COMMERCIAL LEASE WORKOUTS: PRACTICAL ALTERNATIVES TO THE COURTHOUSE (LESSONS FROM THE EIGHTIES)

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I. ***Scope of Article.*** We spend hours [and earn fees] drafting lease contracts for our clients. Most of the time, the parties never call back and never have any problems. Occasionally, as the economy turns down, businesses fail and leases go into default. A landlord has certain legal rights under the lease and law. But what happens when the legal rights available to the landlord isn't what the client wants? For the purposes of this presentation, I will address the issues from the landlord's perspective, since the landlord is usually in the driver's seat. Of course, the tenant is a necessary participant in the process.

For the purposes of this presentation, we need to define a "workout." If the landlord elects to pursue its legal remedies or the tenant simply walks away, there cannot be a workout. But if each side is willing to compromise to find an acceptable business alternative to the mutual advantage of each, you have a workout.

II. ***Evaluate Alternatives.*** A lawyer's usual starting point is to evaluate the legal rights available to the landlord. But in a down economy, having an empty space and the privilege of spending money on legal fees chasing a tenant whose business has just failed, may not produce the best result. In other words, do your legal rights really get you what you want?

III. ***Document Review.***

A. ***Lease, Estoppel, and Guaranty.*** In the loan workout days, we used a standard file review letter, because the workout officer typically did not generate the loan. We wanted to make sure that if we gave advice based on documents presented to us, we would be protected against subsequent information.

For example, we spent a lot of time preparing for a foreclosure, only to learn from the title company that the deed of trust had been released. The banker later confirmed that the local office had accepted a partial payment for the release that was not in our file. Make sure you start with the best information and your client agrees with your assumptions.

B. ***Loan Documents.*** The loan covenants are another factor on a lease workout. Make sure that the client will not create a loan default by terminating a lease or having the vacancy rise. It may be that a few concessions to keep a tenant will prevent a loan default scenario.

PRACTICE TIP: Make sure the lender has actual notice of the proposed modification and consents in writing to the lease workout modifications. Don't just accept oral approvals from a loan officer. This point is illustrated by an Arkansas case involving a

convenience store lease. F.D.I.C. v. Lee, 988 F. 2d (8th Cir. 1993). The tenant's representative testified that he met with the lender / landlord and discussed changing the tenant's lease. The tenant's representative further said the FDIC orally approved the lease amendment and that the FDIC had examined the records and monthly reports showing the payments made under the lease. The lender's testimony, however, reflected that "there was some talk about a lease, but I don't know if anything came of it". The FDIC representative testified that the FDIC (which took over the lender) did not approve any lease amendment.

C. ***Other Leases.*** Some major tenants have the clout to create leasing/ occupancy obligations in their leases. Make sure you consider the effect of the other leases on your situation. Also, you will need to know any use restrictions on the Center.

D. ***Authority of Parties.*** It is imperative that the authority of the business negotiator on behalf of the landlord and tenant be confirmed. Cleontes v. City of Laredo, 777 S.W.2d 187 (Tex. App. -- San Antonio 1989, writ denied). In Cleontes, the tenant leased from the City two apartment buildings located at the airport. During the lease term, the tenant entered into an agreement permitting a partial rent abatement. The rent abatement agreement was signed by the Airport Director, but never ratified or approved by the Airport Advisory Board or the City Council. The tenant subsequently defaulted. The City sued to recover past due rentals [including the amounts (about $32,000) abated by the agreement] and obtained summary judgment at the trial court. The appellate court upheld the trial court and found that the tenant was charged with notice of the City charter provisions vesting all the authority for airport leases in the City Council. Since the Airport Director had no authority to enter into the rent abatement agreement, the City could not be bound by his signing the abatement agreement.

PRACTICE TIP: In more complicated lease workouts requiring lender involvement or approval, be sure to ask if the lender you are contacting has the authority to make the decisions. Get that authority confirmed in writing. With conduit lending and loan participations, the lender representative you are contacting may have authority to deal with servicing issues, but not be the one who has the authority to approve changes to significant collateral like a long term anchor lease.

E. ***Guarantor.*** Texas law has long provided that an extension of time for payment will release a guarantor or surety. Glasscock v. Console Drive Joint Venture, 675 S.W.2d 590 (Tex. App. -- San Antonio 1984, writ ref'd n.r.e.). In Glasscock, the landlord and tenant entered into a settlement agreement to address the tenant's default. The original lease was also guaranteed by Glasscock, individually. The tenant fell behind on the note evidencing the settlement and the landlord pursued. The guarantor was not a party to the workout negotiations. The court found that the guarantor was not liable for the past due rental payments evidenced by the note.

PRACTICE TIP: If the lease guaranty is important to you, make sure that the lease guarantor affirmatively consents in writing to the modification at the time of the lease

workout.

F. ***Brokers.*** Depending on the length of the lease, the number of renewals and the broker's commission agreement, the possible claims of brokers need to be considered. Carpenter (Texas) Realty Corporation v. Allen Center #4, 974 S.W.2d 808 (Tex. App. – [Hous. 14th Dist.] 1998, writ denied). The Carpenter case demonstrates the broker issue. In 1986, Enron leased office space in Four Allen Center from its owner, MetLife. The lease contained an initial term of twenty (20) years and six five year renewal options. A commission agreement existed between MetLife and Carpenter providing that Carpenter would be paid a commission based on the aggregate rentals over the initial term and for each renewal, extension or expansion of it. If Four Allen Center was sold, MetLife would remain liable to Carpenter for future commissions unless MetLife arranged for the new buyer to assume the obligation.

