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In re Suarez

February 2003

Sewell v. Loverde

Franklin Supreme Court (1969)

At issue in this appeal is the allocation of the costs, as between the landlord and the tenant, of connecting a trailer park facility to the public sewer system.

The Loverdes owned a parcel of real property on which they operated an automobile repair shop. In 1960, they leased the property to Sewell for five years. With the consent of the Loverdes, Sewell converted the property into a residential trailer park. The waste disposal system consisted of an on-site septic tank.

The relevant language of the lease stated:

> Maintenance, Repairs and Compliance With Law: Tenant agrees that he will occupy and dispose of the leasehold estate in a manner commensurate with the requirements and limitations of the basic lease and by the requirements of applicable federal, state, county, city, and district laws, ordinances, rules, and regulations pertaining to all uses to which the property may be subjected or put.

During the third year of the lease and while Sewell was using the property as a trailer park, county officials determined that the septic system to which all the trailer sites were connected was in danger of failing. Pursuant to an existing ordinance, the county ordered Sewell to connect to a nearby public sewer or to cease operations as a trailer park.

Sewell demanded that the Loverdes undertake and pay for the sewer connection. The Loverdes refused, asserting that, under the lease, it was Sewell's obligation to do so. After investigating the cost of complying with the order and finding it beyond his means, Sewell evicted all his tenants, closed the park, and abandoned the property. At the time, two years remained on the lease term.

The Loverdes brought this suit to recover back rent. The trial court and the court of appeal found that, under the terms of the lease, Sewell had the duty to comply with the county's order, that his abandonment of the property was unjustified, and that he was liable for the back rent. We granted this appeal.

Ordinarily, neither party to a commercial lease owes a duty to repair leased property in the absence of an agreement allocating that responsibility. However, when preventive or reparative actions are required by laws and orders governing the premises and their uses, public policy requires that someone at all times be obliged to comply with such laws and orders. Parties to a lease, who might not otherwise be under any obligation to repair, will not be allowed to create a hiatus in their respective duties of compliance with specific laws relating to the use of the property. Because the property owner is initially under a duty to comply with all laws and orders governing the use of the land, the owner, as landlord, remains subject to that duty unless

the tenant expressly assumes it or the tenant's changed use leads to the government's compliance order.

In this case, it was Sewell's use of the property as a trailer park that triggered the county's sewer connection order. He is deemed to have known at the time he entered into the lease that laws such as those regulating waste disposal would be of primary importance and would be implicated in the lease language by which he undertook to "occupy . . . the leasehold estate in a manner commensurate with the requirements . . . of applicable federal, state, county, city, and district laws, ordinances, rules, and regulations pertaining to . . . the uses to which the property may be subjected or put."

This lease language, coupled with the use to which he put the property, placed the compliance burden squarely on Sewell's shoulders. Accordingly, his abandonment of the property before the end of the lease term was unjustified, and he owes the back rent.

We affirm.

Brown v. Green
Franklin Supreme Court (1994)

In 1985, Ronald Brown, owner of a 45,000-square-foot building he had used for an automobile dealership, leased the building to Joseph Green, a partner in a retail furniture business. Green made modifications to the building to convert about half of it to a furniture showroom and used the remainder as a warehouse.

In late 1989, in the course of a routine inspection of the building, the county Department of Health Services (Department) found that debris containing asbestos had flaked off the ceiling in the store's showroom. Ambient air samples within the showroom indicated the presence of asbestos fibers at levels deemed harmful to humans. The Department served both Brown and Green with a notice that the asbestos contamination was hazardous and ordered that the hazard be abated.

The evidence at trial clearly established that, at the time of contracting, neither party had actual knowledge that the building contained asbestos and that there had been no discussions between them regarding the allocation of responsibility for abatement if asbestos were found in the building.

In May 1990, amid charges and countercharges by the parties to the lease over who was responsible for paying the cost of removing the asbestos, Green moved the showroom into what had been the warehouse, where no asbestos contamination had been detected, and sealed off the former showroom area. This permitted Green to continue operations with minimum disruption, albeit in a part of the building that was less convenient to the store's customers. However, Green ceased paying rent in May 1990.

