SPECIAL REPORT

THE AMBIGUITIES, CONTRADICTIONS AND DISPARITIES IN THE RISK OF LOSS PROVISIONS OF COMMERCIAL LEASE AGREEMENTS CAN BE A DISASTER FOR LANDLORDS, TENANTS, ATTORNEYS, RISK MANAGERS, INSURANCE AGENTS AND INSURANCE CARRIERS

(02-17-2016)

This Special Report was written by Kenneth R. Hale, J.D., CPCU, AAI, LIC of Marsh & McLennan Agency LLC. Mr. Ken Hale can be contacted at 734-525-2412 or khale@mma-mi.com. More Special Reports are available at www.mma-mi.com.

I HAVE TRIED

I have written, preached, lectured, cajoled, stonewalled, insulted and gone back and forth more times than I can count with lessors, lessees and their lawyers trying to remove the ambiguities, contradictions and disparities from the risk of loss provisions of lease agreements and I have had very little success over the past 44 years of doing this. (Risk of loss provisions relate to what happens if there is damage to property or injury to persons. This report will be primarily limited to the damage to property aspects of the lease.)

Note: In this report, lessor = landlord and lessee = tenant.

WHY IS THIS?

- Many lessors' attorneys have pride of authorship and often do not want to change anything or understand why the changes are necessary and they think that they will be losing something. Actually, if the risk of loss provisions are insufficient, ambiguous and/or lack clarity, the law firm that drafts the lease could be held accountable. The lessor (the client of the law firm) could be left with a pile of debris because neither their insurance nor the tenant's insurance would respond in a timely fashion to repair or rebuild the building. Instead, the carrier(s) could opt to litigate the coverage issues caused by ambiguities, contradictions and disparities in these provisions.

- Lessees are in love with the location to be leased and do not want to walk away from a bad lease thinking their insurance program will fully cover them (not true) or nothing will ever happen. (Also not true.) They do not even know it is actually a bad lease because they sign it without even first sending it for a review by an insurance lawyer or risk manager.

- Insurance agents are generally order-takers and are expected to do what they are told (and have liability when they start giving advice!), so they do not give advice. In most cases, they do not have the legal expertise to challenge the lease agreements or to structure an insurance policy to properly cover the exposures that exist.

- Insurance carriers generally issue policies as they are instructed by insurance agents and are not in the business of giving advice as to avoid legal conflicts down the road. Their policies, without proper modifications, simply do not do an adequate job in covering the interests of the lessees and lessors as respects leased premises.

  When asked to provide building coverage on a building that is not owned by the lessee (and already insured by the lessor), they typically say, "Why in the world would you want to do that?"

- Insurance adjusters are employed by an insurance carrier and in the event of a fire or other major loss must enforce what their views are relative to the terms of the insurance contract. If in doubt, they either deny the loss or file an action for declaratory judgment asking a judge to decide on the ambiguities, contradictions and disparities in the lease agreement.

  In most cases, a reputable insurance carrier is not trying to avoid paying a loss. It is simply trying to determine what should be paid based on the lessor's and lessee's insurance coverage and the lease agreement itself.

  This takes time and causes a delay in rebuilding.

WHY CAN'T WE DEPEND ON A LESSOR'S BUILDING INSURANCE POLICY?

So what happens when there is a big loss on a leased building, such as a fire or tornado? There are at least 10 reasons a lessee will not see a quick repair or replacement of the building:

- The lessor/building owner did not buy sufficient limits under its policy to pay for the repair or rebuilding.

- The lessor did not have coverage for the perils that caused the loss, i.e. no flood coverage.

- The lessor had insufficient coverage for building code/ordinance changes and does not have the money to pay for this expense.

- The lessor (or lessee) violated policy conditions such as coinsurance, protective safeguard provision (sprinkler or alarm systems were not in good working order) and the lessor's insurance company refuses to pay for the repair or rebuilding. (These should have been negotiated away by the insurance agent, but typically this is neglected.)

- The lessor's insurance company says it is the lessee's responsibility under the repair provision (or other provisions) of the lease.

- The lessor refuses to submit the claim to its insurance company saying the loss was the lessee's fault.

- The lessor has a major deductible and does not want to pay the deductible and wants the lessee to pay under the common area chargeback provision.

- The lessor decides not to rebuild and instead terminates the lease and takes a cash settlement from the insurance company.

- The lessor's insurance carrier delays a settlement because it can and/or is waiting for the Circuit or Appeals courts to determine what the lease really means. (The worst that can happen from an insurance carrier's standpoint is that the carrier has to pay the claim.)

- The lessee's insurance carrier refuses to pay under its policy saying the lessee did not have building coverage (typically the case). Their position is the HVAC system or electrical systems or interior walls were not covered under the personal property section of the lessee's property insurance policy because they were part of the building and were not personal property or leasehold improvements.

