legal consequences.

The second method is available in about half of the states, where landlords have been given statutory landlord's lien rights. The statutory lien rights differ from state to state as to timing, priority and limitations, but typically provide the landlord with a lien on all of the tenant's personal property located within the demised premises as security for the tenant's obligations under the lease. In many states, these statutory liens replace or supplement the common law remedies of distress and distraint. In some states, the statutory lien rights are limited to a specific amount or period of time and many states provide that the landlord's lien is subordinate to any perfected security interests in the tenant's personal property existing before such property was transferred to the premises. There is no uniform or model landlord's lien law and reference must be made to the specific statutes in each applicable jurisdiction.

For example, in the District of Columbia, the statutory lien terminates three months after the rent owed became due or upon the termination of any action seeking such unpaid rent brought by the landlord within that three-month period. By comparison, the statutory landlord's lien in Virginia is quite strong, relating back to the commencement of the lease and superior to any other lien upon the tenant's property located at the premises, except for liens attaching prior to the commencement of the lease term and tax liens. Maryland has no statutory lien rights in favor of a landlord, so a landlord would have to pursue an action for distress with the ability to then lien the personal property if successful in obtaining a judgment. In all of the states, enforcement of the statutory landlord's lien rights requires the landlord to file a court action and follow very detailed procedures designed to afford the tenant adequate due process prior to losing its property. While the statutory landlord's lien provides additional security for the landlord, it is also a cumbersome process that is expensive and time-consuming, limited by statute and subject to avoidance in the event of a tenant bankruptcy.

The third way that a landlord may obtain a lien against the tenant's personal property and fixtures is through a consensual security interest under Article 9 of the Uniform Commercial Code (the UCC). Since a written security agreement is required to create the security interest, the landlord must include language in the lease setting forth the security interest and adequately describing the collateral. The landlord must then perfect the security interest by filing a UCC financing statement in the appropriate state filing office — the financing statement may be filed without the tenant's signature provided the filing is authorized by the tenant. Without the required filing, the landlord's security interest would be unperfected and subordinate to any creditor who has a perfected security interest in the same personal property.

After a tenant defaults, the landlord may foreclose on the property pursuant to the procedures set forth in the UCC without filing a court action or exercising other judicial process. The UCC security interest offers significant advantages over both the common law rights of distress and distraint and a statutory landlord's lien. It provides the landlord with greater flexibility in enforcing the lien while giving the landlord the right to immediate possession and control over the tenant's secured property without the need for judicial action. Thus it is a

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claim? Who chooses counsel? And on what terms can the claim be settled?

Insurance provisions are similar to indemnification provisions because they also are risk shifters, but they provide even further security that ultimately the loss will not fall on the franchisor. The significant point to note here is that insurance provides a deep pocket. A small supplier might not be able to pay damages if a major claim — such as a claim arising out of a foodborne illness — is brought against the franchisor. With insurance coverage provided by the supplier, the franchisor's fear that there will not be a pot of money out there to settle with the claimant or cover the litigation costs of defending against any claim is reduced. Note that the franchisor and franchisees may also have insurance to cover these situations.

Why Not Have a Contract?

The one reason not to insist upon a written agreement is leverage. For a big franchisor dealing with a small supplier with numerous competitors, the leverage is all with the franchisor; thus the franchisor is likely to dictate the terms. Conversely, for a small franchisor dealing with a major supplier or distributor, it is not likely that the franchisor will be controlling the negotiations. In fact, the supplier is likely to have its standard terms and conditions.

And where the facts fall in between, it is difficult to predict what the ultimate outcome might be if a written agreement is requested by the franchisor. It is likely that both sides will have experience in these arrangements and thus the negotiations might go smoothly — but then, again, they may not.

Conclusion

So, what is the best approach? There is no simple answer. However, the certainty a contract provides will tell each party where it stands if things go wrong.

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much less burdensome process than enforcing a statutory landlord's lien or pursuing an action for distress. Additionally, in the event of the tenant's bankruptcy, a landlord maintaining a perfected UCC security interest would be treated as a secured creditor, subject to the automatic stay and other bankruptcy protections offered the tenant as debtor.

One caveat for landlords is that UCC financing statements are only valid for five years, so the landlord may want to implement a tracking system in order to safeguard against the failure to file the necessary continuation statements prior to their expiration.

Landlord Waiver Agreement In Favor of Tenant's Lender

As noted above, the tenant's lenders will also want a security interest in the tenant's personal property to secure the repayment of the tenant's loan obligations, thus creating a conflict between the lien rights of the landlord and the lender. Because of this conflict, as a condition to the financing, a lender will typically request that the landlord execute a waiver of its security interest. Landlords may push back at this request, but will often agree at least to subordinate their landlord's lien rights to that of the lender's security interest.

The landlords recognize that financing is a critical need for their tenants, without which the tenant would not be able to operate its business and generate the revenues needed to pay the rent. Consequently, they typically agree to the waiver or the subordination of their lien rights for larger, creditworthy tenants.