Brown sued Green in November 1990 for breach of the lease agreement and obtained a judgment for accrued rent in the amount of $171,000, the cost of the environmental cleanup, estimated by trial experts at $252,000, and attorney's fees as provided in the lease agreement. The court of appeal affirmed the trial court's judgment, finding that this court's holding in *Sewell v. Loverde* (1969) regarding compliance with use-related governmental orders was dispositive. We also affirm, but we do not agree that *Sewell* is controlling in this case because this case, unlike *Sewell,* involves non-use-related governmental orders.

Our task in this case is to determine the intent of the parties regarding non-use-related obligations. First, we look to the four corners of the document. The lease document is a pre-printed, six-page "Standard Industrial Lease-Net" form published by the American Industrial Real Estate Association. The parties modified it by several strike-throughs and

interlineations.[1] Appended to the lease was a three-page, typewritten "Addendum to Standard Industrial Lease-Net."

The lease provided for a term of 15 years at a monthly rent of $28,500. The tenant agreed to pay for the property taxes and liability insurance. The landlord undertook to pay for casualty insurance on the building.

A provision entitled "Compliance with Law" provided that, "Tenant shall comply promptly with all applicable statutes, ordinances, rules, regulations, orders, and requirements regulating the use of the premises in effect during the term of the lease."

In addition, the "Maintenance, Repairs, and Alterations" section of the lease provided that, "Tenant shall keep the premises in good order, condition and repair, including structural and nonstructural conditions, whether or not the need for such repairs occurs as the result of tenant's use, any prior use, the elements, or the age of the premises."

The lease limited the landlord's obligations by providing that, "Except for the obligations of landlord specified [in a later section], in the event of the destruction of the premises, it is intended by the parties that landlord have no obligation in any manner whatsoever to repair and maintain the premises or the equipment or any part thereof."

The parties crossed off provisions stating that the landlord warranted compliance with applicable laws and the condition of the property when the tenant took possession. Finally, the lease contained provisions requiring the tenant to indemnify and hold the landlord harmless against any claim arising from the use of the property during the term of the lease.

As we have noted above, we do not agree that our holding in *Sewell* is dispositive in this case. In *Sewell,* it was the tenant's particular use of the property that led to the county's compliance order, and we found there that the tenant was deemed to have been on notice when he leased the property for use as a trailer park that waste disposal would be of primary importance and that an inadequate septic system would require him to hook into the municipal sewer line.

Here, quite to the contrary, there was nothing about Green's use of the property as a retail furniture store that triggered the Department's asbestos abatement order. Such an order would have been forthcoming no matter what the use of the property.

Because the literal terms of the "Compliance with Law" clause (which requires compliance with only laws "regulating the use . . . of the premises") do not apply to the present situation, that clause, standing alone, does not establish how the parties intended to allocate the risk of compliance with government orders mandating

[1] We point out that the language the parties deleted from the form lease by strike-throughs and cross-outs is as instructive as the language they added in determining the intent of the parties.

corrective action as to property conditions unrelated to a particular use by the tenant. In such circumstances, it becomes necessary to look at the lease as a whole and to other factors employed by courts to determine the intent of the parties.

In the lease as a whole, the tenant agreed to a duty of repair that, on its face, was global in scope. The extent of the lease language shifting the repair and maintenance obligation to the tenant strongly suggests that the parties intended to transfer to the tenant virtually all of the responsibilities of property ownership.

A net lease is an arrangement that is common in long-term commercial leases. The mere fact that a lease document is denominated with the word "net," however, does not conclusively make it a net lease. A net lease presumes that the landlord will receive a fixed rent, without reduction for repairs, taxes, insurance, or any other charges, and that the tenant will make all repairs, inside and out, structural and otherwise, as well as all necessary replacements of the improvements, and comply with all legal requirements affecting these improvements during the term of the lease. The economic exchange characteristic of a net lease has been described as one in which the landlord turns over to the tenant essentially full ownership of the building for the life of the lease.

