TEXAS ANNOTATED OFFICE LEASE

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State Bar of Texas
28TH ANNUAL
ADVANCED REAL ESTATE DRAFTING
March 23-24, 2017
Houston

CHAPTER 11

I would like to acknowledge the assistance of Leslie McCombs Roussev in the editing and updating of this paper.

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	BACKGROUND, EDUCATION, AND PRACTICE	

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- Representation of private equity group in connection with its restructure of regional retailer's real estate holdings in anticipation of private equity transaction
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- Representation of developers in connection with entity formation and company agreements; negotiation and drafting of loan documents; covenants, restrictions, and easements for retail and mixed use developments; management agreements; utility contracts
- Representation of developers and owners in lease negotiations with national big box tenants, regional retailers, high end luxury retailers, and local retailers
- Representation of owner of specialty "to the trade only" center for interior design professionals
- Representation of international hardware wholesaler in negotiation of numerous warehouse and other leases throughout North America
- Representation of several restaurant chains in site acquisition and site leasing transactions
- Representation of office landlords in negotiation of office leases, including lease of over 250,000 square foot space to international tire manufacturer for its United States headquarters
- Representation of buyers, sellers, and lenders in real estate sales, purchase, and financing transactions
- Representation of servicers for conduit lenders in connection with collection, foreclosure, and restructuring of troubled loans
- Representation of borrowers in negotiations, foreclosure and receivership proceedings, and other litigation with servicers and special servicers in connection with lenders' defaults of post-closing funding and other obligations, borrowers' exercise of loan renewal options, and documentation of forbearance and discounted pay off agreements
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- Planning Committee Member, UNIVERSITY OF TEXAS LAW SCHOOL: BERNARD O. DOW LEASING INSTITUTE (2008, 2011, 2012)
- Co-Chair, CLE INTERNATIONAL: NEGOTIATING LEASES (2001-2002)
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- Author and Speaker, *Negotiating and Drafting Repair, Surrender, and Casualty Clauses in Commercial Leases*, UNIVERSITY OF TEXAS LAW SCHOOL: BERNARD O. DOW LEASING INSTITUTE (2012); STATE BAR OF TEXAS: 17th ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (2006)
- Co-Author with Jane Snoddy Smith, *Pigs Get Fed and Hogs Get Slaughtered – Lessons from the Financial Crisis*, American College of Real Estate Lawyers (2010); *Overreaching by Borrowers and Lenders*, ALI-ABA (2011)
- Author and Speaker, *Subleasing*, UNIVERSITY OF TEXAS LAW SCHOOL: BERNARD O. DOW LEASING INSTITUTE (2009)
- Author and Speaker, *Defaults and Remedies from Landlord and Tenant Perspectives*, CLE INTERNATIONAL: NATIONAL NEGOTIATING LEASES CONFERENCE (2008)
- Author and Speaker, *Texas Gross Margins Tax: What's in a Name?*, UNIVERSITY OF TEXAS LAW SCHOOL: 41st ANNUAL WILLIAM W. GIBSON, JR. MORTGAGE LENDING INSTITUTE (2007)
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- Author and Speaker, *Real Estate Remedies,* UNIVERSITY OF HOUSTON LAW FOUNDATION: REAL ESTATE DOCUMENTS, WORKOUTS, AND CLOSINGS (2003)
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- Author and Speaker, *Office Leases: Operating Costs and Related Expense Allocations,* CLE INTERNATIONAL: NEGOTIATING LEASES (1999)
- Co-author, *Determination of Usury in Commercial Transactions,* DALLAS BAR ASSOCIATION (1993)
- Co-author, *Discovery of Commercial Documents*, SOUTH TEXAS COLLEGE OF LAW: ADVANCED LITIGATION COURSE (1991)
- Contributor, *Legal and Ethical Aspects of Tenant Representation and Agency Issues*, SOCIETY OF INDUSTRIAL OFFICE REALTORS (1989)

Education

- University of Dallas (BA., *magna cum laude,* 1982)
- Southern Methodist University (J.D., 1987)
- Citations Editor, *Journal of Air Law & Commerce*
- Member, Wagner Labor Law Moot Court Team
- Blackwell & Patterson Legal Writing Award
- American Jurisprudence Awards in Constitutional Law II and Professional Responsibility

TABLE OF CONTENTS

1. DEFINITIONS. 2
   (a) *Additional Rent* 2
   (b) *Base Rent* 6
   (c) *Base Year* 6
   (d) *Base Year Operating Costs* 6
   (e) *Building*. 7
   (f) *Building Standard*. 8
   (g) *Commencement Date* and *Scheduled Commencement Date* 9
   (h) *Common Areas* 10
   (i) *Effective Date* 11
   (j) *Electricity Costs* 12
   (k) *Excess Operating Costs* 13
   (l) *Expiration Date*. 15
   (m) *Guarantor*. 15
   (n) *Land* 15
   (o) *Landlord Work* 16
   (p) *Landlord Parties* 16
   (q) *Operating Costs* 17
   Operating Costs ***exclude***:
   (i) Electricity Costs 20
   (ii) Real Estate Taxes 20
   (iii) Margin Tax Costs 21
   (iv) leasing, advertising, and promotional costs 21
   (v) any rental and any associated costs 21
   (vi) relocation or takeover expenses 21
   (vii) real estate brokerage commissions 21
   (viii) attorneys' fees 21
   (ix) any costs incurred renovating space for other occupants 21
   (x) costs incurred to provide non-Building Standard services 21
   (xi) costs incurred to furnish goods for which Tenant would be requred toreimburse Landlord 21
   (xii) costs incurred for which (i) Landlord [actually receives] is entitled to reimbursement above Base Rent 21
   (xiii) costs incurred for Landlord's general corporate overhead 22
   (xiv) costs incurred for executive compensation....................22
   (xv) costs incurred for political, charitable, or similar organizations 22
   (xvi) costs associated with operating the entity constituting Landlord....................22
   (xvii) costs incurred for Landlord's leasing agents 22
   (xviii) costs of any art work....................22
   (xix) all compensation paid to clerks managing commercial concessions 22

(xx) costs associated with operating any parking structure 22
(xxi) costs of i any specialty service or amendity 23
(xxii) costs incurred as a result of any Landlord Party's breach of any contractual, statutory, tort, or other legal duty 23
(xxiii) costs, penalties, and fines incurred by Landlord 23
(xxiv) penalties and interest on late payments 23
(xxv) payments to affiliates of Landlord that exceed market charges 23
(xxvi) contributions to reserves 23
(xxvii) legal, auditing, consulting and professional fees 23
(xxviii) payments of principal, interest, defeasance charges 24
(xxix) depreciation and amortization of capital improvements or additions 24
(xxx) costs incurred to remediate Hazardous Substances 24
(xxxi) costs to correct or repair design or construction defects 24
(xxxii) costs of LEED certification and other Green initiatives. 24
(xxxiii) capital expenses. 24
Landlord and Tenant also agree that Operating Costs will be "net" only 24
(r) *Parking Fees*. 25
(s) *Permitted Use* 25
(t) *Premises*. 25
(u) *Project* 26
(v) *Real Estate Taxes* 26
Real Estate Taxes ***exclude***:
(i) federal and state taxes on income 27
(ii) penalties, late fees, ... 27
(iii) any special or benefit assessment 27
(iv) any tax on the financing or transfer 27
(v) *ad valorem* and other taxes on any tenant's personal property 27
(vi) *Texas Margin Tax* 27
(w) *Rent* 28
(x) *Rentable Area* 28
(y) *Rules and Regulations* 28
(z) *Security Deposit* i. 28
(aa) *Service Areas*. 28
(bb) *Tenant Parties*. 29
(cc) *Tenant's Pro Rata Share*. 29
(dd) *Term* 29
(ee) *Trade Fixtures* 29
2. LEASE GRANT 30
3. RENT 31
(a) Payment and Proration Base Rent and Additional Rent. 32
(i) Electronic Payments. 32
(ii) Other Payments. 32

(iii) Change of Payment Address. 32
(b) Excess Operating Costs; Tax Costs; Electricity Costs. 32
(c) Apportionment of Operating Costs; Adjustments. 32
(d) Audit Rights. 33
(e) Late Payment. 34
4. **SECURITY DEPOSIT**. 34
(a) Landlor's Use of Security Deposit. 34
(b) Return of Security Deposit. 36
(c) Standby Letter of Credit *in lieu of* Security Deposit. 36
5. **USE**.. 38
(a) Prohibited Uses. 39
(b) Floor Loads. 39
(c) Compatible Use. 39
(d) Parking. 39
6. **ENTRY BY LANDLORD**. 40
7. **BASIC SERVICES**. 40
(a) hot and cold water 41
(b) heat or air conditioning (HVAC). 41
(c) routine maintenance of electric lighting 41
(d) janitorial service. 41
(e) exterior window washing 41
(f) nonexclusive passenger elevator service. 41
(g) nonexclusive freight elevator service. 41
(h) light and fluorescent bulb replacements 41
(i) access control devices 41
8. **ELECTRICAL SERVICES**. 42
9. **SERVICE TERMS**. 43
10. **GRAPHICS**. 44
11. **IMPROVEMENTS BY LANDLORD**. 44
12. **MAINTENANCE AND REPAIR BY LANDLORD** 44
13. **MAINTENANCE, REPAIRS, AND ALTERATIONS BY TENANT**. 47
14. **MECHANIC'S LIENS** 49
15. **ASSIGNMENT AND SUBLETTING**. 49
16. **TENANT'S INSURANCE** 54
(a) General Liability Insurance. 55
(b) Workers' Compensation and Employer Liability Coverage.. 58
(c) Property Insurance. 59
(d) Business Income and Extra Expense Coverage. 60
(e) Policy Forms and Additional Requirements 60
(f) Evidence of Property Insurance. 61
17. **LANDLORD'S INSURANCE**.. 61
18. **INDEMNITIES AND WAIVERS**. 63

