Real Estate Review

Spring 1978

VOLUME 8, NO. 1

The Real Estate Institute of New York University

WG&L

Resolving the thorny question of who fixes what.

People and Property: Repair Clauses in Store Leases

Emanuel B. Halper

A LARGE BOX arrived in my office last September bearing the engraved label of the legal firm of Erisa, Milltown, Stonehead & Grumble. Considering the sad decline in public morals, I figured that a bomb was enclosed. Of course, it was also possible that Erisa, Milltown, et al. had enjoyed my articles so much that they were sending me a case of liquor for Christmas.* I asked my secretary to open the package—carefully.

The package contained a shopping center lease consisting of 275 pages and fifteen separate supporting documents. The covering letter was so elegantly written that I know you'll benefit from seeing it verbatim.

* If you should ever get such an idea, I like Jack Daniels Tennessee Sour Mash Whiskey.

Emanuel B. Halper is Adjunct Associate Professor of Real Estate, New York University, and is a member of the Garden City (Long Island) and New York City law firm of Zissu Berger Halper & Barron. Mr. Halper is also Chairman of the Board of the International Institute for Real Estate Studies. His book, *The Wonderful World of Real Estate,* which includes many articles in the "People and Property" series, is published by Warren, Gorham & Lamont.

Gentlemen:

This firm is general counsel to Euphoria Real Estate Investment Trust,[1] the owners of a fee simple estate[2] in the land situated on the northwest corner of the intersection of Miracle Mile Road and Keemosobee Trail in the Town of Howe's Bayou, Parish of Howe's Bayou in the State of Louisiana, upon which land a shopping center is to be erected and constructed subject to approval of all regulatory authorities,[3] boards, bureaus,[4] departments, and agencies.[5]

We have been informed that your client, Wally Juniors, is desirous to let, lease, occupy,[6] and rent a premises consisting of approximately 11,235.0241 square feet plus or minus square feet of floor area in building number 1A on the northeasterly side of the shopping center situated between the Diana Unigrant Department Store and the Marlan Supermarket.

As you must have been informed, the demand for this space has been so overwhelming that our client is reluctant to allow excessive time to pass[7] before the lease is executed.

Very truly yours,
J. Chapman Erisa

---

[1] As defined in I.R.C. § 1221(a)(i).
[2] *Erie Railroad v. Tomkins.*
[3] *Brown v. Board of Education.*
[4] *Dennis v. United States.*
[5] *Palsgraf v. Long Island RR.*
[6] *Adams v. Lindsell.*
[7] *Macpherson v. Buick.*

As you may imagine, the letter worried me. There was so much paper in the box that I could hardly carry it. Was I expected to read the stuff and negotiate changes under pressure?

I put in a call to Brent V. Firestone, Chairman of the Board of Wally Juniors. Brent sympathized with my fear that I was inadequate to handle the task. He implied that I was inadequate to handle quite a few other things, too.

Brent was impressed with J. Chapman Erisa's huge quantity of paper. He chided me for my own puny-looking leases. He instructed me to disregard my fears and to get the lease signed before the end of the year.

So I called Erisa to find out when we could get together. He said he was too busy to meet with me that week, but he could see me in about ten days. When I asked him to come to my office, he said he was willing but that he did not know how to find his way through the five city blocks that separated his office from mine. And so, I found myself visiting him.

Prior to the visit, I wound up reading approximately 50 pounds of legal documents. It was not a scintillating reading experience. Whenever Erisa could expand fifteen words to 300, he did so. The average sentence was 2,000 words long and spread over nine pages. By the time I reached the end of any sentence, I had forgotten the beginning. Commas and semicolons were sprinkled about like pepper in a mulligan's stew. They fell here and they fell there. If the author of this literary cancer had a plan or organization, it eluded me.

