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DESTRUCTION, CASUALTY AND MAJOR FORCES
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In ancient times under the common law, property was transferred from a landowner to a tenant by a device known as a conveyance for a term of years. It was, as the title suggests, a full and complete transfer of all the rights and responsibilities of property ownership from the person who held fee title to the person who would be in possession for the stated number of years. There was no division of responsibility during the term of the conveyance, and the tenant paid all of the expenses associated with the property, had all of the responsibility of maintaining and repairing any improvements upon the property, and the only involvement of the landowner was to receive rent during the term of the conveyance.

While a modern lease is technically a conveyance for a term of years, it has evolved into a creature of contract whereby the respective rights and obligations of the landlord and tenant are meticulously set forth. The division of responsibilities is often dictated by the economic conditions in effect at the time the lease is executed. The extent to which the tenant is burdened with more of the incidents of ownership of the property depends also on whether the tenant is leasing an entire building or simply sharing space with other co-tenants in a larger structure owned and operated by the landlord.

I. FIRE, STORM, OR SHIPWRECK:

Among the risks and obligations of the tenant is the risk of damage or destruction to the premises as a result of a casualty. The term casualty may be defined in the lease with specificity or generally. The Internal Revenue Code, in Section 165, describes a casualty for purposes of allowing a tax deduction as a fire, storm, or shipwreck. An example of a clause:

> DESTRUCTION OF PREMISES a) In the event the entire Premises or materially all of the Premises are destroyed by fire, storm or other casualty, Landlord shall have the option of terminating this Lease or of rebuilding the Premises. Landlord shall give written notice of such election to the Tenant within sixty (60) days after the date of such casualty, unless the nature of the casualty is one of wide spread geographic proportion (such as a hurricane) in which event Landlord shall have up to one hundred eighty (180) days in which to make the election. In the event Landlord elects to rebuild the Premises, the Premises shall be restored to its former condition, exclusive of Tenant Improvements which were constructed by the Tenant, within a reasonable time, not to exceed one year from the date of landlord's election, during which time the rent due from Tenant to Landlord hereunder shall abate. The reasonableness of the time for restoration shall be determined with reference to the extent of the damage. In the event Landlord elects to terminate this Lease, rent shall be paid only to the date of such casualty, and the term of this Lease shall expire as of the date of such casualty and shall be of no further force and effect and Landlord shall be entitled to sole possession of the Premises.
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> b) The term "materially all of the Premises" shall be deemed to mean such portion of the Premises, as when so destroyed, would leave remaining a balance of the Premises which, due to the amount of area destroyed or the location of the part so destroyed in relation to the part left undamaged, would not allow the Tenant to continue its business operations. In the event fifty percent (50%) or more of the Property is destroyed, notwithstanding the condition of the Premises, then such destruction of fifty percent (50%) or more of the Property shall be deemed for purposes of this Lease to constitute "materially all of the Premises."

While different types of casualties affect different geographical areas, the events of the past year call attention to the hurricane as an excellent example of the type of casualty that can adversely affect a tenant. Whether a roof leaks, windows blow in, or a storm completely removes the roof exposing the

premises to the elements, any of these situations can make a part of the premises, or materially all of the premises, untenantable and unusable by the tenant for the operation of its business. Even those two concepts may have differing standards. “Untenantable” may be a stronger standard which means that the premises are not suitable for occupancy by anyone. “Unsuitable for the operation of tenant's business” is a more subjective standard that may be used to define the situation where the premises, while they can be legally or practically occupied, cannot be used to invite customers, sell merchandise, manufacture goods, or otherwise be used for the primary purpose that the tenant leased them for, the operation of its business. As an example, in October of 2005, Hurricane Wilma roared through South Florida. While only one lawyer's office in our law firm was actually destroyed when the windows blew out, for two weeks the building was without electricity. While we technically and legally could have occupied the offices, without power to run computers, phones, copiers and similar modern devices, not to mention air conditioning in a place where the temperature and the humidity were both over 80, the premises were not rendered untenantable, but they were not usable for the operation of our business.

II. **THE ECONOMIC BURDEN:**

The next issue becomes the economics of who bears the burden of the premises becoming unusable. In the conveyance for a term of years, the risk of damage to the property belong to the tenant. In modern leasing, a typical tenant will demand that if the premises are unusable, rent abates. In some situations, the landlord will refuse this request and, depending upon the economics at the time the lease is executed, may place the burden upon the tenant to bear the risk of untenantability and recite that even if the premises are unusable as a result of fire, storm, or shipwreck, that the tenant shall continue to pay rent. After all, the landlord will not be excused from its mortgage by reason of the fact that the tenant cannot occupy its premises. As with every other risk associated with casualty, there is insurance available to both the landlord and the tenant to cover the situation of a loss of revenue stream.