Enron ultimately occupied the whole building and decided to buy it from MetLife. To utilize "off-balance sheet" financing, Enron structured the transaction so that a consortium of banks bought the building, a trustee held title to it and Enron leased the building from the trustee. The sale closed, the MetLife lease terminated and Enron entered into a three-year lease with the trustee. While MetLife agreed to pay the broker $5.75 million as commission for the remaining commission on the initial term, Carpenter claimed he was also entitled to commissions on the rents for renewal periods (the value of which was reflected in the sale price of the building). MetLife did not pay (or have anyone assume the obligation) for payment of the claimed renewal commissions. In 1992, Carpenter sued MetLife and Enron for breach of the commission agreement, tortious interference claiming that the sale of Four Allen Center was a sham to deprive Carpenter of commissions for renewals and extensions.

While the broker did not prevail in his commission claims, if a workout results in a long-term lease being terminated and the property being sold to the tenant, then the treatment of possible outstanding commissions needs consideration.

G. ***Subleases.*** If a subtenant is involved, make sure to review the sublease agreement to determine if concurrent rights of the subtenant are impacted. Brown v. RepublicBank First National Midland, 766 S.W.2d 203 (Tex. 1988).

H. ***Management Agreements.*** In a similar vein, agreements with property management companies should be reviewed to make sure that the lease workout does not negatively impact the management agreements.

I. ***Merchant Association.*** In certain types of leases (such as shopping centers), there may also be rules relating to the merchant association and impositions on tenants which need to be considered in the workout.

J. ***Franchise Agreement.*** The tenant may be a franchisee under a franchise agreement operating a restaurant or hotel. If the lease changes modify the obligations of the tenant so radically (such as decreasing maintenance obligations), the franchise agreement may be

violated and /or terminated. The resulting loss of the franchise "flag" may result in the tenant's business being unable to fulfill its workout agreement obligations.

IV. ***Desperate People do Desperate Things.*** As lawyers, leases represent pieces of paper in file cabinets. But to tenants, these are not merely pieces of paper. This is his life. This is her ability to feed and shelter her family. Always keep in mind that when you consider taking adverse action under a lease, you are cornering a wild animal that will attack any way it can. Remember all of the lender liability counterclaims that were created in response to the bank failures? Also consider that in filing a lawsuit, the statute of limitations is waived on counterclaims that are promptly filed. Be sure to review the file and warn your landlord client to expect the worst. Better to hear that before filing suit than as an explanation to a multimillion dollar suit.

V. ***Exhibit A.*** As tensions heat up and the fur is flying, make sure you carefully draft each letter. You should assume that every letter you write will be Exhibit A to the tenant's petition or counterclaim. Strive for simplicity, clarity and respectfulness. This will at times require "turning the other cheek." Make sure your client understands this also. I had a lender client get baited into a shouting match where he threatened to have the police come out and arrest the borrower.

VI. ***Understand the Grief Cycle.*** Most people have heard of the "psychological grief cycle" when it comes to a personal loss, such as the death of a child. But it also applies to a business tragedy situation. Reread section 4 above.

A. ***Denial.*** The first reaction to a loss is denial. Remember some of the meetings with borrowers. When the banker said the situation was hopeless and the bank would have to foreclose, the response was, "There's not a problem! I can turn this thing around. I have a new plan underway right now."

B. ***Anger/ Blame.*** After the denial phase wears off, anger quickly sets in. Most borrowers reacted to the business failure with an attack on the bank (or landlord). "There wouldn't have been a problem if . . .."

C. ***Acceptance.*** At some point, acceptance kicks in. I remember a loan situation where a business had failed. The owner was working overtime to save it. He fired his accountant to save money. The bank insisted on good numbers/ forecasts. The owner finally agreed and rehired his accountant. After the numbers came in, he realized that he was actually losing money on every sale. He accepted the situation and agreed to allow the foreclosure.

D. ***Resolution.*** It is only when the parties get to the resolution stage that you can negotiate a workout. I realized, after having this process explained in the workout scenario, that I had tried to "force" a settlement when the borrower was in the denial stage.

Not every person goes through the process the same way. Some have longer cycles and

some never progress all the way through it. One thing you can count on is that the more the person is personally involved, the deeper the grief cycle will be evident.

VII. ***Don't Make Matters Worse.*** Consider yourself to be in a litigation mode during the workout process. While it is important to meet with the tenant to consider alternatives, you need to avoid claims that can [and did] arise during this time frame. Consider using a negotiation agreement to conduct meetings. I don't recommend a long involved form. A short simple letter agreement that confirms that the parties will discuss options but that the landlord is not waiving any rights, unless an agreement is signed by all parties. Be sure to include any guarantors to the agreement. A sample agreement is attached as Exhibit "A".

I do not like the forms I saw in the foreclosure days that required the borrower to waive all claims and defenses as a condition to meeting. You may as well not meet if that is your condition. Also, I was afraid of the jury's reaction to such a letter just for the privilege of talking.