An experience worse than reading his material was talking to J. Chapman Erisa. It was like talking to a tape recorder. Sitting comfortably in an oversized Brooks Brothers suit, he looked at me through horn-rimmed glasses. He was absolutely shocked at any suggestion to change the documents and took copious notes of every such blasphemy.

After each meeting, I received a new set of documents. But a painstaking reading of each new stack of papers revealed few of the changes I had requested.

The months of October and November passed. By December 17, the repair clause was the only clause that had not been resolved. On that date, Erisa was alerted by his client to get the lease signed before December 31 and to spare no effort to accomplish that objective. Indeed, since Brent V. Firestone was the only officer of Wally Juniors who was authorized to sign leases and since he planned to leave for Acapulco on December 21, there were only three days left in which to work.

Under this kind of pressure, J. Chapman Erisa changed his demeanor. When he called me, he even dialed the call himself. He asked how I was, invited me to call him "Chappy," and suggested an all-day meeting.

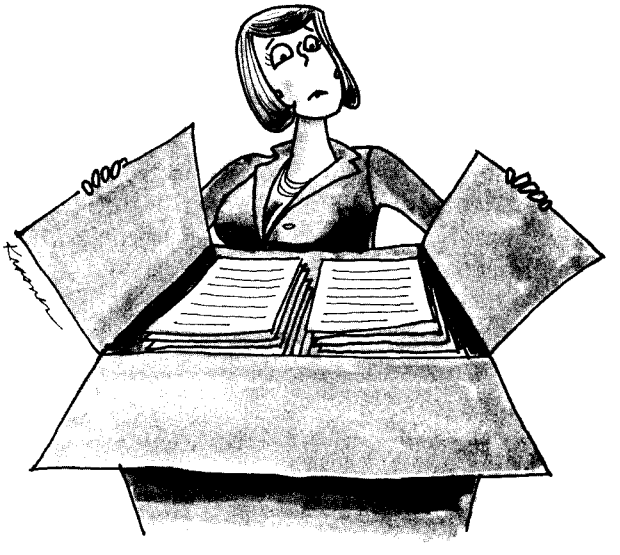
Now I'm not a vengeful person, but it seemed to me that he deserved a little something in return for his general lack of graciousness and for making me read that set of redundant and disorganized documents.

I had nothing to do on December 18, but refused to meet him until December 19. But December 19 was also the date of Wally Junior's Christmas party, and that was the only place to catch Brent V. Firestone on that day. So Erisa agreed to schedule the big meeting for December 19 at 2:00 P.M. at Wally Junior's Christmas party in the company's main warehouse just across the state line in Cloaca.

Brent had his heart set on having a good time at the party, and he insisted that I prepare a memo on repair clauses so that he would know in advance all the pros and cons. This, he figured, would minimize the time he would be required to spend on business. So that you will understand the drama that was about to unfold, I have set forth the memo for your review.

MY MEMO ON REPAIR CLAUSES

Early in the history of shopping center leases, repair clauses were patterned after those in downtown chain store leases. In the latter, some repairs customarily were the responsibility of the landlord while others were assigned to the tenant.



Since downtown chain stores usually occupied premises which were part of large buildings, the chain store tenant saw no sense in any requirement that it make repairs to the structural elements or to the exterior portions of the building. Usually the tenant agreed to repair the interior portions of its premises but exclusive of any structural elements which might be in the interior. It was also the tenant's responsibility to repair its show windows and storefront. Since many stores contained pipes and other conduits that served other portions of the building, tenants were careful to disclaim responsibility for the repair or maintenance of pipes or other conduits used in common.

This allocation of responsibilities was carried over to shopping center leases. By and large, it is a division of responsibility that makes sense but for reasons different from those that made the relationship work in the downtown chain store leases.

Most existing shopping center leases relate to buildings which were not built at the time the lease was negotiated. These leases usually require that the store building be built by the landlord. If the tenant was responsible for making repairs to the entire building, the landlord's incentive to construct a sound building would be impaired. A tenant might find itself in the unfortunate position of being required to make extensive structural repairs to a shoddily constructed building. On the other hand, structural repairs in a sound shopping center building are rarely needed, so shopping center landlords do not object to the responsibility for such repairs.