WHAT HAPPENS? LAWSUITS AND DELAYS.

Unfortunately, this takes a lot of time, at least 18 months typically in Circuit Court and the Michigan Court of Appeals could be another 18 months, so assuming that there is no appeal to the Michigan Supreme Court, you can count on around 36 months. This assumes it is not sent back to the Trial Court for other action. Further delays and expense can be incurred if the litigation takes place in another state because of a choice of law provision in the lease. Lawsuits can be expensive and for a plaintiff, there can be no happy ending.

The insurance company has basically an unlimited amount of money to fund these determinations, lessees do not and lessees cannot generally recover the legal fees, even if they win. Remember also that the worst that can happen to an insurance company is they have to pay the loss (after litigation is settled). The worst that can happen to an insured, whether a lessor or lessee, is that they may have lost a building, rental income and a long-term tenant (in the case of a lessor), or an entire business (in the case of a lessee). Of course, the lawyers involved initially in the lease can also get sued for allowing this to happen, as well as the insurance agents for their inability to structure an insurance policy properly in order to cover this situation.

Experienced trial and attorneys tell us that it is not unusual for the trial and appeals process to cost in excess of $200,000, so even if the lessee wins the verdict, the lessee still losses.

It is a royal nightmare. It is not for the faint of heart and can have tragic consequences for all of the parties involved and it does not need to happen.

Now, for the most part there is never a fire or other loss that destroys a building or a business. But when it does happen, careers, business, jobs, time, legal fees, reputations and a long-term profitable lease are all lost forever – never to be recovered.

I have been an attorney and risk manager for 44 years and I have faced many major property losses over the years and it is never pretty.

Insurance carriers do not easily step up to the plate on a leased building and pay millions of dollars until three contracts are sorted out: the insurance policy for the lessor, the insurance policy for the lessee and the lease itself.

The adequacy of an insurance policy is the subject of many other Special Reports that we have published. This Special Report will take a detailed look at two actual, but typical, leases. (I have never seen a lease that does not have major flaws as respects the "risk of loss provisions".)

I doubt that landlords, tenants or their attorneys will step up to the plate either to understand and remove these ambiguities, contractions and disparities when the lease is being negotiated and seldom do they ask for the advice of a risk manager or an attorney familiar with lease provisions. And so, all of the parties must be sure that absent clearly written and defined leases that the parties have insurance policies that are negotiated to properly protect their interests, giving them at least a shot at survival.

MY ADVICE

If you are a lessee/tenant, my advice is:

1. Be willing to walk away from a lease, either initially or at the time of renewal unless the risk of loss ambiguities, contradictions and disparities can be eliminated. You need absolute clarity in any provision that deals with loss or damage to a building that is being leased to you.

2. Absent this, even though the lessor/landlord is required to buy building insurance covering its insurable interests and even though the lessee has to pay for that policy under most lease terms as a chargeback, the lessee/tenant should also buy full or partial building coverage to cover its insurable interests in the lessor's building.

3. How much building coverage to buy depends on how bad the lease is and could vary between insuring limited building items only, such as HVAC systems and interior walls, or insuring the entire building (even when the lessor also purchases building insurance).

This will allow the lessee/tenant to recover its insurable interests if the lessor's insurance fails to pay because of exclusions, fails to pay because of a violation of the terms and conditions of the insurance policy or seeks recovery from the lessee as a result of repair or other provisions in the lease. This is called "first party building insurance" and again it only covers the lessee's interests, not the lessor's. Those insurable interests are sorted out after a major loss and a major factor will be the lease terms.

WHAT ARE A LESSEE'S INSURABLE INTERESTS?

The case Daeris, Inc. v. Hartford Fire Ins. Co. 105 N. H. 117 (1963) presents a good review of the law as it relates to a tenant's insurable interests.

"It is well-established law that title to the property is not essential to create an insurable interest. Stone v. Insurance Co., 69 N. H. 438, 442; Clark v. Insurance Co., 87 N. H. 353; Lampesis v. Travelers Ins. Co., 101 N. H. 323. "Any interest of pecuniary benefit from the existence of the property insured or of pecuniary loss from its destruction is sufficient."

- Clark v. Insurance Co., supra, 355.

4. A lessee should also secure high limits and broad perils coverage under the Liability section of its insurance policy. Generally this is called "Tenant's legal liability insurance". At least $1,000,000 can be purchased under a properly negotiated Commercial General Liability policy and some carriers will provide additional limits in their Umbrella/Excess Liability policy.