(a) **Definitions**. 64
(i) Beneficiary 64
(ii) Claims 64
(iii) Defend 64
(iv) Indemnify. 64
(v) Injury 64
(vi) Waive 65
(b) Tenant's Performance Indemnities. 65
(c) Tenant's Indemnities for its Insurable Injuries. 65
(d) Landlord's Indemnities. 65
(e) Waivers. 65
19. LIMITATIONS OF LANDLORD'S LIABILITY. 67
20. CASUALTY DAMAGE. 67
21. CONDEMNATION 69
22. SUBORDINATION 70
23. ESTOPPEL CERTIFICATES. 71
24. DEFAULT. 72
(a) Tenant fails to pay where and when due any Base Rent, or any component of Additional Rent. 72
(b) Tenant does not vacate the Premises 73
(c) Tenant or any Guarantor becomes insolvent 73
(d) Tenant or any Guarantor: commits an act of bankruptcy 73
(e) A receiver or trustee is appointed 74
(f) Tenant's leasehold estate is taken in execution. 74
(g) The liquidation, termination, dissolution, forfeiture of Tenant's right to do business. 74
(h) Tenant fails or refuses to deliver any instrument required 74
(i) Tenant fails to comply with any other term of this Lease 74
(j) Tenant fails to take possession of and occupy the Premises. 74
(k) Tenant abandons, deserts, or vacates a substantial portion of the Premises. 76
25. REMEDIES. 77
(a) Terminate this Lease 78
(b) Terminate Tenant's right to occupy all or any part of the Premises. 79
(c) Recover unpaid Rent and any Damages 79
(d) Change or pick the locks. 79
(e) Remove and store (at Tenant's sole cost) any property on the Premises. 80
(f) Sue for eviction 81
(g) Apply the Security Deposit 81
(h) Cure Tenant's Default 81
(i) Withhold or suspend any payment to Tenant 81
(j) Withhold or suspend any service 81
(k) Charge interest at the **Default Rate** 81

(l) Recover **Liquidated Rental Damages** ... 82
(m) Exercise all other remedies available to Landlord ... 82
26. MITIGATION. ... 84
27. EXPIRATION, TERMINATION, SURRENDER, AND HOLD OVER. ... 85
28. TENANT REMEDIES. ... 87
29. QUIET ENJOYMENT ... 87
30. RESERVATIONS BY LANDLORD. ... 89
31. TRANSFERS BY LANDLORD. ... 89
32. TAXES ON TENANT'S PROPERTY.. ... 89
33. SUBSTITUTION OF SPACE. ... 90
(a) Relocation Space Requirements. ... 90
(b) Relocation Concessions. ... 90
(c) Effects of Relocation.. ... 90
34. TENANT'S AUTHORITY.. ... 90
35. BUILDING RULES AND REGULATIONS. ... 91
36. COMPLIANCE WITH APPLICABLE LAWS. ... 91
(a) *Hazardous Materials*. ... 91
(b) *Contamination* ... 91
(c) Tenant will not bring , any Hazardous Material on the Project. ... 92
(d) Tenant will Indemnify Landlord from Contamination caused in whole or in part by any Tenant Party's act or omission ... 92
(e) Landlord may inspect the Premises to ... monitor compliance with Applicable Laws. ... 92
(f) Landlord has no knowledge, of any Hazardous Materials on the Project ... 92
37. AMERICANS WITH DISABILITIES ACT AND TEXAS ARCHITECTURAL BARRIERS ACT. ... 93
38. TELECOMMUNICATIONS. ... 94
39. LANDLORD'S LIEN. ... 96
40. NOTICES. ... 97
41. MISCELLANEOUS. ... 98
(a) Entire Agreement; Amendments. ... 98
(b) Attorneys' Fees. ... 99
(c) Commissions. ... 99
(d) Construction. ... 100
(e) *Force Majeure*. ... 101
(f) Joint And Several Liability.. ... 101
(g) No Merger. ... 102
(h) Nondisclosure. ... 102
(i) Recording. ... 102
(j) Disclaimer of Representations and Warranties.. ... 102
(k) Severability. ... 103
(l) Successors. ... 103
(m) Waivers.. ... 104

(i) Tax Appraisals & Protests.. 107
(ii) Notices . 107
(iii) DTPA. . 108
(iv) Jury Trial. 109
42. EXHIBITS AND RIDERS. 110

APPENDICES

Appendix I **Pass Through Provisions**
- App. I-A 8. Additional Rent
- App. I-B 9. Operating Expense Definition
- App. I-C 10. Taxes; Rent Taxes
- App. I-D 11. Management Fee Calculation

Appendix II **Repair, Maintenance, Surrender & Casualty**
- App. II-A As Is Waiver (*aka* Italian Cowboy Rider)r
- App. II-B Repair & Maintenance Clause

Appendix III **Monetary Damages & Mitigation**

Appendix IV **List of 2013 ISO CGL Form Revisions**

Appendix V **Short Form Subordination of Landlord's Lien**

OFFICE LEASE

This Office Lease (*Lease*)[1] between **OVERLORD LEASING SYNDICATE**, a Delaware limited partnership (*Landlord*), and **SERF PROTECTIVE SERVICES**, a Texas corporation (*Tenant*), will become binding as a contract between the parties as of the date the conditions precedent set forth in paragraph 1(j) are satisfied (*Effective Date*),[2] and each party agrees to memorialize the Effective Date in the Commencement Letter (**Exhibit E**).

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[1] This paper annotates a hybrid form of a modified-gross lease, or, if one prefers, a hybrid form of a modified net lease for a multi-tenant office building. Office leases run the gamut from pure net leases to pure gross full-service leases. A net lease is distinct from a gross lease, and the hybrid forms of each are distinct from each other, with respect to a single ***financial*** question: ***which charges are, or are not, included in base rent?***

Net Lease. A net lease represents one end of the office lease spectrum. Under a pure net lease, base rent is net of (*i.e.*, ***does not include***) operating costs, taxes, and insurance — the expense triumvirate — in a "triple-net" lease. *See Fazio v. Cypress/GR Houston I, L.P.*, --- S.W.3d ----, 2012 WL 3524842 (Tex. App.—Houston [1st Dist.] August 16, 2012, no pet) (Massengale, J., dissenting) (stating that "[a] triple net lease is one under which a tenant pays not only rent but also taxes, common area maintenance fees, and insurance"), *opinion withdrawn and superseded on rehearing en banc by, Fazio v. Cypress/GR Houston I, L.P.*, 403 S.W.3d 390 (Tex. App.—Houston [1st Dist.] 2013, pet. denied); *Hoppenstein Props., Inc. v. Schober*, 329 S.W.3d 846, 850 fn. 2 (Tex. App.–Fort Worth 2010, no pet.) (stating, in context of lease in multi-tenant facility, that "[a] triple net lease is one in which the tenant's rent includes a percentage of the landlord's real property taxes, insurance, and common area maintenance charges for the property in addition to the basic rent."). Under a pure net lease, tenant pays all operating costs and bears the entire risk of operating cost increases. But the triple net label on a lease does not necessarily mean tenant bears all triple-net costs. One type of nearly triple-net office lease allots to landlord certain extraordinary costs, such as those incurred to repair structural defects, to remediate pre-existing environmental conditions, and the like. Also, a tenant in multi-tenant triple-net office lease should ensure that the lease allocates the cost of vacant leasable space to landlord and of leased space to the appropriate tenants.

Gross Lease. A gross lease represents the other end of the office lease spectrum. Under a pure gross lease, tenant pays base rent, and tenant's lump sum rent payment ***includes*** operating costs, taxes, insurance, and all other compensation for hiring the premises. In a pure, full-service gross lease, tenant gets price certainty, and landlord, who is responsible for paying all operating and other ownership costs, bears all of the risks of any cost increases and reaps any rewards of cost decreases.

Hybrid Lease. If pure net leases and pure gross leases were dogs, most office leases would be mutts, as is this mixed-breed office lease. This annotated form is part net lease: Base Rent is net of Electricity Costs and Real Estate Taxes. It is also part modified gross lease: Base Rent includes an expense base equal to the Operating Costs incurred in the Base Year. But Base Rent does not include Excess Operating Costs, the amount by which Operating Costs in a later year exceed Base Year Operating Costs. Base Year Operating Costs are gross (***included in***) Base Rent, while Excess Operating Costs are net of (***excluded from***) Base Rent. Excluding some categories of triple net costs from Base Rent entirely, while including Base Year Operating Costs in Base Rent, is the combination of gross and net features that makes this lease a hybrid. Under a hybrid lease, landlord and tenant, to one degree or another, share the financial risk of, and the responsibility for, containing increases in operating costs.

[2] ***Interesse Termini***. The indeterminate interval between the date of full lease execution – the typical effective date – and the actual beginning of the term is not part of the effective period of the intended landlord-tenant relationship. At common law, a landlord-tenant relationship does not begin until tenant enters into possession and landlord becomes entitled to rent. *E.I. DuPont de Nemours & Co. v. Zale Corp.*, 462 S.W.2d 355, 358 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.), *appeal after reversal and rendition*, 494 S.W.2d 229 (Tex. Civ. App.—Dallas 1973, no writ); *see Weissberger v. Brown-Bellows-Smith*, 289 S.W.2d 813, 817 (Tex. Civ. App.—Galveston 1956, writ ref'd n.r.e.) (holding that landlord-tenant relationship commenced when tenant entered into possession, even though tenant claimed it only did so to correct deficiencies in landlord's buildout of promised tenant improvements). Even though the landlord-tenant relationship does not commence until tenant takes exclusive possession of the premises, a lease, nevertheless, binds landlord and tenant during the interval between execution and occupancy. Landlord is bound to give possession to tenant at the time specified in the lease (*e.g.*, upon completion of leasehold improvements), when tenant would become legally entitled to possession and liable for paying rent. Tenant has a vested present interest during this interval, "not as a tenant[,] but as one legally bound and entitled to become a tenant at a somewhat uncertain date in the future. This interest or right is sometimes called an '*interesse termini*.'" *E.I. DuPont de Nemours & Co.*, 462 S.W.2d at 358 (citing *Austin v. Huntsville Coal & Mining Co.*, 72 Mo.

1. DEFINITIONS. These capitalized terms are some of the defined terms used in this Lease:[3]

(a) Additional Rent means Tenant's Pro Rata Share of (i) Excess Operating Costs [paragraph 1(l)]; (ii) Electricity Costs [paragraph 1(k)], and (iii) and Real Estate Taxes [paragraph 1(w)], together will all other sums due or owing under this Lease (other than Base Rent).[4]

535, 542 (1880); *Morrison v. Chicago & N.W. Ry. Co.*, 91 N.W. 793 (Iowa 1902); *Howard v. Manning*, 192 P. 358, 360 (Okla. 1920)). *See infra* footnote 207 (discussing measures of damages if tenant fails to take, or landlord fails to deliver, possession).

