

Friday, October 25, 2019
12:00 pm - 1:15 pm

Workshop 30

**Maintenance and Repair Obligations Under Commercial Leases –
Does Anyone Really Know What First-Class Condition Means?**

Presented to

2019 ICSC U.S. Shopping Center Law Conference
Marriot Marquis San Diego Marina
San Diego, California

By:

Frank J. Cerza, Esq.
Lewis Brisbois Bisgaard & Smith LLP
77 Water Street, Suite 2100
New York, New York 10005
frank.cerza@lewisbrisbois.com

Nickolas J. McGrath, Esq.
Polsinelli P.C.
1401 Lawrence Street, Suite 2300
Denver, CO 80202
NMcGrath@Polsinelli.com

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The following materials have been prepared in conjunction with the presentation by the speakers at this workshop.

I. Introduction

Every retail store lease contains provisions which allocate responsibility between the landlord and the tenant for the maintenance and repair of the store and the Shopping Center. At first glance, it sounds like this should be an easy exercise since the tenant should be responsible for everything inside of the store and the landlord should be responsible for everything outside of the store; but is that really accurate? What happens when building systems run through the middle of a store, such as chilled water pipes or electrical conduits, the tenant connects to those systems and there is a subsequent damage or loss to those systems, which is not the fault of the tenant. Whose responsibility is it to repair or replace those elements? Does the fact that the systems run through the store premises and that the tenant tied into those systems automatically mean that the tenant must maintain, repair or replace those systems at the tenant's cost?

This workshop will focus on analyzing the allocation of responsibility between the landlord and the tenant under commercial leases for maintenance and repair obligations, including distinguishing between structural and non-structural building components and repair, replacement and maintenance obligations. It will also explore the common use of the term "first-class condition" and what it means (or you think it means) and how to avoid legal entanglements through careful lease drafting.

II. Sample Lease Provision

ARTICLE X - REPAIRS AND ALTERATIONS

SECTION 10.1 Repairs.

Subject to the provisions of Articles ____ and ____ hereof, Landlord shall not be required to make any repairs or improvements of any kind upon or to the Demised Premises or to the Center, except for necessary repairs to the foundation and structural load bearing walls of the Demised Premises. Landlord agrees to make necessary repairs to the roof and the structural load bearing walls of the building of which the Demised Premises is a part, and the water and sewer lines servicing, on a non-exclusive basis, the Demised Premises that are located outside of the Demised Premises but within the Center and are not within the premises demised to any other tenant in the Center. Notwithstanding the foregoing, if the necessity for the making of any of such repairs shall have been occasioned by any act, omission or negligence of Tenant, or any subtenant, concessionaire or licensee of Tenant, or their respective employees, agents, invitees, contractors or subcontractors, Tenant shall be solely responsible for the cost of all such repairs, and at Landlord's election, shall promptly make such repairs.

Except for Landlord's obligations as expressly provided above in this Section 10.1, Tenant, at Tenant's sole cost and expense, **shall keep and maintain in first class appearance**, in a condition at least equal to that which is required when Tenant initially opens the Demised Premises for business, and in good order, condition and repair as determined by Landlord (including replacement of parts and equipment, if necessary) the Demised Premises and every part thereof and any and all appurtenances thereto wherever located. Without limiting the generality of the foregoing, Tenant, at its expense, shall maintain and promptly make any and all **necessary repairs to or replacements** of: (i) that portion of any pipes, lines, ducts, wires or conduits (whether contained within or outside the Demised Premises) which are installed by Tenant or that exclusively serve the Demised Premises; (ii) the glass windows, plate glass doors, and all fixtures or appurtenances composed of glass that are located in or about the Demised Premises; (iii) Tenant's signs; (iv) the floors and floor coverings, doors and door frames, windows and window frames, walls, storefront including security gates, grilles or enclosures, locks and closing devices, partitions and ceilings in the Demised Premises; (v) heating, ventilating, air conditioning, electrical and plumbing system(s) equipment and fixtures (whether contained within or outside the Demised Premises) which are installed by Tenant or which exclusively serve the

Demised Premises; and (vi) the Demised Premises or any part of the Center when repairs thereto are necessitated by any act or omission (negligent or otherwise) of Tenant or any of Tenant's agents, employees, contractors or invitees, or by the failure of Tenant to perform any of its obligations under this Lease. Notwithstanding any contrary provision of this Section 5.1, Tenant, at its expense, shall make any and all repairs to the Demised Premises as may be necessitated by any break-in, forcible entry or other trespass into or upon the Demised Premises, regardless of whether or not such entry and damage is caused by the negligence or fault of Landlord or Tenant or occurs during or after business hours. Tenant, at Tenant's sole cost and expense, shall promptly make all other repairs, replacements, renewals and restorations, interior and exterior, ordinary and extraordinary, foreseen and unforeseen, relating to the Demised Premises.

