



10 TIPS FOR RETAILERS TO REDUCE CAM CHARGES

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The last 10 years have transformed common area maintenance ("CAM") charges from an incidental consideration to a significant factor in the calculation of occupancy charges. CAM charges frequently equal and sometimes exceed fixed rent. They are doubtless a continuing source of friction between tenants and landlords.

One of the reasons CAM has become troublesome is that landlords are now dependent upon its revenue not only to operate and maintain their malls, but also to renovate and improve the ones that have aged or been recently acquired. These upgrades alone may add \$10,000 a year to a tenant's CAM bill. As a result, tenants need to be far more diligent in drafting and negotiating their additional provisions. The alternative, a total occupancy charge ("TOC") that fixes CAM with a 5% or greater annual escalator, may also be a solution too good to be true.

Not surprisingly, conflicts over what CAM may and may not be charged through leases have been the subject of extensive litigation over the years. The following suggestions for reducing a tenant's CAM costs are based in large part upon these decisions, some of which are noted for their convenience of those attorneys who represent tenants.

Limit CAM to costs related to the "common areas," not the "Shopping Center." That way, you will avoid paying for roof replacements over tenant spaces, most management fees and the cost of personnel (mostly off-site). *Remember: C-A-M, stands for common area maintenance. McDonald's Corp. v. Goler, 560 N.W.2d 458, 461-462 (Neb. 1997) (Management fee could be charged only to the extent that the landlord could demonstrate that it was related to common areas.)*

Identify CAM exclusions specifically. Landlords sometimes argue that the "including, but not limited to" phrase that frequently precedes the long

operating cost provision means they can charge anything. However, it doesn't, and no court has ever held that it does. Nevertheless, if the tenant is aware of something objectionable that could be charged to CAM, the tenant should make sure to exclude that item in writing. A common list includes all original construction, utilities and fixtures. But what about words like "replacements" and "depreciation," which are often found in a typical lease? Is there a difference between replacing a pothole, a leak in a roof or a light bulb, and replacing an entire parking lot, roof or lighting system? Courts have frequently said "yes," but you can't always depend on a particular court's decision. *Miller v. Gammon & Sons, Inc.* 2001 Mo. App. LEXIS 331 (Mo. App. 2001) (Cost of repaving entire parking lot was not "maintenance and repair") [contains excellent analysis of short- vs. long-term benefits of capital expenses]. Given the fact that virtually every mall in the United States is undergoing, or will soon need to undergo, extensive renovations, don't agree to pay for "remodeling" "renovations" or "improvements." Make sure that you exclude all improvements, and add the following general exclusion: "costs of a capital nature to the extent they improve the Common Areas to beyond their original condition or utility."

3. **Don't undo what you've just done.** Having reduced your exposure to extraordinary expenses and improvements (see point above), don't increase it by agreeing that "landlord may depreciate all expenses in excess of [pick a number]," which may very well be read as permitting the landlord to charge any capital expenses it pleases, so long as they are depreciated. (Make it clear that this would apply only to the expenses that the tenant has expressly agreed to depreciate.) On the other hand, to the extent that the tenant agrees to depreciate anything (for instance, machinery and equipment used in the operation of the common area), insist that it is depreciated over its "useful life." (*Hint: Under IRS rules, virtually nothing installed in a mall can be depreciated in less than 10 years. Many items, for example, roofs or HVAC systems, require at least 20*

years.) Thus, if you are going to permit the landlord to pass on the cost of a roof replacement, usually with a price tag in excess of \$1 million, make sure that it is amortized at least over 20 years.

4. **Exclude all "off-site expenses," and make your administrative fee charge inclusive of landlord's overhead and administrative costs.** When negotiating your lease, ask the landlord what the "administrative fee" is intended to cover. You may be surprised to learn now that it does not "cover" anything. (Landlords have been known to pass on what they claim to be the "CAM portion" of their off-site MIS, accounting and clerical personnel, even though these general overhead costs should have been covered by the administrative fee.) You may also want to exclude an administrative charge on so-called "third party" vendors performing services at the mall. As tenants are well aware, landlords frequently use subsidiary or closely held entities to perform the mall's maintenance and security functions, only to pass on a monthly charge that includes administration and profit. Even if there is no relation between the vendor and the landlord, the fee for the vendor's services obviously includes the landlord's administrative costs and profit. Tacking on a 15% administrative charge to the payment of a single, monthly check (that already includes administrative costs) is difficult to justify. *South Towne Centre, Inc. v. Burlington Coat Factory Warehouse of Dayton, Inc.*, 1995 Ohio App. LEXIS 4704 (Oh. App. 1995) (Landlord may not add "supervisory fee onto charge from outside contractor.") Although these charges may be covered under a "no duplication" provision, it's best to make this exclusion crystal clear.
5. **Define management fees, if any, clearly and specifically.** Ask if there is a management charge based on revenue, collections, etc. and exclude that charge(s) if possible. (Keep a record of any correspondence.) If exclusion is not possible, make sure there is "no duplication" of charges. Thus, if the landlord is billing all of its on-site personnel to CAM, in addition

