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The Enforceability of Abatement Provisions

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Introduction

The moment a lease is executed, a set of obligations and rights are created between the landlord and tenant.¹ In exchange for the payment of rent, the landlord is required to provide a space suited for the intended purpose of the rental.² In addition, both parties are obligated to abide by any specific terms in the lease.³ Among those terms may be an abatement provision. An abatement provision is a clause in the lease that releases a lessee from the obligation to pay rent when a particular event occurs.⁴ The specific triggering event is usually listed in the lease.⁵ The amount of rent abated may range from a fraction of rent for each day that the breaching condition exists, to a complete abatement of all rents due under the lease.⁶

This Article focuses on the enforceability of abatement provisions under state law. Part I discusses the general purpose of abatement provisions. Part II reviews court decisions from

¹ The specific terms of the lease agreement, as well as a few implied covenants.

² In a residential lease, many abatement cases involve a breach of the warranty of habitability, alleging that the premises are not liveable. As this Article focuses on abatement provisions in commercial leases, however, it will not discuss such cases.

³ <http://legal-dictionary.thefreedictionary.com/bilateral+contract>.

⁴ <http://definitions.uslegal.com/a/abatement-clause/>.

⁵ <http://homeguides.sfgate.com/rent-abatement-35223.html>.

⁶ See *Bates Advertising v. 498 Seventh, LLC* 291 A.D. 2d 179 (enforcing abatement of a daily percentage of rent based on landlord's failure to complete repairs); see also *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. 42 (S.D.N.Y. 2014) (deciding a specific provision in the lease agreement provided for a complete abatement of rent rather than a set-off).

various jurisdictions regarding the enforceability of abatement provisions. Part III addresses the implications for a tenant and landlord as a result of those court decisions.

Part I. Purposes of Rent Abatement Provisions

There are many different purposes for rent abatements.⁷ Landlords may use them as a marketing tool to fill empty properties.⁸ For example, a landlord may offer a first month's rent abatement, or a partial abatement during particular seasons where a business may not collect as much revenue.⁹ In that instance, both parties benefit from the abatement. The landlord gets to collect revenue generated from what would have been an otherwise vacant space, and the tenant gets to enjoy free, or reduced rent. An abatement can also be used to reimburse a tenant for losses or inconvenience caused by the landlord's actions or inaction.¹⁰ Further, a negotiated rent abatement is often included a commercial lease as an alternative to complete termination.¹¹ Whatever the purpose behind the abatement, once the triggering event occurs, the abatement can be given by the landlord in good faith under the lease, or as a result of a court action commenced by the tenant.¹²

Part II. The Enforceability of Abatement Provisions

Since leases are legally binding contracts, they are enforceable under contract law.¹³ Like any other contract, parties to a lease are free to agree to terms they feel will adequately protect their interests in enforcement of the contract. Generally, courts will not interfere with those terms

⁷ <http://www.wisegeek.com/what-is-a-rent-abatement.htm>.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ <http://www.realestatelawyers.com/resources/real-estate/commercial-real-estate/what-grounds-commercial-rent-abatement>.

¹² *Id.*

¹³ <http://legal-dictionary.thefreedictionary.com/Lease+Agreement>.

unless they are unconscionable or contrary to public policy.¹⁴ In determining whether to enforce an abatement provision, a court will consider the nature of the provision. If the court finds that the amount of rent to be abated is proportionate to the loss suffered by the tenant, the provision will likely be enforceable.¹⁵ Similarly, if the amount of actual loss incurred by the tenant is difficult to calculate, but the amount stipulated to in the lease bears a reasonable proportion to the probable loss incurred by the tenant, a court will likely enforce the provision, since it is akin to a liquidated damages provision.¹⁶

Conversely, if the court finds that the provision is merely a penalty, it will not be enforceable. A penalty provision requires the payment of a sum of money that is grossly disproportionate to the amount of actual damages caused by the breach.¹⁷ Rather than compensating the injured party for breach, an abatement provision that is a penalty is designed to secure performance by the compulsion of the very disproportionate consequence.¹⁸ If a court determines that the parties have agreed to an abatement provision that allows the tenant to forgo an excessive amount of payments, the actual damages are calculable or much less than the amount of the abated rent, the court will be more likely find that the abatement provision is an unenforceable penalty.¹⁹

Courts in various jurisdictions have come to different decisions when deciding whether an abatement provision is enforceable.

