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THE USE AND MISUSE OF ESTOPPEL CERTIFICATES

By: Andrew L. Herz

Richards & O'Neil, LLP

Estoppel certificates are unusual and misused instruments. They progress from being considered unimportant lease boilerplate during lease negotiations, to being prepared as documents immediately before a sale or financing, yet thereafter are ignored completely. Most leases contain an obligation by the tenant (and frequently the landlord) to deliver an estoppel certificate within a specified period of time to the other party as to certain matters relating to the lease. It is interesting that only in the context of leases are estoppel certificates critical documents. For lenders and purchasers frequently try to use them for purposes for which they are not intended.

Almost all important encumbrances on title are disclosed by the public record. A lender or purchaser can easily learn the amount of judgments, the size of mortgage amounts claimed by mechanic's lienors. This is not so with leases. In most jurisdictions, a tenant, by having possession of premises, puts the world on notice as to the extent of all of its rights, whatever those rights may be. Moreover, a tenant is generally not required, absent a contractual obligation to do so, to disclose to anyone the extent of its rights and obligations. Thus, the importance of the estoppel certificate becomes apparent. Since the terms of a lease are not generally reflected on the public record, leases are frequently amended, and the landlord/tenant relationship constantly "under construction," the definition of what constitutes the "lease" is in a state of constant flux. This explains the critical need for a lender or purchaser to confirm the lease's status -- particularly with respect to a claim or defense which cannot be independently verified by looking at the lease. Despite all of this, landlords themselves rarely use estoppel certificates to confirm the status of leases.

Although the goal of any estoppel certificate is to "estop" a tenant from asserting facts inconsistent with the certificate, the tenant's mere signing of an estoppel certificate does not necessarily achieve that desired result. The doctrine of estoppel is grounded in equity and is not applied mechanically.

common-law principles of equity. Before any party can claim an "estoppel" against another, that party (here the lender or purchaser) must be able to prove five

- (i) lack of knowledge of the facts in question;
- (ii) lack of any means of obtaining such knowledge;
- (iii) reliance on the words or conduct of the party to be estopped;
- (iv) reasonableness and good faith in so relying; and
- (v) action, based on such reliance, resulting in a prejudicial change to the party's position.

Because estoppel is an equitable principle, the party seeking its benefit must be innocent and must act in good faith. A party cannot assert estoppel in good faith if it is charged with actual knowledge of the matters in the estoppel certificate. In some jurisdictions, ignorance of the truth of the matter in question is good enough for the enforcement of an equitable estoppel. Other courts, though, will require the party relying on the estoppel certificate to exercise some degree of due diligence, care and circumspection in ascertaining the underlying facts. Furthermore, a party acting on "inquiry notice" as to the truth of the matter in question or who had the opportunity to discern the truth generally cannot assert an estoppel. Similar to the situation where both parties are equally informed of the matters at hand and have equal access to obtaining the necessary knowledge, an estoppel will not be given effect and a party seeking the estoppel has obtained knowledge which reveals information contradicted by the statement in the estoppel certificate, reasonable reliance can not be established.

A party trying to claim estoppel also must experience a material and detriment in its position or status from that which it would otherwise have occupied. An alleged detriment or injury must arise from the denial of the estoppel. In other words, the court needs to conclude that an injury will result if the other party is not estopped from denying the truth of the statement previously made in the certificate.

This article will discuss the elements of and the obligation to provide an estoppel certificate, the effectiveness of estoppel certificates in achieving an actual estoppel, and some common problems and pitfalls practitioners encounter in negotiating, creating and enforcing estoppel certificates in the context of leasing transactions.

Elements of An Estoppel Certificate.

Estoppel certificates generally contain the following elements, some of which are more prevalent than others:

I. Identification of the Lease and All Amendments and Related Documents

By identifying all of the documents that constitute the "lease agreement," the party receiving the estoppel certificate can satisfy itself that it has identified and reviewed all relevant lease documents. Often a form of estoppel certificate will say that a true and correct copy of the lease is attached for purposes of identification. In other instances, parties do not attach such documents because it can become unwieldy to do so.

The party delivering the certificate must be careful to make sure that amendments and ancillary documents which could modify the lease are in the estoppel certificate. Documents which could potentially be included in the "lease agreement" include: commencement date agreements, alteration agreements and consents, the exercise (or waiver of) option to prior assignments and sublettings, settlement agreements regarding the lease, subordination, non-disturbance and attornment agreements, memoranda of lease, recognition agreements with ground lessors, change of address notices, material correspondence and even prior estoppel certificates. Rarely though do the parties carefully consider such ancillary documents in defining the "lease package."

