This Lawyer's Perception of What Leasing Brokers Do

I am aware that a lot of effort by both the broker who represents the tenant (known as the "tenant rep broker") and the broker who represents the property (usually referred to as the "landlord's broker") goes into a lease deal before the parties even consider looking at the leasing document. Of course, both brokers must be familiar with the market to determine if the rent and other business terms are consistent with what is being offered for comparable premises.

The broker may be familiar with the lease form that the landlord uses and may even be familiar with the physical condition of the space from having worked on that landlord's properties before. Unless the tenant rep broker has represented tenants leasing from that landlord in the same property, he or she has a longer learning curve. In either case, that broker must understand the particular client's business to be able to evaluate whether the location, size, and amenities are appropriate. In the case of a retail facility, he or she must ascertain whether the location of the particular shopping center is conducive for attracting the type of clientele the client caters to and whether the parking is adequate. A restaurant or a grocery store needs a lot of parking, but a furniture store, which sells fewer but higher-priced items, needs less. A store in a shopping center will be concerned that a kiosk or other facility does not obstruct visibility. The prospective tenant might be concerned with existing competition and may need some sort of exclusivity to protect it from future competition. In the case of a warehouse building, the user may be concerned about the fire protection system. Will sprinklers ruin the merchandise, so that another type of system will be required? Is

the ceiling height appropriate for the use? Will the tenant need space that allows trucks to drive in, load, and drive out the other end? Even office tenants have unique concerns. Is the adjoining tenant one with a lot of traffic, which will cause noise and possibly tie up the elevator? A medical tenant might need access to water and extra electric power.

In addition, the tenant rep broker must confirm that the physical condition of the premises will not create any problems when the client occupies them. This issue revolves around the nature of the physical structure and the proposed business to be conducted in the space. Needless to say, if office premises are in the middle of a relatively new high-rise building, there should not be much danger of a roof leak, but a single-story warehouse building or retail space might well be at risk. Thus, depending again on the circumstances, the tenant rep broker may encourage the client to perform physical due diligence, or arrange for due diligence inspections on the client's behalf, by obtaining some or all of the following:

1. general description of the property and of the neighborhood
2. building plans and specifications, if available
3. roof report
4. engineering reports to cover the following items:
    a. structure including the condition of the slab, columns, bumpers, structural walls, exterior doors, and dock doors
    b. masonry
    c. exterior caulking
    d. exterior painting
    e. washrooms and locker rooms
    f. interior ventilation
    g. unit heaters
    h. mechanical systems including sprinkler systems, electrical, plumbing, and heating, ventilating, and air-conditioning (HVAC)
    i. lighting, ceiling tiles and light lenses, dry wall, entrance steps
    j. compliance with laws and ordinances (including Americans with Disabilities Act)
    k. building size
    l. parking lot

m. landscaping
5. Phase I Environmental Assessment (including asbestos)
6. Phase II Environmental Assessment, if recommended by engineer
7. floor or space plans
8. warranties (including roof) and assignability thereof
9. meters in multi-tenant spaces
10. permits
11. soil analysis for load-bearing capacity, in the case of new construction
12. access and other appurtenant rights, such as easements that benefit the property
13. code violation search from the local municipality, if required
14. availability of utilities
15. loading docks
16. vermin infestation or bad odors

The tenant rep broker should do some due diligence dealing with the credit of the landlord, particularly if the landlord is performing leasehold or other improvements to the property, or is agreeing to pay a tenant allowance. He or she should also check the zoning to make certain that the proposed use complies. Landlords usually resist warranting the zoning, ostensibly because they claim not to be familiar with the nature of the tenant's use, but actually because the landlord does not want to take the risk of a breach that might give the tenant a right to terminate the lease or sue for the breach if the market turns sour.

Both brokers will negotiate the terms of the deal, with client input or participation, based on the respective needs of the parties. In addition to the basic concerns, such as rent and initial term, those may include term extension, early termination, expansion or contraction rights, build-out, responsibility for repairs, maintenance, and replacements, and a host of other matters customarily included in term sheets or letters of intent.

Once the parties agree on those basic terms and the prospective tenant is satisfied with the condition of the premises (or is confident that it will have the opportunity, before it is fully bound, to satisfy itself), the parties may often prepare and sign a letter of intent. Usually the lawyers for the

parties will not see the letter of intent before it is signed. That may be a serious mistake.

Letters of Intent

When it comes to letters of intent, there are two questions to be considered. The first is, when are letters of intent binding? The second is, for what purpose? Are they binding for the purpose of creating an obligation to negotiate in good faith? Or are they binding as an agreement between the parties as to the terms and conditions of the transaction?