   Understand, however, that this is different than first party building insurance that we are also recommending because it covers the tenant only when it was negligent in causing the loss. An example of this is a windstorm loss damaging a roof. This would certainly not be the result of a tenant's negligence; however, a repair clause without a fire and casualty exception in the lease agreement could contractually impose the responsibility for replacing the roof on the tenant.

Under these circumstances, the tenant's legal liability coverage would not respond because there is no negligence and the first party building coverage that we mentioned would respond. You need both coverages as a safety net.

5. We have previously recommended in a separate Special Report that a lessee avoid having to insure a lessor's building under a net-net lease. In an ideal world, a building owner should insure its own assets and a lessee should avoid the significant liability and not assume responsibility for insuring a lessor's building.

   The downside of carrying coverage on both the lessor and lessee's policy is that in the event of a major loss, there will be two different insurance carriers involved, increasing the chance of litigation and delays. Also, you cannot count on a lessor buying a properly negotiated insurance policy (blanket limits, no coinsurance, no protective safeguard clause, etc.). A lessor will also likely have only 12 months loss of rents coverage.

   Better advice is that the lessee buy building insurance covering both the lessor's and lessee's insurable interests and be sure the coverage is properly negotiated with robust limits (typically this is not the case). This should be accomplished on one property insurance policy. If you elect to or are required to buy building insurance covering the lessor's interests, do not purchase a separate policy but include it on your policy that already covers personal property and leasehold improvements.

6. Lessees also need long-term business interruption coverage also known as loss of income coverage to cover them during the period of time it should take to rebuild (even with this coverage, litigation delays are not covered). Of course, the lessor could terminate the lease, forcing the tenant to look elsewhere to rebuild the building and/or relocate and delaying the resumption of the Tenant's operations.

   When purchasing business interruption/loss of income coverage, lessees should be certain that they have coverage not only during the period of time it takes to rebuild with due diligence, but the time that it takes thereafter to recover lost business. This is known as the extended period of indemnity. Lessees need to be sure that they do not have an actual loss sustained 12-month limitation on the rebuilding time and they

want to be certain that they have at least 365 days after rebuilding is completed to restore their business.

7. If you cannot renegotiate each risk of loss provision, try to add the following addendum to the lease:

   However, this doesn't solve every problem. For example, the lessor could still elect not to rebuild or it may have an inadequate insurance program and may not receive enough money to rebuild.

LEASE ADDENDUM

The purpose of this addendum is to set forth the respective obligations of the Landlord and Tenant if an event or series of events causes damage to the leased premises affecting the property interests of the Landlord or Tenant.

The provisions of this addendum shall prevail over any other provision to the contrary in this lease agreement as respects damage to the building or personal property interests of the respective parties and any resulting loss of income or rents that either party may sustain.

If the leased premises is damaged or property is stolen with the exception of the intentional acts of either party to the lease, the parties agree that:

1. Landlord and Tenant, respectively, release each other from any and all liability or responsibility and waive any right of recovery, whether direct or by way of subrogation or otherwise, against each other, their agents, officers, members, owners or employees for any loss of or damage to their respective property, which occurs in or about the building or premises whether or not covered by any insurance, regardless of the cause or origin and even if such loss or damage shall have been caused by the fault or negligence of the other party or anyone for whom such party may be responsible. This release and waiver remains effective despite either party's failure to obtain insurance. If either party fails to obtain insurance, it bears the full risk of its own loss.

2. During the period of time that the Tenant is unable to conduct its customary activities without impairment or disruption, the rent shall abate, regardless of the negligence, except for intentional acts, of the Tenant, its agents, officers, members, owners or employees.

3. If the loss or damage cannot be restored, replaced or repaired within 90 days from the date of loss or damage and if as a result of this, the Tenant cannot continue its normal operations at the premises, the Tenant shall have the option to terminate the lease by providing written notice to the Landlord.

This addendum modifies the lease between the parties dated _____ as respects the premises at _____ and shall be effective _____.

Agreed to by the Landlord and Tenant:

_____ _____

Landlord Tenant

CONCLUSION

All parties are losers if the ambiguities, contradictions and disparities in the risk of loss provisions of commercial lease agreements are not corrected up front.

A lessor's attorney might feel good that they did not cave in on various issues because they did not want to take the time to understand the consequences of the ambiguities. However, that attorney's client, the lessor, will lose in the end because of the inability of the lessee/tenant to pay rent or to survive and the legal fees necessary to sort everything out will be significant. This could come back to haunt the lawyer that negotiates the lease on both sides.

A tenant will certainly lose because it is still out of business and does not have the money to rebuild or relocate until the insurance company agrees to pay and this takes years in many cases if litigation is involved.

Everyone loses if these issues are not recognized and dealt with, either by way of appropriate lease amendments or appropriate insurance policies.

ATTACHMENTS

I have annotated the attached actual lease provisions for two leases chosen at random. After reviewing thousands of leases over the years, believe me – these are typical.