¹⁴ See McKinney's Consolidated Laws of NY Annotated, Real Property Law Chapter 50, Article 7 §235-C *Unconscionable Lease or Clause*; see also *City of Rye v. Public Serv. Mut. Ins. Co.*, 34 N.Y.2d 470, 472—73 (N.Y. 1974).

¹⁵ *Red Sage Limited Partnership v. DespaEuropa* 254 F.3d 1120, 1127 (D.C. Cir. 2001).

¹⁶ *Id.*

¹⁷ See *Equitable Lbr. Corp. v. IPA Land Dev. Corp.*, 38 N.Y.2d 516, 521—22 (N.Y. 1976).

¹⁸ *Id.*

¹⁹ *Borden Co., Pioneer Ice Cream Division v. Manley*, 127 N.J.L. 461, 463, 23 A.2d 281 (N.Y. Sup. Ct. 1942).

a. California Case Law – An Abatement Provision was an Unenforceable Penalty

Under California law, in determining whether to enforce an abatement provision, a court will analyze whether the provision is penalty. For example, in *Grand Prospect Partners, L.P. v. Ross Dress For Less, Inc.*,²⁰ while declining to establish a categorical rule of law, a California appeals court held that a particular abatement provision operated as an unreasonable penalty and was thus unenforceable.²¹ Under California law, a contractual provision is an unenforceable penalty if the property forfeited under the provision bears no reasonable relationship to the range of harm anticipated to be caused in the event of a breach.²²

Grand Prospect Partners involved a lease for retail space in a shopping center.²³ The lease contained a co-tenancy provision, conditioning the tenant's obligation to open the store and pay rent on the continued operation of a department store in the shopping center on the commencement date of the lease.²⁴ The co-tenancy provision also granted the tenant the option to terminate the lease if the department store ceased operating and was not replaced with an acceptable retailer within twelve months.²⁵ Before the tenant took possession, the department store filed for bankruptcy and closed.²⁶ While the tenant subsequently took possession of the premises, it never opened for business.²⁷ As no replacement was found for the department store, the tenant elected to terminate the lease after the twelve-month cure period ended, never having paid any rent.²⁸ The landlord then sued the tenant, seeking (1) a judicial determination that the co-tenancy provision was unenforceable and (2) money damages for unpaid rent, future rent, and

²⁰ *Grand Prospect Partners, L.P. v. Ross Dress For Less, Inc. et al.* 232 Cal. App.4th 1332 (Cal. App. 5th Dis. 2015).

²¹ *Id.* at 1337-38.

²² *Id.* at 1338.

²³ *Id.* at 1336.

²⁴ *Id.* at 1337.

²⁵ The court handled the termination provision and the abatement provision separately, ultimately finding the termination provision enforceable.

²⁶ *Grand Prospect Partners, L.P.* 232 Cal. App. 4th at 1337.