[3] ***Defined Terms***. Office lease forms use similar defined terms, but few forms define the same terms in precisely the same way. The same term does not mean the same thing from one lease to the next and, in some cases, from one paragraph in the same lease to the next. *See* Bryan A. Garner, ADVANCED LEGAL DRAFTING (1996), at p.8 (creating definitions as last rather than first resort), at pp. 81—89 (using definitions effectively). *See* BOMA Industrial Terms and Definitions, http://www.boma.org/research/Industrial%20Terms/Pages/default.aspx.

Defined Terms Ordinarily Prevail Over Ordinary Meaning. The definitions parties give to certain terms generally prevail over common law definitions, except when they don't. "When contracting parties set forth their own definitions of the terms they employ, the courts are not at liberty to disregard these definitions and substitute other meanings." *Fulton v. Texas Farm Bureau Ins. Co.*, 773 S.W.2d 391, 392 (Tex. App.—Dallas 1989, writ denied) (interpreting defined term "occupying" in insurance contract in accordance with contractual definition instead of ordinary meaning); *Hart v. Traders & Gen. Ins. Co.*, 487 S.W.2d 415, 417-18 (Tex. Civ. App.—Fort Worth 1972, writ ref'd n.r.e.).

Defined Terms and Unambiguous Provisions Sometimes Yield. But courts freely exercise the liberty, which they profess to deny themselves, to disregard the parties' definitions, or the commonly accepted meaning of undefined terms, to effectuate overriding policies. *See, e.g., infra* footnotes 4 (discussing Bankruptcy Code provisions that override parties' definition of ***rent***), 172 (noting that express negligence rule deprives "all" of its ordinary meaning when "all" modifies the word "claims" in an indemnity that involves an extraordinary shifting of risk), and 217 (discussing circumstances in which equity will intervene to deny literal enforcement of default and forfeiture provisions).

[4] ***Additional Rent***, as used in this Lease, includes all amounts Tenant is required to pay to Landlord other than Base Rent. Someone created the concept of additional rent in a mostly vain attempt to avoid an imagined collision between state common law or contractual definitions of ***"rent"*** and the provisions of the Bankruptcy Code that first allow but then limit the amount of a landlord's claim for rejection damages to the greater of ***"rent reserved"*** for one year, or **15** percent, not to exceed three years. *See* 11 U.S.C. §§ 365, 502(g) (allowing landlord to assert a general unsecured claim for damages resulting from tenant-debtor's rejection of a lease); 11 U.S.C. §502(b)(6) (capping amount of landlord's rejection damages claim).

Texas Law – Rent

Rent. At common law, "[t]he word 'rent' has a well-defined significance. The substantive means compensation which the owner of land receives for its use by another. The verb 'rent' means `to let out; to lease; as to rent one's house.' Those definitions are given, in substance, by all the standard dictionaries." *Turner v. First Nat'l Bank*, 234 S.W. 928 (Tex. Civ. App.—Texarkana 1921, no writ). "While rent is defined as the recompense for the use and occupancy of lands, it is not confined solely to compensation for the use of the land, for chattels are often demised with the land, and form no inconsiderable portion of the consideration for which rent is paid." *Stein v. Stely*, 32 S.W. 782, 783 (Tex. Civ. App. 1895, no writ) (stating rent for furnished house need not be segregated between compensation for use of real property and use of furniture to determine maximum amount of rent secured by statutory landlord's lien).

Taxes, Insurance & Repair Costs Are Not "Rent." The common law did not consider taxes, insurance, repair costs, and other charges to be part of rent.

> [I]n one sense the performance of every covenant on the part of the lessee is a return made by the tenant for the use of the land. Yet it would hardly be contended that money stipulated to be expended in repairs or for insurance, or in the way of improvements, was any portion of the rent.… Taxes are not, on that account, any more rent than the expenditure of money for insurance, under a covenant to that effect on the part of the lessee.

Korn v. Johnson, 117 S.W.2d 844, 846 (Tex. Civ. App.—El Paso, writ ref'd) (stating that "one of the 'properties' of rent at common law is certainty"); *see A.J. Robbins & Co. v. Roberts*, 610 S.W.2d 854, 856 (Tex. App.—Amarillo 1980, writ ref'd n.r.e.) (stating that tenant's lease and possession of privately owned realty does not obligate tenant to pay taxing authority or to reimburse landlord for *ad valorem* taxes, unless the lease contract requires tenant to do so).

Additional Rent is Not Rent in Eviction Proceedings. Texas law also distinguishes between rent, as such, and other charges accruing under a lease in eviction proceedings. Rule 510.3(e) of the Texas Rules of Civil Procedure provides, as a general rule, that "actual possession" is the only issue to be tried in a forcible entry and detainer or forcible detainer

action. TEX. R. CIV. P. 510.3(e). But Rule 738 establishes a narrow exception to the general rule. Rule 510.3(d) allows landlord to recover only rent, as such, of not more than $10,000 in the justice court, but it does not allow landlord to recover other damages of any kind in any amount. TEX. R. CIV. P. 510.3(d); TEX. GOV'T CODE § 27.031(a)(1) (justice court's maximum jurisdiction over amount in controversy is **$10,000**, exclusive of interest); *see Haginas v. Malbis Mem'l Found.*, 349 S.W.2d 957, 958 (Tex. Civ. App.—Houston 1961), *aff'd*, 354 S.W.2d 368, 371 (Tex. 1962) (holding landlord cannot recover damages for wrongful withholding of the premises in eviction suit); *Dews v. Floyd*, 413 S.W.2d 800, 805 (Tex. Civ. App.—Tyler 1967, no writ) (stating that landlord cannot join claims for wrongful withholding of premises or for other benefits accruing under lease contract in eviction suit). Likewise, a tenant cannot properly assert claims or offsets against rent in an eviction case. *Grayson v. Rodermund*, 135 S.W.2d 178, 180 (Tex. Civ. App.—Austin 1939, no writ) (holding that tenant could not assert counterclaim against landlord in forcible detainer action because possession is only issue to be tried); *John E. Morrison Co. v. Harrell*, 148 S.W. 1122, 1123 (Tex. Civ. App.—El Paso 1912, no writ) (stating that tenant in forcible detainer proceeding cannot assert counterclaim for value of services in excess of justice court's jurisdiction as an offset to landlord's claims for rent).

Rent v. Damages. Texas law also distinguishes between landlord's claim on the lease for rent and its claim for damages resulting from tenant's breach of the covenant to pay rent. *Maida v. Main Bldg. of Houston*, 473 S.W.2d 648, 651 (Tex. Civ. App.—Houston [14th Dist.] 1971, no writ) (summarizing "alternatives available to a landlord when tenant, without justification, abandons leased premises and stops paying the rent due… ***[u]nder the language of the usual lease contract"***), *cited* in *Speedee Mart, Inc. v. Stovall*, 664 S.W.2d 174, 177 (Tex. App.—Amarillo 1983, no writ) as authority for proposition that common law provides landlord with four "common law remedies" for tenant's anticipatory breach of covenant to pay rent. *See infra* footnote 220 (discussing remedies for anticipatory breach).

Bankruptcy Law – Rent Reserved

Rent in Bankruptcy: Rejection Damages, Allowable Claims & Applicable Cap. In bankruptcy, landlord is entitled to assert a general unsecured claim for damages resulting from tenant-debtor's rejection of a lease. *See* 11 U.S.C. §§ 365(g)(1), 502(g). But 11 U.S.C. §502(b)(6) disallows a landlord's claim against tenant-debtor's bankruptcy estate "to the extent that… such claim is the claim of a lessor for damages ***resulting from the termination*** of a lease of real property, [and] such claim exceeds—

> (A) the ***rent reserved*** by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of—
>
> (i) the date of the filing of the petition; and
>
> (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus
>
> (B) any ***unpaid rent due*** under such lease, without acceleration, on the earlier of such dates[.]

11 U.S.C. § 502(b)(6) (emphasis added). "There is a split in the case law regarding the meaning and scope of this statutory phrase." *In re Energy Conversion Devices, Inc.*, 483 B.R. 119, 122 (Bankr. E.D. Mich. 2012) (extensively analyzing split in authority). Despite this split, bankruptcy courts generally agree that the amount of ***"rent reserved"*** in a lease is first determined by state law and by the terms of the lease and that section 502(b)(6) is then applied to determine the maximum amount of landlord's claim for damages ***"resulting from the termination of the lease."*** *In re Smith*, 249 B.R. 328, 334 (Bankr. S.D. Ga. 2000) (citing *In re Gantos, Inc.*, 176 B.R. 793, 795 (Bankr. W.D. Mich.1995); *In re Iron–Oak Supply Corp.*, 169 B.R. 414 (Bankr. E.D. Cal.1994); *In re Financial News Network, Inc.*, 149 B.R. 348, 350–51 (Bankr. S.D.N.Y. 1993); *In re Q–Masters, Inc.*, 135 B.R. 157, 159 (Bankr. S.D. Fla.1991)); *see also In re Fulton*, 148 B.R. 838, 843 (Bankr. S.D. Tex.1992) (holding that damage cap in section 502(b)(6) applies to sums awarded landlord in final state court judgment for tenant's breach of lease). Yet, despite general agreement in the abstract, courts disagree profoundly about what specific charges constitute "rent reserved" and what damages "result" from the rejection of a lease.

The preponderant, though waning, view holds that tenant-debtor's rejection of a real estate lease under 11 U.S.C. § 365(a) constitutes a breach of all covenants in the lease, including, for example, covenants requiring debtor-tenant to maintain and repair the premises. From this logical premise, some courts reason that ***"all damage claims by the lessor are subject to the cap of § 502(b)(6)(A) plus § 502(b)(6)(B)."*** *In re Energy Conversion Devices, Inc.*, 483 B.R. at 123 (analyzing, but rejecting, this view).

