Presented:
2012 Bernard O. Dow Leasing Institute

October 3, 2012
Dallas, Texas

October 24, 2012
Austin, Texas

Drafting Functional Maintenance, Repair, Casualty and Insurance Provisions for Different Types of Commercial Leases

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INTRODUCTION

When the leased premises, or another part of landlord's property, requires routine repair or suffers catastrophic damage, the landlord and tenant each look back to the lease to determine who must make or pay for the required repairs and who must bear any financial losses caused by the resulting interference with the tenant's use of the premises. Too often, however, the operative lease provisions, which seemed clear and unambiguous when drafted, appear far less so once the anticipated events actually occur. This outline attempts to identify some of the more important legal and practical issues that frequently bedevil efforts to draft functional repair, surrender, casualty, insurance, indemnity, and related risk management provisions for commercial leases and to offer some drafting suggestions in the hope that one of the insurance claims after a casualty is not made on the drafter's E&O policy.

The first step in the process is to revisit the basic common law rules that assign the rights and duties for repair and maintenance and allocate the risks of loss between a landlord and tenant in the absence of express lease provisions to the contrary. Leases are not written on a blank page. English common law doctrines in this area of the law fill in any blanks on the page in ways that sometimes run contrary to contemporary commercial expectations. And even though express lease covenants, as a general rule, supersede implied covenants on the same subject, it is important to understand how express lease terms alter common law rules and conversely how common law doctrines influence the interpretation and construction of express lease terms.

The second step in the process is to make sure that the legal rights and duties assigned in the lease take into account the practical obstacles that often prevent or delay one party or the other from satisfactorily performing its assigned duties, sometimes through no fault of its own. To avoid, or at least minimize conflicts that too often plague property condition and risk management problems, the drafters of a commercial lease must first ask the right questions about mostly mundane and tedious details on which the smooth and effective functioning of these lease provisions depend. And even though the questions that should be asked are essentially the same for virtually every lease, the right answers often differ dramatically based on tenant's use of the premises, the nature of the improvements within the premises, the age, physical condition, configuration, of the buildings, the type of development in which the premises are located, the financial structure of the lease, and even the landlord's financing arrangements.

Scope & Organization

The outline is divided into two parts. Part I focuses on drafting ***routine*** repair and maintenance provisions. It covers the parties' respective implied obligations for repair and maintenance of the premises, the landlord's implied obligation to repair and maintain common areas, the effect of express repair, surrender, and casualty clauses on the parties' implied obligations, and judicial interpretations of implied and express covenants. Part I ends with a review of common, but problematic, lease terms and offers some drafting tips to avoid or minimize these sempiternal drafting challenges.

Part II discusses the common law rules governing a landlord and a tenant's rights and responsibilities after a ***catastrophic*** casualty when the lease is silent on the subject, the parties' practical concerns in drafting functional casualty provisions, and the three major issues that must be addressed by the casualty provisions in every lease —continuation of the lease term, restoration of the premises and related improvements, and continuation or abatement of rent. This part of the outline also points out some issues to consider in drafting insurance and indemnity provisions, and while this part of the outline does

not attempt a comprehensive exposition of insurance, indemnity, and other risk management issues, it does point to other outlines and resources that cover these substantive topics in greater detail.[1]

Acknowledgments

The authors wish to acknowledge and thank those who have previously written on the topics covered in this outline. A list of those authors and their works are listed in Appendix 1. Their fine work is the source of many of the substantive and practical considerations noted in this outline.

Appendices – With Disclaimers

The Appendices provide examples. The checklist is a starting point for thinking through issues, not as a substitute for thinking. The lease forms are like clothes. One size never fits all. Nothing fits well off the rack. And if you start with a bad fit, too many alterations usually make the bad fit even worse. Drafters should size up the premises before cutting a lease from any form.

[1] *See* Note 154.

PART I
REPAIR, MAINTENANCE, AND SURRENDER OBLIGATIONS

A. BASIC CONCERNS OF LANDLORD AND TENANT

A landlord and tenant share an interest in drafting clear and consistent repair, maintenance, and surrender clauses in commercial leases. But they may have different, sometime conflicting, practical and financial concerns that vary with the type of lease and development.

In most cases, a landlord wants to ensure that the premises, as well as the remainder of the property, is well maintained during the term and that the premises are returned to the landlord at the end of the term in good, or some other desirable, condition. To achieve these objectives, the lease must assign clear responsibility for making repairs to the premises during the term, allocate responsibility for paying for maintenance and any needed repairs, specify the condition in which the tenant is required to surrender the premises, and provide landlord with meaningful remedies, such as self-help, if the tenant fails to perform its assigned duties.

Different types of leases divide these responsibilities in dramatically different ways. A single tenant, triple-net or bond lease may assign all maintenance, repair, and insurance obligations to the tenant during the lease term. An office lease in a high-rise building within a mixed use development may require the landlord to clean, maintain, and repair the premises but obligate the tenant to reimburse the landlord for performing these services. This kind of arrangement allows a landlord to retain control over the work performed within the building while leaving the financial burden on the tenant.

Some leases divide responsibility for making repairs to one part of a building to the landlord and other parts to the tenant. When responsibility is divided between a landlord and tenant, the lease should make clear who bears the loss if one party, in the course of performing its repair obligations, causes damage to a portion of the premises of the building the other party is obligated to repair.[2] If landlord does agree to make certain repairs, it may wish to limit its repair obligations by requiring tenant to give landlord notice of the need for repair and a reasonable time to start and complete the repairs.[3] A landlord also wants to ensure that the lease grants it access the premises to inspect tenant's work or, if need be, to perform the tenant's work.