A. ***Good Faith.*** Is there an obligation of good faith and fair dealing in workout negotiations? It appears that there is not. Section 1.203 of the Texas Business and Commerce Code states the general rule that "every contract or duty within this title imposes an obligation of good faith in its performance or enforcement". TEX. BUS. & COMM. CODE ANN. §1.203 (Vernon 1994, Supp. 2002). Neither Section 205 of the Restatement of Contracts nor UCC Section 1.203 apply to good faith in the formation of a contract. In the lending workout context, a borrower attempted to claim a lender violated a duty of good faith in negotiating. Commercial National Bank of Beeville v. Batchelor, 980 S.W. 2d 750 (Tex. App. -- Corpus Christi 1998, no writ). In Commercial National Bank, the borrower asserted that the bank's failure to renew, extend and lower the payments under the note somehow violated its obligation to enforce the notes in good faith. The court stated that the bank's previous acts of lenience with the borrower do not impose any obligation to continue such extra contractual lenience in the future based on the U.C.C.'s good faith provision. The court found that "what some might consider to be cold heartedness by the bank in not renewing or restructuring debt is not the equivalent of the absence of good faith....A jury may not restructure or recast promissory notes or other contracts to satisfy their sense of justice contrary to the written agreement of the parties".

B ***Workout Techniques.***

1. Attempt to resolve all issues while the parties are "at the table". Workout negotiations require both patience and the ability to get all of the parties to the negotiation to focus until all of the critical issues are resolved. The subsequent lack of agreement on one issue (which wasn't anticipated at the original negotiations) can disrupt an otherwise settled lease workout. An unpublished Dallas Court of Appeals opinion referenced a mediated dispute over a ground lease in North Dallas. Thornton v.Ventura [1996 WL 132237]. The landlord and tenant reached an agreement during the mediation and filled out and signed a pre-printed settlement agreement form provided by the mediator. The agreement provided for the transfer of the ground lease in return for the payment of $1.9 million. There were also provisions relating to how the

obligations to the lender would be handled. Following the agreement, the parties exchanged drafts of the documents to be signed to perform the tenets of the settlement agreement. One of the documents provided for a note assumption and contained an indemnity. The disagreement over the indemnity resulted in the parties going back to court.

2. Unless a party actually intends to use a remedy, they should refrain from vague threats to use a remedy as a means of "strong arming" the other side.

VIII. ***Think Outside the Box [Lease].*** Remember, you've decided that the legal rights aren't necessarily what the landlord needs [in light of all considerations]. Be sure to ask, "What do the parties really want?" It may be just an operating business to avoid default under another key lease or help with operating expenses. Maybe a tenant can move to an undesirable location, pay some rent and allow another tenant to move into the better spot?

IX. ***Understand the Rules of Bankruptcy.*** It is beyond the scope of this presentation to fully explore the rules of bankruptcy, because the rules of bankruptcy are beyond the scope of the authors' abilities. If bankruptcy should occur, get good counsel.

A. ***Automatic Stay.*** I'm sure you understand the concept of the automatic stay, but everything should be covered. Once a debtor files for bankruptcy protection, the landlord is prevented [stayed] from exercising any rights against the debtor's property without seeking relief from the bankruptcy court. 11 U.S.C. §362. That does not mean that you can't do anything and sometimes the stay does not apply to the specific remedies you want, such as suing the guarantor.

B. ***Post-Filing Rent Must Be Paid.*** Most bankruptcy attorneys know this rule and file for protection around the second day of the month. That gets them the longest protection period for rent relief. For example, by filing on July 2, the next rental payment [assuming a monthly payment] would be August 1. Many landlords assume that once a tenant files, rent will be delayed indefinitely.

C. ***Assume or Reject Period.*** A lease is an executory contract under the bankruptcy code. 11 U.S.C. §365. A debtor must either assume or reject the lease within 60 days of filing through the filing of a motion to assume. If the trustee or debtor fails to assume a lease of nonresidential realty within sixty days after the order for relief is entered (absent an extension for good cause), the lease is automatically deemed rejected. 11 U.S.C. §365(d)(4) . Make sure your bankruptcy counsel is prepared to object to an extension of this 60-day period, if the lease is not being kept current post-filing or if there is other cause to object.

Prior to the actual rejection of the lease, the trustee or debtor in possession must continue to make all payments under the lease even if the debtor has vacated the premises. 11 U.S.C. §365(d)(3). Leases that have been terminated prior to a bankruptcy filing under state law (through lockout or FE&D) may not be assumed by the bankruptcy estate as they are no longer subject to reinstatement. 11 U.S.C. §365(c)(3). Prior to the assumption of the lease in bankruptcy, any defaults must be "promptly cured". A "prompt" cure means very shortly after

the assumption, but depends on the facts of each case. Additionally, to assume the lease, the debtor or trustee must provide adequate assurance of future performance under the lease.

Since the unpaid post-filing rent has a higher priority of payment, the Courts are careful about allowing the debts to go unpaid. If the lease is rejected, the landlord generally has the following claims: (1) general unsecured claim for accrued unpaid rent prior to bankruptcy; (2) an administrative (priority) claim for rent that accrued after the filing, but before rejection; and (3) general unsecured claim for "rejection damages". There are certain limitations on the maximum amount that may be claimed. 11 U.S.C. §502(b).

X. ***Put it in Writing***. Warning, this is a war story. A landlord spoke to a tenant about a payment default. He agreed if she would bring the lease current and pay one month's rent in advance, he would cancel the lease. She agreed, paid, and moved out. He changed the locks and put up a "for lease" sign. He called me when he got a letter from her attorney claiming damages for wrongful eviction because she was current on her rent. He never got anything in writing from her. A simple letter or lease termination agreement would have prevented the claim. [Remember also that the Texas Statute of Frauds applies to leases which are for a term longer than a year.] TEX. BUS. & COMM. CODE ANN. §26.01(a)(5) (Vernon 2002).