BAD LEASE LANGUAGE #1

15. Insurance, Indemnity

a) Requires that the Tenant insure the "interior" of the premises, which means interior walls, plumbing, electrical, HVAC systems, office ceilings, leasehold improvements of prior tenants, etc. These can only be insured under a building insurance policy, which is not typically purchased by tenants where the Landlord has the responsibility for the purchase of building insurance.

a) At all times during the Lease term, Tenant shall procure and maintain, at its sole expense, Commercial Property Insurance covering the perils insured under Insurance Services offices (ISO) Special Causes of Loss Form, in an amount not less than one hundred percent (100%) of the replacement cost covering (a) the interior of the Premises, (b) all Tenant's leasehold improvements in and to the Premises and (c) Tenant's trade fixtures, equipment, business records and other personal property from time to time situated in the Premises.

2. This says even though the Landlord has to purchase building insurance at the Tenant's expense, it is the Tenant's insurance that is primary and does not contribute to the Landlord's insurance. Since two different insurance carriers are involved, this is a lawsuit waiting to happen.

2. All insurance required by Tenant shall (i) be primary and non-contributory, (ii) provide for severability of interests, (iii) be issued by insurers, licensed to do business in the state in which the Premises are located and which are rated A:VII or better by Best's Key Rating Guide.

(B) Confuses both General Liability and Property insurance. In the underlined section, the word "of" should be "and". That aside, "insured against by reasonably prudent…" lacks clarity to say the least. In insurance policies, there is no such thing as "all risk" property insurance.

(B) Landlord's insurance. Landlord shall maintain on the Building an "all risk" property insurance policy in the amount of the Building's full replacement cost, insuring against risks normally insured against by reasonably prudent owners of comparable general liability insurance with a minimum combined single limit of liability of Five Million and No/Dollars ($5,000,000.00) per occurrence for bodily injury and property damage, insuring against liability occurring in, on or about the property of Landlord and providing additional insured status to Tenant. Landlord shall utilize insurance companies that are rated no less than "A-, X" by A.M. Best or equivalent rating agency and Landlord will endeavor to provide a thirty (30) day notice of cancellation of non-renewal. Prior to the Rent Commencement Date, Landlord will furnish evidence of said insurance program.

(C) This waiver of subrogation only applies to the extent either party is able to collect from its insurance carrier. Since neither party can control the quality of the other parties' insurance program, the clause cannot provide any sense of clarity or security to either party.

(C) Waiver of Subrogation. To the extent permitted by law and without affecting the coverage provided by insurance required to be maintained hereunder, Landlord and Tenant each waive any right to recover against the other on account of any and all claims Landlord and Tenant may have against the other with

respect to property insurance actually carried, or required to be carried hereunder, to the extent of the proceeds realized from such insurance coverage.

7. Repair, Maintenance, Operating Expenses, and Payment.

(A) Note: Landlord's repair obligation does not include damage caused by an act or omission of the Tenant. Most losses in a leased building will be as a result of Tenant negligence because it controls the premises. Even if damage is not caused by the Tenant, the Landlord repair obligations do not include interior walls or utility systems outside the premises.

(A) Landlord's Repair and Maintenance Obligations, Landlord Notification. Landlord, at its sole expense and exclusive of Operating Expense reimbursable from Tenant in accordance with Section 7. (B), and unless if caused by an act or omission of Tenant, shall keep in good order, condition and repair the foundations, structural supports, roof and exterior walls of the Building, and utility systems outside the Premises.

(B) Note: The Tenant has to pay for the Landlord's insurance premiums, but does not have the benefit of this insurance.

(B) Operating Expenses and CAM Defined. "Operating Expenses" are all costs incurred by Landlord relating to the ownership and operation of the Industrial Property, Building, and Premises including but not limited to the following: Real Property Taxes as defined in Section 14. (A) and Section 14. (B); premiums for any insurance policies maintained by Landlord for General Liability or Property coverage including loss of rent, association dues, and licensing or certifying of the Building or Industrial Property to any governmental agency and any administrative or property management expenses together with the cost of any Common Area Maintenance "CAM" hereby defined as all costs and expenses relating to the operation, repair, maintenance, and non-structural replacement of the Building, specifically serving the Premises, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, all doors (including all personal and overhead doors) and all related door hardware (i.e. latching mechanisms, handles, hinges, keys etc.), flooring and base coverings, ceilings, framing, and drywall and wall coverings. Tenant's obligations shall include restorations, replacements or renewals, when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Notwithstanding anything to the contrary as herein contained in this Section 8. (A), Tenant shall have thirty (30) days grace period to make any said repair or replacements, such time period may be extended if such repair or replacement cannot be made within said thirty

(B) Note: No exception for fire or other casualty losses. So if the lessor does not have adequate insurance, the repair or replacement could be charged to the Tenant under this operating expense clause.

