The Marin Lawyer

An Official Publication of the Marin County Bar Association

March 2009 Volume 40, Issue 3

Lisa Goldfien

Perry Taubman

GENERAL MEMBERSHIP MEETING
PRO BONO APPRECIATION LUNCHEON

Legal Aid of Marin was incorporated on April 19, 1958 and has been serving the community for over 50 years. What started as a group of Marin County Bar Association volunteers now has a staff of 13 (including 6 attorneys) serving over 2000 households each year. This month's MCBA General Membership Meeting will coincide with the annual Pro Bono Appreciation Luncheon. MCBA will host Legal Aid of Marin's Pro Bono Appreciation Luncheon, and the presentation of the 2009 Pro Bono awards, on **Wednesday, March 25, 2009**, at **12 noon** at **Rickey's Restaurant** in Ignacio.

We will celebrate 160 attorneys including nineteen recipients of the Wiley W. Manuel Award – issued by the State Bar of California for 50 or more hours of pro bono services. Presiding Marin County Superior Court Judge Verna Adams will present their certificates. In addition, MCBA members **Lisa Goldfien** and **Perry Taubman** will address our group on their experiences with Legal Aid of Marin and the pro bono services they have provided.

The attorney **Wiley W. Manuel Award Recipients** are: Jean Bordon, Matthew Brenner, Diana Campbell-Miller, Antonio Cortes, Kevin Dwight,

(Continued on page 13.)

Calendar of Events

March 25, 2009
Legal Aid Pro Bono Luncheon
12-1:30 pm

March 18, 2009
ADR Section Meeting
12 – 1:30 pm

March 18, 2009
Probate & Estate Planning Section Meeting
12 – 1:30 pm

March 19, 2009
Real Property Section Meeting
12 – 1:30 pm

March 20, 2009
Intellectual Property Section Meeting
12 – 1:30 pm

March 23, 2009
Probate & Trusts Mentor Group
12 – 1:30 pm

March 27, 2009
Spring Diversity Section Meeting
4:00 pm

Look for details each month in *The Marin Lawyer*

In This Issue

Andrew C. McCullough was Guest Editor of this issue of *The Marin Lawyer.* Philip R. Diamond is Series Editor for 2009.

TEN SIMPLE REQUESTS FROM YOUR BUSINESS CLIENT

*By Andrew C. McCullough**
©2009

In these challenging economic times, few outside lawyers can afford missteps with their clients. For that reason, I thought that I would dust off some advice I was asked to give when I served as General Counsel for a retail company that retained local counsel throughout the western United States. Without further preamble, here is what I ask of my outside counsel.

Don't Surprise Me. This is the cardinal rule. Every client invokes it. It's also the rule most

(Continued on page 13.)

GOING GREEN

By Kate Rockas, MCBA Director

Americans buy more water in plastic bottles than any other nation in the world. It is estimated that we buy 29 *billion* water bottles every year. In order to make all of these bottles, manufacturers use 17 million barrels of crude oil. How much oil is that? It is enough to fuel approximately 100,000 cars for one year. Or, if you want to visualize it, picture a water bottle filled a quarter of the way up with oil – that is how much oil is needed to produce just one bottle.

In addition to requiring significant amounts of energy to manufacture plastic water bottles, plastic water bottles have other harmful effects on our environment. The manufacturing process for creating bottled water creates more than 2.5 million tons of carbon dioxide each year. It also takes more than three liters of water to create one liter of bottled water.

Clearly, there are many reasons to recycle plastic water bottles. Unfortunately, for every six water bottles we use, only one is recycled. The ones that are not recycled end up in our landfills, or worse, in our rivers, lakes and oceans. Plastic bottles take hundreds of years to disintegrate.

Another reason to avoid using plastic water bottles is that they are bad for your health. Plastic is a porous material, which means that some of the chemicals that were used to make the plastic leaches into the liquid it contains. You should pay attention to the recycling number on the bottom of plastic bottles. Numbers 1, 2, 4 and 5 are considered usable for human consumption (but you should not reuse them). Numbers 3, 6 and 7 should be avoided at all costs. These plastics are made from products which may leach out a human endocrine disrupter. Using plastics with any of these numbers over a prolonged period of time can actually change or interfere with the chemical balance of the human body.

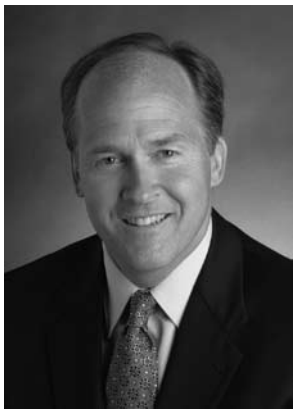
The bottom line is that instead of buying plastic water bottles, consider a greener solution. At your office, consider signing up for a water delivery service, or get a Brita water filter. For those of you on the go, buy a stainless water bottle and reuse it over and over.