Among the structural elements of a shopping center building which are customarily repaired by the landlord are the following: footings, foundation, load-bearing walls, columns, beams, lintels, and roof-deck. In addition, the landlord customarily agrees to repair the floor slab, the roof, and the nonload-bearing exterior walls.

Repairs Due to Defects

Tenants customarily insist that for one year after the lease term commences, the landlord agree to make *all* repairs to the demised premises that arise because of defective workmanship or materials in the original construction. Such an obligation is not likely to cost the landlord anything. The landlord's contract with the construction contractor usually obligates the contractor to make these repairs during most or all of this period.

On the other hand, a number of chain store tenants insist that the landlord be responsible for defects in original construction throughout the entire term of the lease. A landlord who agrees to such terms may be required to bear the cost of these repairs himself. Furthermore, he may find that no matter what type of repair is necessary, the tenant will claim that the repair was due to a defect in original construction.

A common compromise is to extend the period of the landlord's obligation from one year to two. If this is done, the landlord should also attempt to extend the period of the construction contractor's obligation to make repairs due to defects in original construction.

Repairs Required by Settling of the Building

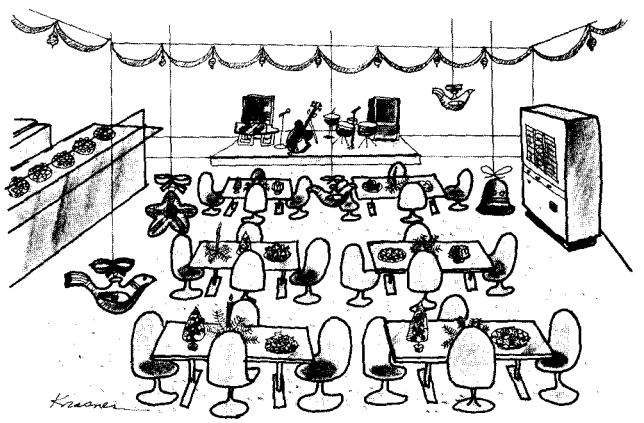
Any building may sink, or settle, a bit after construction. Some buildings settle for years after the

completion of construction. Tenants often insist that landlords be required to make all repairs (even interior repairs) made necessary by such settling. The issue is often resolved by agreement to make the landlord responsible for this kind of repair for a limited period of time. A period of landlord responsibility lasting two years after completion of construction is common.

However, some tenants insist that the landlord be responsible throughout the term. I've seen compromises which extend the landlord's obligation to as late as the eleventh anniversary of the completion of construction.

Repair Clauses and the Courts

Unless care is taken in drawing the lease clauses, the division of repair responsibilities between the landlord and tenant can have the odd result that neither party is responsible for a particular kind of repair. Agreements in which each party is allocated the responsibility for specific members of the building are vulnerable to such flaws. The solution, of course, is to allocate specific responsibilities to one party and to specify that the other party must make all other repairs. Accordingly, the landlord's lawyer might ask that the landlord's responsibility be limited to the repair of specific elements, such as the roof, exterior walls, columns, lintels, beams, foot-



ings, foundation, gutters, and downspouts and that the tenant make all other repairs. The tenant's negotiator would prefer that the tenant make only interior nonstructural repairs to the demised premises and that the landlord be responsible for all other repairs.

Both parties must be aware that courts do not always think that leases mean what they say. In order to avoid a miscarriage of justice, courts have been known to distort the language of a lease to mean something that it does not appear to mean. In downtown shopping districts in the past, local merchants and smaller chains usually had to sign archaic standard lease forms. These leases assumed that a tenant had few rights, and they usually provided that the tenants should make all repairs. A judge sympathizing with a small merchant who was obliged to make big repairs to a building that he did not own, would decide that despite the fact that the lease imposed the obligation for all repairs on the tenant, the parties never intended to impose such a burden on the tenant. Judges have reached such tenant-saving conclusions because the parties could not reasonably have foreseen the consequences of the repair clause or simply because the repairs required were "extraordinary."