(30) days but Tenant has commenced same and is diligently working to make such repair or replacement.

8. Tenant Maintenance, Repairs, Trade Fixtures, Alterations, Construction Liens.

(A) Tenant's Obligations. Except as provided in Section 7. (A), Tenant shall, at Tenant's sole cost and expense and at all times, keep the Premises and every part thereof as herein described, in good order and condition as it substantially existed upon Commencement Date, normal wear and tear, structural repairs and replacement not arising out of Tenant's use of the Property, damage by fire, vandalism, the elements and any other insurable casualty, damage by condemnation and damage due to or occasioned by the negligence or acts of Landlord and/or other tenants in the Building, excepted. Tenant's obligations shall include, without limiting the generality of the foregoing, all equipment or facilities specifically serving the Premises, such as plumbing, and plumbing fixtures in the Premises, heating, air conditioning, ventilating, electrical, lighting, fire extinguishers current and updated, fire house connectors if within the Premises, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, all doors (including all personal and overhead doors) and all related door hardware (i.e. latching mechanisms, handles, hinges, keys etc.), flooring and base coverings, ceilings, framing, and drywall and wall coverings. Tenant's obligations shall include restorations, replacements or renewals, when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair. Notwithstanding anything to the contrary as herein contained in this Section 8. (A), Tenant shall have thirty (30) days grace period to make any said repair or replacements, such time period may be extended if such repair or replacement cannot be made within said thirty (30) days but Tenant has commenced same and is diligently working to make such repair or replacement.

(A) This language says that the Tenant does not have responsibility for:
- Wear and tear
- Repairs not arising out of Tenant use (meaning that damage caused by negligence or arising otherwise from Tenant's use of property is not an exception)
- Fire, vandalism, the elements and other "insurable casualties" (not defined)
- Damaged caused by the Landlord and other tenants

This provision could be a minefield of opportunities to pin damage claims on the Tenant.

(B) HVAC. Apart from the limited warranty provided by Landlord for the HVAC system as set forth in Section 31 hereof, Tenant will be responsible for and shall undertake any repairs and/or replacements of the HVAC system.

(B) Even though Landlord insures the building and its mechanical elements such as HVAC systems, this provision requires that the Tenant not only repair but replace the HVAC system, even if caused by an act of God such as lightning. This will not be covered by the Tenant's personal property insurance because it is a building item only covered by building insurance.

(E) Indemnity, Damage by Tenant to Other Tenants.

1. Indemnity. Excepting to the extent arising out of the willful or negligent acts or omissions of Landlord, Tenant shall protect, indemnify and hold the Landlord harmless from and against any and all loss, claims, liability or costs (including court costs and reasonable attorney's fees) incurred by reason of:

a) This broad requirement conflicts with some exceptions in prior language. It clearly says if the Tenant is negligent and the building is damaged, the Tenant has to pay.

a) any damage to any property (including but not limited to property of any Landlord) or death or injury to any person occurring in or about the Premises, the Building or the Industrial Property to the extent that such injury or damage shall be caused by or arise from any actual act, neglect, fault or omission by or of Tenant, its agents, servants, employees invitees, or visitors;

b) the conduct or management of any work or anything whatsoever done by the Tenant on or about the Premises or from transactions of the Tenant concerning the Premises;

c) Tenant's failure to comply with any and all governmental laws, Applicable Laws, ordinances and regulations applicable to the condition or use of the Premises or its occupancy; or

d) any breach or default of the part of Tenant in the performance of any covenant or agreement on the part of the Tenant to be performed pursuant to Lease.

e) In no event, however, shall Landlord be entitled to indemnification under this Section if such claim arises from a breach or default in the performance of any obligation on Landlord's part to be performed under the terms of this Lease, or arising from any negligence of the Landlord, or any of Landlord's agents, contractors or employees.

24. Damage or Destruction

(A) Is favorable because so far it gives the Tenant the right to terminate the lease if there is a major loss

(A) Termination Right. Subject to the provisions of Section 24. (B), if the Premises or the Building shall be damaged to such an extent that there is a substantial interference for a period exceeding sixty (60) consecutive days with the conduct by Tenant of its business at the Premises, Tenant, at any time prior to commencement of repair of the Premises and following five (5) business days written notice to Landlord, may terminate Lease effective thirty (30) days after delivery of such notice to Landlord. Such termination shall not excuse the performance by Tenant of those covenants, which under the terms hereof survive termination. Rent shall be abated in proportion to the degree of interference during the period that there is such substantial interference with the conduct of the Tenant's business at the Premises.

