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Community Arts Q&A Series: Negotiating Real Estate Leases and Licenses

As part of its Community Arts initiative, Lawyers Alliance is providing a series of Q&As to help nonprofit community arts organizations (an "Organization") better understand the legal issues that arise in a number of different circumstances and contexts. This Q&A addresses particular issues faced by such Organizations when they negotiate for access and use of certain types of real estate, including theaters, art galleries, and pop-up shops.

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Like many nonprofits, Organizations need to rely on leased or licensed real estate to conduct their activities. However, such Organizations have unique needs and circumstances given their focus on the production and facilitation of arts and arts-related programming. What are some of the unique legal issues that arise when Organizations negotiate for access to theaters, galleries, or pop-up shops? Note that the answers here are, by necessity, generalizations only and that, in all circumstances, actual negotiation of a contractual legal document (of which a lease or license is a type) should be handled by legal counsel.

This memo addresses the following common questions relating to negotiation of a real estate lease or license for a theater, gallery, and pop-up shop:[1]

- What is the difference between a lease and license?
- Is it common for the owner of a theater to ask for a cut of the income earned by a production taking place at the theater?
- Can a theater owner kick my production out of space I have rented if the show performs badly?
- I need to make sure that the space I'm renting for an art show has a certain number of square feet, what should I do?
- When my Organization leases space for my art show, I can do whatever I want in it, right?
- What is a pop-up? Can it work for my Organization?
- I want to alter the space that I'm leasing, what should I be mindful of?
- I plan on leaving some property in the space I'm leasing when the term ends, is that ok?

[1] Note that this Q&A addresses issues under New York law only.

Question: What is the difference between a lease and a license?

Answer: Leases and licenses are both contractual agreements between temporary users of real estate and the real estate's owner. Primarily, the difference between the two arrangements lies in the degree of control that a temporary user of real estate can exert over the property. A lease is a possessory interest in real estate; it entitles the lessee or tenant to full and exclusive control over the space subject to the lease.[2] For example, even a landlord could not, generally speaking, enter into property leased to someone else absent the tenant's express permission. By contrast, a license does not grant the holder, or licensee, exclusive possession or control over a space. In a license, other persons, such as the landlord, have a right to access the space. In other contexts, the two arrangements are similar, and have provisions for rent, maintenance and repairs, alterations, uses, services provided by the landlord, etc. In this Q&A, the terms will be used interchangeably, though do keep in mind that they are different types of arrangements.

Question: Is it common for the owner of a theater to ask for a portion of the income earned by a production using the theater?

Answer: Yes; arrangements in which a production company renting a theater must provide a portion of the income earned from the production to the landlord are common. There are generally two different ways this may be structured. The first is when a portion of the show's earnings are shared after a break-even point is established. In this structure, the theater and the production agree that no revenue sharing will occur until a show takes in "x" dollars or earns a certain return. Thereafter, some portion of the excess above the threshold is tendered to the theater. In the second structure, the theater takes a cut without regard to a break-even point. Typically, the portion taken in these circumstances is smaller than it would be if a break-even point were established. Thus, if a show does well and easily expects to meet or exceed its break-even point, it may be more advantageous for a show to tender a smaller portion of its earnings to the landlord right away.

Question: Can a theater owner kick my production out of its space if I have a lease and the show isn't doing well?

Answer: As with many contractual arrangements between parties, it depends. In many theater leases a clause may allow the landlord to remove a tenant if a given production does not gross a certain amount of money in a given period of time. Understandably, of course, if a landlord expects a portion of its income to be dependent on the quality or popularity of a production, it wants to ensure the production is successful. Sometimes, perhaps, an Organization would prefer to have such a clause in its lease; after all, leases and licenses are expensive and if an unsuccessful production can shut down and negate its leasing costs, so much the better. Otherwise, if no such clause is present, the landlord could always try to breach the lease, but in that case the landlord would generally be liable for damages.

Question: I need to make sure that the space I'm renting for an art show has a certain number of square feet, what should I do?

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[2] Mirasola v. Advanced Capital Group, Inc., 73 A.D.3d 875, 876 (N.Y. App. Div. 2010).

Answer: You should ask the landlord what the usable area of the space to be licensed or leased is. Often, the subject space of a lease or license is described in terms of rentable square feet. However, rentable square feet is a metric that often includes some portion of a space that cannot be used, because it may be occupied by a piece of furniture, a fixture or piece of equipment. A large divider running the length of a floor would, for example, take up some portion of the rentable square footage. Landlords may not be keen to actually reveal the usable square footage of a space, but it doesn't hurt a tenant to ask if the actual, usable area is an important consideration.

Question: When my Organization leases space for my art show, I can do whatever I want in it, right?