XI. ***Standstill Agreements***. If the workout involves several conditions on the tenant, consider a Standstill Agreement. A sample agreement is attached as Exhibit "B". This document acknowledges the defaults, clearly outlines the tenant's conditions and requires the landlord to "standstill" [or not take action] so long as the tenant is not in default under this agreement. These are usually short term arrangements where the tenant agrees to refurbish the space, hire a new manager, or change the concept/name. The landlord agrees to accept less rent during this time period- so long as the tenant is fulfilling its promises.

XII. ***Be Careful of the Abandoned Stuff***. Tenants usually leave stuff in the space after they move out. Be sure to get pictures and a written inventory, even if the client is sure that it is just junk. In the lawsuit, it will be very valuable property. Send a letter offering the tenant a chance to get the stuff, **without any conditions, such as payment of rent.** Remember, you've looked at it and considered it to be junk. If possible, get a waiver/ release from the tenant. If you dispose of anything, keep a record. I had a landlord call a donation company, but later he couldn't find the name or any receipt.

Tenants may also claim that they had to leave personal property in the space because they were told by the landlord to leave without being allowed to remove their personal property. An unpublished Amarillo Court of Appeals case involving a horse stable lease describes a sequence of events involving personal property remaining on the leased premises after failed settlement negotiations which reinforces the concept that remaining personal property can be very valuable property. Salisbury v. Glasscock [1997 WL 200555].

Be sure to look for any lender estoppel agreements in the file. Your client [or its predecessor] may have a contractual obligation to give notice to the lender. Consider also, for

potentially valuable property, to get a UCC search and notify any lenders on the search. Rarely is this stuff worth the cost of selling it, but it often becomes a source of a damage claim later.

Consider conducting a strict foreclosure sale under the UCC, provided your lease has a security interest. A simple letter to the tenant stating the date after which the property will be disposed of in a private sale is sufficient. Of course, under this method, the landlord cannot sue for a deficiency because a private sale is in lieu of any claim. But it is faster and cheaper than trying to conduct a "commercially reasonable" public sale to keep a right to seek a deficiency. If you have property and you want to keep your right to a deficiency, be very careful.

XIII. ***Remedies***. Be sure to review the "standard" lease and confirm your legal remedies [obligations] under the lease. Just because it is in the standard lease, your remedies may have been modified, either in the lease or by an addendum. Some major tenants have a "standard" addendum that says "notwithstanding anything in the lease to the contrary . . .."

XIV. ***Negotiation Tips***. Workout negotiations can be some of the most extended and trying negotiations a real estate lawyer encounters. As referenced earlier, the tenant is often fighting to keep his business alive and the lease is a major asset (or liability) of the business. As a negotiator, it is important to remember that the tenant may vacillate between a passive approach ("I'll just file bankruptcy") and an aggressive approach ("I'm not going to make this easy for the landlord"). The landlord may also vacillate between wanting to keep the tenant ("I need to keep this 'revenue stream' ") and immediately ejecting the tenant ("Forget it, it's not worth it, let's take the space back"). The negotiator will find himself in the middle and the key is patience.

> PRACTICE TIP : Caution clients, especially landlords, about brash pronouncements or threats. When negotiations on workout terms stall, be careful about threatening to exercise default remedies when there is no intent to exercise them (or the landlord is barred from exercising them by other agreements).

A. ***Who is Negotiating?*** In small lease workouts, there is often just the individual tenant and individual landlord as the key negotiators (or their respective attorneys). These parties can speak directly and (while not always agreeing) don't usually have to worry about concepts or positions being filtered or "spun". When the workout has more parties and interests involved, it becomes critical to get a spokesman appointed especially if the tenant or landlord is a partnership. Additionally, there will be third parties, who because of an economic interest or wanting to "facilitate" the deal will attempt to get involved. Property managers and leasing agents often fall into this category. These individuals can be a double-edged sword. They may know about tenant or lease specific issues which the corporate landlord will not have knowledge. At the same time, they may be too familiar with the tenant (or landlord) and make statements to the opposing side which are contrary to the main negotiating positions. As the attorney, strive to keep control of the main negotiating position and minimize views that are at variance with the main negotiating position.

XV. ***CAM Charges***. Ever have a landlord begin a discussion on a lease default and then tell

you it incorrectly assessed CAM rates for the last year and a half and it just discovered the tenants owe a huge charge-back? I have and it is like putting salt on the wound. Make sure your landlord client is reevaluating the CAM escrows against actual expenses. This is not the time to be getting further in the hole.

XVI. ***Curb the Hatred.*** Banks learned to transfer bad loans to a new officer. The old officer [that made the loan and suffered the wrath of loan committee] often wanted a pound of flesh. Make sure there isn't some animosity between the client and tenant that could prevent a reasonable settlement form coming out. If it is a large entity, maybe a change would be best.