²⁷ *Id.*

²⁸ *Id.*

expenditures on tenant improvements.²⁹ In particular, the landlord argued that the rent abatement provision was an unenforceable penalty.³⁰ The tenant filed a cross-complaint, seeking judicial declaration of the parties' rights and duties under the lease.³¹

The *Grand Prospect Partners* court held that the abatement provision was an unenforceable penalty,³² finding that the tenant had not suffered any damages from the closure of the department store.³³ Therefore, the *Grand Prospect Partners* court concluded the amount of abated rent bore no reasonable relationship to the actual damages the tenant would have suffered if they had opened the store.³⁴ Accordingly, the *Grand Prospect Partners* court order the tenant to pay the unpaid rent; however, the tenant was allowed to terminate the lease.³⁵

b. New Jersey Case Law – An Abatement Provision is an Enforceable Forfeiture Provision

Under New Jersey law, a court will analyze an abatement provision as a forfeiture provision. For example, in *In re The Great Atlantic & Pacific Tea Company, Inc.*,³⁶ a federal district court held that an abatement provision was enforceable as a complete forfeiture.³⁷

Great Atlantic involved a twenty-year commercial lease of a retail space that was to be used a grocery store.³⁸ Under the terms of the lease, the tenant would construct its own building on the premises, and within ninety days of opening the store to the public, the landlord would to pay the tenant a \$1.9 million construction allowance.³⁹ The lease further provided that if the landlord failed to pay the allowance, the tenant's "obligation to pay fixed annual rent and charges

²⁹ *Id.* at 1342

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 1338.

³³ *Id.* at 1362-63.

³⁴ The record reflects that no studies were done to calculate the loss of business to the tenant without the department store traffic, and also that the location remained desirable even without the department store.

³⁵ *Grand Prospect Partners, L.P.* 232 Cal. App. 4th at 1367-68.

³⁶ *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. 42 (S.D.N.Y. 2014).

³⁷ *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. at 44.

³⁸ *Id.* at 44.

³⁹ *Id.*

shall abate...until [the tenant's] receipt of the Construction Allowance, together with interest on the unpaid balance thereof"⁴⁰ After the grocery store opened, but just prior to the deadline for payment of the construction allowance, the tenant filed for bankruptcy under chapter 11 of the Bankruptcy Code.⁴¹ Since the landlord did not pay construction allowance within the ninety-day time frame,⁴² so the tenant withheld all rent and charges pursuant to the abatement provision until the allowance was paid nine months later.⁴³

The landlord commenced an action in the bankruptcy court that sought to reduce the construction allowance by the amount of rent that was withheld.⁴⁴ In particular, the landlord argued that the provision was an unenforceable penalty since the resulting amount of damages was grossly disproportionate to and bore no reasonable relationship to the actual damages sustained.⁴⁵ The tenant responded that the provision was an enforceable forfeiture provision because there was no fraud, accident, surprise, or improper practice present.⁴⁶ The bankruptcy court agreed with the tenant, holding that the provision enforceable.⁴⁷ On appeal, the district court affirmed.

In reaching its decision, the Great Atlantic court found the clause was inconsistent with the definition of a penalty because the clause did not provide for a specific amount as damages in the event of breach.⁴⁸ Relying heavily on *Dunkin Donuts of America, Inc. v. Middletown Donut*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² The landlord secured financing for the allowance, but it was contingent upon the tenant assuming the lease, which was not done until six months later.

⁴³ *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. at 45.

⁴⁴ *Id.*

⁴⁵ Brief for Appellant In Re: THE GREAT ATLANTIC & PACIFIC TEA COMPANY, INC., et al., Debtor. N. Providence, LLC, Appellant, v. The Great Atlantic & Pacific Tea Company, Inc., Appellee., 2014 WL 4180151 (C.A.2), 35.

⁴⁶ *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. at 47.

⁴⁷ *Id.* at 54.

⁴⁸ *Id.* at 52.

