

Commercial Lease Hypo (Questions)

Sideways Startup

Marta Stewardess, Britni Spearstein, and Mayra Estefan were all grad students at a college in San Francisco, majoring in chemistry, computer science and business, and electrical engineering, respectively. All three had a passion for wine and winemaking and were aficionados of a popular movie about a wine-tasting excursion, “*Sideways*”.

Marta came up with an idea for refining the wine-making process, by building a device that would continuously monitor certain key chemicals during the process and use sophisticated software algorithms to determine exactly what quantities of which ingredients to add at what times during the process, in order to achieve an optimum balanced wine. Britni worked with Marta to refine the algorithms and develop the software code for such a device. Mayra came up with a hardware design for the device (chemical-sensing probe inserted into the wine-making vat, attached to a computer input and readout device), and built a crude prototype of the device in the school’s engineering lab, which Britni programmed, and Marta then tested on her next batch of “home brewed” wine. The results were surprisingly good!

Marta, Britni, and Mayra dubbed their device the “Sideways Winemaker” and began holding “dorm parties” featuring their “Sideways Wine” made using the Sideways Winemaker. Mayra even designed a cute little label for the Sideways Wine bottles – showing a wine bottle on its side with the letters “**SiWi**” written on it (for “**Sideways Wine**”). Britni created a little web page (SiWi.com) where she described the delicious taste of the Sideways Wine created using their Sideways Winemaker.

Word soon got around, and other amateur winemakers began asking about the Sideways Winemaker, and if they could purchase one. Britni and Marta became excited about the prospect of setting up a business to manufacture and sell their Sideways Winemaker. Mayra was graduating and had a nice job offer in New York that she wanted to pursue, so she wished Britni and Marta luck in their new venture and left. Britni and Marta scrapped together some funds of their own and received a nice \$20,000 infusion from Britni’s parents to start up their business.

Britni and Marta have now now organized a limited liability company and are looking to rent a commercial space to manufacture wine and the Sideways Wine Widget (SiWiWi™).

SIDEWAYS STARTUP – COMMERCIAL LEASING ISSUES

1. Terms Every Commercial Lease Should Clearly Set Forth

Q. What issues should we consider when negotiating a lease?

- Proper description of the Premises.
- The Permitted Use of the premises.
- The Term of the initial lease.
- The amount of Base Rent.
- Whether the tenant is responsible for the landlord's maintenance costs, real property taxes, insurance and Operating Expenses, and if so the exclusions.
- How Rent Is to Be Increased during the term of the lease, or upon its renewal.
- The Security Deposit required, and any Personal Guarantees required.
- Detailed Listing of any Improvements, Alterations and/or Repairs.
- Who will own and pay for any trade fixtures the tenant and/or the landlord install and its removal at the end of the lease.
- Who will be responsible for Maintenance, Utilities, And Code Compliance?
- Tenant's Right of Access to premises, hours of operation and HVAC Hours of operation.
- Landlord's Right of Entry (reasonable notice and at reasonable times?)
- Tenant's responsibility to carry Insurance and the amount of coverage.
- Any Options to Renew.
- Right to Sublet and Assign.
- Going Dark Rights.
- Exit Clause – Tenant's Right to Terminate the Lease.
- Breach of the Lease and remedies.

2. Option or Right to Lease Additional Space

Q. We want a smaller space for now but what if we grow during the term of our lease?

- The tenant may bargain for an option or right of first refusal to lease additional space.
- For a smaller, new tenant, landlords may be more willing to grant a right of first refusal, rather than option, for additional space.
- The additional space should be described both as to location and quantity.
 - Reference to a map or floor plan.
- Clearly state:
 - appropriate time limits on the tenant for exercising the right or option.
 - Same terms and conditions as set forth in the lease?
 - The amount of rent.

- Other specific terms of the lease, such as tenant improvements.

