

A man in a dark suit and glasses is running through a chaotic storm of white papers that are flying through the air against a blue sky with white clouds. The man is in the foreground, looking back over his shoulder with a distressed expression, holding a black briefcase. In the background, another smaller figure of a man is also running through the papers. The overall scene conveys a sense of panic and being overwhelmed by a large volume of documents.

# When **DISASTER** Strikes Your Tenancy

—REVISTED—

By Brian D. Womac

**W**e all remember Hurricane Ike and how that storm damaged so much property along the Texas coast and Houston area in the blink of an eye. Many of us were without power or basic services for weeks. Our homes and offices were made uninhabitable overnight. That particular storm tested many commercial lease provisions governing casualty. We can all tell a story about how a fire, flood, or hurricane damaged a building, but has it ever happened to you? I can assure you that if you are in business long enough, it will happen if it hasn't already.

That is how I opened this article in 2015. We didn't have to wait long before Hurricane Harvey and the flooding rains disrupted our lives again. Here is what was discussed previously. Very little has changed.

Commercial leases are the income source for landlords to pay their mortgages and generate their profits. Commercial leases are often the largest monthly debt being serviced by tenants. Without the tenant's income, landlords are at risk. Without habitable offices, tenants have no way to generate the income necessary to pay the rents and remain profitable. The commercial lease is the agreement that sets out the rights and obligations between the parties. Then why do most tenants fail to even consider negotiating the provision that could affect their tenancies? What happens if that lease space becomes uninhabitable overnight from a storm?

If a storm or other casualty damages a tenant's lease space, most lease forms that weren't changed by the tenant during lease negotiations only require the landlord to rebuild the tenant's lease space out to the condition the space was in when tendered to the tenant. If the tenant took a building shell, then the landlord would only have to rebuild the building shell. However, leases negotiated by some educated tenants require landlords to rebuild the building and any improvements that existed at the time of the loss. Under this situation, the landlord would be required to rebuild the building and leasehold improvements. This applies to all types of casualties if the casualty provision states this obligation and the proper insurance coverage is in place.

## Know Your Casualty Lease Provision

If you want to know who is responsible for rebuilding what after a casualty, you have to look at your casualty lease provision. Here is how it would work under storm damage. I worked on a job where the lease space and improvements were damaged by wind and rain under a standard casualty provision found in many leases today. The landlord's insurance covered the building shell and improvements. However, the insurance company denied the landlord's claim for coverage of loss for the tenant's improvements because the lease obligated the landlord to rebuild only the landlord's property (i.e., building shell and improvements belonging to landlord).

The subject lease stated the tenant's improvements did not become property of the landlord until the lease expired. The insurance company relied on certain lease language that did not impose specific obligation on the landlord for the tenant's improvements. In this case, both parties thought the tenant's improvements were covered by the landlord's insurance. However, the lease was deficient in language to obligate the landlord to rebuild the tenant's improvements. In this particular case, the tenant didn't carry insurance for the improvements. A properly-worded

casualty provision would have protected the landlord and tenant.

Each casualty lease provision should address who is responsible for constructing the building and tenant's lease space improvements. Your casualty provision should be read along with the insurance requirements for both the landlord and tenant. Keep in mind that every lease is different. If there is a casualty, both parties should have a way to be made whole within a reasonable period of time. It is not a bad idea to confirm with your insurance agent what is and is not covered. Both parties should be concerned if no insurance is in place to restore the building and lease space back to the condition before the casualty.

## Know Your Lease

Both landlords and tenants should take the time to know their casualty

provisions. The issue should come up during lease negotiations for a new lease or can be brought up at time of renewal. Most tenants simply bypass the casualty provision and leave form language in place. Most of the time, this is inadequate to protect the tenant.

Also, did you know that landlords usually have a unilateral right to terminate the lease should a casualty occur? Landlords have many reasons they may terminate a lease in the event of a casualty. Should tenants be granted the same right? Tenants have an interest in the restoration process and normally want to keep their space even after a casualty. Depending on the amount of loss, the restoration process may take months to get back to habitable status. A tenant's insurance may only cover certain equipment and limited business interruption loss. This doesn't

completely make the tenant whole if the tenant is waiting months to get back in the space.

### **Negotiate Your Lease**

Tenants should insist on more control of the situation when casualty occurs as well as how and when a lease can be terminated when there is a casualty. Landlords want to be able to take as much time as possible to rebuild the damage. Tenants want the landlord to make quick decisions on whether the building and space will be rebuilt. Tenants always lose, and landlords win when the lease doesn't obligate the landlord to commence repairs until insurance proceeds are available.

Another important issue is rent abatement. Rent abatements are not always guaranteed. You may find that your lease provision limits or fails to allow rent abatement even for a total loss. Landlords don't always grant rent abatements. Rent abatements can be tricky. Is it fair to have rent abatement if there is no damage to the lease space but the building is damaged? Landlords should be protective of not allowing rent abatement, especially when tenants carry sufficient insurance to protect from business interruption loss. Some provisions

## **A TENANT'S INSURANCE AND OBLIGATIONS FOR REBUILDING NORMALLY COVERS ONLY MOVABLE FIXTURES AND MOVABLE PARTITIONS, TELEPHONE AND OTHER EQUIPMENT, COMPUTER SYSTEMS, TRADE FIXTURES, AND OTHER FURNISHINGS.**

only allow for base rent abatement, not triple net charges, under certain circumstances. In all cases, both parties should examine the type and amount of insurance each party is required to carry.