There are many judicial decisions dealing with letters of intent. Unfortunately, the answer to the questions may turn, in part, on the language in the letter of intent and in part on other evidence of the intent of the parties. In other words, even though there may be language in a letter of intent stating that it is not intended to bind the parties to an agreement until a final agreement is written up, executed, and delivered, the parties may in fact be bound. At the very least, a letter of intent may create an obligation to negotiate in good faith, unless that is expressly negated in the letter of intent.

Brokers like letters of intent. First, but not necessarily foremost, the letter of intent may result in the entitlement to a commission based on the broker having found a ready, willing, and able tenant for his or her client's space. More often, however, commissions are not really earned until a lease is signed, so that is not a major reason. No, brokers like letters of intent because they document the basic terms of the deal and facilitate the drafting of the lease. The letter of intent drafted by the broker may contain language that negates the intent to create a binding agreement, but that may not be entirely effective.

Often a broker representing a tenant will make a request for proposal (RFP) to the landlord or its broker and receive a detailed response, which will contain the business terms of the deal. Sometimes the broker will make an "offer," setting forth the terms on which the tenant or the landlord, as the case may be, is willing to enter into the lease. That offer may be "accepted" or may be subject to a "counteroffer." I put the words in quotation marks because the offers, acceptances, and counteroffers are not really intended to be used in the context of creating a binding agreement, and they probably do not do so for several reasons. First, it is understood in the trade that it is

not their purpose. More importantly, the broker does not usually have the authority to bind a client to a lease. The actual parties do not customarily sign the papers being exchanged (unless, of course, there are no brokers involved). The problem really arises when the brokers take the terms that have been discussed, either orally or by RFP or offer and acceptance, and reduce them to writing in a letter of intent and ask the parties to sign them. Remember that, at this point in time, it is most likely that neither party has consulted its attorney.

Let us assume that I, as one of the party's attorneys, am consulted at that point in the process. Whether I represent the landlord or the tenant, my advice is do not sign! The parties, by signing, may create a binding agreement, even though important matters have not been dealt with, or have been dealt with in an imprecise manner. Even if the letter of intent is accurate and contains all sorts of language about not creating a binding lease, there may still be problems. The problems may be made worse by making the letter of intent very detailed. I have seen letters of intent that were extremely long and contained almost all of the terms of the agreement, using in many instances the very language contained in the lease proposed to be entered into. I do not believe that any amount of language stating that the letter of intent is not binding (except, perhaps, conditions such as approval by the party's governing body, such as a board of directors of a corporation or members of a limited liability company) could have kept that letter of intent from actually being enforced as the agreement between the parties.

What are some of the other problems with letters of intent?

While a major purpose of a letter of intent is to discourage each party from seeking a better deal before the current negotiations are wrapped up, some letters of intent actually require the landlord to stop marketing the property. The landlord's broker should strongly object to that provision because it places what I deem to be intolerable burdens on that party. It may have to incur the cost of removing large and expensive "For Rent" signs (and replacing them if the deal does not go through), but that is a minor matter compared with the requirement that the client turn away prospects or not seek a backup tenant when it does not have a firm deal. The problem is more serious when the tenant is to be afforded a period of time to conduct its due diligence or obtain zoning or permits, at the end

of which period it may terminate the proposed deal, leaving the landlord with no alternative tenants.

In addition, a letter of intent may create an obligation to negotiate in good faith, and the refusal to agree to some important term may result in a claim (and litigation) that the party has failed to live up to that obligation. That puts particular pressure on the parties subsequently negotiating the lease, especially if, in the course of negotiation, issues are raised (and agreed to) that are inconsistent with the terms of the letter of intent. I experienced an example of that some years ago. A landlord client signed a letter of intent, which committed the landlord to forgo certain benefits. The tenant asked for a larger build-out allowance than was contemplated by the landlord (the issue was not clear in the letter of intent). The landlord granted the concession, but changed the lease to restore the benefits, and sent a redlined copy of the lease to the tenant, highlighting the change in the benefit language. The tenant actually signed the redlined copy of the lease (implying that it had reviewed the changes since the prior draft), but then sued the landlord, claiming that the lease did not accurately reflect the agreement of the parties. To avoid protracted litigation and expense, the landlord settled the case.

Under the circumstances, what do I recommend?