A contrary, though still minority, view appears to be gaining traction. It generally agrees that the terms of the lease and state law concepts adumbrate the meaning of "rent reserved" under a particular lease, but it holds that the statutory term "rent reserved" in section 502(b)(6) applies to future (unaccrued) rent (*e.g.*, base rent, insurance, taxes, CAM charges, and the like) and that the statutory phrase "damages resulting from the termination of a lease" only limits "damages accrued while the tenant-debtor was still obligated under the lease *prior to* the surrender of the property." *See, e.g., In re MDC Sys.*,

Inc., 488 B.R. 74, 94 (Bankr. E.D. Pa. 2013) (discussing allowable damages caused by tenant's removal of equipment, waste, and other materials).

Differing Treatments of Lease Rejection Damages. The following cases catalogue differing treatments of particular damage items under section 502(b)(6) of the Bankruptcy Code. *See generally* Josiah M Daniel, *Landlord Rejection-Damage Claims: Lawyering Using Graphic and Mathematical Expressions*, 31 AM. BANKR. INST. J. No. 11, at p. 26-27 (Dec./Jan. 2013) (using flow chart to illustrate and explain damage and cap calculation methodologies under section 502(b)(6) of Bankruptcy Code).

Taxes, Insurance & CAM – Allowed but Capped. Both lines of cases consistently allow landlord's claim for taxes, insurance, and common area operating costs but cap the claim amount in accordance with section 502(b)(6). *See, e.g., In re Clements,* 185 B.R. 895, 902-03 (Bankr. M.D. Fla. 1995) (allowing lessor's claim for rejection damages, subject to cap, under net lease that required lessee to pay taxes, maintenance costs, insurance premiums, and attorney's fees as "additional rent"); *In re Rose's Stores, Inc.*, 179 B.R. 789, 791 (Bankr. E.D. N.C. 1995) (stating taxes and insurance are allowable as "rent reserved" when (1) the lease clearly obligates tenant to pay the charge, ***even though it need not be denominated as rent***, and (2) the charge is related to "the value of the property and the value of the lease"). The results in cases involving landlords' claims for physical damage to the premises, electricity charges, attorneys' fees, and other such charges are anything but consistent. *See, e.g, In re Energy Conversion Devices, Inc.*, 483 B.R. at 122.

All Landlord Actual Damages – Allowed but Capped. "The damage cap [§ 502(b)(6)] applies to all damages, which are then arbitrarily capped and measured by rent reserved.… Thus, as a matter of law, the actual damage claim of the [landlord] for termination of the lease, whether for non-payment of rent, taxes, costs, attorney's fees, or other financial covenants, are [sic] limited by the damage cap in § 502(b)(6)(A)." *In re Storage Tech., Corp.*, 77 B.R. 824, 825 (Bankr.D.Colo. 1986); *compare In re Clements*, 185 B.R. at 902-03 (citing legislative history of H.R. 95–595 to accompany H.R. 8200, 95th Cong. 1st Sess. pp. 353–355 (1977) for proposition that, under § 502(b)(6), landlord's "allowed claim is for his total damages, as limited by this paragraph") *with In re Energy Conversion Devices, Inc.*, 483 B.R. at 123 (analyzing, but rejecting, cases taking this view).

Damages for Breach of Maintenance Obligations – Allowed but Capped. Some courts follow the rule that damages arising from tenant-debtor's pre-petition breach of repair and maintenance covenants do not constitute "rent reserved" but are limited by the statutory cap on damages. *In re Foamex Int'l, Inc.*, 368 B.R. 383 (Bankr. D. Del. 2007); *Kuske v. McSheridan (In re McSheridan),* 184 B.R. 91 (9th Cir. B.A.P. 1995) (holding that statutory damage cap applies to all damages flowing from the failure of a party that has rejected a lease to perform future routine repairs or pay utility bills), *overruled in part by In re El Toro Materials Co., Inc.*, 504 F.3d 978, 981-82 (9th Cir. 2007) (holding that "[t]o the extent that *McSheridan* holds section 502(b)(6) to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenant's failure to complete a lease term, it is overruled, but declining to address *McSheridan's* holding that the statutory damage cap applies to all damages flowing from the failure of a party that has rejected a lease to perform future routine repairs or pay utility bills"), *cert. denied, El Toro Materials Co., Inc. v. Saddleback Valley Cmty. Church,* 552 U.S. 1311 (2008); *In re Mr. Gatti's, Inc.*, 162 B.R. 1004, 1013-14 (Bankr. W.D. Tex. 1994) (holding that damages landlord suffers because tenant-debtor rejects lease and fails to perform its maintenance and repair obligations are allowable but that section 502(b)(6) caps a landlord's claim against the bankruptcy estate once a debtor rejects a previously unexpired lease of real property).

Landlord's Claim to Recover TI Allowance – Disallowed. In *In re Gantos, Inc*., the bankruptcy court stated that "[a]lthough the Bankruptcy Code does not define rent reserved, several cases have recognized that it includes items payable under a lease that are (1) expressly labeled as rent in the lease and (2) classifiable as rent because the item is regular, fixed and periodically payable in the same manner as pure rent." 181 B.R. at 907. Based on this rule, the court disallowed landlord's claim to recover the construction allowance. Even though the lease contractually defined the allowance as "rent," the bankruptcy court held that the construction allowance did not constitute "rent reserved" *Id.*

Landlord's Claims for Attorneys' Fees – Disallowed. In *In re Storage Tech. Corp.*, the bankruptcy court ruled that landlord's attorneys' fees do not relate to value or use of the property, even though the lease included attorneys' fees in the definition of "rent reserved[;]" that such fees are simply another financial covenant, which cannot figure in the calculation of the damage cap in § 502(b)(6)(A); and that, as a result, such fees are not allowable in the damages calculation as part of the rent reserved. 77 B.R. at 825.

Electricity costs – Not Rent Reserved, Not Allowed. The bankruptcy court for the Southern District of New York has held that the minimum base charge for electricity usage pursuant to Electricity Rent Inclusion Factor (ERIF) in a tenant-debtor's lease did not constitute "rent reserved," and, as a result, that landlord could not include the electricity charge in its claim for lease rejection damages. The court reasoned that, while the charge was fixed, regular, and specifically

(b) Base Rent[5] means the amounts stated in the following schedule:

PERIOD	ANNUAL BASE RENTAL RATE	MONTHLY BASE RENT**

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designated as additional rent in lease, it had nothing to do with value of rental property or lease. *In re Andover Togs, Inc.*, 231 B.R. 521, 540-41 (Bankr. S.D. N.Y. 1999).

Claims for Future (Unaccrued) Rent – Capped; Other Non-Rent Damages Allowed But Not Capped. The following cases advocate the emerging, but minority, view, which recognizes that a landlord may suffer actual damages – *e.g.*, those resulting from a tenant's failure to maintain or repair the premises – that are not caused by tenant's failure to pay future (unaccrued) rent and do not "result from" the rejection (termination) of the lease. As a result, these cases hold that landlord's claims for breach of covenants to repair and maintain the premises are allowable but are not capped. Another basis for rejecting the predominant view rests on an analysis of the historical treatment of a landlord's claims under the Bankruptcy Act before the 1934 amendments to section 63a (section 502(b)(6)'s predecessor). This amendment to the Act, for the first time, allowed a lessor's claims for future (unaccrued) rent, "albeit in a limited fashion." *In re Energy Conversion Devices, Inc.*, 483 B.R. at 122-24 (discussing split in authority and arguing that purpose of cap is to limit amount of landlord's claim to future rent but not to limit claims for other damages); *see Oldden v. Tonto Realty Corp.*, 143 F.2d 916, 918–20 (2d Cir.1944) (noting that, before 1934 amendments to section 63a of the Bankruptcy Act, a landlord did not have a provable claim for rent "destined to accrue after the filing of a petition [because it] was not capable of proof, since there was no fixed liability absolutely owing, but merely a demand contingent upon uncertain events"). As Justice Holmes put it:

> But the law as to leases is not a matter of logic *in vacuo*; it is a matter of history that has not forgotten Lord Coke. Massachusetts has followed the English tradition and we believe that it is the general understanding in that State that in the absence of statute or express contract a lessor who has terminated a lease and evicted the tenant has no further claim against the lessee.

Gardiner v. William S. Butler & Co., 245 U.S. 603, 605 (1918) (Holmes, J.) (emphasis added).

Damages for Pre-Petition Breach of Maintenance Obligations Are Allowable But Not Capped. Damages caused by tenant's removal of equipment, waste, and other materials are allowable but not subject to the damage cap in section 502(b)(6). *See, e.g., In re MDC Sys., Inc.*, 488 B.R. at 94; *In re Best Prod.s Co., Inc.*, 229 B.R. 673, 679 (Bankr. E. D. Va. 1998) (holding that landlord is entitled to include in its claim pre-petition damages for deferred maintenance and that statutory cap on landlord's claim for "rent reserved" in section 502(b)(6)(A) does not preclude damages for deferred maintenance); *In re El Toro Materials Co., Inc.*, 504 F.3d at 981-82 (holding that "[t]o the extent that *McSheridan* holds section 502(b)(6) to be a limit on tort claims other than those based on lost rent, rent-like payments or other damages directly arising from a tenant's failure to complete a lease term, it is overruled, but declining to address *McSheridan's* holding that the statutory damage cap applies to all damages flowing from the failure of a party that has rejected a lease to perform future routine repairs or pay utility bills); *cf. Kuehner v. Irving Trust Co.*, 299 U.S. 445, 455 (1937) (stating, *in dicta*, that statutory phrase "rent reserved… has some relationship to the value of the property and the value of the lease thereon").

Mitigation is Not Considered in Applying Cap. *In re Shane Co.*, 464 B.R. 32, 39 (Bankr. D. Colo. 2012) holds that the state law measure of damages for breach of the lease (after taking mitigation into account) should not be used to compute landlord's damages. Instead, the court ruled landlord's lease rejection damages should be computed on the amount of rent reserved in the lease after rejection). *Id*. at 39 (articulating "minority" view that limitation on recovering rent due for 15% of the remaining lease term up to three years, in addition to delinquent pre-petition rent, is a *temporal* limitation, not a *monetary* limitation).