If Tenant fails to promptly make any repairs required hereunder, Landlord may make such repairs without obligation to do so and without liability to Tenant for any loss or damage that may accrue to Tenant's stock or business by reason thereof, and if Landlord makes such repairs, Tenant will pay to Landlord, on demand, the entire cost thereof, together with an administrative fee equal to twenty-five (25%) percent thereof. Landlord shall use reasonable efforts to do any required repair work with minimum inconvenience, annoyance, disturbance, interruption or loss of business to Tenant, as may be practicable under the circumstances consistent with accepted construction practice, but in no event shall Landlord be responsible or liable for any of the same or required to incur any additional expenses for work to be done during hours or days other than regular business hours and days. **Tenant shall keep the Demised Premises in a first class, like new and attractive condition throughout the Lease Term, consistent with the high standards of the Center.** All flooring must be replaced by Tenant and all parts of the interior of the Demised Premises (including display racks and other sales apparatus) and of the storefront and exterior doors and entrances shall be painted or otherwise refurbished by Tenant periodically as determined by Landlord, in accordance with plans and specifications first submitted to and approved by Landlord, in accordance with applicable provisions of this Lease. In addition to the requirements set forth in this Article X (and not in lieu thereof), all damage to Tenant's fixtures, leasehold improvements and other personal property in the Demised Premises must be repaired and/or refurbished by Tenant periodically as determined by Landlord, in accordance with plans and specifications first submitted to and approved by Landlord in accordance with applicable provisions of this Lease. Tenant agrees to provide regular maintenance and service (for example, without limitation, regular filter changes and fan replacement) to the heating and air conditioning and ventilating equipment in the Demised Premises and to keep in full force and effect a standard maintenance agreement on all heating and air conditioning equipment serving the Demised Premises. Tenant agrees to furnish a copy of such maintenance agreement to Landlord, upon request from time to time.

III. Repair Obligations in Retail Leases

a. Maintenance vs. Repair vs. Replacement Obligations

Leases contain various obligations that are to be performed by each party. Such responsibilities include, to varying degrees, maintenance, repair and replacement. Often times, however, these terms are not defined within the four corners of the lease. Unfortunately, a lack of clarity as to what these terms really mean, and whether they even differ, can lead to disputes between the landlord and the tenant. In order to avoid the potential consequences of vague drafting, it is worthwhile to consider how the courts have interpreted these commonly used, yet seldom defined, words.

i. Maintenance

The court in *Best Buy Stores, L.P. v. Shops at Pinnacle Park, LLC*, No. 05-17-01054-CV, 2018 WL 6716620, at *5 (Tex. App. Dallas December 21, 2018) noted that the lease did not define maintenance even though operating costs were to include costs to 'maintain' the common areas. The court then sought to give the term its "plain, common, or generally accepted meaning" as there was nothing in the lease document to indicate that the dictionary definition would be insufficient. The dictionary, however, contains multiple definitions for 'maintenance' and, naturally, the parties selected different definitions to present to the court. While the tenant argued that maintenance in the lease meant to "keep in an existing state (as of repair, efficiency, or validity)," the landlord argued that the term was also meant to encompass the obligation to "sustain against opposition or

danger.” *Id.* The landlord’s argument to include this definition of maintenance within the lease definition of maintenance was the landlord’s attempt to categorize security costs as a maintenance expense, thereby requiring the tenant to pay its proportionate share of such costs. The court found that each party had a reasonable basis for its interpretations of ‘maintenance’ in the lease, based on the dictionary definitions, which created a fact issue for the parties to address in the lower court. Even though the court ultimately punted the issue of what ‘maintenance’ is, the case serves as a reminder of the importance of specificity when drafting what obligations constitute ‘maintenance’ and further, that all terms (even in the dictionary) are open to interpretation and, in the context of a lease, may even be contradictory.

ii. Repair vs. Replacement

Similar to the court in *Best Buy*, the court in *Abbe Road Realty, LLC v. Kuehne & Nagel, Inc.*, No. 1:14 CV 2463, 2017 WL 10858881, at *8 (N.D. Ohio July 10, 2017) also consulted the dictionary to provide clarity on what an undefined lease term may mean. The court, citing the dictionary and other case law, stated that while repair is to “renew or restore an existing thing” or to “fix” it, the term replace means to “provide a substitute or successor for” the item as a whole (please note that while repair can include replacement, it only does so to the extent it is the “replacement of subsidiary parts”). *Id.* If changes are extensive, or “breathe new life” into the item, increasing longevity and transforming it, then such changes are considered far greater than repair; such changes are replacements. *Id.*

b. Landlord vs. Tenant - Who is Responsible?