For the landlord, the coverage is loss of rent insurance. It covers the situation where the tenant is unable to pay rent because of a casualty. For the tenant, it is business interruption insurance, which covers the loss of revenue to the tenant because of its inability to operate its business. If the landlord maintains loss of rent insurance, assuming that the lease is properly worded, the cost of this insurance, along with all other insurance associated with the property, will be passed through to the tenants as common expenses.

> Common Expenses are defined as the sum of Real Estate Taxes, Landlord's Insurance, and Common Area Maintenance. Tenant shall pay, as additional rent, Tenant's Pro Rata Share of Common Expenses. Tenant's Pro Rata Share shall be defined as a fraction, the numerator of which shall be the rentable square feet of the Premises, and the denominator of which shall be the total rentable square feet in the Property.
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> a) Real Estate Taxes shall be defined as all regular and special taxes assessed against the Property.
>
> b) Landlord's Insurance shall be defined as the cost of all types of insurance carried by the Landlord with respect to the Property.

Therefore, as a practical matter, it does not matter whether the landlord or tenant maintains the insurance since it is likely that the tenant or tenants will pay for it anyway. The advantage to abating the rent in the event of a casualty and having the landlord maintain the loss of rents insurance, even at the tenant's expense, is a matter of simplicity in handling the insurance claim. The amount of rent is a finite and easily determined amount since it is stated in the lease and reflected in monthly rent billings. For the landlord to make an insurance claim for loss of rents is a fairly simply computation. Conversely, for the tenant to make a claim for lost revenues, the tenant must prove to the insurance company the amount of revenues and expenses which would have been received but for the casualty, which requires the tenant to go through its historical records and prove to the satisfaction of the insurance company the potential revenue loss which it seeks to recover. Therefore, simply out of ease of processing the claim, the landlord's loss of rents insurance is a simpler way to handle the problem.

There is another economic burden looming on the horizon which must be anticipated in drafting leases. The cost of insurance premiums in regions recently affected by majors disasters has skyrocketed. A small shopping center owner in South Florida faced an increase from $11,000 to $100,000 if the center were sold, but only an increase to $25,000 if the policy was renewed. Further, a condition to this renewal was an increase of the deductible to $100,000.

These drastic financial shifts affect the Landlord and Tenant and must be considered in revising the expense pass through language. Does the tenant have a right to demand that it be protected from the landlord's risk of monumental insurance costs? Most leases which limit increases in Common Expenses do not limit non-controllable costs such as taxes, utilities and insurance. The answer, as with many other economic decisions in negotiating a lease, depends upon the market conditions and respective strengths of the parties at the time the lease is negotiated.

The same considerations apply to the deductible. A well drafted Common Expense provision will include the cost of repairs not covered by the Landlord's insurance in the event of a casualty.

> Notwithstanding anything herein, except as contemplated by Article XX neither Common Area costs nor common mall area costs shall include: the cost of capital improvements…….; the cost of painting, redecorating or other work or services which Landlord performs for any particular tenant or prospective tenant….. **the cost of repairs or other work necessitated by fire or other casualty or condemnation (but Common Area costs shall include insurance deductible amounts);** ……the cost of any items for which Landlord is reimbursed by insurance…...

This clause is actually a carve-out of the exclusions from Common Costs, but it makes the point. If the Landlord can do it, it will pass the deductible along to the tenants.

III. **USE OF INSURANCE PROCEEDS:**

The hurricane is over. The skies are clear. The power is back on and people are cleaning up. Little by little, businesses are reopening and people are getting back to work. After much effort, the insurance adjuster approves the landlord's claim to repair the premises and issues a check. Much to the surprise of the property owner, the check is payable to the property owner and to the mortgagee. What happens to the money?