Conclusion. Under the emerging view of section 502(b)(6), drafting "additional rent" definitions in leases in an attempt to bring all "all sums due and owing under the lease" within the ambit of "rent reserved" may not work or work as intended. Be careful what you draft for. You might get it. Justice Kozinski, writing for the Ninth Circuit, has proposed a "simple test [to determine] whether the damages result from the rejection of the lease: Assuming all other conditions remain constant, would the landlord have the same claim against the tenant if the tenant were to assume the lease rather than rejecting it?" *El Toro*, 504 F.3d at 981 (discussing perverse economic incentives of applying cap tenant's liability for collateral damage to premises). Under this test, pre-petition damages for, among other things, a tenant's failure to maintain the premises are allowable but are not subject to the cap.

[5] ***Base Rent***, as used in this Lease, is the "minimum rent" or "fixed rent" that Landlord charges Tenant for the use of the Premises. To compute the monthly installment of Base Rent, multiply the Annual Base Rental Rate (expressed in dollars per rentable square foot per year) by the Rentable Area of the Premises (expressed as the number of rentable square feet in the Premises) and then divide the product by twelve (12). Base Rent in this Lease is "semi-gross" or "semi-net."

	PER RSF	
Commencement Date through the last day of the 24th full calendar month after the Commencement Date	**$30.00**	
The first day of the 25th full calendar month after the Commencement Date through the last day of the 72nd full calendar month after the Commencement Date	**$33.00**	
73rd full calendar month after the Commencement Date through the Expiration Date	**$35.00**	
**If this Lease requires or permits re-measurement of the Premises, Landlord will use the Building Standard measurement method and standard [paragraph 1(f)] to determine the Rentable Area of the Premises, and the Monthly Base Rent will be recalculated based on Landlord's determination.		

(c) *Base Year* means ***2013***.[6]

(d) *Base Year Operating Costs* mean Operating Costs incurred during the Base Year as grossed up using the same methodology as used in the year in question[7] and as further adjusted so that any cost item, cost category, or cost subcategory included in Operating Costs for the year in question, but which is not incurred in the Base Year, or over the entire Base Year, will be deemed to be increased in the Base Year by the amounts Landlord would have incurred during the Base Year had each such separate cost item, category, or subcategory of costs been included in Operating Costs during the entire base year.[8]

(e) *Building*[9] means the XXX story office building (including the parking garage in the Building)[10] located on the Land. Landlord and Tenant stipulate that the Rentable Area of the Building is XXX

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[6] ***Base Year***. A base year or expense stop is the distinguishing characteristic of a modified gross lease such as this one. This Lease sets Operating Costs per rentable square foot in a designated calendar year — the Base Year — as the base amount of Operating Costs included in Base Rent. Tenant is required to pay, as a separate charge in addition to Base Rent, Tenant's Pro Rate Share of Excess Operating Costs (*i.e.*, Operating Costs for the period in excess of Base Year Operating Costs). In this Lease, Real Estate Taxes and Electricity Costs are net of Base Rent. In other words, there is no base year or expense stop for Real Estate Taxes or Electricity Costs. If a lease, as does this one, allows landlord to gross-up operating costs or other costs passed through to its tenant, the gross-up formula also should gross-up expenses in the base year with desirable normalizing adjustments. If a lease, unlike this one, sets a base year for real estate taxes, the provision for base year real estate taxes should include a provision requiring a "full value" assessment of *ad valorem* taxes in the base year.

[7] ***Base Year Gross-Up.*** Whenever a modified or hybrid gross lease uses a base year, the lease should employ a consistent gross-up methodology to compute the difference between operating costs incurred in the base year and costs incurred in the year in question for purposes of quantifying the deemed costs included in tenant's *pro rata* share of excess operating costs. In addition to the gross-up calculations, an increasing number of office leases allow adjustments for the ostensible purpose of normalizing comparisons between base year and out year operating costs. *See infra* footnotes 8 (discussing normalizing adjustments to Base Year Operating Costs), 45 (discussing "full assessment" concept for normalizing adjustments to base year real estate tax costs), and 62 - 63 (discussing real estate taxes and explaining, in Gilliland, *The Texas Property Tax System*, at pp. 23-40 (property tax appraisal process) and at pp. 45-51 (assessment phase)).

[8] This ***Base Year Operating Cost*** provision requires Landlord to add to Operating Costs in the Base Year any separate expense items or expense categories that Landlord incurs in a later year but that Landlord did not actually incur in the Base Year. It is, in concept, a type of reverse gross-up clause designed to normalize anomalous expenses and extraordinary changes in operations. "These separate items can include changes in management fee rates, types of revenues used in calculating the fee, methodology(ies) of gross-up calculations, changes in contractor services, such as cleaning, security and engineering, insurance coverage changes, and other adjustments." Paul S. Rutter and Josh Leonard, *Don't Sign Blind: Cost Allocation in Commercial Leases*, ACC DOCKET 23 at fn. 7 (November 2010) (discussing big-ticket operating expense issues and explaining important accounting issues in interpretation and administration of operating cost provisions).

[9] ***Building***. This Lease uses a minimalist approach to defining the Building. A more complex definition, for example, may include attributes of the building that are appropriate in one context (*e.g.*, allocating maintenance obligations) but that are not appropriate in another (*e.g.*, insurance, taxation, or any number of others). *See infra* footnote **169** (definition of ***Building*** in property insurance policy). Here is one example where seemingly innocuous, but non-essential descriptive information, in a defined term contributed to a potential conflict, a brief period of high anxiety, but no lasting harm.

square feet.[11] Landlord disclaims any representation or warranty, express or implied, that the stipulated Rentable Area of the Building or of the Premises is more or less than the actual amount of rentable space or that the initial stipulated area measurements conform to any industry standard measurement methodology. Tenant

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- "***Building*** shall mean the office building located on the land… in Big City, Texas, more particularly described on Exhibit A, and all building mechanical systems, improvements, betterments, fixtures, equipment,… owned by Landlord.
- "All tenant improvements shall become property of landlord, whether paid for by landlord or tenant, upon installation thereof,
- "Tenant shall be responsible for maintaining full replacement cost fire and extended coverage insurance on all improvements installed in the Premises. Landlord shall have no responsibility for insuring tenant personal property or improvements in the Premises."

After a fire, a panicked tenant calls his lawyer: Do I have an insurable interest in tenant improvements owned by landlord? The lease twice says all improvements are property of landlord and says at least once landlord has no obligation to insure them. The answer in this example, fortunately, was yes. Tenant's ISO Building and Personal Property Coverage Form (CP 00 10 04 02) provided coverage for tenant improvements, despite the lease term vesting ownership of the improvements in landlord. Under this policy form, tenant has an insurable and covered interest in the ***use value*** of its improvements as business personal property over the lease term. But this analysis also highlights another insurance pitfall. A tenant should procure full replacement cost coverage for its improvements in the premises, even if the lease does not require this type of coverage. The insurance proceeds payable under an actual cash value policy decline over the lease term (the shorter the term the more rapid the decline), ordinarily leaving tenant with insufficient insurance proceeds, especially late in the term, to pay the cost to restore or replace the damaged improvements.

[10] ***Parking Garage Operating Costs.*** Most operating cost provisions require tenant to pay the operating expenses incurred in connection with a particular facility or facilities (*e.g.*, Building or Project). The building or project may include facilities (*e.g.*, a separate parking garage or health club), which tenant does not use or for which the tenant is already paying market rate fees. If a tenant does not use or have the right to use those facilities, that tenant may justifiably seek to exclude from the definition of operating costs some portion of the operating costs associated with operating such unutilized facilities. If a tenant uses facilities other than the building itself, but pays a market rate fee for their use, that tenant may seek to exclude the costs associated with operating the other facilities on the ground that it is already paying fully for their use. In some office buildings, and almost all mixed-use projects, space is leased to restaurants, health clubs, and retail establishments. Each use places different demands on building services. A restaurant, for example, typically uses far more water per square foot of occupied space than an ordinary office tenant. An operating cost provision that does not segregate between the space within the building or project devoted to non-office uses but that obligates office tenants to pay their *pro rata* share the entire building or project's operating costs may, in effect, require the office tenants to subsidize costs properly attributable to the other types of users.

Change defined terms with great caution. To address specific issues such as this, it is usually better to think locally rather than to act globally. Rather than redefine a defined term to address an issue peculiar to a single clause or issue, modify the way a specific clause operates on a defined term. Changing a defined term effects a global change in the meaning of every clause where that term is used.

Here is an example of a proposed definitional change that could have had more unintended consequences than the party proposing it probably imagined. During negotiations, tenant agrees to pay for parking in the separate parking garage owned by landlord on the same parcel of land at the same rate as non-tenant parkers on the condition that landlord pass through as an operating cost only parking garage related operating costs that exceed parking revenues.

To effect this compromise, tenant's counsel proposes to delete the word "including" and to substitute "excluding" (~~including~~ <u>excluding</u> the parking garage in the building) from the parenthetical elaborating the definition of Building like the definition in the annotated clause that is the subject of this footnote. The purpose of the proposed change – to prevent Landlord from passing through parking garage operating costs by eliminating parking facilities from the definition of Building – would have fathered innumerable unwanted consequences, most of them adverse to tenant's interests. *See* Rutter & Leonard, *Don't Sign Blind,* at p. 26 (discussing exclusion of garage operating costs and audit finding landlord overcharges of $.50 per foot, per year). Because the lease requires landlord to maintain, repair, and insure the Building, tenant's counsel's proposed change to the definition of Building, if agreed to, not only might have relieved tenant of the obligation to pay operating costs for the parking garage (which, by the way, was not exactly the deal) but inadvertently also might have relieved landlord of its obligation to clean, maintain, and repair the garage, leaving tenant without clear remedies for landlord's failure to do so.

has made its own independent investigation of the Rentable Area of the Premises and the Building and has not relied on any representation by Landlord concerning the accuracy of these measurements.[11]

(f) Building Standard means the type, brand, quality, or quantity of materials, equipment, insurance coverages, methods, scheduling, usages, services, measurement methodology (currently ANSI/BOMA Z65.1—2010 A),[12] or engineering standards that Landlord may designate, from time to time, for minimum, exclusive, or general use in the Project. If the measurable physical dimensions of the Premises, the

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[11] ***Landlord Representations***. Both fraud and negligent misrepresentation require a showing of reliance. *Federal Land Bank Ass'n of Tyler v. Sloane*, 825 S.W.2d 439, 442 (Tex.1991) (negligent misrepresentation); *Eagle Props., Ltd. v. Scharbauer*, 807 S.W.2d 714, 723 (Tex.1990) (fraud). As a general rule, a party's own independent investigation negates a party's right to rely on the other party's representation. *Pleasant v. Bradford*, 260 S.W.3d 546, 554 (Tex. App.—Austin 2008, pet. denied); *Bartlett v. Schmidt*, 33 S.W.3d 35, 37-38 (Tex. App.—Corpus Christi 2000, pet. denied). Thus, a party cannot successfully assert a claim for fraud or misrepresentation when it "conducts an independent investigation into the matters covered by the representations, which is sufficient to inform him of the truth, and which is not interfered with or rendered nugatory by any act of any other party." *Marcus v. Kinabrew*, 438 S.W.2d 431, 432 (Tex. Civ. App.—Tyler 1969, no writ). But the opportunity to conduct an independent investigation of a representation, while possibly relevant to the issue of whether reliance on the representation was reasonable, does not, by itself, negate the element of reliance. *Bartlett*, 33 S.W.3d at 38; *see also Ortiz v. Collins*, 203 S.W.3d 414, 421 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (stating reliance on misrepresentation must be "reasonable and justified" to sustain fraud and negligent misrepresentation claims). The mere opportunity to investigate, bereft of evidence that the party given the opportunity took it, "is insufficient for the rationale of *Bartlett* to apply." *Pleasant*, 260 S.W.3d at 554.