The landlord would obviously prefer the subordination over the waiver, as a secondary secured position could at least provide some limited recovery in a default situation. In any event, landlords would be wise to pay close attention to the form landlord waiver presented by the lender, as such forms often grant lenders favorable rights with regard to the leased premises and place burdensome obligations on the landlord. The tenant is not typically a key party in the negotiation of the landlord waiver, as their main role is to serve as referee between their landlord and lender. However, the sophisticated tenant would be wise to include the form of their lender's required waiver form as an exhibit to their lease agreement, to save time and expense later. Note that the landlord could likely pass its legal fees incurred in negotiating the landlord waiver onto its tenant. Five key landlord-friendly points that should be addressed in the landlord waiver/subordination document are set forth here:

1. First, the landlord should try to subordinate its landlord's lien instead of an outright waiver. The true value of a secondary position may be questionable, but there could be some recovery and it is better for the landlord to be a secured creditor in the event of a bankruptcy.
2. Second, the landlord should try to retain control over the process of the lender removing the collateral. For example, the lender should only remove the collateral after business hours and from designated loading areas. The lender should also agree to pay for any damage caused by the removal, and indemnify landlord in case of third party claims resulting from the lender's entry into the premises for such purposes. The landlord could also insist that the lender furnish evidence of insurance before entering onto the premises to remove the collateral.
3. Third, the parties need to make clear what equipment is part of the collateral. The landlord should agree that personal property remains personalty (and not part of the real estate) in exchange for the lender

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agreeing not to pursue its security interest against building systems such as plumbing and HVAC or other fixtures. The landlord could violate the terms of its own mortgage were it to waive its interest in these items. Further, the landlord will want to make sure that the tenant's leasehold interest in the premises is not part of the collateral. Lease provisions dealing with the assignment of the lease by the tenant are typically very landlord-friendly and the landlord does not want the tenant to do an "end run" around those provisions by including the lease itself as part of the collateral package to which the landlord has consented in the waiver/subordination document.

4. Fourth, the lender will want notice of tenant's default under the lease and an opportunity to cure on behalf of the tenant. This presents an administrative burden for the landlord, so the number and cause of notices should be limited, if possible, to notices that may result in a termination of the lease. With respect to giving the lender an opportunity to cure the tenant's default, the time period should be short and limited only to monetary defaults.
5. Fifth, the lender will request a period of time following the termination of the lease (perhaps up to 60 or 90 days) to take inventory and remove the collateral. Such a request by the lender may not be unreasonable, but the landlord should insist that the lender pay the amount which would otherwise be payable as rent under the lease during such period.

Conclusion

Subject to the terms of their lease agreements and the applicable state law, there are many kinds of lien rights available to landlords in the personal property of their tenants. Landlords would be wise to learn the lien laws of their respective states and draft their leases accordingly. At the same time, lenders for the tenants will object to these broad landlord's liens as they will look to secure their loans against the same personal property. The resulting conflict is best resolved through a fair subordination of landlord's lien agreement, which should be attached to the lease as a pre-approved form to save time, expense and aggravation later.

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article is the existence of a shopping center declaration previously recorded against the entire shopping center that includes the premises. A shopping center declaration imposes certain covenants, conditions and restrictions on, and grants easements over, the shopping center for its successful development and operation as one integrated retail or mixed-use project.

Some sophisticated developers have a vision of, or plan for, the type of retailers and restaurants desired in the shopping center, and will address issues common to such tenants in the declaration prior to finalizing and recording the declaration. However, it is also the case that some developers do not exercise that degree of control or foresight. For this reason, a tenant should carefully examine the declaration as early as possible during its lease negotiations with the landlord. While it is recommended that the tenant still review the official declaration complete with all amendments, once it is received from the issuing title agent, landlords are generally willing to help expedite a tenant's review by providing a copy of the recorded declaration that they have on hand. This article highlights three often overlooked, yet significant declaration issues tenants should address when leasing space in a shopping center or adjacent outparcel: omitted easements, future amendments to the declaration and common area maintenance (CAM) obligations and charges.

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Omitted Easements

One of the main purposes of a shopping center declaration is to provide cross easements over the various parcels comprising the shopping center for its harmonious operation. The easements granted will generally include pedestrian and vehicular ingress and egress, parking, utilities, storm water drainage and possibly signage. These easements will typically be granted from each parcel owner for the mutual benefit of all other parcel owners and their permittees, except with respect to exclusive easement areas specifically defined in the declaration. A tenant in the shopping center or outparcel must identify the easements needed for its proposed use of the premises, and determine if all required easements have been granted in the declaration for the benefit of the tenant. A comprehensive examination of the shopping center site plan, survey and declaration will alert the tenant if any required easements have not been granted in the declaration.

Consider the example in which a landlord mistakenly misrepresents to the tenant that the declaration of record included an easement grant for the placement of the tenant's sign panels on the pylon sign located at the shopping center's main entrance. Consider further that obtaining a sign easement in connection with the lease is critical for the tenant because it relies heavily on its signage to stand out from competitors. Reviewing the recorded declaration in the beginning of lease negotiations would disclose that no such easement was granted for the shopping center. This discovery would provide the tenant with an opportunity to negotiate suitable language in the lease whereby the landlord directly grants, or causes to be granted, the signage easement to the tenant.

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