1. The actual parties to the deal should not sign letters of intent. I mean that in two senses. The parties should avoid using letters of intent. They will, however, probably use them because they have some advantages. In that case they should not sign them—nor should they give a written authorization to any third party to sign on their behalf, because they may be deemed to have complied with the Statute of Frauds and be bound by the terms of the letter of intent without intending to be.[1] There are alternatives to letters of intent that are far less dangerous. For example, I recommend using a term sheet. It states, in essence, that "the following are the terms on which the parties propose to

1. Most states have enacted the "Statute of Frauds," which provides that contracts for the sale of real estate and leases for a term in excess of one year must be signed by the party to be bound.

lease such and such property," and then only the basic terms are set out. It is always wise to provide that the document set out a date after which either party may terminate discussions without liability. It may even expressly negate an obligation to negotiate in good faith, if that is agreeable to the parties. Vagueness is the key. If the parties do not sign the letter of intent and the Statute of Frauds applies, the letter of intent does not bind the parties. There are two caveats. First, if a broker signs for a party, it should be clear that the broker is without written authority to bind the party. Second, beware of the federal Electronic Signatures in Global and National Commerce Act. A letter of intent sent via e-mail by a person who is employed by one of the parties and who has authority to sign a lease may satisfy the requirements of that act and bind the party.

2. If parties must use and sign a letter of intent, it should certainly contain the language negating the intent to create a binding agreement, despite the issues discussed above. If possible, conditions to the conclusion of a lease should be inserted, such as board approval, the tenant's confirmation of the zoning or condition of the premises (in its discretion), or the landlord's satisfaction (again in its discretion) with the tenant's financial condition or operation of its prior premises. If the obligation to negotiate in good faith is not negated in the language of the letter of intent, time periods should be provided for the delivery of the draft lease and for the completion of the negotiations, after which the parties will have no obligations under the letter of intent.
3. If you represent the landlord, recommend to your client that it not agree to take the space off the market until a lease is signed.

If you have a question about the letter of intent and its possible effect, you should ask your client if you may contact its lawyer to make certain that you do not fall into any of the traps I have described.

Enter the Lawyer

Yes, some lawyers are deal killers—but most are not. Some deals should be killed, especially if issues arise that are important to one of the parties

and they cannot be satisfactorily resolved. In those situations, the broker should be as eager to protect the client as the lawyer is.

It is important to understand where the lawyer is coming from—and where the broker is coming from as well. Both parties have common goals: to enable the client to lease premises (either as the landlord or the tenant), but also to protect the client from making a bad deal.

The lawyer's role is the more conservative one. He or she is seeking to protect the client from risk. The lawyer drafting the lease and the lawyer reviewing the lease on behalf of the other party are both trying to anticipate all the bad things that might happen during the term of the lease and to make certain that their clients are not materially injured by those events.

The lawyers (other than in-house lawyers) are generally paid by the hour, although that is no longer universally true. And they are usually paid whether the lease is finalized or not. That makes brokers suspicious that the lawyer has no incentive to push the lease to fruition.

Brokers tend to be more entrepreneurial than lawyers. They are out there in the business world creating deals. Brokers are often (but not universally) paid on a contingent-fee basis—they are paid commissions if the lease is signed, but nothing if the deal dies. The commissions are often substantial, generally more substantial than the legal fees. That makes lawyers suspect that brokers are pushing the conclusion of the lease to get paid, without adequately protecting the interests of the client. The lawyer may be particularly suspicious of a broker in the situation of dual agency, in which different brokers in the same firm represent the landlord and the tenant, especially if the broker representing his or her client is a principal in the firm. Even though protections are built into that situation, the lawyer might feel that the particular broker working withthe lawyer's client may not be wholeheartedly representing that client.

While there can be no doubt that some lawyers are unprincipled enough to try to kill deals in order to get a second bite at fees, just as some brokers are willing to let the client sign an unfavorable lease just to get paid the commission or to ease up on the negotiations because another person in his or her firm is representing the other party. However, on further consideration, we can see that such unethical behavior is not in the interest of either professional. The lawyer's client will soon figure out that it did not

get a much better deal on the subsequent lease and conclude that either the lawyer did not know what he or she was doing or that the handling of the matter was not appropriate. As to the broker, the client will also decide that the broker was not acting in its interest and, even if it may not cost the broker a commission on that deal, it may cost the broker future business with that client, and perhaps his or her reputation in the community.

The broker's relationship with lawyers, or a specific lawyer, may depend on whether the broker is working for the landlord or the tenant and on the nature of the work with the landlord or the tenant. Thus, if the broker is representing a landlord with numerous properties, a standard lease and a lawyer it deals with on all its leases, that broker will already have a method of operating with the lawyer and vice versa. Likewise, if a tenant has numerous locations and a standard lease form, the situation is pretty much set, except that the tenant may use different lawyers in different states. In the latter situation, although the broker may be familiar with the lease form, the broker may not be aware of particular local customs or laws and thus be required to work with an unfamiliar person. In a one-off situation, in which the landlord owns little or no other property and is not generally in the real estate business or the tenant is leasing a single location for the operation of its business, the relationship between the broker and the lawyer on the same side may become more tenuous or adversarial.