How are maintenance obligations typically allocated to the landlord and the tenant? According to recent case law, the landlord’s obligation to repair must be expressly set forth in the lease and will not be implied. *Leeber Realty LLC v. Trustco Bank*, 316 F. Supp. 3d 594, (S.D.N.Y. 2018). As such, the more explicit a landlord’s obligation to repair provision is in the lease document, the more the landlord will be responsible for. In *Leeber*, the tenant attempted to argue that while the interior issues fell within its explicit repair obligation; those issues were caused by external defects, thereby shifting the responsibility to the landlord. The court, however, was not convinced as all of the remediation work would be performed within the interior of the premises and the tenant did not, with specificity, demonstrate the relationship between the external factors (landlord’s responsibility) and the interior issues (tenant’s responsibility). Though the tenant was unsuccessful, the case highlights that there is potential to shift responsibility if enough of a causal link is established.

c. Restoration Obligations at End of Lease

Depending on the specificity of a repair and maintenance provision, a court may look to it rather than a surrender clause when evaluating restoration obligations at the expiration of a lease. For example, in *Abbe Road Realty LLC*, the operating expenses provision required the tenant to maintain certain parts of the premises and went on to state that any failure to do so would survive lease termination. Towards the end of the term, the parties performed a walk through inspection and the landlord noted various items (that were the tenant’s responsibility under the lease) requiring repair, however, the tenant vacated the premises without undertaking any of those repairs. The tenant attempted to argue that it was not responsible for the post-lease repairs in light of the surrender clause, as those items constituted normal wear and tear. The court, however, ruled that the tenant was liable for the repairs under the maintenance and repair provision of the lease which did not exempt normal wear and tear. *Id.* at 12.

Even in cases where maintenance and repair or restoration provisions allow for ‘ordinary wear and tear,’ such exemption will not allow a tenant to neglect to make capital repairs or replacements. *Apple Glen Investors, L.P. v. Express Scripts, Inc.*, No. 8:14-cv-1527-T-33EAJ, 2016 WL 909322, at *12 (M.D. Fla. March 10, 2016). In fact, if systems or components are “approaching, have reached, or have exceeded their typical expected useful life,” such conditions have exceeded the standard of ordinary wear and tear. *Id.* at 13. In its determination of what constitutes ordinary wear and tear, a court may evaluate whether an improvement is still under warranty and what industry standard would consider ordinary wear and tear.

IV. Good Condition vs. First Class Condition

a. What is Good Condition?

We often see reference to “good condition” in retail leases. Courts may consider a variety of factors and sources when attempting to define good condition. In *Zundel v. Zundel*, 901 N.W.2d 731, (N.D. 2017), the court

relied on the landlord's testimony that they equated good condition and repair with "functional and operable." In light of such interpretation, the court found that given the evidence that tenant made repairs on an as-needed basis, thereby keeping the site in functional condition, tenant had met its obligation to keep the site in good condition and repair. *Id.* Another way to define good condition, without extreme particularity, is to require a tenant to keep its premises in as good condition as when tenant first occupied the space, which will at least provide tenant (and the courts) with a basis from which to start.

b. What is First Class Condition?

Does anyone really know what first class condition means? Is first class condition the same as good condition? Generally, first class condition is an extremely high standard. In *Apple Glen Investors, L.P.*, the lease required the tenant to maintain the premises in a first class condition, however, first class condition was never actually defined. Given that the lease was silent on the definition of first class, the court looked to the meaning first class had to experts and people in the field (HVAC technicians, mechanical engineers, general contractors, appraisers, architects, etc.). In support of its assertion that the premises was in first class condition prior to leasing, the landlord hired an architect to inspect and prepare a conditions reports of various systems and aspects of the premises, using a scale ranging from first class condition to unacceptable condition requiring extensive repair and replacement. In addition, the landlord hired experts to testify as to the condition of various aspects of the premises before and after the tenant's occupancy thereof. Experts specifically stated that certain aspects of the premises were in a "Class A condition" which, in their opinions, was synonymous with first class. *Id.* at 4, 10. Also relevant was how much the landlord had invested into the premises prior to leasing it and what features the premises boasted, as experts used this in their review of the before and after. For example, experts considered what the age and estimated value of various improvements at the commencement of the term were and how much would it cost to repair or replace such improvements at the term's expiration.

Royal St. Louis, Inc. v. United States, 578 F.2d 1017, (5th Cir. 1978) took an extreme approach in defining first class condition, finding the term to mean that the landlord will not suffer any economic loss. Though this is a very harsh interpretation of first class, this case is important to note as it highlights the extreme standard that a first class maintenance obligation in a lease may impose on a tenant.

In defining first class, it is also helpful to consider what it is not. One of the landlord's experts in the *Apple Glen Investors, L.P.* case relied on industry-standard published authorities to define a physical deficiency which encompasses items approaching or exceeding their typical life and specifically excludes items that may be remedied with routine maintenance. *Id.* at 12. The court found that a premises cannot be in first class condition if there is a physical deficiency. *Id.* at 12.

c. Tenant's Obligation to Maintain Premises in First Class Condition

As discussed above, the lease in *Apple Glen Investors, L.P.* required the tenant to maintain its premises in first class condition, but, did not define what that meant. While the exact definition was not explicitly set forth in the lease, the court evaluated the tenant's maintenance and repair during the term. The tenant's internal documents reflected that it decided to only perform necessary repairs and only replace equipment at the end of its life. *Id.* at 8. In addition, the tenant stopped performing regular, required maintenance which led to significant deterioration. The court stated that these internal documents evidenced the tenant's affirmative decision to "stop fulfilling its obligations under the lease" as this was not reflective of maintaining a premises in first class condition. *Id.* at 8. Clearly, then, if a tenant is only performing the bare minimum with respect to repairs and maintenance, it is not maintaining its premises in a first class condition.