XVII. ***Drafting the Workout Documents.*** Because each workout is unique, there is no one standard set of documents that fits in all situations. For example, in addition to the main workout document, there may also be a new lease, a guaranty modification, a promissory note, a letter of credit as additional collateral, an amended partnership agreement (if the tenant had to add more partners as a credit enhancement). We have already suggested some pre-negotiation documentation and there may be intermediate memorandums or term sheets. When the parties have agreed to all the deal points, it should be described in a separate agreement which may be characterized as a "workout agreement", "restructuring agreement", "settlement agreement", "compromise agreement", or "lease modification". Regardless of how it is titled, some document drafting tips are in order:

A. ***Beware of Unresolved Issues (no matter how seemingly small):*** An unresolved minor issue can lead to big consequences. Castroville Airport v. City of Castroville, 974 S.W.2d 207 (Tex. App.-- San Antonio 1998, no writ). In Castroville, the settlement memorandum referenced that the amended lease would be in the form attached as an exhibit "with **minor** revisions to be agreed to by the parties". The court interpreted this provision to be "some indication that the parties contemplated further negotiation at least with respect to some minor revisions". The tenant testified that he never intended to be bound by the settlement memorandum absent a final written agreement. The court found that the testimony raised a fact issue as to whether the parties intended their agreement to be conditioned upon the execution of a formal written lease. The court further noted that for an agreement to be enforceable, the parties must agree to all material terms. If an essential term is left open for future negotiation, the contract is not binding.

B. ***Confirm that you have Incorporated the Workout Terms into the Lease:*** (and not inadvertently created a "free standing" document which doesn't incorporate the lease default terms) -- Ghidoni v. Stone Oak, Inc., 966 S.W.2d 573 (Tex. App. -- San Antonio 1998, writ denied).

C. ***Remember Basic Contract Modification Principles:*** A "modification must satisfy the elements of a contract: a meeting of the minds supported by consideration." Hathaway v. General Mills, 711 S.W.2d 227 (Tex. 1986)

D. ***Make Sure that all the Workout Documents are executed Contemporaneously:***

Pay particular attention that if a new lease guaranty is signed, it is signed simultaneously with the other workout documents. A recent case reminds us that to avoid an argument that a guaranty fails for lack of consideration, the guaranty should be signed contemporaneously with the other operative documents. Windham v. Cal-Tim, Ltd., 47 S.W.3d 846 (Tex. --Beaumont 2001, pet denied).

E. ***Secure Representations:*** The workout is an opportunity to confirm and receive various representations from the tenant. For example, if there have been previous disputes over non-financial issues which have not been previously resolved, get a representation in the workout. Since a delinquent tax bill on a triple net lease can ruin a workout, take the opportunity to get a representation that all of the taxes have been paid.

F. ***Beware Assignments:*** If the workout involves the assumption by another party of the existing lease, make sure that the lease obligations assumed by the new tenant include the unfulfilled obligations of the prior tenant.

XVIII. ***Releases.*** I said earlier that asking for a full settlement as a condition of negotiations was a bad idea. However, if the parties reach a settlement, be sure to get a full waiver/ release as part of the deal. Exercise care and caution, however, in drafting the release provision. A Houston case emphasized that to effectively release a claim, the releasing instrument must "mention" the claim to be released. Any claims not clearly within the subject matter of the release are not discharged, even if those claims exist when the release is executed. The court further noted that a "court should construe a contract by considering how a reasonable person would have used and understood such language, considering the circumstances surrounding its negotiation and keeping in mind the purposes which the parties intended to accomplish by entering into the contract". Baty v. Protech Insurance Agency, 63 S.W.3d 841 (Tex. App. -- Houston [14th Dist.] 2001, no pet)

> PRACTICE TIP: Do not try to be too clever in "hiding things" or being obtuse in drafting the release language for the workout. Be clear and specific in the points or matters which you are including in the release and the ones which are being reserved.

XIX. ***Taxes.*** While a detailed analysis of the tax consequences of a lease workout is beyond the scope of this paper, practitioners should keep the potential federal income tax consequences of any lease workout. For example, if the workout provides that an existing tenant indebtedness be forgiven, the tenant will be impacted by the forgiveness of debt rules. Another tax consequence involves adding partners to a partnership as a credit enhancement for a lease.

XX. ***Securities Disclosures.*** In today's heightened awareness of disclosures under the securities laws, be aware that a publicly traded company (especially as a tenant) may be obligated to disclose a lease restructuring or workout in filings with the SEC and in disclosures to its shareholders.

XXI. ***Post Workout Considerations.*** Signing the documents and recording them is not

necessarily the end of the workout process. There are some additional considerations for consideration:

A. ***Communicate the Deal***: Make sure that the management company and accountants who will be trying to keep "track of the numbers" have a copy of the workout documents and, more importantly, understand the deal. An unpublished Dallas Court of Appeals opinion shows the confusion (even resulting in attorneys sending demand letters for late payments referencing incorrect rental amounts) when the property manager did not understand a retroactive reduction in rent as part of a workout. Ferguson v. Mellon Bank, N.A. [1994 WL 197078].

B. ***Impress on your Client to keep Good Records Post-Workout***: Keep in mind that if the tenant has gone into financial difficulties once and the economy continues in a slump, there is a strong likelihood that the tenant will not be able to fulfill its obligations under the workout. A San Antonio case provides an illustration. Stucki v. Noble, 963 S.W.2d 776 (Tex. App. -- San Antonio 1998, writ denied). The landlord and tenant entered into a settlement and the tenant signed a promissory note. The tenant subsequently defaulted and could not pay the remainder of the note. The landlord had drafted the settlement agreement in such a manner that it preserved both the promissory note remedies and the lease's default provisions. The tenant, on the other hand, had poor records to evidence any payments that he had made since the workout. See also Hillhaven, Inc. v. Care One, Inc., 620 S.W.2d 788 (Tex. Civ. App. -- San Antonio 1998, writ ref'd n.r.e).

