



## Limiting your company's legal risk by negotiating form contracts

*Smart Business* spoke to Lee Dresie, a partner at [Greenberg Glusker Fields Claman & Machtinger LLP](#), about ensuring that your business does not assume all the risk in a transaction by carefully examining form contracts.

Form contracts account for more than 80 percent of all agreements used to complete business transactions today. That percentage may be even higher when it comes to commercial real estate transactions like the ones you signed to acquire a corporate headquarters or satellite offices.

Unfortunately, many executives do not carefully review the specifics of a form contract before signing. Instead, they assume the form contract to be an agreement equitable to both parties. However, unless the form is an industry-neutral form such as one from the AIR Commercial Real Estate Association or Commercial Association of Realtors, terms in a standard form contract are designed to favor the party that presents it.

To limit your company's risk, it is vitally important to be able to recognize and negotiate unfavorable provisions out of form contracts. This may necessitate a call to in-house or outside counsel with expertise in the area.

By negotiating the form contract presented to him, a savvy building owner in Los Angeles was able to collect 15 years of rent from an outdoor sign company even though the sign company was prevented by law from constructing a sign on the building. The building owner had been approached by a well-known outdoor sign company about leasing the roof of his building for a large billboard. After reaching an agreement on the rent amount and term of the lease, which totaled \$750,000 over 15 years, the sign company presented the building owner with its "standard" form lease. The form lease provided that if the sign company could not obtain a building permit to erect the billboard, or if applicable building codes changed, the sign company could terminate the lease with no penalty or payment. The form lease placed all risk on the building owner if the sign company could not construct the billboard.

The sign company was the expert in the field and familiar with the building permit process. Unknown to the building owner, the sign company was aware of a movement by the Los Angeles City Council to ban all new signs. Since the possible ban did not affect existing signs, the sign company was anxious to get this deal done quickly by having the billboard constructed before any ban occurred. Once the ban went into effect, all existing signs became that much more valuable.

Instead of the lease provision allowing the sign company to terminate the lease if it could not obtain a building permit, the building owner requested a different provision noting that the sign company had done all necessary investigation concerning city regulations and the availability of building permits. Because the sign company was anxious to acquire this site and get started on the construction of the billboard, the sign company agreed to replace its provision with the building owner's provision.

Immediately after the parties signed the lease, the sign company's engineer re-measured the distance from the proposed sign location to the nearest competing sign, since city codes provided minimum distances between billboard signs. The sign company's preliminary measurements had been inaccurate. The sign company learned, after signing the lease, that the proposed sign location in the lease violated city codes. The sign company therefore informed the building owner that the lease was terminated because it was illegal and impossible to construct its sign. Subsequently, a citywide ban on new signs was in fact instituted, giving the sign company a second basis to claim a lease termination.

Believing that the sign company assumed the risk of an inability to construct its sign, the building owner filed suit in order to enforce the lease. The sign company vigorously protested, asserting that no court would require it to pay 15 years of rent for a sign which it could not construct.

The building owner argued that the sign company had knowingly assumed a foreseeable risk, and that the parties had re-allocated this risk to the sign company, and away from the building owner. From the judge's point of view, the key fact arose when the building owner elected not to simply sign the form lease.

Consequently, the judge agreed with the building owner's position and ruled in favor of the building owner for the entire 15-year term, and \$750,000, despite the fact that no sign could ever be constructed. Additionally, the court awarded the building owner the attorney fees incurred in the enforcement of the lease.

This example highlights the importance of carefully negotiating all contracts, especially those presented as the other party's "form contract." Such form contracts extend beyond real estate transactions, and could include executive employment contracts, lending transactions, and confidentiality or non-disclosure agreements.

You can rest assured that the other party in a transaction will take the time and make the effort to carefully construct each provision to shift as much risk away from them as possible. Unless you are willing to assume all of that risk, you should spend the same time and make the same effort to re-allocate the risk back to the other side.