In any sale transaction, purchaser's counsel will want an estoppel certificate to cover as many issues and be as broad as possible. Seller's counsel will keep things simple and will try to strictly construe the "lease package" to include only the lease and formal amendments. If all of the potential lease documents described above are included in the "lease package," a tenant may find it difficult to confirm documents it may have misplaced. When negotiating an obligation to deliver estoppel certificates from tenants, seller's counsel must be aware of the terms of the estoppel provisions in the existing leases. A tenant can only be required to give the information that is required to provide by the estoppel provision of its particular lease. Similarly, the seller can only agree to provide the purchaser information that is set forth in the estoppel provisions of the leases with the tenants.

II. Confirmation of Factual Matters Not Documented Within the Lease Itself

Once the lease document is defined, the next most important job the seller's counsel performs is to require the party giving the estoppel to confirm (or in some cases to establish) that certain elements of the landlord/tenant relationship must be confirmed by reviewing the documents have occurred, or conversely, do not exist. These may include:

- A. Setting forth key lease dates, such as the commencement date, the rent commencement date and the expiration date, at least where these dates are not certain but depend upon the occurrence of certain events;
- B. Determining that contingencies or conditions precedent relating to the lease have been satisfied;
- C. Confirming satisfactory performance by the landlord of any obligations (or, if not, what loose ends remain), the payment of amounts owed by the landlord to the tenant in connection with the construction or build-out of the premises and the taking of possession of the premises by the tenant; and
- D. Establishing whether any default exists. This can be done in various ways relating to whether a present default exists and whether a waiver has been given. Frequently this is confirmed only to the best knowledge of the signer.

III. Confirmation of Independent Facts Relating to the Tenant.

Often a landlord (or purchaser or lender) may want to know about facts relating to the lease itself which affect the ability of the tenant to continue to perform obligations under the lease. These could include:

- A. The financial condition of the tenant or guarantor delivered in certificate and its solvency;
- B. Whether such party is involved in any litigation that could affect its ability to perform;
- C. Such party's net worth, especially where there is a net worth for obligations under the lease such as posting security, deposit bonds for construction or obtaining a release of liability upon assignment; and
- D. Composition of the ownership of such party, especially where the lease has been assigned or where the premises is sublet from a related party where there is an obligation that such relationship continue.

Frequently, the obligation of a party to certify as to any of the above may be outside of the scope of the required certificate called for under the lease. In such an instance, it would be within its right to refuse to provide any such information or confirmation.

IV. Confirmation of Matters Set Forth in the Lease.

Many estoppel certificates provide for detailed information which is set forth in the lease such as the rent, the premises and key dates. For a lender or purchaser, it is often easier to verify lease information set forth in an estoppel certificate, memorandum, loan application, rent roll or contract of sale by checking the estoppel certificates rather than the leases themselves. To the extent that the information in the estoppel certificate matches the lease, no one is prejudiced and the review process may be made simpler. But what if there are major discrepancies? What if the tenant certified that it did not have a renewal option when the lease provided for one? Would not the lease, rather than the estoppel certificate, govern in the event of a conflict since the lease constitutes the best evidence? Could the party who issues the certificate truly say that it relied upon the facts in the estoppel certificate?

V. Attempts to Modify the Lease by the Lender, or More Frequently, by its Lender.

Frequently, a lender will seek to use estoppel certificates to impose upon the tenant additional and independent duties to the lender. These either (a) obligate the tenant to the lender or recognize an exercise of an assignment of rents to the lender or (b) grant the lender additional rights and time to perform. The purpose of these changes is to grant the lender the benefits of a subordination and attornment agreement without having to grant the tenant non-disturbance protections.

Usually there are rights which a landlord could have anticipated and provided for in the initial lease. Had they been included in the original lease they probably would have been acceptable to the tenant. However, they were not. But now, does the obligation of the tenant to the lender continue to have a life of its own? If the landlord and the tenant amend the lease and ratify it without referring to the estoppel certificate, do the obligations undertaken for the benefit of the lender go away? If the tenant files for bankruptcy, does the estoppel certificate, does it have liability to the lender if the tenant later terminates the lease because of the landlord's default without giving notice and a cure to the lender? Clearly, the better practice would be to amend the lease to add these provisions and provide that it may not be further amended without the lender's consent. But if the lease, the tenant must be willing to enter into an agreement and must provide consideration.

The Obligation to Give An Estoppel Certificate.

Normally, a lease specifically provides what information may be required in a certificate. Frequently there is an omnibus clause at the end of the lease providing for estoppel certificates which enables either the landlord or the lender to request such additional information as such party may reasonably request. This general obligation is intended to ensure that novel requirements of future lenders can be satisfied.

Absent an obligation to give an estoppel certificate, a tenant is not obligated to deliver one. However, a purchaser who acquires property accepts title to the property subject to any and all rights which the tenant may have. For example, a tenant in possession which holds an unrecorded lease which includes an option to acquire the property, takes priority over a subsequent lien or purchaser and/or a new leaseholder. Therefore, absent delivery of an estoppel certificate, a purchaser of the property has no assurance as to the rights of a tenant. Of course, a seller can make representations as to the tenant's rights but such representations, if given, typically lapse after a certain survival period.