PRACTICE TIP: When the closing binder for the workout documents is sent to the client include a letter that not only references the transmittal of the documents, but also outlines the specific changes which accountants and managers should include in their records.

XXII. ***Ethical Considerations:***

A. ***Who is the Client?*** We've seen how there can be a number of parties with different interests involved in a lease workout. There is the tenant which may be an individual, partnership or a small corporation. The tenant's lease obligation may be guaranteed by the individual general partner or the individual shareholder of the corporate tenant. There may be an individual lease guarantor who is related to one of the partners or a relative of the shareholder. These individuals who are in the midst of going through the grief process described earlier (and are potentially financially strapped) are not going to be cognizant of the ethical issues that an attorney faces. They refuse to understand that they all may be liable to different degrees for the various lease obligations and that their various interests may come into conflict in a lease workout. It is incumbent on the attorney to recognize the ethical issues associated with negotiating lease workouts so that the attorney is not having to "workout" things with his malpractice carrier later.

B. ***Know Your Client***: Is your client an individual person, a partnership or

corporation?

1. If your client is an organization:

T.D.R.P.C Rule 1.12 provides, in part,

(a) A lawyer employed or retained by an organization represents the entity. While the lawyer in the ordinary course of working relationships may report to, and accept direction from, an entity's duly authorized constituents, in the situations described in paragraph (b) the lawyer shall proceed as reasonably necessary in the best interest of the organization without involving unreasonable risks of disrupting the organization and of revealing information relating to the representation to persons outside of the organization.

(b) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing or when explanation appears reasonable necessary to avoid misunderstanding on their part.

T.D.R.P.C Rule 1.12 requires that an attorney who represents an organization owes his or her primary loyalty to the organization, and not to any individual member of the organization.

Sometimes, an attorney may be hired to represent the interest of both the organization and an individual constituent of the organization -- T.D. R.P.C. Rule 1.12 , Comment 5.

Rule 1.12(e) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interest are adverse to those of the constituents with whom the lawyer is dealing or when explanation appears reasonably necessary to avoid misunderstanding on their part.

Representation of an organization and an individual associated with it may also trigger the provisions of Rule 1.06 dealing with conflicts of interest.

Rule 1.06 Conflicts of Interest: General Rule

(a) A lawyer shall not represent opposing parties to the same litigation.

(b) In other situations and except to the extent permitted by paragraph (c), a lawyer shall not represent a person if the representation of that person:

(1) involves a substantially related matter in which that person's interests are materially and directly adverse to the interest of another client of the lawyer or the lawyer's firm; or

(2) reasonably appears to be or become adversely limited by the lawyer's or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests.

(c) A lawyer may represent a client in the circumstances described in (b) if:

(1) the lawyer reasonably believes the representation of each client will not be materially affected; and

(2) each affected or potentially affected client consents to such representation after full disclosure of the existence, nature, implications, and possible adverse consequences of the common representation and the advantages involved, if any.

2. But He's "My Lawyer Too" - When Someone Thinks You're their Lawyer:

We've discussed the rules applicable when you and the person who you are representing are both in agreement that an attorney client relationship exists. What about the situation that can occur in a lease workout as follows:

The landlord calls you and asks you to represent him in the workout negotiations. You do so and contact the tenant saying you are going to "negotiate and paper the deal on behalf of the landlord". The tenant is an older person in the "grief cycle" described earlier and does not listen to what you tell him about who you represent. All he knows is that he's got to keep the space and realizes that he has little spare money and certainly none to afford his own attorney. Subsequently, the landlord (who is in a hurry) reviews the workout documents you have drafted and is satisfied. Pursuant to the landlord's instructions, you send the draft documents to the tenant. The tenant is now in the acceptance phase of the "grief cycle" and calls you to ask just a few questions "he's not clear on". The questions start innocently with confirming where he is suppose to sign and develop into "well, let me ask you this, how will my brother's lease guaranty be impacted by this workout?". On the one hand, as attorney, you know that you should advise the tenant that he needs to get separate counsel and that you don't represent him. On the other hand, your landlord client is anxious to get this workout finished (besides, he's got limited funds to pay legal fees also). You believe that you can answer this last question of the tenant without prejudicing your client and get the deal done. You answer the tenant's question and three follow-ups. Does the tenant now believe that you are now his attorney also?

3. Merely a Scrivener or Negligent Misrepresentation

Beware of confusion between liability to a non-client and merely acting as a scrivener for the transaction. A 2001 Corpus Christi opinion case illustrates the issue. Sutton v. Estate of McCormick, 47 S.W.3d 179 (Tex. App. – Corpus Christi 2001, no writ). The circumstances described in this case have a close resemblance to a lease workout scenario. The opinion begins by recognizing that the attorney-client relationship is a contractual relationship with the lawyer agreeing to provide professional services for a client. The opinion also cites the Roberts case noting that for the relationship to be established, "The parties must explicitly or by their conduct

manifest an intention to create it. To determine whether there was a meeting of the minds, we use an objective standard examining what the parties said and did and do not look at their subjective states of mind". Roberts v. Healey, 991 S.W.2d 873, 880 (Tex. App. – Houston [14th Dist.] 1999, pet denied).