(B) Damage Caused by Tenant. Tenant's termination rights under Section 24. (A) shall not apply if the damage to the Premises or

(B) takes (A) away if the loss is the result of Tenant's negligence . (Chances are this will be the case because the Tenant has possession)

Building is the result of any negligent or willful act or omission of Tenant or of any of Tenant's agents, employees, customers, invitees or contractors ("Tenant Acts"). Tenant shall continue to pay all rent and other sums due hereunder. If Tenant does not terminate the Lease pursuant to Section 24. (A) above, then Landlord shall promptly repair and restore the Premises to substantially the same condition prior to such casualty. If Landlord fails to restore within ninety (90) days after the date of casualty, then Tenant shall have the right to terminate the Lease at any time thereafter upon at least thirty (30) days prior written notice unless Landlord completes restoration within such time period.

25. <u>Surrender/Restoration</u>

This language is favorable in some respects because most leases indicate that at the end of the lease, the Tenant has to return a complete, undamaged building. This has some exceptions, but the words "insurable casualty" lack clarity.

Tenant shall surrender the Premises by the end of the last day of the Termination Date or any earlier termination date, clean and free of debris and in good operating order, condition and state of repair, ordinary wear and tear, structural repairs and replacement not arising out of Tenant's use of the Property, <u>damage by fire, vandalism, the elements and any other insurable casualty</u>, damage by condemnation and damage due to or occasioned by the negligence or acts of Landlord and/or other tenants in the Building, excepted. Without limiting the generality of the above, Tenant shall remove all personal property, trade fixtures and floor bolts, patch all floors and cause all lights to be in good operating condition, as more specifically set forth in <u>Exhibit E</u> ("Move-Out Conditions"). Upon Termination Date or earlier termination of Tenant's right of possession, Tenant shall surrender the Premises to Landlord in substantially the same condition as received, broom clean, ordinary wear and tear structural repairs and replacement not arising out of Tenant's use of the Property, damage by fire, vandalism, the elements and any other insurable casualty, damage by condemnation and damage due to or occasioned by the negligence or acts of Landlord and/or other tenants in the Building, excepted.

BAD LEASE LANGUAGE #2

2. Rental

This implies that if the lessor does not receive sufficient proceeds from its property insurance policy, the difference is chargeable as additional rent.

Lessor shall receive the rent set forth in this Paragraph 2 free and clear of any and all other impositions, taxes, liens, charges or expenses of any nature whatsoever in connection with the ownership and operation of the Premises.

3. Repairs and Replacements to the Premises

This repair clause encompasses the entire building and has only two exceptions. This also requires that the lessee pay for the additions or improvements to a fire sprinkler system if required by the lessor's insurance carrier. This could be very expensive.

Lessee shall, during the continuance of this Lease, at its own expense: (a) keep the Premises and every part thereof, including, but not limited to, all electrical, mechanical and plumbing systems, the roof, plate glass and the four walls (interior and exterior) of the Premises in good appearance and repair (including all necessary replacement of any portion thereof), except for reasonable and normal wear and tear and subject to Lessor's obligations to repair the Premises in the event of a casualty as expressly set forth herein; and (b) make any repairs, alterations, additions or improvements to the Premises or any of its systems (e.g. plumbing, electrical, mechanical), which are required by any law, statute, ordinance, rule, regulation or governmental authority or insurance carrier.

4. Insurance

This is a mess. It is a hodge-podge of liability and property insurance.

- It requires $2,000,000 in liability insurance, but the lessor can increase this at any time. An increase to $25,000,000 could cost thousands of dollars.
- It requires insurance for all liability. This is a problem because commercial liability policies have multiple exclusions. One of these exclusions is that there is no coverage for damage to the building that has been leased by/from the lessor, yet this says the insurance has to cover "damage to property".
- It requires insurance for perils covered by a "standard extended coverage endorsement" and no such endorsement exists in the insurance world.

As additional rent, Lessee shall, during the continuance of this Lease, at its own cost and expense, maintain the following insurance policies: (a) commercial general liability and, if necessary, commercial umbrella insurance with a limit of not less than $2,000,000 for each occurrence (if such commercial general liability insurance contains a general aggregate limit, it shall apply separately to the Premises), or such other amounts as Lessor may from time to time reasonably require, against all liability for injury to or death of a person or persons or damage to property arising from the use and occupancy of the Premises; (b) business interruption insurance; and (c) insurance against fire, vandalism, malicious mischief, and such other perils as are from time to time included in a standard extended

coverage endorsement, insuring all merchandise, trade fixtures, furnishings, equipment and personal property such as signs, wall coverings, carpeting and drapes located on or within the Premises, in an amount equal to not less than 100% of the full replacement cost thereof. All insurance policies shall name both Lessee and Lessor as insured parties (and at the request of Lessor, shall name Lessor's mortgagee as an additional insured). Each damage policy insuring against loss or for damage to the Premises shall provide for payment of all losses directly to Lessor for the building and. to Lessee for Lessee's trade fixtures, furnishings, equipment, plate glass and personal property. Each liability policy shall provide that all losses be paid on behalf of Lessee and Lessor as their respective interests appear. Lessee and Lessor shall cause each insurance policy described in this Lease to be written in such a manner so as to provide that the insuring company waives all right of recovery by way of subrogation against the Lessee and/or Lessor in connection with any loss or damage covered by any such policies.