3. Landlord's Right of Entry

Q. Because our wine making system is a trade secret, can we restrict the landlord's entry onto the Premises?

- A Right of Entry Clause gives the landlord the right to enter the Premises on an as-needed basis.
- Landlords normally insist on the Right of Entry without notice in an emergency.
- The tenant should insist on:
 - Landlord or its agents be equipped with proper personal protective equipment, including protective clothing and masks, before entry to maintain a sterile environment. [May be a hard sell.]
 - A reasonable notice period of at least 24 hours for normal repairs.
 - Landlord's agents can enter only if Martha Stewardess or Britni Spearstein are present on the Premises.
 - A time for non-emergency repairs (e.g. evenings, after 2:00pm, etc.).
- The right to enter premises at any time to make inspections or repairs is an unnecessary invasion of privacy and unsafe.
- Have the landlord sign a non-disclosure, however, for a big entity landlord, entry may be limited to only those agents who have signed the NDA.

4. Furniture, Fixtures & Equipment (FFEs) and Tenant Improvements (TIs) or Alterations

Q. We will be using chemicals as reagents in testing the wine, so we need secure storage for those.

Fixtures

- Many chemicals have special storage requirements with temperature, time, or security restrictions
- Depending on the type of the storage and the tenant's intent, the lease should clearly define storage as equipment or fixture.
- Equipment and fixtures are taxed differently so the tenant should consult a CPA.
- A fixture is tangible property that is affixed to and is deemed part of the real property to which it is affixed.
- Constructive annexation may be found when the objects, although not themselves attached to the realty, constitute a necessary, integral, or working part of some other object that is attached.
- A trade fixture is governed by Civ. Code § 1019, for which the law makes a special provision permitting removal by the tenant under certain circumstances.

- A tenant may remove a trade fixture if the removal can be effected without injury to the premises.
- Trade fixtures may not be removed if it has become an integral part of the premises.
- The tenant loses the right to remove fixtures if he or she fails to exercise the right within a reasonable time after the lease terminates.
- If the tenant plans to install substantial and expensive fixtures, the lease should provide for each party's rights in the fixtures on termination of the lease, including wrongful termination and the tenant's breach.
- In the absence of a provision in the lease, courts resolving the question of whether or not an article constitutes a fixture, the element of intent is regarded as the crucial and overriding factor.

Alterations

- Absent an express provision in the contract permitting or requiring alterations, the tenant may not make material alterations to the leased premises without the landlord's consent.
- The lease should permit the tenant to alter or improve the premises as the tenant's business may require without the prior approval of the landlord.
- A tenant who makes alterations to the premises may become obligated to comply with governmental rules and regulations, including upgrades/modifications to base building and systems.
- The tenant bears the burden of conforming to the law and of taking all actions necessary to rectify any subsequent instances of noncompliance.

Q. What will happen to our alterations at termination?

- The tenant's duty is to restore the premises to the landlord unimpaired beyond ordinary wear and tear.
- Remove any alterations and to restore the premises to their original condition on termination.

5. Limitations on Use; Compliance with Laws

Q. Do we need to be concerned about compliance with TTB, ABC and other laws for wine manufacturers?

- The tenant should be diligent in preliminary inquiries to find out the laws applicable to its business and to particular leased property.
- If particular licenses/permits are required, tenant should be sure it can obtain same, or negotiate for condition precedent to effectiveness of lease to allow tenant to obtain needed permits and approvals.
- The landlord may place a restriction on use.

- May also require the landlord's consent for a change in use, which may not be unreasonably withheld.
- Complying with laws regulating the tenant's use of the premises does not obligate the tenant to comply with laws that do not regulate that use.
- The tenant ordinarily responsible for compliance if the tenant will make improvements or alterations to the premises.

6. Repairs and Maintenance

Q. To what extent is the LL responsible for the condition of the property upon delivery?

- LL owes no general duty to prepare the premises for the use of the tenant.
- If the tenant takes the property "as-is" beneficial to a landlord if Hazardous Materials are discovered later in the lease term.
- Negotiate a tenant improvement allowance.

Q. Who is responsible for maintenance and repairs?

- The tenant only has the duty to use ordinary care for preserving the premises in safe and good condition.
- The tenant must repair all injuries occasioned by its lack of ordinary care.
- The landlord customarily is required to maintain and repair common areas while the tenant is required to maintain its leased space.
- The landlord is ordinarily responsible for repairs to the structural elements.
 - i. exterior load-bearing walls, the roof, the foundation and subflooring, and heating, ventilation, and air conditioning (HVAC), but expressly exclude doors, exterior plate glass, and skylights.
- Normally, the tenant makes all repairs resulting from the tenant's use.
- The tenant may negotiate a maximum dollar ceiling on its duty to repair or maintain.
- A landlord may insist that the tenant waive its rights under Civil Code Section 1941 and 1942 with respect to the landlord's obligations for maintenance and repairs of the premises and the tenant's right to make repairs and deduct the expenses of such repairs from the rent or to vacate the premises.