As background, Sutton lived in Maine and wanted to buy a ranch in Texas and relocate. He contacted Attorney McCormick to help with the ranch purchase. Before closing on the ranch, Sutton learned of an ostrich rancher named Mantzel who was in financial difficulty. Mantzel flew to Maine to discuss how they might come to an arrangement to save Mantzel's ostrich business and enable Sutton to break into the ostrich-farming business. The two men quickly negotiated a deal within twenty-four hours and called Attorney McCormick in Raymondville to draw up the paperwork.

In the trial regarding the malpractice claim which Sutton brought against the attorney, some of the testimony of the two businessmen gives valuable insight into how to avoid a similar claim:

Sutton first testified that he told the ostrich farmer that "We would have to have an attorney". Sutton told the ostrich farmer that he (Sutton) had an attorney in Raymondville. They then called the attorney "Because I wanted Mr. McCormick to start drawing up the contracts as we had agreed to them in my living room and I wanted him to have all the information available, so that when we got down there the following day...everything would be ready to sign." The ostrich farmer was on the same phone call and dictated the terms of their agreement to the attorney's secretary.

Sutton's testimony continued as follows: "Well I just wanted to make sure that he would be available to create a document to protect both Mr. Mantzel and myself; primarily me, though because he did represent me. And I wanted to be sure that he understood the contents of our agreement... This seemed to be very urgent to Mr. Mantzel. Time was running out on who he had to pay this money to, and I wanted to help in that situation...And I also wanted to make sure that he understood Mr. Mantzel was going to be responsible for this". Sutton then recounted how when he went to get a bank loan, the borrower had to pay the bank's legal fees and "in this case [Mantzel] was going to pay my attorney's fees that I incurred"..

The documents were prepared by the attorney and the two businessmen flew to his office in Texas and signed the documents.

Sutton later testified: " I wanted McCormick to be aware that he is drawing up this contract for both parties. Even though he is representing me, he is also wanting to protect, you know, the other party as far as the agreements that I made to the other party in terms of what I was going to perform...He told me he understood what I meant and he would most definitely protect me".

Unfortunately the attorney died shortly after the deal. Sutton sued his estate for malpractice and the only offered evidence of the attorney-client relationship between Sutton and the attorney was Sutton's testimony. The appellate court affirmed the jury's verdict in favor of the attorney's

estate. The appellate court notes that the attorney "was unable to give testimony regarding his understanding of the agreement between himself and Mr. Sutton". The appellate court also held that "Sutton's testimony left unclear the exact parameters of the relationship between himself and Attorney McCormick". The jury may have believed that the attorney was acting as a mere scrivener or that he was "to a limited extent -- representing them both".

See also Parker v. Carnahan 772 S.W.2d 151 (Tex. App. -- Texarkana 1989, writ denied). The Carnahan case noted that "an attorney can be held negligent where he fails to advise a party that he is not representing them on a case where the circumstances lead the party to believe that the attorney is representing him".

> PRACTICE TIP: Communicate to the parties in the workout and document your files to prevent misunderstandings of who you are (and are not) representing and the extent of that representation. Be especially aware of non-clients and inform them both orally and in writing that you are not their lawyer and are not seeking to advance their personal interests.

XXIII. ***Summary.*** Lease workouts afford a business alternative to going to the courthouse and still achieve a "win/win" outcome for both the tenant and landlord. They often require a level of detail, organization and negotiating expertise that is analogous to the loan workouts of the late 1980s. With patience and an understanding of the motivations of the various parties involved, the lease workout becomes an economical compromise to the exercise of legal remedies or bankruptcy. Finally, as an aid to helping the practitioner involved in a lease workout to quickly review and organize the issues discussed in the paper, a workout checklist is attached as Exhibit "C .

EXHIBIT "A"

NEGOTIATION AGREEMENT

Date:

Landlord:

Tenant:

Lease: Dated _____ for premises located in _____ County, Texas executed by Tenant and Landlord

Guarantor:

Tenant has requested that Landlord meet regarding the status of the Lease. Landlord is willing to do so, but only with the understandings set forth below.

1. We all agree that, any statements, whether written or oral, made at any time after the execution of this agreement in connection with the Lease by any party is privileged and, without exception, constitute settlement negotiations that are not admissible as evidence or subject to discovery in any administrative or judicial proceeding.

2. We further agree that all meetings on this date or any time thereafter are for the purposes of settlement negotiations and that the discussions, correspondence or any other matter between the parties cannot be introduced for any purpose by any party against an other party in any litigation.

3. Any amendment to this agreement must be in writing, executed by all parties, and expressly refer to this agreement.

4. Our attorneys have been instructed that these are our agreements. Any party may terminate this agreement, upon written notice actually received by the other party, or its counsel. Any such termination shall not affect the prior discussions.

5. Tenant represents that they have discussed this with their legal counsel.

ADD SIGNATURES

EXHIBIT "B"

STANDSTILL AGREEMENT

Date:

Landlord:

Tenant:

Guarantor:

The parties to this Standstill Agreement (the "Agreement") agree as follows:

BACKGROUND

A. Tenant and Landlord are parties to a _____ Lease Agreement dated as of (the "Lease Agreement").

B. Tenant has disclosed certain defaults, as set forth herein.

C. It is the desire of Tenant and Landlord, subject to the following terms and conditions, to defer remedies based on such defaults and for this purpose are entering into this Agreement.

AGREEMENT

The parties for valuable consideration, the receipt of which is acknowledged, agree as follows:

1. All terms which are defined in the Lease Agreement have the meaning therein if used in this Agreement, unless this Agreement explicitly provides otherwise.