If the tenant is executing a net lease and is adventurous enough to agree to repair the building throughout the term, the conscientious lease draftsman should remember the bequests of these judges and provide that the duty to make repairs is imposed on the tenant whether the repair is ordinary or extraordinary, structural or nonstructural, foreseen or unforeseen.

Repairs Needed Because One Party Is Negligent or in Default

Tenants want landlords to be responsible for repairs to the interior of the demised premises in these situations: when the repair must be made because of the landlord's negligence; because of the landlord's failure to comply with lease provisions; or because of the landlord's failure to repair a portion of the building which the landlord should have repaired. For example, assume a tenant is obliged to make all repairs to the ceiling. That tenant may insist that the lease provide that if a leak in the roof (the landlord's responsibility) damages the ceiling, the landlord must repair the ceiling as well as the roof.

Repairs Because of Fire or Casualty Damage

Although the obligation is usually not mentioned in repair clauses, landlords usually agree in other portions of the lease to make all repairs of damage resulting from fire or other catastrophe. In addition, the cost of many repairs which the lease may assign to the tenant are covered by insurance which the landlord is required to carry. An alert tenant will insist that the lease provide that the landlord

be required to make any repair arising from an event covered by the insurance the landlord is required to carry. Suppose a show window is damaged by a hurricane. Hurricane damage is usually covered by extended coverage insurance. The lease requires the landlord to repair the hurricane damage even if, under other circumstances, repairs to the window are the tenant's responsibility. Some landlords agree to turn over the insurance proceeds to the tenant instead of undertaking repairs.

Repairs to Heating and Air-Conditioning Equipment

Many tenants insist that landlords make all repairs to air-conditioning, heating, and sprinkler system equipment. Most landlords are reluctant to accept this responsibility. The fan and duct portions of air-conditioning systems and boilers rarely require repairs. Tenants usually agree to make such repairs. However, air-conditioning compressor units need replacement every five years or so. They are not cheap. Neither party wishes the responsibility of replacing the compressor units three or four times during the term of the lease.

Tenants who accept the responsibility of making compressor replacements throughout the term may nevertheless insist that the cost of replacements during the last few years of the term be shared by their landlords. For example, a landlord may be required to share the cost during the last five years of the term. He would pay one-fifth of the cost if the repair was made in the first year of the terminal period and two-fifths of the cost in the second year, and so on.

Repairs Required Near End of Term

Some tenants feel that landlords should contribute to any large repair which occurs during the last few years of the term. They do not wish to be required to make a major repair to a building if the cost of the repair cannot be amortized during the balance of the term. In this case, the landlord could agree to bear a fraction of expenses during the last five years in an arrangement similar to that made with respect to replacements of air-conditioning equipment. Of course, the lease should require the tenant to return this contribution if the tenant subsequently extends the term of the lease.

What Is an Interior Repair?

Arguments inevitably arise as to whether a member of the building is interior or exterior. To avoid such arguments, it's a good idea to specify precisely which members should be repaired by landlord or tenant. Doors, door frames, windows, and window frames all may be partly interior and partly exterior. Except in the case of powerful chain store tenants who may be able to impose any obligation upon landlords, it is customary for the tenant to make repairs to the doors, door frames, windows, and window frames.

Tenants are usually required to repair the sheetrock or other panels that are installed inside of the exterior perimeter walls, and landlords are required to repair the exterior perimeter walls themselves.

Repairs to Pipes and Wires

Landlords usually agree to repair electrical lines up to the point where they reach the panel box in the demised premises. The tenant's obligation to repair wiring usually begins at the panel box. Similarly, landlords usually agree to make necessary repairs to water and sewer lines up to the point that they enter the demised premises.