Q. How can we make sure that the landlord performs its obligations to repair and maintain?

- Time limits for performing required repairs and maintenance should be included in the lease.
- Applicable standards for quality and frequency of repairs and maintenance.
- The lease should include the procedure the landlord is required to follow in order to gain access to the premises and to notify the tenant of intended repairs.
- The lease should also describe any remedies in the event the landlord does not perform repairs and maintenance.
- The landlords are generally unwilling to grant a tenant a right to terminate the lease in the event the landlord fails to perform repairs or maintenance.
- The tenant may negotiate the right to make repairs or perform maintenance not timely done by the landlord and to be reimbursed by the landlord. Failing prompt reimbursement, the tenant may have the right to sue the landlord for damages.

7. Damage and Destruction of the Building

Q. Who is responsible for rebuilding if the premises are damaged by fire, and we have many years left on the lease?

- Absent a lease provision requiring repair or restoration, either party may terminate the lease on destruction of the premises.
- The landlord is under no obligation to rebuild the premises.
- However, almost always, the parties agree that the landlord will rebuild destroyed premises if repairs can be completed within a certain period of time (e.g. 9 months to 1 year) and there is insurance coverage, in which case the destruction will not terminate the lease.
- While it is the usual practice to require the landlord to rebuild, in a true net lease a landlord may insist that the tenant rebuild.
- Some lease forms do not give tenant a termination right in the event of damage or destruction, and require tenant to remain obligated under the lease until repairs/restoration are completed. Tenant should negotiate right to terminate if more than a certain percentage of the premises are damaged/destroyed and/or it will take more than a designated period of time to restore.
- The tenant should obtain agreements from the landlord that the insurance proceeds, will be applied towards the cost of the restoration.

- The obligation may arise on either a partial or total destruction of the premises.
- Landlord's restore/rebuild obligation typically will not include TIs. Tenant must make sure its insurance will cover restoring its tenant improvements.

Q. Can the landlord limit its obligation to rebuild?

- Landlords normally place limits on their obligation to rebuild, such as:
 - i. Only if the damaged portion does not exceed a maximum number of square feet or a maximum percentage of the then replacement value of the premises.
 - ii. Or rebuilding only if it can be accomplished within a stated number of days.
 - iii. Conditioning the obligation to rebuild on a stated minimum of time remaining on the lease term.
- The landlord may insist on a right to terminate the lease if the cost of rebuilding exceeds the amount of insurance proceeds unless the tenant agrees to pay the difference in cost.

Q. What should we do to make sure the landlord does not delay the rebuilding?

- The exact scope and extent of the rebuilding should be clearly stated.
- Time periods within which construction must begin and be completed should be described.
- Remedies for untimely performance or nonperformance, such as termination of the lease, should be stated.
- Whether the party obligated to rebuild is entitled to wait for insurance proceeds prior to rebuilding.
- The tenant should receive any abatement or reduction of base rent and pass-through expenses during a reconstruction period.
- If the landlord fails to make the required repairs, the tenant may perform the work and charge the costs against future rent.

8. Insurance

Q. Should we get general insurance, and if so, must we name the landlord as an additional insured?

- The landlord will usually require that it be named as additional insured on the policy.

9. Hazardous Materials

Q. How can we make sure that the premises are free from hazardous materials when we take possession, so we are not liable for contamination by other people.

- Boilerplate language may serve as a good framework for how to initially address Hazardous Materials.
- The landlord may insist on an overbroad definition of Hazardous Materials to cover virtually any type of Hazardous Materials that may be present on the property.
- A broad definition may also be advantageous for the tenant, because undefined Hazardous Materials can create ambiguities regarding each party's responsibilities under the lease.
- The tenant should insist on carving out exceptions to the broad Hazardous Materials definition to allow for small quantities of "everyday commonplace use" hazardous materials directly related to and necessary for the Tenant to conduct its business.
- This carve-out represents the practicalities of operating a business and can still be narrowly tailored to protect a landlord.