[12] ***BOMA Office Measurement Standards.*** The Building Owners and Managers Association International (BOMA) promulgates the generally recognized industry standard methodology for measuring both occupant space as well as the space that benefits all occupants in office buildings.

The Office Buildings: Standard Methods of Measurement (ANSI/BOMA Z65.1—2010) is available through BOMA http://www.boma.org/standards/office-buildings/Pages/default.aspx.

One effect of the new standards is to boost property values, a purpose sometimes at odds with a tenant's desire to save money. *See* William B. Tracy, *Market SOP Drives New BOMA Standard*, http://www.buildingareameasurement.com/sop.pdf.

2010 BOMA Office Building Method A and Method B. The 2010 Office Building Standard offers two methods, A & B, for measuring floor area. Method A, known as the Legacy Method, is the same as the 1996 BOMA measurement standard, uses the same terminology, and computes the load factor on a floor-by-floor basis. Method B uses a single load factor for the entire building and replaces some familiar terms (*e.g.*, common areas) with new terms (*e.g.*, amenity areas and service areas). The use of Method A or Method B results in the same total building rentable area. Method B's new terms (*e.g.*, occupant area, service area, amenity area, *etc.*) and measurement methodologies alter the relative measures of occupant areas, amenity areas, and service areas, the computation of the R/U ratio, and, in so doing, the computation of rents and distribution of costs among tenants and between tenants and landlord.

2012 BOMA Mixed Use Standard. BOMA also promulgates measurement standards for Mixed-Use Properties: Standard Methods of Measurement (ANSI/BOMA Z65.6 – 2012). BOMA claims that these 2012 mixed use standards prescribe methods for users to consistently:

- Classify the floor areas in a mixed-use property into different use components, parking components, and mixed-use common areas.
- Measure the exterior gross areas of use components for office, industrial, retail and multi-unit residential use components, for which rentable area, gross leasable areas or unit areas are individually measurable using measurement standards published by BOMA.
- Measure the exterior gross area of use components for which BOMA does not publish specific measurement standards, such as hotels, theaters, institutional and civic uses, and parking components.
- Measure the exterior gross areas of mixed-use common areas and fairly allocate those areas among all use components and parking components within a mixed-use property.

Press Release, *BOMA Releases New ANSI-Approved Mixed-Use Standard* (October 9, 2012), http://www.boma.org/research/newsroom/press-room/2012/Pages/BOMA-Releases-New-ANSI-Approved-Mixed-Use-Standard.aspx.

Building, or the Project are changed for any reason (*e.g*, by condemnation, casualty, exercise of an expansion option, or other cause), and this Lease requires or permits the measurement of the affected area, Landlord's architect shall measure the affected area using Landlord's then current Building Standard measurement methodology, and Landlord and Tenant stipulate and agree that Landlord's architect's determination of Rentable Area and any other ancillary measurements of the affected area shall be binding on Landlord and Tenant for all purposes under this Lease.[13]

(g) *Business Day(s)* mean Mondays through Fridays, except for normal business holidays for New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, and Christmas Day (*Holidays*), and *Tenant's Normal Business Hours* mean from **7:00 a.m.** to **8:00 p.m.** on Business Days, and from **8:00 a.m.** to **1:00 p.m.**, on Saturdays, except for Holidays. *Building Standard Business Hours* mean Tenant's Normal Business Hours, ***excluding*** the period from **7:00 p.m.** to **8:00 p.m.**[14]

(h) *Commencement Date*[15] will be the earlier of: (i) the date Landlord actually tenders to Tenant physical possession of the Premises in the condition required by the Work Letter (**Exhibit D**) as adjusted for any Delay[16] or (ii) ____________________, 20__ (*Scheduled Commencement Date*).[17]

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[13] Even if landlord and tenant stipulate to the initial space measurements, it is probably prudent to agree on a measurement standard that will apply if there are any changes to the physical configuration of the building or the premises.

[14] ***Building Standard Times—Cost Issues.*** In this Lease, Landlord must supply Tenant with Building Standard services (including HVAC) during *Tenant's Normal Business Hours*, but Landlord must exclude from Operating Costs and Electricity Costs the costs Landlord incurs to provide HVAC between 7:00 p.m. and 8:00 p.m. (the period within Tenant's Normal Business Hours but outside of Building Standard Business Hours) to Tenant and other tenants in the Building. Tenant is entitled to an extra hour of HVAC service without paying for the extra hour either as a separate extra-hours HVAC charge or as an increase in Operating Costs or Electricity Costs.

[15] ***Commencement Date.*** The occurrence of a specified event provides the requisite certainty for lease commencement, and, if the event does not occur, no tenancy is created. Although an event (*e.g.*, completion of construction) may be sufficiently certain to mark the beginning of the term, the same, or a similar, condition may not be sufficiently certain to mark the end of a term. Milton R. Friedman & Patrick A. Randolph, Jr., 1 FRIEDMAN ON LEASES, *The Term – Possession* § 4.1, at pp. 4-3 (5th Ed. 2004) [hereinafter FRIEDMAN ON LEASES] (discussing death of a person, which is certain to occur at an uncertain future date). *See infra* footnotes 75 (discussing common law meaning and requirements for lease "term") and 292 (discussing common law and contractual definitions of *force majeure*).

[16] ***Delay*** consists of three distinct concepts. In layman's terms, Landlord Delays are delays that count against Landlord's performance deadlines or add to Tenant's time for performance; Tenant Delays do the opposite; and *forces majeure* extend the affected party's deadline to perform without breach. When the commencement date is tied to completing construction of tenant improvements, care should be taken to ensure that the lease, work letter, construction contract, and landlord's loan documents are compatible on a wide variety of issues, including, for example, the definitions and effect of *force majeure* events; the conditions for, and duration of, rent abatement in the lease; the amount of delay damages in the construction contract for tenant improvements; tenant's termination rights for untimely delivery; insurance, indemnity, and claim and subrogation waivers; contractor warranties, warranty assignments, and independent landlord warranties for completed work; lien removal and bonding time requirements in landlord's loan documents and in the lease. *See infra* footnote 292 (discussing common law concept of *force majeure* and contract definitions).

[17] ***Delivering Possession***. A landlord impliedly covenants in every lease to place tenant in possession at the commencement of the lease term. This covenant is one of the few ***dependent the covenants*** in a lease, and, as a result, a landlord's failure to tender the premises for tenant's occupancy as promised by date specified may excuse tenant from its obligation to pay rent. *Richker v. Georgandis*, 323 S.W.2d 90, 95 (Tex. Civ. App.—Houston 1959, writ ref d n.r.e.). Such a delay also may give rise to a claim for damages and tenant's right to terminate the lease. *Langham's Estate v. Levy*, 198 S.W.2d 747, 754 (Tex. Civ. App.—Beaumont 1946, writ ref d n.r.e.) (holding that landlord may be liable for damages for failing to complete tenant improvements when promised and that injured tenant's measure of damages is the difference between the market rental value of the leasehold for the unexpired term of the lease and reserved rentals stipulated therein); *see also Regency Advantage, L.P. v. Bingo Idea-Watauga*, 928 S.W.2d 56 (Tex. App.—Ft. Worth 1996), *aff'd in part and rev'd in part*, 936 S.W.2d 275 (Tex. 1996); *cf. ABS Sherman Props., Ltd. v. Sarris*, 626 S.W.2d 538 (Tex. Civ. App.—Texarkana 1981, writ ref d

(i) Common Areas are those corridors, elevator foyers, mail rooms, restrooms, mechanical rooms, elevator mechanical rooms, janitorial closets, electrical and telephone closets, vending areas, lobby areas, and other similar facilities in the Building and driveways, sidewalks, loading areas, and similar areas outside the Building but on the Project that Landlord makes available from time-to-time for the non-exclusive use or benefit of tenants generally.[18]

(j) Effective Date is the date if, as, and when this Lease, and all options granted in this Lease, become enforceable.[19] The Effective Date will be the date when the last of the seven (7) conditions specified below have been satisfied:

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n.r.e.) (interpreting 60 day notice and cure period in way that extended landlord's deadline to complete tenant improvements from 12 to 14 months).

[18] The term ***Common Area***, as commonly used, describes at least two overlapping but technically distinct concepts. In a typical commercial office lease, the term common area describes in general terms the physical areas of the building that are accessible to, and available for, the non-exclusive use of building occupants. Common area also was, and, in some circumstances, still is, a term of art used to describe a certain type of space in an office building and to compute the building's load or R/U factor (the ratio of rentable to usable space). 2010 BOMA measurement Method A (*a/k/a* the Legacy Method), which is the same as the 1996 BOMA measurement standard, retains common area as operative term of art.