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- to an administrative fee, ask what "cost" does the management fee now cover? See the *McDonald's* case above.
6. **Make sure that Gross Leasable Area (GLA) exclusions are "operating stores."** A space that is vacant or being built out is creating no traffic in front of your store. Such space should also not be counted in any of your co-participation requirements. In addition, tenants who no longer pay CAM are an increasing problem. Traditionally, the CAM contribution of an "excluded" tenant is applied to reduce operating costs. But what if that tenant no longer pays CAM and instead pays a single charge for all occupancy expenses (rent, CAM, etc.), sometimes called a "TOC"? You can bet that many landlords will argue that there is no "contribution" to CAM. Put something in your lease to include any TOC in the CAM portion of the rents.
 7. **Don't include taxes, insurance and utilities as an "operating cost."** If you do, make sure they're not part of the "administrative fee." (At a typical mall paying \$3.5 million in property taxes, the add-on of an administrative fee increases the annual CAM bill of a smaller tenant by least \$5,000.)
 8. **Reduce the landlord's profit on utility charges.** The larger landlords now use various consultants to "calculate" tenant energy charges. Many of these consultants, including the former Enron, work on a contingent fee. Make sure that your CAM clause restricts the utility charges to the landlord's cost. (Of course, unless the lease states otherwise, an operating cost provision that limits the landlord to amounts "actually incurred" means that the landlord is not permitted to charge anything other than actual cost. *Recoll Mgt. Corp. v. Stone & Webster Engineering Corp.*, 1999 Mass Super. LEXIS 557 (Mass. Superior 1999). (Profit markup was not an actual expense incurred by landlord. However, given some of these practices, it is far wiser to make the lease as clear as possible.) Don't agree to pay any part of the original construction (or depreciation) of the landlord's central plant

and energy plant, or any other original construction for that matter, even if it is "depreciated." For tenant premises (and at a minimum), if you can't get the landlord to agree to charge its "unit costs," then at least get an agreement that you will pay the same amount (not the same *rate*) that the tenant would pay if metered directly. That still gives the landlord some profit margin if you're an in-line tenant, but at least you will receive some protection. In any event, always get a right to demand a copy of the landlord's energy calculation and always reserve the right to check the meter and adjust.

9. **It is better to have no audit provision than a restrictive one.** For example, an audit clause that restricts the personnel who may conduct the audit, requires the tenant to audit within a very short period — i.e., 90 or 180 days; or prohibits an audit if the year-end statement has been certified by the landlord's accountant, is far worse than no provision at all. (Because there is mounting case law that a tenant may obtain discovery of its CAM billings if the lease is silent, most landlords provide an audit of CAM billings to avoid doing so in discovery.) If the tenant does negotiate an audit clause, make sure it covers at least three prior years and nothing will become "conclusive" before that time. Don't agree that you will not use a contingent fee auditor unless you have a lot of personnel already conducting audits (not to be confused with "desktop" audits). The purpose of these provisions is to eliminate most tenants' ability to conduct audits.
10. **Watch out for fixed occupancy costs.** They may be very good for dealmakers but very bad for stockholders.

From the landlord's perspective, the purposes of a single charge are to eliminate CAM disputes and fix high occupancy charges. Only one of these goals is in the tenant's best interest. Nevertheless, tenants do have an important interest in lease peace. Thus, "Fixed CAM" or TOCs make sense if the tenant has audited the landlord's operating costs and can negotiate a fixed charge with reasonable increases. The tenant first has

to know what it is paying for currently. If the CAM is already inflated by thousands of dollars of renovation costs, that the tenant shouldn't be paying to begin with, why agree to make them permanent? Even if the charge is for something the lease does allow, e.g., a roof replacement, why include in CAM that large ticket item that needs to be paid only once every 20 years? A good solution is contained in some new "TOC leases" that permit the tenant to audit the first year's CAM, settle any disputes, and then use the "settlement amount" as the base, fixed charge throughout the term.

Another difficulty with fixed CAM is the annual increases. A 5% fixed increase may seem reasonable to both sides, but over time it will certainly favor the landlord. On the other hand, a landlord that offers to "cap" CAM at a 7% or higher rate on a cumulative basis (meaning the tenant is likely to pay a total of 7% each year) will undoubtedly end up with the better side of the bargain. Finally, the capped or fixed CAM should include all CAM costs, not just the ones that aren't likely to increase appreciably. (Thus, don't agree to a fixed CAM with the exception of "extraordinary" or "renovation" expenses. Most of these expenses shouldn't be passed through to CAM to begin with, and they are more than offset by other large expenses, such as utilities, which tend to increase very little over time.)

Conclusion

Experience has taught that the vigilant tenant can save \$3 or more per square foot a year on operating expenses if it follows these suggestions. Most tenants will fight very hard to save that much in rent; it makes sense to fight equally hard to save that much in CAM. ■

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