Landlords like to pass loss onto tenants when casualty strikes. Properly shifting the burden to the tenant to carry the insurance is just the first step. Passing through the deductible and other expenses indirectly resulting from the casualty is

just one more example of passing a loss on to the tenants. Most commercial lease forms should set out who is responsible for the reconstruction after the loss. Landlords should be the responsible party for rebuilding the building and tenant improvements in most cases.

Landlords should want to take control over the rebuilding process, and most do. In the case of specially-fabricated tenant improvements, landlords should think twice about rebuilding and should put the burden on the tenant to do the build after the landlord has completed the requisite repairs. Most lease forms do not specifically address this issue. A tenant's insurance and obligations for rebuilding normally covers only movable fixtures and movable partitions, telephone and other equipment, computer systems, trade fixtures, and other furnishings.

Here are two examples of casualty provisions found in commercial leases in Texas. The first one is from a standard landlord form obligating the landlord to only rebuild the building and not the tenant's improvements. The second provision is from one that was negotiated by an educated tenant. The difference is obvious.

## FIRE AND CASUALTY DAMAGE

- a) If the Building should be damaged or destroyed by fire, tornado, or other casualty, Tenant shall give immediate written notice thereof to Landlord.
- b) If the Building should be totally destroyed by fire, tornado, or other casualty, or if they should be so damaged, thereby that rebuilding or repairs cannot, in Landlord's sole estimation, be completed within two hundred (200) days after the date upon which Landlord is notified by Tenant of such damage, this Lease shall terminate and the rent shall be abated during the unexpired portion of this Lease, effective upon the date of the occurrence of such damage.
- c) If the Building should be damaged by any peril covered by the insurance to be provided by Landlord under this Lease, but only to such extent that rebuilding or repairs can, in Landlord's sole estimation, be completed within two hundred (200) days after the date upon which Landlord is notified by Tenant of such damage, this Lease shall not terminate, and Landlord shall, at its sole costs and expense thereupon, proceed with reasonable diligence to rebuild and repair the Building to substantially the condition in which it existed prior to such damage, except that Landlord shall not be required to rebuild, repair, or replace any part of the partitions, fixtures, additions, and other improvements which may have been placed in, on, or about the Leased Premises. If the Leased Premises are untenable, the rent owed by Tenant shall not be abated but shall be reduced to such extent as may be fair and reasonable under all of the circumstances.
- d) Notwithstanding anything herein to the contrary, in the event the holder of any indebtedness secured by a mortgage or deed of trust covering the Leased Premises requires that the insurance proceeds be applied to such indebtedness, then Landlord shall have the right to terminate this Lease by delivering written notice of termination to Tenant within fifteen (15) days after such requirement is made by any such holder, whereupon all rights and obligations hereunder shall cease and terminate.

As you can see, these provisions grant the landlord and tenant different rights and obligations that matter. A properly negotiated casualty provision along with adequate insurance in place will make the next casualty easier to deal with. The time to determine your rights is not the day after the storm. Look over those provisions now and see if you have anything to negotiate to better protect your business. For your first floor and ground floor tenants, make sure there is adequate flood insurance.

Most leases don't require tenants to carry a separate flood policy. **N**

*WOMAC LAW, founded in 1987, is an aggressive, commercial-based law firm providing a broad range of legal services to companies and individuals on a state-wide basis. Brian D. Womac, a licensed attorney in Texas since 1985, is celebrating 32 years as an attorney who specializes in commercial landlord/tenant lease negotiations and litigation. The firm's client base consists of corporations, partnerships,*

## FIRE AND CASUALTY DAMAGE

- a) In the event of a fire or other casualty in the Leased Premises, Tenant shall immediately give notice thereof to Landlord. If the Leased Premises shall be partially destroyed by fire or other casualty so as to render the Leased Premises untenable in whole or in part, all rent, including additional rent, shall abate thereafter as to the portion of the Leased Premises rendered untenable until such time as the Leased Premises are made tenable as reasonably determined by Landlord and Tenant.
- b) In the event of a partial destruction, Landlord agrees to commence and prosecute such repair work to the Building and Leased Premises promptly and with all due diligence; provided, however, in the event such destruction (i) results in total or substantial damages to or destruction of the Building and/or Leased Premises and Landlord shall decide not to rebuild or (ii) results in the Leased Premises being untenable in whole or in substantial part and the reasonable estimation of a responsible contractor selected by Landlord as to the amount of time necessary to rebuild or restore such destruction to the Leased Premises and all other portions of the Building exceeds four (4) months from the time such work is commenced, then in either event, Landlord and/or Tenant shall have a right to terminate this Lease Agreement effective as of the date of casualty or destruction, and upon such termination, all rents owed up to the time of such destruction or termination shall be paid by Tenant. Landlord shall give Tenant written notice of its decisions, estimates, or elections under this Section within sixty (60) days after any such damage or destruction. If any portion of rent is abated under this Section, Landlord may elect to extend the expiration date of the Term of this Lease Agreement for the period of the abatement.
- c) Notwithstanding anything in this Lease Agreement to the contrary, if the Leased Premises are damaged by fire or other casualty resulting from the intentional act or gross negligence of Tenant, or the agents, employees, licensees, or invitees of Tenant, such damage shall be repaired by and at the expense of Tenant under the direction and supervision of Landlord, and rent shall continue without abatement.

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