Q. Can we be held liable for contamination?

- If materials attributable to a tenant are discovered on the property, the tenant may be solely responsible for all costs of investigation and remediation.
- If Hazardous Materials attributable to the landlord are found on the property, the landlord should be solely responsible for the cost of remediation.
- The tenant may request rent abatement if it cannot operate due to the presence of Hazardous Materials attributable to the landlord.
- If the tenant causes the presence of Hazardous Materials on the property, the landlord is going to want an indemnity from the tenant and will also likely want copies of the tenant's material safety data sheets (MSDS). This indemnification can be mutual, and equally apply to the landlord (depending on the tenant's leverage).

10. Commercial Frustration and Impossibility of Performance

Q. If our business is shut down due to another pandemic, can we exit the lease?

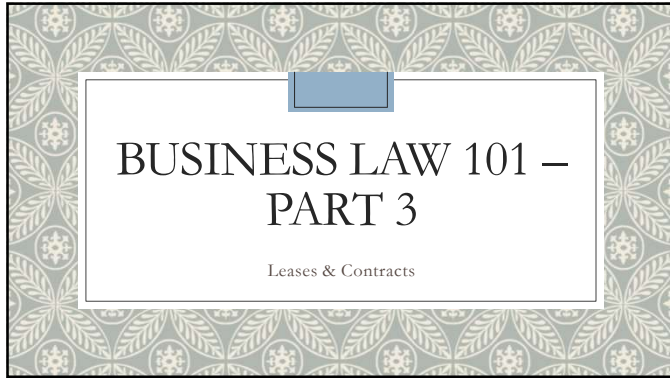
Commercial Frustration

- Lease will terminate if an event occurs that vitiates the purpose of the lease.
- A party may seek to be excused from performance in cases of extreme hardship.

- When performance is possible, but the expected value of performance has been destroyed.
- Risk of the frustrating event was not reasonably foreseeable and that the value of performance was totally or nearly totally destroyed.
- Less profitable or more difficult, but that do not entirely prohibit the business do not terminate the lease or excuse the tenant from further performance.

Impossibility of Performance

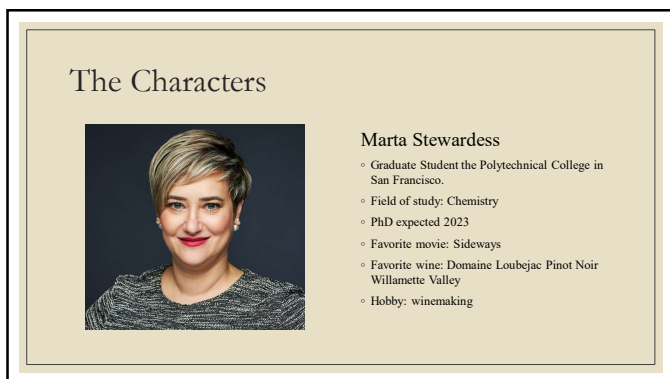
- Excuses performance of a contractual duty.
- The doctrine applies to cases of impracticability due to excessive and unreasonable difficulty or expense.
- Performance is deemed impracticable when it can be accomplished only at an excessive and unreasonable cost.
- A party is not excused, however, merely because performance would be more expensive than anticipated or would entail a loss.
- Provide for the foreseeable contingencies in the lease.
- A tenant may bargain for the right to terminate the lease if the tenant's right to conduct business is impacted by a government regulation. Landlords typically will not agree to this, but some tenants have been able to negotiate a short term (e.g., 3 month) rent deferment with payback amortized over the balance of the lease term.
- COVID pandemic was NOT held to constitute a frustration of purpose or creating impossibility of performance. See *Gap Stores Inc. v. Ponte Gadea*.