Answer: No. Typically, a lease or license will have a section on permitted uses. These uses are dictated by many factors, including governmental regulations and the landlord's own preferences about how its space is used. In some cases, leases between the landlord and other tenants may prohibit certain types of uses in subsequent leases the landlord executes with different tenants. This is particularly true in the context of retail leases, where some tenants may not want competitors nearby or in the same building. Organizations should think through the myriad ways in which their space may be used and ensure that they are permitted under their lease. For example, if an Organization that is running a gallery space intends on having a reception and making alcohol available to patrons, it should ensure the landlord has no prohibitions against alcohol being served in the space or understand whatever requirements (such as additional insurance) the landlord may impose if alcohol is to be served. Bear in mind that an Organization that misuses its space may be liable for a breach of contract claim by the landlord.

Question: What is a pop-up? Can it work for my Organization?

Answer: A pop-up is a temporary occupancy arrangement between a landlord and a tenant. Pop-ups became extremely popular during the most recent economic downturn, when it was difficult for landlords to find tenants willing to commit to long-term rental agreements.[3] For an Organization, pop-ups may be advantageous if the Organization doesn't want to commit to a long-term rental contract but does want to garner attention or needs to use space for a short period of time, such as for an arts exhibition. In some cases, landlords may be particularly interested in attracting short-term occupancy from Organizations that will draw life to the street and serve as an advertisement for the building. One thing that all Organizations should consider is whether they want the option of allowing the pop-up arrangement to turn into a more permanent one, in which case an option to renew or expand the occupancy agreement should be included in the relevant document setting forth the pop-up relationship.

Question: I want to alter the space that I'm leasing, what should I be mindful of?

Answer: Alterations are very common when a tenant leases space. After all, not all tenants have the same needs, use of space or aesthetic sensibilities. Organizations may, especially, have unique space or design needs, which alterations can be used to fulfill. There are many issues to be mindful of when handling alterations. First, of course, make sure that the relevant agreement between the landlord and tenant includes the ability of the tenant to conduct alterations, whether

[3] Keith Mulvihill, *Pop-up Stores Become Popular for New York Landlords*, N.Y. TIMES, June 23, 2010, at B5.

with the landlord's consent (an unfavorable provision for a tenant), or not (a more favorable provision for the tenant). Keep in mind that not all alterations are created equal; a landlord may require consent for structural alterations, in addition to a bevy of other requirements, because of the effect such alterations have on the space and the property, whereas non-structural alterations (such as installing carpeting or a partition) probably wouldn't rise to the level of requiring the landlord's consent. Additionally, any agreement should also include provisions for what happens to the alterations when the lease or license term ends. Do the materials brought into the space become the property of the landlord, or remain in the tenant's possession?

Finally, tenants should be mindful of fixtures and trade fixtures, and whether the same can be removed or become the property of the landlord at the conclusion of a lease term. The distinction between the two types of fixtures isn't precise under New York law, though generally speaking, trade fixtures are articles of property that are brought into a leased space and attached to it for the purposes of the tenant's trade or business.[4] Machinery and equipment are common examples. Courts generally find that these items are removable by the tenant and do not become a part of the landlord's estate. Some personal property, by contrast, may become characterized as a fixture and thus become the property of the landlord. To determine whether personalty is a fixture, New York courts rely on a three-part test: (i) whether the personalty is actually annexed, or attached, to the real property, (ii) whether the personalty is applied to the use or purpose for which the part of the real property it is attached to is applied and (iii) whether the personalty was intended by the parties to be a permanent annexation to the real estate.[5] For example, a shelving unit brought into the premises by a tenant could become a fixture if it met these conditions, though again, there would need to be evidence that the parties intended for the shelving unit to remain after the conclusion of the tenant's lease. If these factors are met, even though a tenant may have purchased and installed the personal property, a court could find that upon attachment they became a part of the landlord's property. To avoid this, parties should clearly set forth what happens to personal property at the conclusion of a lease or license term and note in the relevant agreement that it is not the intention of the parties for the item to become a fixture.

Question: I plan on leaving some property in the space I'm leasing when the term ends, is that ok?

Answer: It depends. A tenant should review its lease or license agreement carefully to see what the end of term requirements are. In some cases, a landlord may permit a tenant to leave its personal property in a space, thereby becoming the landlord's property. In others, the lease may require the tenant to remove any personal property and, if such removal is not accomplished by the end of term, the tenant could be subjected to a holdover action or an argument that it has not fully vacated a space by the required time. A tenant should never assume that it can leave even immaterial items behind thinking the landlord will take care of disposing of such items.

This memo is meant to provide general information only, not legal advice. Please contact Judith Moldover at Lawyers Alliance for New York at (212) 219-1800 x 250 or visit our website www.lawyersalliance.org for further information.

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[4] Chittenden Falls Realty Corp. v. Cray Valley Prods., Inc., 208 A.D.2d 1114, 1115 (N.Y. App. Div. 1994).

[5] Mastrangelo v. Manning, 17 A.D.3d 326, 327 (N.Y. App. Div. 2005).

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