Evolving Terms of Art. 2010 BOMA Office Building Method B, however, drops the term ***common area*** and adopts two substitute terms, ***building amenity area*** and ***building service area.***

> An ***amenity area*** is space within a building that adds a convenience to more than one tenant, such as a building conference room or fitness center. A ***floor amenity area*** benefits the occupants of a specific floor, and a ***building amenity area*** benefits the occupants of the entire building. ***Building amenity areas*** include only amenity areas that are convertible to occupant area and are not required by code or for the operation of the building. Shared conference rooms, exercise areas/fitness centers, child-care centers, and vending areas typify building amenity areas.
>
> A ***building service area*** is an area that serves the building, such as mechanical rooms, equipment rooms, main lobbies, and ingress and egress corridors. ***Floor service area*** is an area of a floor that provides services that are necessary for occupancy on that floor.

2010 BOMA Office Building Method B also replaces ***office area*** and ***store area*** with a new term, ***occupant area***. The term ***occupant area***, like the two terms it replaces, means the space where an occupant normally houses its personnel, FF&E and goods. In addition, Method B creates a separate space category for ***occupant storage area***, which is an area that is not fully finished, is useable for storage only, and usually is not located on the same floor as occupant areas. Occupant storage area is deducted from the interior gross area (formerly, gross measured area) so that occupant storage space does not dilute the load factor applied to the other occupant areas.

Method B computes ***usable area*** as the sum of occupant areas plus building amenity areas. Occupants include tenants and owner – occupants, which brings management offices within the definition of usable area. ***Usable area*** does not include ***building service areas***, such as main lobbies and corridors; fire control centers and equipment; restrooms and janitors' closets; mechanical, electrical and communications rooms and closets; truck loading areas, receiving and trash areas; or building management and maintenance offices. By contrast, Method A (BOMA 1996) defines usable area as the sum of office area, plus store area, plus building common area.

Before prescribing 2010 BOMA Method B as the measurement standard in a lease, it would be prudent to review the new standards carefully and to harmonize the defined terms in the lease with the new measurement terminology.

[19] ***Unsigned and Binding?*** Upon completion of the final draft, landlord often sends the final unsigned lease to tenant in executable form and invites tenant to sign the lease and return it, along with the security deposit, proof of insurance, and the like. Until both parties fully execute and deliver the final lease, and any other conditions precedent to its effectiveness have been satisfied, the parties often assume that no enforceable agreement can exist. After all, not one, but two, statutes of frauds apply. *Compare* TEX. BUS. & COM. CODE § 26.01(5) (Vernon 2013) (stating that "lease of real estate for a term longer than one year… is not enforceable unless the promise or agreement, or a memorandum of it, is (1) in writing; and (2) signed by the person to be charged with the promise or agreement or by someone lawfully authorized to sign for him[]") *with* TEX. PROP. CODE ANN. § 5.021 (Vernon 2013) ("A conveyance of an estate of inheritance, a freehold, or an estate for more than one year, in land and tenements, must be in writing and must be subscribed and delivered by the conveyor or by the conveyor's

- Tenant signs and delivers to Landlord an original of this Lease, the Work Letter (**Exhibit D**), and the SNDA (**Exhibit XX**);
- Tenant delivers to Landlord the initial Security Deposit in the amount of ($XX,XXX.xx), and the first full month's Base Rent ($XX,XXX.xx);
- Each Guarantor (if any) signs and delivers its Guaranty (**Exhibit F**) to Landlord;
- Landlord and Tenant each deliver to the other any insurance policies, endorsements, certificates, or proof of insurance required in this Lease;
- Landlord's mortgagee (if any) gives Landlord written approval of this Lease, and Landlord, Tenant and Landlord's mortgagee each execute and deliver the SNDA to the other parties; and
- Tenant delivers appropriate evidence that it is in good standing in the state of its formation and that Tenant and the person signing this Lease on its behalf each has the authority to do so.
- Landlord signs and then delivers to Tenant a copy of the fully executed Lease and Work Letter.

Landlord's delivery to Tenant of an unsigned copy or draft of this Lease does not constitute an offer to, or option in favor of, Tenant.[20] If all seven (7) conditions precedent have not been satisfied, or waived in an

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agent authorized in writing."); *Cottman Transmission Sys., L.L.C. v. FVLR Enters., L.L.C.*, 295 S.W.3d 372, 377 (Tex. App.—Dallas 2009, pet. denied) (holding that "lease agreement and lease rider are subject to the statute of frauds [TEX. PROP. CODE ANN. § 5.021] because they concern the lease of commercial real estate for a period greater than one year.").

[20] ***Moore Burger***. An important exception to the statute of frauds may render an executable version of an unsigned or partially signed lease enforceable. *Moore Burger, Inc. v. Phillips Petroleum Co.*, 492 S.W.2d 934, 937-38 (Tex. 1972).

In *Moore Burger*, two real estate traders, Dowd and Craus (D&C), learned that Phillips Petroleum Company (Phillips) had an interest in securing a site on Guadalupe Street in Austin. D&C acquired an option from the Ing Estate to acquire a small tract of land (Ing Tract) next to another tract the City of Austin leased to Moore Burger (City Tract).

About this time, the City became interested in selling the City Tract. The City told Moore Burger that the City wished to sell the City Tract and invited Moore Burger to bid. Moore Burger secured commitments to finance the possible purchase. In the meantime, D&C heard about the City's possible sale of the City's tract and of Moore Burger's interest in buying it.

Moore Burger's president testified that D&C proposed building a restaurant on the Ing Tract and leasing it to Moore Burger for 20 years if Moore Burger would refrain from bidding on the City Tract. D&C's attorney drew up an agreement to lease and a lease for the Ing Tract. Moore Burger's attorney then made some changes, and Moore Burger signed the revised agreements, and delivered them to D&C. D&C told Moore Burger that D&C "accepted" the revised agreements, and D&C's representative said he would sign them. In reliance on these promises, Moore Burger advised the City that Moore Burger had a lease agreement and would not be bidding on the City Tract.

During this entire time, D&C had a contract to sell the Ing Tract to Broadway Oil Company (Broadway), which planned to build a service station for Phillips. Phillips later bought this contract of sale from Broadway. D&C bought the Ing Tract and the City Tract and sold both tracts to Phillips.

Moore Burger asked its new landlord, Phillips, about Moore Burger's build-to-suit lease with D&C on the Ing Tract. Phillips denied it knew about Moore Burger's build-to-suit lease with D&C and refused to build the restaurant on the Ing Tract. Still, Phillips accepted 15 rental payments from Moore Burger on its lease for the City Tract before attempting to cash them all at once. The bank returned the checks NSF. Phillips evicted Moore Burger. Based on these facts, the Texas Supreme Court held:

> The promise which is determinative here is the promise to sign a written agreement which itself complies with the statute of frauds. No other promise was discussed by the Court in the recitation of the summary judgment evidence, whereas promises to sign were set forth at two points, followed by the recitation that, relying on these promises, 'Moore' Burger did not bid at the sale of the City land. This is the significance of the emphasis upon Section 178, comment f, Restatement, Contracts, and the citation to *Cooper Petroleum Co. v. La Gloria Oil & Gas Co.*, 436 S.W.2d 889, 896 (Tex.1969), where 'the promise was to sign a written guaranty, and a written guaranty would

agreement signed by Landlord and Tenant, by [Closing Deadline], 20___ at 5:00 p.m., this Lease, and all obligations arising under this Lease, will be null and void, exclusive of the obligation of each recipient to return to the delivering party any document or payment tendered by another party under this paragraph 1(j).

(k) *Electricity Costs* mean all costs (excluding Operating Costs) incurred by Landlord, which are directly attributable, or reasonably allocable, to the Project, including, without limitation, (i) electrical services used in the operation, maintenance, and occupancy of the Project; (ii) sales, use, excise, and other taxes assessed by governmental authorities on electrical services supplied to the Project; and (iii) all other costs of providing, monitoring, managing, contracting for, or otherwise incurred in obtaining electrical services for the Project,[21] but Electricity Costs ***exclude***: (A) the cost to supply electricity (including electricity used to

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> have been enforceable.' *See also* 3 Williston, CONTRACTS § 533A, at 786 (3d ed. Jaeger 1957); Comment, *Agreements to Reduce to Writing Contracts within the Statute of Frauds*, 15 VAL. L. REV. 553 (1929).

Moore Burger, Inc., 492 S.W.2d at 937-38 (citing *Cooper Petroleum Co.*, 436 S.W.2d at 896 for proposition that a "claim for promissory estoppel sufficient to remove a lease from statute of frauds requires proof that: (1) the promisors should reasonably have expected that ***their promise to sign the lease*** (2) would induce [the promissee] to forbear bidding on the property (3) which was a forbearance of a definite and substantial character (4) induced by the promise, and (5) that injustice to the promissee can only be avoided by enforcement of the promise.").

[21] ***Electricity Costs: Net of Base Rent.*** This Lease, in the vernacular, is a Plus E (Plus Electrical) modified net lease; that is, all Electricity Costs are net of Base Rent. It treats Electricity Costs as a separate cost category for two reasons. First, unlike Operating Costs, there is no base amount of Electricity Costs included in Base Rent. And, second, the gross-up methodology for Electricity Costs differs from the gross-up methodology for Operating Costs.

Components of Electricity Costs. A landlord typically incurs four separate components of electricity costs in normal office building operations. In most circumstances, only one of the four components – electricity supplied to ***leased*** space –is properly grossed up.

- *Vacancy related electricity costs.* When leasable, but unleased, space is vacant, landlord still must supply electricity to heat and cool the vacant space to prevent pipes from freezing in winter and heat related damage in summer. A tenant should seek to exclude this component of its landlord's total electricity costs from any gross-up of tenant's *pro rata* share of total building electricity costs.
- *Base building electricity costs.* This category includes both the fixed costs of capital and other equipment necessary to supply electricity service throughout the building and the costs of supplying electricity to the common areas throughout the building. A tenant should seek to exclude these costs from any gross-up of electricity costs. A landlord recoups tenant's *pro rata* share of base building electricity costs through the R/U factor, which converts the usable area in tenant's premises to rentable area. But a tenant does not use more of the electrification infrastructure or consume more or less of the electrified building common areas because building occupancy rises or falls.
- *Separately metered, sub-metered, and excess electrical charges.* An increasing number of office buildings separately meter, sub-meter, or measure each tenant's electricity usage within its premises and require the tenant to pay for its own usage as a separate charge. Also, most office leases require the tenant to pay for its own after hours HVAC usage. But not all leases also require landlord to exclude other tenants' metered, sub-metered, or excess HVAC usage from landlord's calculation of tenant's *pro rata* share of building electrical charges. Charges within this category should be entirely excluded from, or amounts payable (not just the charges actually paid) by each user should be subtracted from, charges included in the bucket of electrical costs landlord uses to compute tenant's *pro rata* share.
- *Electrical Usage in leased tenant space.* This component of electricity costs does vary directly with occupancy and ordinarily is properly grossed up in a multi-tenant office building. If a building is 50% leased, and one tenant leases 10% of the leasable space, that tenant is using 20% (assuming all tenants use an equal amount of electricity per square foot) of the electricity supplied to leased and occupied leasable space. In such cases, a landlord ordinarily is justified in charging tenant 20% of this component of landlord's electricity costs but not 20% of landlord's total electricity costs.