- It requires that the lessee insure trade fixtures, equipment, wall coverings, carpeting and drapes. Even if these were Landlord-owned items, since these would not constitute lessee-owned personal property or leasehold improvements paid for by the lessee, the lessee is not covered under its insurance unless it buys building insurance.
- Plate glass is a building item that can only be insured under a building policy.
- This says "each liability policy shall provide that all losses be paid on behalf of lessor and lessee". The drafter of this lease meant to apply this to a property policy. This language is not appropriate or available under a liability policy.
- This has a "waiver of subrogation" clause, which is fine, but it limits the waiver to the extent loss or damage is covered by insurance, leaving open the possibility of lawsuits where coverage is not provided.
- The language relating to a lessee's insurance being primary applies to both property and liability insurance. This is a lawsuit waiting to happen when both policies cover the same item.

Lessee's insurance shall provide primary coverage to Lessor when any policy issued to Lessor provides duplicate or similar coverage, and in such circumstance Lessor's policy will be excess over Lessee's policy. All such insurance policies shall be in form, and issued by companies, reasonably satisfactory to Lessor.

Lessor shall, during the entire term hereof, carry insurance for fire and special extended coverage (as determined by Lessor) insuring the improvements located within the Premises and all appurtenances thereto (except merchandise, trade fixtures, furnishings, equipment, plate glass and personal property, such as signs, wall coverings, carpeting and drapes), for the full insurable value thereof (with deductibles determined solely by Lessor). Such insurance carried by Lessor shall include loss of rents coverage. During the term of this Lease, Lessee shall pay to Lessor as additional rent the cost of the premiums for all such insurance carried by Lessor and the expenses incurred by Lessor relative to insurance appraisals, adjusters and reasonable insurance consultants' and attorneys' fees in connection therewith. Such additional rent owing for the insurance carried by Lessor shall be paid in monthly installments

- Although it looks like the lessor has to buy insurance on the building, it is only for fire (because as we said, there is no such thing as "extended coverage". There are many perils that could damage a leased building such as wind, hail, tornados, vehicle damage, collapse, bursting of pipes, vandalism, etc. If the lessor does not have coverage and the lessee does not buy building coverage, who is going to rebuild the building?
- This says "full insurable value". This is not defined anywhere. It is replacement cost or is it actual cash value? The lessee has to pay for this insurance on the building, but does not control the quality of the coverage or limits or the cost and derives no benefit whatsoever.

on the first day of each calendar month, in advance, in an amount estimated by Lessor.

Subsequent to the end of each calendar year, Lessor shall furnish Lessee with a statement of the actual cost of such insurance carried by Lessor. If the total amount paid by Lessee under this Paragraph 4 for any calendar year shall be less than the actual amount due from Lessee for such year as shown on such statement, Lessee shall pay to Lessor the difference between the amount paid by Lessee and the actual amount due, such deficiency to be paid within 10 days after the furnishing of each such statement, and if the total amount paid by Lessee hereunder for any such calendar year shall exceed such actual amount due from Lessee for such calendar year, such excess shall be credited against the next installment due from Lessee to Lessor under this Paragraph 4. For the calendar years in which this Lease commences and terminates, the provisions of this Paragraph 4 shall apply, and Lessee's liability for its proportionate share of such costs for such years shall be subject to a pro rata adjustment based on the number of days of the calendar year during which the term of this Lease is in effect. Lessee will not do or suffer to be done, or keep or suffer to be kept, anything in, upon or about the Premises which will contravene Lessor's policies insuring against loss or damage by fire or other hazards or which will prevent Lessor from procuring such policies in companies acceptable to Lessor.

Note the last four lines. Although this is a clause that relates to the reimbursement of insurance premiums, it adds this provision that makes the lessee liable if anything it does is in violation of the conditions of the lessor's policy.