Katharine E. Allen, Esq

WHEN GOOD LEASES GO BAD:
WORKOUT STRATEGIES FOR LANDLORDS AND TENANTS

*By Douglas Van Gessel, Esq., and Katharine E. Allen, Esq **

With consumer confidence plunging and companies significantly reducing their workforces, the remainder of 2009 will likely bring a rise in troubled commercial leases. Office and retail tenants alike will find themselves burdened with either too much space or rent that exceeds current market rates. Either way, more and more tenants will begin contemplating lease restructuring in the upcoming year.



Douglas Van Gessel, Esq.

The simplest solution for a tenant seeking to reduce its occupancy costs is to find a subtenant. However, in the current market, subleasing may not be feasible for most tenants due to an increase in supply and a decrease in demand for commercial space. Accordingly, tenants may seek more creative alternatives to alleviate their lease burden. Prior to taking action, the initial question a tenant must ask is whether the tenant and its business are sustainable in the long run. The answer to this question not only dictates the tenant's strategy in approaching its landlord, but also the options available to it.

Strategies for a Non-Sustainable Tenant

If, after careful consideration, a tenant determines that its business is not sustainable, reorganization or even dissolution is likely inevitable. This tenant will probably first attempt to reorganize or dissolve its affairs on its own, which, among other things, will require negotiating the early termination of its commercial leases. If all else fails, this tenant will file for bankruptcy.

If the tenant knows its business is going to fail, its first course of action will likely be to approach its landlord about voluntarily terminating its lease. With the threat of bankruptcy looming, a landlord may be more inclined to discuss this option in order to avoid receiving little or no lease damages in a bankruptcy liquidation. A lease termination agreement generally provides for the early termination of a lease in exchange for a lump sum payment to the landlord equal to a few months' rent due under the lease

(Continued on page 14.)

(Ten Simple Requests, continued from page 13.)

served a demand of $_____. Please advise as to your response." I do not have a response. I am paid to analyze the options and select those that are in the best interests of my company. So, help me out. Tell me what the options are and what you recommend. And, by the way, if I routinely accept your recommendation, that is a good sign.

Tell me what the law is. Most in-house lawyers are forced to be generalists, facile in some areas and ignorant in others. In smaller companies, which do not have inside counsel, the legal sophistication can be quite modest. So, inevitably, a matter will arise where the client is clueless. If so, outside counsel must educate the client early on. And the education process must continue throughout the life of the matter. This prevents big misunderstandings. If I feel uninformed at the end of a matter, and its result or cost is a surprise to me, I will blame you. Bottom line: your excellent legal work is worthless if I do not understand it.

Get to know me and my business. Every client is different. Each has his or her own preferences, and you won't know what they are if you've never met your client contact. This can be an issue when a company is referred to and retains counsel out of state. It also happens with local and regional referrals. If you are the new counsel, find an excuse to visit your in-house contact. The personal touch is important, but you will also have the chance to learn about the organization, its hierarchy, and your contact's authority within that hierarchy. You might even meet other people in the organization who will retain your services if your contact person leaves. Fundamentally, though, you will improve your client's trust if he or she has met you. In those few instances where I use counsel I have never met, I wonder whether they are as competent and presentable as my referring source claims.

Pretend I'm your only client. This needs no explanation. I'm pretending it's true, and so should you.

**Andrew McCullough is Executive Vice President and General Counsel for Syufy Enterprises, a real estate and retail holding company in San Rafael. He previously occupied the same position with its subsidiary, Century Theatres, which at the time of its sale in 2006 was the country's fourth largest movie theater chain.*

(When Good Leases Go Bad, continued from page 3.)

plus any unamortized portion of tenant improvement and brokerage costs incurred in connection with the lease. Additionally, the parties may wish to address other issues in the lease termination agreement, such as what happens to any rent already past due, the security deposit, the condition of the premises upon surrender, and the removal of tenant improvements or furniture. A savvy tenant will also bargain for a general release of all claims and obligations under its lease (including California Civil Code Section 1542 language) as part of any lease termination agreement.

A key obstacle a tenant may encounter in negotiating a lease termination agreement is its ability to make a termination payment. The termination payment is generally made upon termination in a lump sum cash payment. In many instances, the security deposit held by the landlord can be used to offset the amount of the termination payment. However, if the tenant cannot make a lump sum cash payment even with the application of the security deposit, the parties may consider an installment payment arrangement. Nonetheless, a landlord will likely have concerns about such an arrangement given the uncertainty over the continued existence of the tenant and its ability to make those payments when they come due. The landlord might suggest that any such payment obligation be secured by a letter of credit or promissory note secured by additional collateral.