Pipes and wires which are part of a system serving more than one premises are usually considered to be the landlord's obligation even if they pass through a tenant's premises.

Downtown chain stores want the landlord to repair unexposed pipes and wires. They argue that

they may be unable to find the source of problems because they are not adequately familiar with the construction of the building. In modern shopping centers, most of the buildings were built to the larger tenant's specifications. Such a tenant is in as good a position as the landlord to make repairs to unexposed pipes, wires, and conduits.

Customarily, a tenant agrees to make repairs to the sprinkler system in its premises, but it commonly insists that the landlord be responsible for the water pressure in the sprinklers.

Glass Storefronts

Many stores in downtown shopping districts were made attractive by removing a brick front and replacing it with glass. Since the tenants were making fundamental changes to the buildings, landlords frequently refused to assume responsibility for repairs to their tenant's glass storefronts. Glass could be broken by vandals, by children playing ball, or as a result of installation defects. Almost universally, today, tenants are conditioned to agree to making repairs to storefronts themselves.

The rise of the shopping center in which tenants leased new buildings introduced the problems of damage to store windows and other parts of the storefront from the settling of the building. Many tenants now demand that storefront repairs be made by the landlord, but few landlords agree to accept this burden.

Construction Warranties

Warranties of landlord's contractors, subcontractors, and suppliers should be assigned to the tenant. If a warranty is not assignable, the landlord should be required to enforce the warranty for the benefit of the tenant. Sometimes, the landlord insists that the tenant agree to pay the landlord's expenses in connection with the enforcement of the warranty.

Repair Clauses in Net Leases

Some shopping center leases are intended by the parties to be net leases. A net lease (sometimes called a net net lease or even a net net net lease) is an arrangement under which some or all of the landlord's normal responsibilities are shifted to the tenant. A major responsibility which might be shifted is the obligation to make repairs to the roof and structural elements of the building.

When a tenant agrees to a net lease under a build-to-suit arrangement, it removes an important incentive from the landlord to be militant about constructing a good and workmanlike building. Of course, many landlords do not do the construction themselves. They enter into contracts with general construction contractors to perform the construction. Tenants in net lease build-to-suit arrangements must, therefore, be all the more concerned with the warranties of the construction contractor, subcontractors, and suppliers.

Roof Bonds and Other Warranties

The warranty of the roof subcontractor and the bond (or guarantee of the warranty by the roofing materials supplier) deserve particular attention. Roof bonds are strange instruments. They purport to guarantee that the roof will be free of defective workmanship for ten years or more. Many building owners have found the roofing supply companies, which issue the bonds, to be less than conscientious about their obligations. In fact, these companies are noted for the fervor with which they avoid responsibility under their roof bonds.

The guarantor's obligations under many roof bonds may be disclaimed if a roof repair is made without the original roofing contractor's approval or if an alteration is made to the roof. There are many situations in which the shopping center manager or the tenant's manager might send a repair crew onto a roof to stop a leak. Such work might void the responsibility of the guarantor.

When the bond is voided, the expense of roof repairs is shifted from the roof contractor or roofing company to the party responsible under the lease for making repairs. This being so, the responsible

party may insist that if the other party performs work or otherwise does anything which results in voiding the roof bond, the obligation to repair the roof would shift.

Compressor units in air-conditioning systems are normally guaranteed by the manufacturer for a five-year period. If the obligation to repair and replace the compressors is agreed to be the tenant's responsibility, the parties should make sure that the warranty for the compressors runs to the tenant. If the warranty runs in favor of the landlord, the landlord should be required to enforce it on behalf of the tenant.

Approval of Large Repairs

Some shopping center leases require the tenant to perform costly repairs to the premises but at the same time, they prohibit the tenant from performing extensive repairs without the landlord's approval. Some standard leases require that plans and specifications for the repairs be submitted to the landlord before any work is actually done. Few chain store tenants will accept such a limitation on their actions. The landlord's refusal to allow a repair might prejudice the conduct of the tenant's business, and it might prejudice a tenant's performance under a clause which requires the tenant to make the repair.