Corp.,⁴⁹ which the court found to be the controlling law, the *Great Atlantic* court conclude that it would be proper to enforce the clause.⁵⁰ In doing so, the *Great Atlantic* court emphasized that the plain language of the lease stated that the rent would abate, and the judicial task is only interpretive, not to rewrite the contract.⁵¹ Moreover, the *Great Atlantic* court noted enforcing the unambiguous terms of a contract, particularly when sophisticated parties are involved, served a strong policy.⁵² Accordingly, the *Great Atlantic* court enforced unambiguous terms even though the result was a windfall to one of the parties.⁵³

c. New York Case Law – An Abatement Provision is an Enforceable Liquidated Damages Provision

Under New York law, in determining whether to enforce an abatement provision, a court will apply a liquidated damages analysis. For example, in *Bates Advertising USA, Inc. v. 498 Seventh, LLC*, a New York intermediate appellate court upheld an abatement provision in a lease because the court concluded that the provision was an enforceable liquidated damages provision that reasonably estimated the tenant's damages.⁵⁴

In *Bates*, an advertising company entered into a commercial lease with its landlord.⁵⁵ Pursuant to prior negotiations, the lease provided that certain repairs were to be made to the building to accommodate the advertising agency.⁵⁶ Since both parties were intent on commencing the tenancy, they agreed to include an abatement provision in the lease to ensure that the landlord performed the necessary repairs after the tenant took possession of the

⁴⁹ *Dunkin' Donuts of Am., Inc. v. Middletown Donut Corp.*, 495 A.2d 66 (1985).

⁵⁰ *In re The Great Atlantic & Pacific Tea Company, Inc.*, 510 B.R. at 53 n.27.

⁵¹ *Id.* at 49.

⁵² *Id.*

⁵³ *See id.* at 52 (enforcing forfeiture despite windfall to the tenant since no fraud, accident, surprise, or improper practice).

⁵⁴ *Bates* 291 A.D.2d at 180.

⁵⁵ *Id.* at 181.

⁵⁶ *Id.* at 180-81.

premises.⁵⁷ Upon the landlord’s default in completing the repairs, the lease provided for two abatement options: repairs that were deemed more important were granted a full day abatement, while the remaining repairs were granted a half day abatement.⁵⁸ When the landlord failed to make the repairs, the tenant brought suit to enforce the abatement provision.⁵⁹

In enforcing the abatement provision, the *Bates* court noted that both parties, highly sophisticated and represented by experienced attorneys, understood that the contemplated repairs were necessary for the plaintiff to serve as the “anchor” tenants, which would benefit the landlord by attracting other tenants, thereby increasing the building’s value.⁶⁰ Further, the *Bates* court found that the parties made every reasonable effort to provide for appropriate compensation in the event that the landlord failed to make the repairs.⁶¹ Moreover, the *Bates* court opined that amount of abated rent provided for under the provision was not grossly disproportionate to the tenant’s probable loss, and it would be difficult to calculate the tenant’s actual damages caused due to lack of repairs.⁶² Therefore, the *Bates* court rejected the landlord’s argument that the abatement provision was an unenforceable penalty and concluded that the provision was a valid liquidated damages provision.⁶³ As a result, the *Bates* court determined that the tenant was entitled to withhold the payment of rent as provided for in the lease.⁶⁴

d. Washington D.C. Case Law – An Abatement Provision is an Enforceable Liquidated Damages Provision

Under Washington D.C. law, in determining whether to enforce an abatement provision, a court will also apply a liquidated damages analysis. For example, in *Red Sage Limited*

⁵⁷ *Id.* at 181-182.

⁵⁸ *Id.*

⁵⁹ *Id.* at 180.

⁶⁰ *Id.*

⁶¹ *Id.* at 183.

⁶² *Id.* at 183-84

⁶³ *Id.* at 180.

⁶⁴ *Id.*

Partnership v. DespaEuropa,⁶⁵ the D.C. Court of Appeals held that a tenant was entitled to an abatement based on the landlord's breach of the lease's exclusive use covenant because the abatement provision provided for the tenant's reasonable liquidated damages.⁶⁶