Well-negotiated leases will also contain an obligation of the landlord to deliver an estoppel certificate upon the tenant's request. This is an especially useful obligation for the tenant in the event of an assignment or sublease or upon a sale of its assets.

Not only do attorneys representing purchasers negotiate what is included in an estoppel certificate, but they also negotiate the percentage of the tenants required to deliver estoppel certificates, since generally it is very difficult to get all of the tenants in a building to deliver estoppel certificates. The percentage can be based on a pro rata share of the aggregate square footage of the leases in the building, a specified percentage of the tenants or both. Additionally, if less than all of the estoppel certificates in the building are presented to the purchaser, the seller/landlord may be required to deliver its own seller's or landlord's estoppel certificate upon which the purchaser can rely for a specified survival period to cover all of the leases for which estoppel certificates were not obtained.

Is An Estoppel Certificate Effective?

Despite the importance of the estoppel certificate, and often the obligation contained in a lease to provide one, it is a document that landlords generally do not require to be delivered as a matter of course. While sophisticated landlords will go to the expense of having annual financial statements prepared and lenders will require borrowers to submit financial information regarding their properties on a regular basis, landlords, for the most part, do not require tenants to deliver estoppel certificates on any regular basis. Why is this? Probably the main reason is that landlords do not want to put in the effort necessary to obtain estoppel certificates. Since the certificate does not "estop" a tenant from asserting a claim different than set forth in the estoppel certificate unless the landlord relied upon it, landlords inadvertently may be making a poor business judgment. Even if the estoppel certificate purports to (and does) bind the terms of the lease for the benefit of a new landlord or a lender, it is rarely treated as a "lease document" in defining what constitutes the lease. In sublease agreements, rarely is an estoppel certificate treated within the definition of a "lease" whose terms are ratified and confirmed.

Perhaps a mutual estoppel certificate between the landlord and the tenant would constitute adequate consideration and obviate the need for reliance upon the estoppel. But, alas, it is often much easier for a landlord to point to the provisions of the lease than to obtain an estoppel certificate.

lease which requires the tenant to provide an estoppel certificate than to contribute anything to the tenant.

Thus, unless the tenant could otherwise be estopped, it may be argued that certificates are of fleeting relevance or importance. Nevertheless, in those few cases where there is a major discrepancy between a matter asserted in the estoppel certificate and a subsequent claim by a tenant, the estoppel certificate can be of great importance. Interestingly, however, issues raised in estoppel certificates appear to be rarely litigated.

Problems and Pitfalls.

Each party to a leasing transaction, from the tenant to the landlord to the lender, encounters various pitfalls and concerns in creating the most favorable and effective estoppel certificate. As discussed above, reliance is an essential element for the effectiveness of an estoppel certificate. However, estoppel certificates are frequently treated as mere items and, accordingly, a party receiving the benefit of an estoppel certificate may say it relied upon the estoppel certificate in acquiring the property or making the acquisition. If the estoppel certificate is delivered after the closing of the acquisition or the acquisition is completed, an estoppel certificate should state exactly who may rely upon it. If a party is not an intended beneficiary, it would have no right to so rely.

To a tenant, estoppel certificates are fraught with peril. They frequently are obtained from tenants without advice of counsel, sometimes without even careful thought. Commonly, they also are utilized as a "back door amendment" of the lease to modify the tenant's duties and obligations to lenders and other strangers.

To a landlord, estoppel certificates can be troublesome. For a closing, a landlord may play "middleman" between a tenant and a new purchaser or a lender that requires the tenant to sign a particular form of estoppel certificate. Even when a landlord obtains an estoppel certificate for its own benefit, the landlord may not be able to derive the intended benefit from the estoppel certificate because it cannot show reliance. Whenever a landlord attaches consequences to possible future facts relating to the tenant, the landlord negotiating that lease should think about how the landlord -- and its possible transferee or possible purchaser -- will be able to monitor and stay fully informed about the tenant's future facts. It is a concern that a landlord's counsel should raise whenever the parties agree to provisions of this type, and take into account in tailoring the estoppel certificate requirements in the lease.

Conclusion.

Estoppel certificates are neglected progeny of leases. Their enforceability relies on basic principles of equity rather than principles of contract law which require consideration. As such, they are often misused because they seek to do more than they were intended to do and are often utilized in situations where reliance is not appropriate. If practitioners better understood how, when and to what extent estoppel certificates can effectively be relied upon, they would be easier to negotiate.

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Contact information:

ABA Section of Real Property, Trust and Estate Law
321 N. Clark St.
Chicago, IL, 60610
phone: (312) 988-5824
rppt@abanet.org

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