2. Additional Definitions:

a. "Defaults" means the defaults under the Lease Agreement, as set forth on Schedule I.

b. "Standstill Period" means the period from the Date through or upon a Standstill Default.

c. "Standstill Default" means [INSERT LANDLORD'S TERMS THAT NEED TO BE PROTECTED DURING THE STANDSTILL PERIOD, such as a default as defined in the Lease Agreement that has not been disclosed]

d. "Standstill Covenants" means [INSERT LANDLORD'S CONDITIONS THAT MUST BE MET IN ORDER TO WAIT, such as payment of a judgment, adding inventory, paying some additional rent in addition to current rent].

3. Regular Meetings: Landlord and Tenants agree that their representatives will meet at the Landlord's office in the months of March, June, August, and December 200_.

4. Expenses: All reasonable expenses and fees incurred by Landlord, including reasonable fees and expenses of its attorneys and other advisers ("Expenses") with respect to the preparation, administration and enforcement of this Agreement will be "expenses" under Lease Agreement. Tenant agrees to pay to Landlord on demand.

5. Lease Agreement: Except as expressly permitted by this Agreement, the Lease Agreement continues in full force and effect and Tenant must comply with each provision thereof during the Standstill Period.

6. Remedies: Upon the occurrence of a Standstill Default, Landlord's remedies include without limitation, the right to terminate the Standstill Period and the right to terminate the Standstill Agreement generally, and in either or both events, all Defaults previously waived will be defaults upon which Landlord may take any action permitted under the Lease Agreement. In addition, Landlord shall have all remedies provided for in the Lease Agreement , as amended, and any other remedies provided in law or in equity, this provision not being any limit thereon. The exercise of any remedy will not be exclusive of the right to exercise any other remedy, except as required by Applicable Law.

ADD SIGNATURES

EXHIBIT "C"
LEASE WORKOUT CHECKLIST

I. Obtain Operative Documents:

_____ Executed Lease (with exhibits)
_____ Lease Side Letters
_____ Lease Amendments
_____ Loan Documents
_____ Property Management Agreement
_____ Broker Agreement
_____ Sublease
_____ Estoppel Certificate
_____ Lease Guaranty
_____ Franchise Agreement
_____ Merchant Association Agreement
_____ Ancillary Documents:
_____
_____

II. Determine Parties: Contact Info:

_____ Landlord _____
_____
_____
_____

_____ Tenant _____
_____
_____
_____

_____ Lease Guarantor _____
_____
_____
_____

_____ Property Manager/ Broker _____
_____
_____
_____

_____ Lender _____
_____
_____

_____ Tax Advisor _____
Accountant _____
_____

III. Type of Default(s)

_____ Monetary Amounts Due (confirm by rent roll)

$_____ total as of _____

_____ Non Monetary Default

_____
_____

IV. Workout Negotiations – Documentation

_____ Workout / Settlement Agreement - Amendment
_____ Corporate Authorization Documents
_____ Consents of Lender(s)
_____ Consent of Guarantor(s)
_____ Amend and File Memo of Lease (if recorded)
_____ Schedule of Time Periods if Non Monetary Defaults

V. Post Workout Considerations

_____ Distribute Fully Executed Workout Documents
_____ Notify Property Management of Revised Terms
_____ Notify (or confirm notification to) Accountant / Tax Advisor of Terms

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Kevin graduated from the University of Houston College of Law, in May, 1981, where he served as the Executive Editor of the *Houston Law Review*. Before law school, he graduated from University of Texas at Austin in December, 1977, graduating with honors and majoring in Finance.

ACTIVITIES

Past Chair, Real Estate Forms Committee, State Bar of Texas.

Past Chair (1993-1996), Dallas Bar Association, Real Property Section.

Member, Various Planning Committees for the State Bar of Texas and University of Houston.

Director, Advanced Real Estate Law Course (1994) (State Bar of Texas).

Moderator, Advanced Real Estate Law Course (1995) (State Bar of Texas).

Speaker/Author: Numerous articles written for real estate related legal topics, including the Dallas Bar Association Real Property Section, State Bar of Texas, South Texas College of Law, University of Texas Law School, University of Houston Law Center, and Southern Methodist University School of Law.

Former Member: City of Allen, Texas Planning and Zoning Commission

Current Member: Allen Independent School District Board of Trustees

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Don graduated in 1983 from the Dedman School of Law at Southern Methodist University and was an editor of the SMU Law Review. Prior to law school, he graduated with a Bachelor of Business Administration, magna cum laude, from Southern Methodist University in 1980.

In private practice in Dallas from 1983 to 1991, he practiced primarily real estate, banking, and corporate law. From 1991 to 1992, he worked as counsel for the FDIC on various real estate workouts and restructurings. In 1992 Don joined the legal department of International Paper Company in Dallas. As senior counsel for International Paper Company, his responsibilities include real estate, commercial transactions and corporate law issues.

He is licensed to practice law in Texas and Colorado and is a member of the American Corporate Counsel Association and the College of the State Bar of Texas. Don is also a member of the Dallas Bar Association and is vice chairman of the library committee. He co-authored "Surveyors', Architects' and Other Certificates" for the 1991 Advanced Real Estate Drafting Course (State Bar of Texas PDP).

The views and opinions expressed in this paper are those of the author only and do not necessarily reflect the views or position of International Paper Company.