How does the broker's suspicion of lawyers affect the transaction? Well, the broker may discourage the client from using a lawyer at all. The broker may say, "This is a simple lease. I can negotiate it myself. I can even draft any necessary changes in the document."

I submit that such a course is very dangerous, not only for the client but for the broker as well. Let me propose a hypothetical situation.

A tenant rep broker receives the lease draft from the landlord's representative and reviews it. Leases are not as simple as they may look. In this hypothetical situation, the tenant is a restaurant and will be spending a lot of money on tenant improvements. The lease provides for subordination (which will be discussed starting on page 41), but the broker, who does not have much experience or expertise, considers it legal mumbo jumbo and skips over it. The broker does notice some language that is not in accordance

with the letter of intent or what he or she deems not to be in the best interest of the tenant, so he or she drafts alternative lease language.

The lease is signed and the first thing that happens during the term is that there is a dispute between the landlord and the tenant—and it happens to relate to the language the broker drafted. It seems that the language is ambiguous, which is not unusual. Unfortunately, the parties are unable to resolve the dispute and a lawsuit is filed. The judge is asked to determine what the language means. It being ambiguous, the judge cannot interpret the language. Since neither party really considered the issue when the lease was being negotiated, they cannot testify as to what was intended, so the judge takes recourse to a rule of construction to help decide the issue. That rule says that, in the case of ambiguous language, it is construed most strongly against the drafter. The tenant loses the lawsuit because its broker drafted the language on its behalf, so the tenant looks around for some way to recoup the loss resulting from the ambiguous drafting. Where does it look but to the drafter—the broker! And when the broker tries to collect on the errors and omissions (E&O) insurance, he or she will find out that the E&O insurance does not cover the unauthorized practice of law, which is exactly what happened here. The broker (or the broker's firm) will have to pay the tenant's loss out of its own pocket. Mark my words: drafting lease language constitutes the practice of law, and the practice of law by someone not admitted by the Supreme Court of the state to do so is illegal—probably even a criminal offense.

All right, the broker pays the loss and does not happen to be prosecuted for practicing law without a license. Is he or she out of the woods? Remember that other little twist? The one about the legal mumbo jumbo? Something about subordination? The next thing that happens to our poor tenant is that the landlord defaults under the mortgage and the lender files a foreclosure. The lender concludes that the broker's client got too good a deal (he or she did a good job on that one, or maybe the market has changed). So, in the foreclosure action, the lender names the tenant as a defendant and terminates the lease. There goes the profitable restaurant. There goes all the money spent on leasehold improvements. Our poor broker did not know about a thing called a non-disturbance agreement, where the lender agrees not to foreclose on the tenant. Guess who pays again, and big-time now.

It is certainly true that a lawyer may draft ambiguous language, too, or forget a non-disturbance agreement. I have seen it done. However, the lawyer can insure against his or her errors and omissions relative to the practice of law, and from the broker's point of view, "Better him than me!"

A situation may arise in which the client, desiring to save legal fees, asks the broker to review the lease and draft language. The broker should respectfully decline to do it. The client may even pressure the broker to undertake that task, but the broker should bear in mind the risk and tell the client that he or she is legally prohibited from practicing law and cannot undertake the task.

In Illinois, lawyers and brokers litigated over what constituted the unauthorized practice of law by brokers and settled the case by entering into a Broker-Lawyer Accord. It authorizes brokers to fill in the blanks in printed contract forms. This may work out fine in connection with the sales of homes or condominium apartments, but has little application to leasing. There may be blanks in the landlord's form, but those are the tip of the iceberg in leases. Of course, what may be determined to be unauthorized practice of law differs from state to state, and, in fact, the Illinois rule may be considered pretty liberal in favor of brokers. It was, after all, a settlement.

I have heard brokers say that they draft language and submit it to their attorney or the client's attorney for approval. I am sorry to inform you that, even if the lawyer approves it (and may create his or her own liability), it does not get the broker off the hook for unauthorized practice of law and also being held liable for bad consequences. I am not just trying to protect my turf; I am saying this for the broker's own protection.

The lawyer does not come out scot-free from his or her suspicion of the broker, either. Many lawyers think the broker should bring the deal to the lawyer and get out of the way, but that can have some bad effects for the lawyer. The problem is that the lawyer was not in on the deal from the get-go. He or she does not have the same feeling as the broker often does for the client's needs, an understanding of the market and that this deal may be the only reasonable choice for the client, and certainly the sense of the nuances of the prior negotiations. Of course, the lawyer can get a lot of information from the client, but if the client is not sophisticated in real