Most commercial mortgages provide something like:

> **Mortgagors shall give Mortgagee immediate notice at its principal office of any loss or damage to the premises caused by any casualty. In the event of loss under any policy required to be deposited with the Mortgagee, the proceeds thereof shall be paid by the insurer to the Mortgagee, who shall have the right to settle or compromise claims under all such policies and to demand, receive and receipt for all monies becoming payable thereunder. Mortgagee, in its sole discretion, shall apply the proceeds of such policy paid by the insurer to the Mortgagee, wholly or partially after deducting all costs of collection, including reasonable attorneys' fees, either as a payment on account of such part of the indebtedness secured hereby as Mortgagee may elect, without affecting the amount or time for payment of other installments required hereunder, whether or not then due or payable, or toward the alteration, reconstruction, repair or restoration of the premises, either to the portion thereof damaged by such loss thereon or any portion thereof.**

Without getting into the details of the rights of a landlord to cancel the lease at its election rather than rebuild premises that are materially destroyed, (see the earlier example clause) it is an important consideration that the landlord protect itself against the possibility that it will be obligated under the lease to rebuild while its lender maintains the right to take the insurance proceeds and apply it as a principal reduction to the landlord's mortgage. To protect landlord it should provide in the lease,

> Notwithstanding any provision of this Lease to the contrary, in the event the holder of any indebtedness secured by a mortgage or deed of trust covering the Property or the Premises requires that 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 Landlord's lender, whereupon this Lease and all of the rights and obligations arising out of this Lease shall terminate.

Add to this confusion a side issue: In a volatile interest rate environment, many mortgages prohibit prepayment or impose a prepayment penalty. The landlord should be careful to carve out from the prepayment penalty the application of insurance proceeds which, at the election of the lender, are retained by the lender. More importantly, and an issue less considered, is the situation where there is a material destruction of a portion (such as one of several free standing buildings) of a project. The lender takes and applies the insurance proceeds and the remainder of the mortgage is locked out of prepayment or subject to a large prepayment penalty or yield maintenance. This would leave the property owner with a partially destroyed property, no money to rebuild the space for its tenants, and no ability to refinance the project in order to obtain construction funds to complete the repairs or rebuild. One might ask whether this is outside the scope of what a tenant can require, but if the tenant is taking a substantial portion of the landlord's property, then perhaps such an requirement would be appropriate.

IV. *FORCE MAJEURE*:

A hurricane is certainly a major force. What, conversely, constitutes a *force majeure*? This is the legally described provision found in many contracts and most leases that excuses the performance of one party, as a result of something outside the control of the parties. But what qualifies as an event outside the control of the parties that should excuse performance? The typical clauses deal with natural disasters and catastrophes, strikes, public insurrection, war, or similar types of things. However, since the lease is a creature of contract, it is possible for the parties to agree upon other factors that could excuse the performance of the parties under the broad definition of *force majeure*. The following clause was used successfully in the lease by an operator of hotel condominium units pursuant to an agreement where the operator was to pay a fixed rental to the unit owner regardless of whether the unit was occupied. The tourist industry slumped in the aftermath of the World Trade Center disaster. (The business deal may not have been the greatest, but take a look at this provision.)

> **Force Majeure.** The provisions of this Section shall be applicable if there shall occur, during the lease term, or prior to the commencement thereof, any (i) strike, lockout or labor disputes; (ii) inability to obtain labor or materials or reasonable substitutes therefor or (iii) acts of God, governmental restrictions, regulations or controls, enemy or hostile governmental action, terrorist act, substantial economic downturn constituting a "depression" as defined by applicable governmental standards, continuing economic downturn constituting a "recession" as defined by applicable governmental standards which continues for three or more months, substantial industry wide (i.e., tourism and/or hotel industry) economic downturn affecting South Florida which continues for three or more months, civil commotion, fire or other casualty or other conditions similar or dissimilar to those enumerated in this item, which is or are beyond the reasonable control of the party obligated to perform. If Unit Owner or Operator shall, as a result of any of the above described events, fail punctually to perform any obligation on its part to be performed under this Lease, including, but not limited to, the payment of rent, then such failure shall be excused and not be a breach of this Lease by the party in question, but only to the extent occasioned by such event. If any right or

> option of any party to take any action under or with respect to this Lease is conditioned upon the same being exercised within any prescribed period of time or at or before a named date, then such prescribed period of time and such named date shall be deemed to be extended or delayed, as the case may be, for a period equal to the period of the delay occasioned by any above described event. Notwithstanding the foregoing, in the event that Operator is unable to pay rent as a result of the provisions of this section for more than three months, Unit Owner shall have the right to cancel this Lease.

If the parties agree, *force majeure* can include almost anything you can get away with. This is just another example of the evolution of the conveyance for a term of years into a pure creature of contract.