

Audit Gross Sales of Tenant Exercising Kickout or Rent Reduction Right

You may have been forced to give a strong retail tenant either a performance kickout right or a reduced rent remedy. If that's the case and your lease is like many we've seen, it may have a loophole that could unnecessarily leave you with either an empty space or an undeserving tenant paying reduced rent.

With a performance kickout right, the tenant has a right to terminate its lease if its gross sales fall below or don't reach a minimum sales threshold during a set time period—or “performance period.” With a reduced rent remedy, the tenant has the right to reduce its rent until its gross sales meet the minimum sales threshold. With either right, you need to watch out for the following loophole: The lease doesn't give you the right to audit the tenant's gross sales statement after the tenant notifies you that it intends to exercise its performance kickout right or reduced rent remedy. This loophole means that you could be vulnerable to a deceitful tenant that decides to exercise the right or remedy when it's not entitled to it, warns Dallas attorney T. Andrew Dow.

Cover Five Points in Audit Clause

To plug this loophole, get the right to audit the tenant's gross sales statement if the tenant notifies you that it's going to exercise its performance kickout right or reduced rent remedy, advises Dow. Conducting a gross sales audit allows you to verify the validity of the tenant's claim that its gross sales have fallen below or haven't reached the minimum sales threshold during the performance period, he explains. You can then blow the whistle on a tenant that isn't entitled to exercise its performance kickout right or reduced rent remedy.

To get an effective audit right, make sure that your lease, like our Model Lease Clause on p. 2, includes these five points:

You have audit right. Say that if the tenant sends you a notice that it will exercise its performance kickout right or reduced rent remedy, you've got the right to audit the tenant's gross sales statement relating to the performance period, says Dow [Clause, par. a]. This should keep a tenant from claiming that you don't have that right.

PRACTICAL POINTER: Agree in the lease that you'll send the tenant a copy of the audit results so that it can review your findings [Clause, par. a]. If the tenant thinks that your audit results are convincing, it may be inclined to accept them without dispute.

You get enough time to conduct audit. Give yourself enough time—say, at least 90 days after getting the tenant's notice—to conduct the audit, says Dow [Clause, par. a]. Otherwise, the tenant could terminate the lease or reduce its rent before your audit is completed, he warns.

Tenant has limited time to dispute audit results. Give the tenant a short deadline to dispute audit results that show the tenant's gross sales haven't been low enough to trigger the kickout right or reduced rent remedy, advises Dow. You don't want the tenant to wait until the last minute before the termination goes into effect to dispute your audit results. So, for example, require the tenant to dispute the audit results within 10 days after getting them [Clause, par. b]. The less time you give the tenant to take action, the more likely it is to miss the deadline.

Undisputed audit results are deemed accepted. Say that if the tenant doesn't dispute your audit results by the deadline, the audit results will be considered—that is, deemed—to have been approved and accepted by the tenant as correct, says Dow [Clause, par. b]. In other words, if the tenant doesn't act quickly, it must accept your audit results and not exercise the kickout right or reduced rent remedy, he explains.

(continued on p. 2)

Verify Tenant's Right to Terminate Lease or Pay Reduced Rent

The following clause was drafted with the help of Dallas attorney T. Andrew Dow. Put it in your lease if your lease doesn't have a gross sales audit clause.

Paragraph a gives you the right to audit the tenant's gross sales statement for the performance period indicated in the lease after getting the tenant's notice to exercise its kickout right or reduced rent remedy. Paragraph b says that if the tenant doesn't dispute your audit results by a set deadline, it's deemed to have accepted them. Paragraph c requires the

appointment of an independent auditor to determine the tenant's gross sales if you and the tenant dispute each other's gross sales findings.

Select the appropriate wording from the choices offered in our clause, depending on whether you're using the clause in conjunction with a performance kickout right or a reduced rent remedy. Show the clause to your attorney before putting it into your lease near the right to which it applies.

AUDIT OF GROSS SALES STATEMENT

- a. Landlord's Audit Right.** Landlord shall have the right to audit Tenant's statement of Gross Sales within [insert #, e.g., 90] days of Landlord's receipt of a notice from Tenant indicating its intent to exercise its [Termination Right/Reduced Rent Remedy] under Clause [insert # of kickout right or reduced rent clause] hereof, and Landlord shall provide Tenant with the results of such audit ("Audit Results").
- b. Audit Results.** If the Audit Results reveal that Tenant's Gross Sales are in excess of the amount required for the exercise of the [Termination Right/Reduced Rent Remedy], then Tenant shall have the right to dispute the Audit Results by sending Landlord, within [insert #, e.g., 10] days after Tenant's receipt of the Audit Results, written notice specifying the reasons Tenant is disputing the Audit Results (the "Notice"). If Tenant fails to send the Notice within said [insert #, e.g., 10]-day period, then the Audit Results shall be deemed to have been approved and accepted by Tenant as correct, and Tenant's notice of its intent to exercise the [Termination Right/Reduced Rent Remedy] shall be withdrawn and [choose one:] this Lease shall continue in full force and effect or Tenant shall not be entitled to reduce its rent under Clause [insert # of reduced rent remedy clause] hereof.
- c. Resolution of Dispute.** If Landlord and Tenant each dispute the other's findings, then Landlord and Tenant jointly shall elect an independent auditor to determine the actual Gross Sales for the relevant period. The costs of the third-party audit shall be borne by the non-prevailing party. In the event the independent auditor determines that Tenant's Gross Sales were understated to the extent that Tenant is not entitled to exercise the [Termination Right/Reduced Rent Remedy], then Tenant's notice of its intent to exercise the [Termination Right/Reduced Rent Remedy] shall be withdrawn and [choose one:] this Lease shall continue in full force and effect or Tenant shall not be entitled to reduce its rent under Clause [insert # of reduced rent remedy clause] hereof.

Independent auditor settles dispute. Set out a process to use if the tenant disputes your audit results by the deadline. Say that you and the tenant will select an independent auditor to determine the gross sales for the performance period and whether the tenant is entitled to exercise its kickout right or reduced rent remedy, says Dow. The losing—or “non-prevailing”—party should pay the costs of the audit, he says. Say that if the independent auditor decides that the tenant understated its gross sales and isn't entitled to exercise its kickout right or reduced rent remedy, the tenant's notice exercising the kickout right or reduced rent remedy is considered withdrawn, says Dow [Clause, par. c].

PRACTICAL POINTER: With a kickout right, expect a savvy tenant to demand that your audits and inquiries (including the audit by the independent auditor) be completed before the termination date set out in the kickout right clause, notes Dow. You'll have to negotiate this point with the tenant. ▲

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