In *Red Sage*, the tenant operated an internationally-known fine dining restaurant.⁶⁷ The lease granted the tenant an exclusive-use covenant, which provided that the tenant was to be the only food-service establishment on the premises.⁶⁸ In the event that the covenant was breached, the lease granted the tenant an abatement of one-half of the base rent.⁶⁹ The landlord subsequently breach the exclusive-use covenant by renting space to a specialty cake shop.⁷⁰ The tenant then sued the landlord for breaching the exclusive-use covenant after the landlord refused to grant the rent abatement.⁷¹ The *Red Sage* court held that under the plain language of the lease, the abatement provision was an enforceable liquidated damages clause rather than a penalty.⁷²

In so holding, the *Red Sage* court noted that the D.C. Code governing leases provided that “damages payable by either party for a default . . . may be liquidated in the lease agreement, but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default”⁷³ Applying that statutory standard, the *Red Sage* court held that the abatement provision was valid as a matter of law.⁷⁴ In particular, the *Red Sage* court determined that at the time they signed the lease, the parties could have believed that that the tenant's damages from a breach of the exclusive-use covenant would have been difficult to calculate and the amount provided for under the lease had a reasonable relation to the tenant's probable

⁶⁵ 254 F.3d 1120 (D.C. Cir. 2001).

⁶⁶ *Id.* at 1122.

⁶⁷ *Id.*

⁶⁸ *Id.* at 1123

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.* at 1124.

⁷² *Id.* at 1125.

⁷³ D.C. Code Ann. §28:2A-504(a)

⁷⁴ *Red Sage Limited Partnership* 254 F.3d at 1126.

damages. Therefore, the *Red Sage* court enforced the terms of the covenant and permitted the tenant to abate the rent.

Part III. Implications of Abatement Provision Case Law

The decisions on the enforceability of abatement provisions vary from state to state. The differences in those decisions could have a significant impact on both landlords and tenants.

From a landlord's perspective, if the wording of the abatement provision has the potential of resulting in a complete forfeiture, they could put themselves in a dangerous position. Not only will they be unable to collect rent, they will also still have the duty to provide services and/or repairs without the income stream coming in. This could affect their insurance liabilities and make them a high-risk candidate for lenders.

From a tenant's perspective, if there is not adequate protection in the provision, they could potentially be stuck paying rent for a property that does not adequately meet their needs. On the other hand, if the provision seems too good to be true, then there is the potential that the court will consider it a penalty and not enforce it.

Parties involved in drafting leases should be aware that abate provisions will be interpreted as either liquidated damages provisions or forfeiture provisions, and courts will enforce them in many circumstances. Moreover, a court will be particularly likely to enforce the provision if it resulted from negotiations between sophisticated parties. The court will assume that sophisticated parties knew what they were doing and chose specific language to reflect their intentions. On the other hand, just because sophisticated parties are involved does not mean that the court will enforce a provision that it finds to be a penalty.

As a result, parties should take great care when negotiating and drafting abatement provisions and look to local law to determine whether the provision will be enforceable since the

same provision may be enforceable in some jurisdictions but not others. Parties should be careful to include specific language that addresses the law of their jurisdiction. For example, in a jurisdiction that applies a liquidated damages analysis, something as simple as not providing for a specified sum as damages may result in the provision being characterized as a penalty provision, as opposed to a liquidated damages provision.

Importantly, a court will not use its equitable powers to rewrite the contract for the benefit of one of the parties. Therefore, a landlord should be aware that a court will likely enforce an provision that permits a tenant to abate rent in amount that is a reasonable estimation of the damages incurred by the tenant as a result of the event that triggered the abatement.

Conclusion

Rent abatements are a powerful tool in drafting lease agreements. They can be beneficial and detrimental to both the landlord and tenant. Courts in various jurisdictions have reached different conclusions when determining the enforceability of abatement provisions.

Most courts apply a liquidated damages analysis, which provides that an abatement provision is enforceable if it is not a penalty. In particular, the court will likely enforce the provision if the court determines that the amount of rent to be abated is a reasonable estimate of the damages that the tenant will incur upon the event that gives rise to the abatement. Other courts, however, will enforce an abatement provision as a forfeiture provision, regardless of whether it provides a windfall to the tenant.