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The Characters



Britni Spearstein

- Graduate Student the Polytechnical College in San Francisco.
- Field of study: Computer Science and Business
- MBA expected 2022
- M.A. in Computer Science expected 2022
- Favorite movie: Sideways
- Favorite wine: Louis Bouillot Perle De Vigne Brut
- Hobby: Cooking and pairing her recipes with wine

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The Characters



Mayra Estefan

- Graduate Student the Polytechnical College in San Francisco.
- Field of study: Electrical Engineering
- M.A. expected 2022
- Favorite movie: Sideways
- Favorite wine: Mascota Vineyards Unanime Malbec, 2017
- Studies to be a sommelier specializing in South American wines.

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Their Story

- Marta's idea: refining the wine-making process, by building a device that would continuously monitor certain key chemicals during the process
- The device would use sophisticated software algorithms to determine exactly what quantities of which ingredients to add at what times during the process, in order to achieve an optimum balanced wine.
- Britni worked with Marta to refine the algorithms and develop the software code for such a device.
- Mayra produced a hardware design for the device (chemical-sensing probe inserted into the wine-making vat, attached to a computer input and readout device), and built a crude prototype of the device in the school's engineering lab.
- Britni programmed the device.
- Marta then tested on her next batch of "home brewed" wine. The results were surprisingly good!

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Their Story

- The trio dubbed their device the "Sideways Winemaker"
- They began holding "dorm parties" featuring their "Sideways Wine" made using the Sideways Winemaker.
- Mayra even designed a cute little label for the Sideways Wine bottles – with the letters "SiWi" written on it (for "Sideways Wine").
- Britni created a little web page (SiWi.com) where she described the delicious taste of the Sideways Wine created using their Sideways Winemaker.



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Their Story

- Word soon got around, and other amateur winemakers began asking about the Sideways Winemaker, and if they could purchase one.
- Britni and Marta became excited about the prospect of setting up a business to manufacture and sell their Sideways Winemaker.
- However, changes were brewing under the surface...



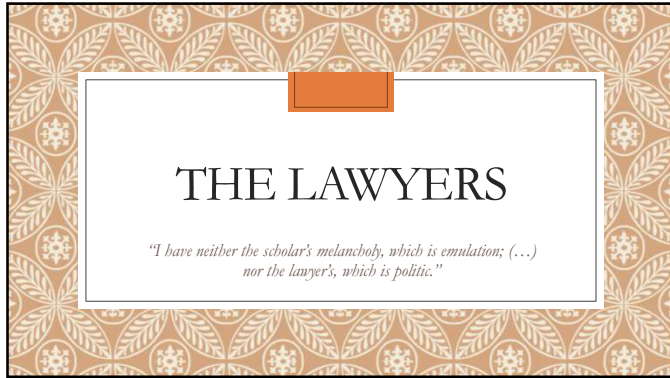
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Their Story

- Mayra was graduating and had a nice job offer in New York that she wanted to pursue, so she wished Britni and Marta luck in their new venture and left.
- Britni and Marta scrapped together some funds of their own and received a nice \$20,000 infusion from Britni's parents to start up their business.
- Now organized as an LLC and received seed funds from an "angel investor," Sideways Wines LLC is looking to lease office, and winemaking space, and also a manufacturing facility for their Sideways Wine Widget (the SiWiW™).



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The Lawyers

- **Lubna Jahangiri, Esq.**
- Principal of the Jahangiri Law Group, APC
- <https://www.thejlawgroup.com/team/lubna-jahangiri>
- Over 20 years of experience in a variety of business and real estate transactional and litigation matters.
- Lubna graduated top of her class at Golden Gate University in 2001.
- Serves on the Discovery Facilitator Committee of the Contra Costa County Superior Court.
- Prior to becoming a lawyer, she worked in the field of mental health, and, among other things, as the Clinical Supervisor of the Bowman House, a drug and alcohol rehabilitation facility for pregnant women and women with young children.



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The Lawyers



- **Myra Mitzman, Esq.**
- Principal of MSMLaw.
- <https://msmlawfirm.com/>
- Over 34 years' experience handling complex commercial real estate and business transactions.
- Myra's areas of expertise include commercial leasing (office, retail and industrial), purchase and sale, and real estate lending and financing.
- Myra received her J.D., Cum Laude, from Fordham University (New York City) in 1987.
- Serves as an annual update editor to CEB on its *Ground Lease Practice*, *Office Leasing*, and *Retail Leasing* titles.

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