By contrast, a tenant wants to ensure that its landlord maintains any common areas (as this can affect tenant's customer's and client's perception of tenant). Many tenants seek to preserve the right, but to avoid the obligation, to remove their trade fixtures at the end of the lease term and to limit the obligation to restore the premises to the original condition at the end of term. A tenant also usually seeks to exclude from its repair obligation any items covered by construction warranties that benefit the landlord.

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[2] *See, e.g., Fisher v. Temco Aircraft Corp.*, 324 S.W.2d 571, 574 (Tex. Civ. App. – Texarkana 1959, no writ) (lease provision obligating landlord to maintain roof, foundation, and exterior walls in good repair and obligating tenant to maintain interior required landlord to repair roof when roof was damaged in connection with interior repairs performed by tenant).

[3] *See, e.g., Hoover v. Wukasch*, 274 S.W.2d 458, 460 (Tex. Civ. App. – Austin 1955, writ ref'd n.r.e.) (where lease expressly provided that landlord was not liable for failure to repair roof until landlord given notice of the need for repairs and a reasonable time to make the repairs and tenant never gave notice, landlord's duty to repair did not arise).

Both landlord and tenant want the right to exercise self-help remedies and to be reimbursed for performing repair and maintenance obligations for which the other party is responsible but fails to effect. No landlord wants to be in default if it fails to make immediate repairs. As a result the landlord default provisions typically require the tenant to give a landlord 30-days' notice and opportunity to cure before the tenant can exercise its remedies for default. But a restaurant tenant with a leaky roof is not in a position to wait 30 days for the landlord to get around to fixing the roof. In such circumstances, a landlord will require the tenant to give notice of the need for immediate repair, and permit the tenant to exercise self-help with a pre-approved contractor, and to be reimbursed for the cost of the repair. A landlord may seek to limit tenant's remedies in exchange for this concession. A landlord and tenant both need to be aware of conflicting terms. While the lease may obligate tenant to make repairs within the premises, any limitation on tenant's ability to make changes without landlord's permission (*e.g.*, a provision prohibiting tenant from making alterations) may create a conflict.[4]

B. LANDLORD'S REPAIR AND MAINTENANCE OBLIGATIONS

The common law and most commercial leases distinguish between a landlord's duty to repair common areas and other facilities over which the landlord retains possession or control, as opposed to the leased premises. Based largely on principles of control, a landlord – even when a lease is silent – has an implied contractual duty to its tenant, and a legal duty to third parties sounding in tort, to keep common areas and other facilities within the landlord's control in good repair and condition.[5] But, at common law, a landlord generally had no implied duty to the tenant (in contract or implied from the parties' relationship) or to third parties (in tort for premises liability) to keep the premises in good condition, absent either the express obligation to do so in the lease or the landlord's exercise of control of conditions within the premises.[6] The next section of the outline focuses on a landlord's obligation to its

[4] *See, e.g.*, *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 340-43 (2011) (noting that tenant was "expressly excluded from making alterations to utility lines or systems" without landlord's consent).

[5] *Brown v. Frontier Theatres, Inc.*, 369 S.W. 2d 299, 303 (Tex. 1963) (holding that when landlord retains possession or control of portion of leased premises, landlord is charged with duty of ordinary care in maintaining portion retained so as not to damage tenant); *Lang v. Henderson*, 215 S.W.2d 585, 588 (Tex. 1948) (stating that when landlord breaches duty to maintain common area or facility, landlord is liable to tenant who suffers injury due to defects in facilities over which landlord retains possession or control); *McCreless Props., Ltd. v. F. W. Woolworth Co.*, 533 S.W.2d 863, 866 (Tex. Civ. App. – San Antonio 1976, writ ref'd n.r.e.) (stating that when landlord retains possession or control of portion of leased premises, landlord, in absence of any agreement to contrary, has implied duty to tenant to maintain retained portion of premises "so as not to damage the tenant").

[6] *Johnson County Sheriff's Posse, Inc. v. Endsley*, 926 S.W.2d 284, 285 (Tex. 1996) (holding that landlord has no duty to tenant or its invitees for dangerous conditions in leased premises, unless landlord: (1) makes negligent repairs; (2) conceals defects in premises of which landlord is aware; or (3) retains control over that portion of premises where defect or unsafe condition causes injury); *Tillery v. Trans Texas Inv. Props.*, 2003 WL 1461476 (Tex. App. – Dallas 2003, pet. denied) (released for publication June 23, 2003) (assuming, without deciding, that – when applicable – implied warranty of suitability would create duty of landlord to third party injured as a result of latent defects in facilities essential to tenant's use of leased premises, but finding "nothing in the record . . . to establish that the condition of the sink made the premises unsuitable for its intended commercial purpose."); *see generally CMH Homes, Inc. v. Daenen*, 15 S.W.3d 97, 99 (Tex. 2000) (stating that 4 elements of injured invitee's premises liability claim are: (1) owner or occupier's actual or constructive knowledge of condition on premises; (2) existence of that condition poses unreasonable risk of harm; (3) owner or occupier fails to exercise reasonable care to reduce or eliminate that risk; and (4) owner's or occupier's failure to use reasonable care is proximate cause of invitee's injury); *Texas Co. v. Wheat*, 168 S.W.2d 632, 635 (Tex. 1943) (stating that, unless landlord has right to control, or undertakes right to control tenant or tenant's employees in details of performing covenant to keep premises clean, tenant's employees are not servants of landlord and, therefore, landlord is not liable to third party for premises liability claim arising from negligence of tenant's employees).

Title search: Drafting Functional Maintenance, Repair, Casualty and Insurance Provisions for Different Types of Commercial Leases

First appeared as part of the conference materials for the
2012 Leasing Institute session
"Drafting Functional Maintenance, Repair, Casualty and Insurance Provisions for Different Types of Commercial Leases"