Compliance With the Law

Standard-form shopping center leases usually require the tenant to comply with the requirements of all governmental bodies and insurance rating organizations concerning the demised premises and concerning the conduct of the tenant's business in the demised premises. Careful tenants agree to comply only with those legal or insurance requirements which apply to the use of their premises. They specify that if they conduct their business approximately as that business is conducted at a majority of other premises, they are in compliance with the clause.

The "compliance with laws" clause raises important problems. A tenant's improper or illegal use of a premises can subject the owner of the building to criminal penalties. Suppose a tenant is conducting a restaurant business in a building which includes a residence over the store. If the tenant conducts a filthy operation that attracts vermin to the entire building, violation of local health ordinances may result.

Violations are often charged to owners even if the premises are occupied by tenants under net leases. Building owners can find themselves troubled by summons and prospective fines or jail sentences as a result of failure to make repairs even if the lease asserts the tenant's obligation to make repairs. A landlord may be responsible for failure to provide adequate heat or hot water to residential tenants, even if the failure results from the negligent action of a retail tenant.

The prospect of fines and jail sentences is the reason landlords insist on a "compliance with laws" clause in the lease. On the other hand, a tenant must protect itself against the possibility that its failure to comply with some law regulating the conduct of its business, which has nothing to do with the condition of the premises, might result in its liability to the landlord or even a termination of the tenant's leasehold interest.

After all, the violation of a Sabbath blue law is a violation of a legal requirement which relates to the use of the premises. Consider that retail businesses are also governed by such laws as the Sherman Antitrust Act, the Federal Trade Commission Act, and the Robinson-Patman Act.

It is not unusual for the operator of a retail business to be in violation of one or another law from time to time. Consequently, a tenant must limit its obligation to comply with legal requirements to laws relating to the physical condition of the premises.

Compliance With Insurance Requirements

An obligation related to "compliance with laws" is the obligation to comply with insurance company requirements.

Usually, the shopping center owner carries fire and extended-coverage insurance for the shopping center. But the insurance rates and sometimes the availability of the insurance itself depend in some measure upon compliance with insurance company or fire insurance rating organization requirements.

If a tenant fails to comply with requirements of "special-rate fire insurance companies," those companies may refuse to insure the shopping center. The landlord could then be stuck with a dramatic increase in fire insurance premiums. Special-rate fire insurance companies specialize in insuring properties which present especially low risks. The original cost of construction of a new building is increased by the features needed to qualify for the special rate of fire insurance, but many tenants are

willing to pay more rent if the building qualifies for this type of insurance cost savings. The landlord's insurance on the building is also much cheaper. Consequently, it is a matter of urgent concern to both parties if either fails to comply with a requirement of a special-rate fire insurance company.

Where the obligation to repair is divided between the landlord and tenant, the parties might agree that each will comply with insurance requirements relating to the elements of the building each is required to repair. However, variations from this pattern are sometimes indicated. For example, if a landlord agrees to be responsible for repairs to the sprinkler system, he might still insist that the tenant perform routine sprinkler maintenance functions prescribed by the insurance company. On the other hand, even if a tenant agrees to bear the burden of sprinkler repairs, the tenant should ask that the landlord be responsible for maintaining appropriate water pressure in the system.

A broad statement by a tenant that it will comply with all insurance company requirements could be a burdensome error. The landlord's choice might be a fire insurance company with stringent rules which might insist upon expensive changes or might insist that the tenant stop selling merchandise that it is permitted to sell in its other stores.

Consequently, some tenants insist on the right to approve or disapprove the landlord's choice of a fire insurance company. Another way of handling this problem is to provide that if the tenant is dissatisfied with the requirements of the landlord's fire insurance company, the tenant can assume the obligation to carry fire insurance. The tenant would then select the company, subject to the landlord's approval, and the landlord would reimburse the tenant for the insurance premiums at amounts the landlord had previously paid.