Financial considerations implicit in the lease agreement persuade us that Brown negotiated a "net" lease. It is clear from the four corners of the agreement that the parties intended to transfer from the landlord to the tenant the major burdens of ownership of the real property over the life of the lease.

The fact that it is a "net" lease, however, is not dispositive of whether, in the absence of explicit language so declaring, the parties intended that the tenant should be responsible for non-use-related legal compliance such as the abatement order served on Green. To determine this, we look to six factors courts use in determining the allocation of repair and maintenance obligations in commercial leases.[2] These factors are especially germane to so-called "form" leases where the logic of the preprinted terms does not necessarily reflect the intent of the parties.

(1) The relationship of the cost of the curative action to the rent reserved in the lease. Over the 15-year lease term, the rent reserved in the Brown/Green lease amounts to $5,130,000 ($28,500/mo. x 12 mos. x 15 yrs.). Although in absolute terms, the $252,000 found by the trial court to be the cost of abatement is a substantial sum, in terms relative to the total rent over the life of the lease, it amounts to only 4.9%.

[2] Even had we found that the lease in this case was not a net lease, we would still consider these six factors as further evidence of the intent of the parties.

In cases where the term of the lease is relatively short and the cost of the repair in percentage terms is large in relation to the tenant's rent over the life of the lease, courts will almost universally refuse to give effect even to relatively clear language imposing the repair duty on the tenant. But where, as here, the percentage is small, courts will consider it a significant factor in allocating the risk to the tenant.

(2) The term of the lease. There is little doubt that a lease for a term of 15 years is a comparatively long-term lease. There is no need for us to declare that in all circumstances a lease of 15 years is a "long-term" lease, but in the context of this case involving the lease of an entire building and a transfer of substantial ownership obligations to the tenant, it is certainly long-term in relation to the typical three- to five-year, short-term lease.

With a short-term lease, it is highly unlikely that the tenant would have expected to take on ownership obligations for costly repairs. Conversely, with a long-term lease, the tenant has a longer period over which to amortize the costs.

(3) The amount of benefit the tenant will derive from the repairs as compared to the benefit the landlord/reversioner will derive. The record is silent as to the projected useful life of the building, so it is impossible to say to what extent removal of the asbestos will benefit the landlord after he regains possession. However, in view of the fact that the asbestos contamination was discovered in the third year of a 15-year lease, the clean-up would benefit the tenant for the remaining 12 years. Clearly, the benefit of the mandated clean-up would benefit both parties but the benefit to the tenant would be more substantial.

(4) Whether the required curative action is structural or nonstructural in nature. Ordinarily, the burden of making structural repairs falls on the landlord, and, absent lease language that shifts that burden, Brown would be required to make structural repairs. In this case, however, even though there is no language specifically assigning the non- use-related repairs to the tenant, there is ample language expressing the general intent that the tenant undertook to make structural repairs. That intent affects the interpretation of the entire lease so that the structural work required by the asbestos abatement order is the tenant's responsibility.

(5) The degree to which the tenant's enjoyment of the premises will be interfered with while the curative work is being performed. If the tenant's use of the premises is substantially interfered with by the required work, the case law supports an inference that the parties intended the landlord to bear the cost of the repairs. Here, although the factual record is scanty, it appears that the tenant was able to "work around" the flaking debris by moving the showroom to the unaffected area. On balance, it appears that the disruption was not so great as to compel a conclusion that the landlord should have borne the cost of the repairs.

(6) The likelihood that the parties contemplated the application of the particular law or order involved. Although neither party knew that the building was contaminated with asbestos, Green was an experienced tenant, and his experience should have told him that a building of this vintage posed an asbestos risk. An inspection would have disclosed it, and he could have negotiated an exception to his pervasive repair obligation.

Where a condition is unforeseeable, we would be loath to apply this factor against an unsuspecting tenant, but where it is foreseeable to an experienced tenant, this factor, although by no means dispositive, will weigh against the tenant.

An evaluation of the lease terms in light of these factors leads us to conclude that the parties intended that the tenant assume responsibility for removing the asbestos- laden material from the building.

We affirm.