While the threat of bankruptcy may give the landlord an incentive to reach an agreement for the early termination of a lease, this threat is somewhat of a double-edged sword. Landlords should be aware that if the tenant ends up filing for bankruptcy even after its initial restructuring or dissolution attempts, any termination agreement entered into within ninety days prior to the tenant filing for bankruptcy risks being treated as a preferential transaction under the U.S. Bankruptcy Code. As a result, a landlord could end up being bound by the termination agreement but having to return any payments made under the agreement within such ninety day period to the bankruptcy estate. Therefore, any lease termination agreement should state that it unwinds and the parties retain their existing remedies if the agreement is deemed a preference in bankruptcy court.

If a failing tenant is not successful in negotiating a lease termination agreement with its landlord, its only other option to rid itself of its lease may be through bankruptcy. If the tenant files for bankruptcy, the bankruptcy trustee, upon request by the tenant within 120 days after the bankruptcy petition (subject to extension for an additional 120 days) has the power to reject the lease, thus effectively forcing the landlord to accept termination. If the lease is rejected, Section 502(b)(6) of the U.S. Bankruptcy Code caps the amount of damages recoverable by the landlord to the

(Continued on page 15.)

(When Good Leases Go Bad, continued from page 3.)
greater of (a) twelve months rent or (b) fifteen percent of the rent for the remainder of the lease term, not to exceed three years. The amount of any security deposit or draws made on any letter of credit held by the landlord will be applied to offset these capped damages. However, the stark reality for a landlord is that it will likely not receive its statutory damages unless there are sufficient funds in the bankruptcy estate to pay all of the tenant's unsecured creditors.

Strategies for a Sustainable Tenant

If a tenant's business is sustainable in the long run and it simply suffers from a temporary decrease in profitability, the goal of both the landlord and the tenant should be to arrive at some compromise to ensure that the lease also remains sustainable. In this instance, bankruptcy is not an effective option and, in any event, the tenant will most likely want to keep the leased space with a few adjustments. Thus, the tenant's primary objective will be to reduce the financial burden of the lease by negotiating a temporary reduction in the rent in exchange for other concessions.

One approach is to reduce the amount of space leased and/or relocate the premises to a less desirable or less improved location in the building. This is especially appealing to the landlord if it frees up a full floor of space, for example, to lease to a new tenant.

Another approach is to alter the amount of rent due under the lease, either by unconditionally reducing the rent per square foot, declaring a lease "holiday" for a discrete period of time, or deferring a portion of the rent until later during the term of the lease. It is not uncommon for the parties to agree to extend the lease term in exchange for the rent reduction under the theory that by granting the rent reduction the landlord is creating a more viable tenant the landlord will want to lease to for a longer period of time. However, a landlord will want to condition any such rent modification on the tenant not defaulting in the future. Upon any future default, the tenant's previous higher rental obligations return.

A landlord's rental accommodations typically come at a price to the tenant, however. Landlords will typically look to strip the lease of: (i) existing economic advantages, such as undisbursed tenant improvement allowances or impending free rent or moving allowances; (ii) tenant options, such as early termination rights, expansion and/or extension options; and/or (iii) generally favorable provisions, such as representations and indemnities given to the tenant in a more generous leasing market. In addition (or in the alternative) to such provisions, landlords might ask for additional lease guaranties or increased security deposits (or a security deposit in the form of a letter of credit instead of cash), or introduce net worth, income flow or other financial tests to be met in order for the tenant to expand the premises or extend the lease, or possibly as a covenant allowing the landlord to terminate the lease if such financial test is not met by the tenant. More aggressive landlords might also ask for a stipulated judgment for possession of the premises, avoiding the eviction process in the event of a subsequent tenant default. Finally, sometimes a landlord will ask for – or a tenant will offer – warrants in the tenant's company at an attractive "strike price" under the theory that a landlord who grants a tenant rental concessions is much like an economic partner in the company who deserves a piece of the "up side" created by those concessions.

The foregoing overview is not an exhaustive list of all possible options available for dealing with troubled leases. It is merely meant to outline several ways to address leases involving too much space or that are above market rents. The best available option will vary based on individual circumstances, and landlords and tenants will want to discuss all of these options with experienced counsel.

**Doug Van Gessel is a partner with Sheppard Mullin Richter & Hampton in San Francisco. His practice focuses on real estate and business transactions. He can be reached at dvangessel@sheppardmullin.com. Katey Allen is an associate at Sheppard Mullin Richter & Hampton in San Francisco. Her practice emphasizes real estate and land use. She can be reached at kallen@sheppardmullin.com.*