BACK TO THE NEGOTIATION

We sat down to negotiate in the company cafeteria on December 19 promptly at 2 P.M. The band was setting up, and kitchen personnel were bringing platters to the buffet table. I was hoping that we would come to agreement by 3 P.M. and could get Firestone to sign by dinner time. But there were too many distractions for J. Chapman Erisa to keep his mind on a lease negotiation.

When the music started, J. Chapman asked Firestone's secretary to dance. They melted into a crowd of young folks wiggling and spinning to the cacophonic sounds.

Erisa came back three hours later. He was uncharacteristically cooperative and cheerful. All disputes relating to the repair clause were settled amicably in thirty minutes. He made me swear that I would redraft the clause fairly and disappeared again.

Finally, finally, I completed the changes, and found someone to type the material. I looked for Firestone and Erisa so that I could get the papers signed. I couldn't find either one until 2 A.M., and was I surprised when I did find them. I'll tell you where that was only if you promise not to tell their wives.

Firestone had invited Erisa to a private party in Firestone's office. Fifteen of the prettiest secretaries and key-punch operators in the whole organization were also there as well as seven or eight executives. You want to know what was going on at the party? I'll tell you this much. Every person in that room was bombed. Perhaps that excuses their behavior.

I beseeched Firestone and Erisa to come and sign the papers. Brent responded by asking me to join the party, but I couldn't bring myself to do such a thing when a lease was just sitting there waiting to be signed.

At 4 A.M., the party began to peter out, and I brought the document in for signature. J. Chapman Erisa was still alert and insisted that twelve counterparts of each document be signed. Since there were twelve documents, Brent V. Firestone had to sign his name 144 times. He finished at 4:53 A.M.

By 5 A.M., I was in my car and on my way home. I was sure glad that I had snow tires because a snowstorm had started.

When I got to the office at noon the next day, there was an urgent message to call J. Chapman Erisa at his home.

I: Hi, Chappy. What's on your mind?
Erisa: I need your help desperately.
I: You need *my* help?
Erisa: Please don't fail me!
I: What's the matter?
Erisa: Do you remember this morning?
I: How could I forget?
Erisa: Well, I just got home an hour ago! My car broke down and got stuck in the snow.

I: Do you want me to help you get it started?

Erisa: No, stupid. A mechanic got it started. How else could I have gotten home?

I: You got me.

Erisa: Don't clown around. I'm in serious trouble and you're the only one who can help me. My wife doesn't believe that I was working on a real estate deal. She thinks I was out with another woman.

I: Well, I'm sorry about that. What can I do about it?

Erisa: My wife is threatening to kick me out of the house unless I can prove that I was actually at a real estate closing. I need a letter from you immediately, and it's got to be convincing.

My sympathy for Erisa's plight exceeded my desire for revenge. I immediately dictated the following letter:

December 24, 1977

J. Chapman Erisa, Esq.
Erisa, Milltown, Stonehead & Grumble
375 Park Avenue
New York, N.Y. 10022

Dear Mr. Erisa:

Our client, Wally Juniors, Ltd. has asked me to write to thank you for your extraordinary effort on the afternoon and evening of December 19 and the morning of December 20 at the lease negotiation for the Howe's Plaza Shopping Center in Howe's Bayou, La.

Your meticulous attention to detail, your unending patience, and your judicious temperament enabled the parties to conclude their negotiations successfully.

Sincerely yours
Emanuel B. Halper

WHITHER FARMLAND VALUES?

"Labor costs involved in getting food to the consumer from the farm are expected to exceed the basic farm value of food [in 1977] for the first time in history, according to the Agriculture Department. The department says prices received by farmers have remained unchanged since 1974 while labor costs have shot up 30% in the same period."

—*Wall Street Journal*
Nov. 29, 1977, p. 1