6. Indemnity

Lessee assumes liability for and shall indemnify, protect, save and keep harmless Lessor, its assigns, agents, servants and beneficiaries from and against all losses, damages, penalties, claims, actions, suits, costs, expenses and disbursements, including reasonable attorneys' fees, of whatsoever kind and nature imposed upon, incurred by, or asserted against Lessor, or any other party so protected, in any way relating to or arising out of this Lease or of the use or possession of the Premises. Lessor assumes liability for and shall indemnify, protect, save and keep harmless Lessee, its assigns, agents, servants and beneficiaries from and against all losses, damages, penalties, claims, actions, suits, costs, expenses and disbursements, including reasonable attorneys' fees, of whatsoever kind and

- Although the intention of this language is to require that the lessee take care of third party lawsuits, it does not say this.

  It says the Tenant will pay for all losses in any way related to the premises.
- Granted it has a reciprocal provision, but it only applies to losses prior to the commencement date.

nature imposed upon, incurred by, or asserted against Lessee, or any other party so protected, in any way relating to use or possession of the Premises prior to the Commencement Date. The indemnities contained in this Paragraph shall continue in full force and effect notwithstanding the termination of this Lease.

9. Non-Liability

This is a one-way waiver of subrogation of sorts, saying the lessor has no liability unless it is grossly negligent. Where is the language that does the same thing for the lessee?

Except in the event of Lessor's gross negligence or willful misconduct, Lessor shall not be responsible or liable to Lessee for any loss or damage to Lessee or its property from any cause whatsoever, including, but not limited to, any loss or damage resulting from burst, stopped or leaking water, gas, sewer or steam pipes. No such occurrence shall be deemed to be an actual or constructive eviction from the Premises or result in an abatement of rent.

11. Return

This provision is a big one. It says that except for wear and tear and unless the lessor is obligated to repair the premises, the Tenant has to give back the building in the same condition as when leased. When we look at the other lease provisions that relate to the lessor's repair obligations, Paragraph 13 speaks to this.

At the end of the term of this Lease, Lessee shall return the Premises to Lessor in the same condition in which it was received by Lessee, ordinary wear and tear, excepted and subject to Lessor's obligations to repair the Premises in the event of a casualty as expressly set forth herein.

13. Fire

- The lessor has to elect to rebuild.
- If the lessor elects to rebuild, it does not have to spend more than it receives from its insurance company.
- Even if the lessor elects to rebuild, the lessee has to pay for certain building items owned by the Landlord, such as trade fixtures, equipment, plate glass, wall coverings, carpeting, etc. Typically, a lessee will not be covered for this without "building" insurance.
- If more than 50% of the premises is damaged, the lessor only can terminate the lease and keep all the insurance proceeds, depriving the lessee of a valuable location (if the last two years of the lease term, then lessee can also terminate the lease.

If the Premises are shall be partially or totally destroyed by fire or other casualty insured under the insurance carried by Lessor so as to become partially or totally untenantable, then the damage to the Premises shall be repaired by Lessor (unless Lessor shall elect not to rebuild as hereinafter provided) using the as-built plans and specifications for the Premises (as modified to give effect to any subsequent modifications to the Premises, any prior condemnation affecting the Premises and all applicable laws, rules, regulations and ordinances) in Lessor's possession, or, if no such as-built plans exist, using such plans and specifications as shall be developed by Lessee and approved by Lessor, so as to restore the Premises to the same operation, function and value as existed immediately prior to such fire or other casualty. From the date of the fire or casualty until the Premises are repaired by Landlord, the fixed rent due hereunder shall abate in the proportion that the part of

the Premises destroyed or rendered untenantable bears to the total Premises. Lessor shall not be required to expend more for repair or restoration of the Premises than the amount of insurance proceeds paid Lessor with respect to damage to the Premises, but not including any amounts received on account of lost rent. Except as expressly provided to the contrary this Lease shall not terminate as the result of a fire or other casualty. If Lessor repairs or rebuilds, Lessee, at Lessee's sole cost, shall repair or replace all merchandise, trade fixtures, furnishings, equipment, plate glass, signs and personal property (including but not limited to wall coverings, carpeting and drapes) in a manner and to at least a condition equal to that prior to the damage or destruction thereof. Notwithstanding the above, if the Premises shall be destroyed to the extent of more than one-half of the value thereof, Lessor may at its option terminate this Lease forthwith by a written notice to Lessee, in which event, any and all insurance proceeds received from insurance policies insuring against loss o for damage to the Premises shall be and remain the property of Lessor. If the Premises shall be destroyed by casualty loss during the final two years of the Lease or if the repairs to the Premises shall take more than one hundred eighty (180) days to complete, Lessee and Lessor shall each have the option to terminate this lease with written notice to the other party.

14. Care of the Premises

It looks like the intent here is to keep the premises neat and clean, but that's not what it says.

The plain language of this provision indicates that if the building is destroyed by fire or bursting of pipes as two examples because of the Tenant's negligence, the lessee has to pay for the building damage.

Lessee shall not perform any acts or carry on any practices which may injure the Premises.