Other specific cost allocation issues should be considered to protect a large tenant from bearing a disprortionate cost burden when it has unoccupied space under lease. *See* footnote 22 (explaining potential impact of grossing-up from leased as opposed to occupied space).

supply heating, cooling, and climate control services) to any leasable but unleased areas within the Building; and (B) electrical usage by other tenants or occupants in amounts, of types, or at times that are not Building Standard (including after-hours electrical service and electricity used to supply after-hours HVAC service). If, and to the extent, Landlord receives, or is entitled to receive, reimbursement for providing electrical service to tenants or other occupants (exclusive of reimbursements for other tenants' pro rata share of electricity costs), Landlord will subtract these amounts from Electricity Costs before computing Tenant's Pro Rata Share of Electricity Costs.

(l) *Excess Operating Costs* mean the amount (prorated daily for any partial calendar year) by which Operating Costs for any later calendar year exceed Base Year Operating Costs, but Base Rent will never be reduced, even if Operating Costs for any calendar year are less than Base Year Operating Costs. Landlord will compute Operating Costs in accordance with GAAP; if less than 95% of the Rentable Area of the Building is not fully leased ~~occupied~~,[22] or if Building Standard services are not provided to 95% or more of the

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Electricity Costs: Gross Lease. Some gross leases feature full or partial plus-E structures. One variety of plus-E gross lease does not include the cost of electricity supplied to the premises in base rent; the tenant either pays the electrical service provider directly for electricity supplied to the premises or reimburses the landlord for the tenant's metered or measured electricity usage in the premises. Landlord also bills tenant for tenant's *pro rata* share of building electrical usage (the cost of electrifying the building other than in leased space). If each tenant pays separately for electricity supplied to its own space, there is little justification for grossing-up landlord's general electrical costs before computing tenant's *pro rata* share. Another variety of hybrid gross lease, on the other hand, includes, as part of base rent, a threshold amount of electricity costs per square foot for tenant's normal electrical usage and then charges tenant for its *pro rata* share of any overage. Full service gross leases, which include all electricity costs in base rent, are nearly extinct.

[22] ***Gross-Up Methods and Madness.*** Office leases usually establish hypothetical full occupancy as a percentage of the Rentable Area in the Building. 95% and 100% are common gross-up thresholds. One gross-up method proportionately increases the amount paid by landlord and applies each tenant's fixed *pro rata* share to the deemed increase in cost. Another method proportionately increases each tenant's *pro rata* share and applies each tenant's increased share to the actual cost incurred by landlord. The result is, or should be, mathematically identical.

Grossing-up from the amount of *leased space*, as opposed to the amount of *occupied space*, however, can be financially significant when a sizeable amount of the rentable area in a building is leased but not occupied. Consider this example under a net lease.

Tenant A, B, and C each lease 25% of the rentable area of the building, but tenant C does not occupy its premises. The remaining 25% of the rentable area is both unleased and vacant. The building is thus 75% leased but only 50% occupied. Suppose variable costs (*e.g.*, tenant janitorial service) in the year in question are $100, and landlord is entitled to gross-up to deemed occupancy of 100%. Suppose further that landlord actually pays $50 to clean A's space and $50 to clean B's space.

No Gross-Up. Without any gross-up, tenants A, B, and C each would pay its *pro rata* share (25%) of the $100 total cost of tenant janitorial service or $25, and A, B & C collectively would pay $75. Tenants A and B each would pay only $25, despite the fact that A and B each use $50 in janitorial services. Tenant C, who does not occupy its space, would pay $25 for janitorial services it does not use, and landlord would pay $100 to clean A and B's space but would receive only $75 in reimbursements. Tenant C and landlord subsidize tenants A and B.

Gross-Up from Occupied Space. If landlord grosses up janitorial costs from 50% occupied space to 100% deemed occupancy, Landlord would be deemed to have incurred $200 for tenant janitorial services; tenants A, B, and C would each pay 25% of the grossed-up total or $50, and landlord, who only spent $100, might recover $150, unless the gross-up calculation imposes a sublimit capping landlord's right to reimbursement at 100% of the actual variable costs incurred. This sublimit is easier to compute and apply under the first of the two gross-up methods discussed above. If, in this example, the $100 actual cost-sublimit on cost recovery does not operate on the grossed-up charges, the extra $50 may leak into the general bucket for all operating costs, which are not capped at all or subject to a higher general cap on cost increases. With such a sublimit in place, however, tenants A, B, and C would each pay only $33, and the extra $50 cannot leak back into the general operating cost bucket.

Gross-Up from Leased Space. Grossing-up from 75% , the amount of leased space, rather than from 50%, the amount of occupied space, to 100%, the amount of deemed full occupancy, reduces each tenant's financial exposure. By grossing-up from leased space, landlord would be deemed to have incurred $133.33 for tenant janitorial services instead of $200, and

Rentable Area of the Building during any portion of any calendar year (including the Base Year), Landlord must gross-up in the Base Year and in the year in question only those components of Operating Costs (i) that vary directly with occupancy as if 95% of the Rentable Area of the Building had been fully occupied[23] ~~and Building Standard services had been provided to Rentable Area in the entire Building during that calendar year in question~~ and (ii) that Landlord supplies to Tenant for Tenant's direct use or consumption.[24]

(m) *Expiration Date* is the last day of the 120th full calendar month after the Commencement Date;[25] Landlord and Tenant will sign and deliver a Commencement Letter (**Exhibit E**) confirming the exact Expiration Date and — if requested by either party — a lease amendment.

(n) *Guarantor* means Manny, Mo and Jack, and any other person guaranteeing any of Tenant's obligations under this Lease.[26]

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tenants A, B, and C each would pay 25% or $33.33. Moreover, using leased space to compute the gross-up, rather than occupied space, precludes landlord's entitlement to more than 100% of actual costs incurred.

Adjustment for Vacant Space. This clause may protect a tenant in the position of Tenant C from bearing a disproportionate share of operating costs while is leasing but not occupying its premises:

> If Tenant vacates or ceases operations in all or a sizeable portion of the Premises, and, as a result of such vacancy, Landlord reduces the type, amount, or frequency of Building Standard services furnished to the Premises, then Landlord will equitably reduce Tenant's Pro Rata Share of Operating Costs and Electricity Costs during such vacancy to take into account the reduced level of services provided to the Premises. By way of example, and not limitation, if Landlord receives vacancy credits from its janitorial service contractor for some or all of Tenant's vacant space, Tenant's Pro Rata Share of such variable Operating Costs will be reduced by the amount of such vacancy credits. In addition, Landlord will reduce the variable component of Electricity Costs (including the cost to operate HVAC) for electricity supplied to occupied leasable space in computing Tenant's Pro Rata Share of such costs.

See Rutter & Leonard, *Don't Sign Blind,* at pp. 26—27 (this clause is adapted from a cost containment clause for leased but vacant space in *Don't Sign Blind*).

[23] BOMA publishes THE ESCALATION HANDBOOK FOR OFFICE BUILDINGS by William H. Brownfield, CRE, CCIM, and Lawrence Mayerhofer, CPA. This handbook explains escalation and gross-up methods and discusses the rationales and excuses for grossing-up various charges.

[24] Part (II) of this clause is a response to a landlord's contention that real estate taxes vary directly with occupancy and are properly grossed up. Landlord argued real estate taxes vary directly with occupancy under appraisal and assessment methods and, therefore, should be grossed-up. *See generally* Charles E. Gilliland, *The Texas Property Tax System*, TEXAS REAL ESTATE CENTER (Publication 1192) (July 2011) (comprehensively discussing real estate interests subject to tax; valuation and appraisal processes, assessments, and collection procedures; and other features of Texas' real and personal property tax system), https://assets.recenter.tamu.edu/Documents/Articles/1192.pdf; *see* COMAN & ANDERSON P.C. NEWS ALERT, *The Operating Expense "Gross-Up"*, (October 2010) (explaining rationale for treating real estate taxes as a variable cost for purposes of gross-up clause in commercial lease), http://w.comananderson.com/publications/alerts/october2010.php (last visited February 6, 2017).

[25] *See supra* footnotes **15** (commencement), **16** (delay and *force majeure*), and **17** (delivery of possession), and *infra* footnote **75** (discussing lease term and related common law concepts).

[26] Many of the provisions, and much of the law, addressed in the Texas Annotated Guaranty applies to lease guaranties. *See* Winstead, *Texas Lease Guaranty,* THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 35TH ANNUAL WILLIAM W. GIBSON JR. MORTGAGE LENDING INSTITUTE, at p. 1, fn. 1 (2001-2011). A reasonably well drafted commercial lease guaranty, with occasional help from the conversion statute, should survive entity conversions, lease modifications, and many of the innumerable other impediments to enforcement that the common law placed between creditors and guarantors, the latter being members of a class of persons long regarded as "favorites of the law." *See, e.g., Wasserberg v. Flooring Servs. of Texas, LLC,* 376 S.W.3d 202, 205- 208 (Tex. App.—Houston [14th Dist.] 2012, no pet.) (holding that personal guaranty of debt owed by debtor LLC applied to debtor LLC's debts after LLC converted to a limited partnership, and personal guaranties of any debt owed by debtor LLC to creditor limited partnership applied to indebtedness of debtor LLC after creditor limited partnership merged into an LLC). *But see, e.g., Glasscock v. Console Drive Joint Venture,* 675 S.W.2d 590, 592 (Tex. App.—San

(o) *Land* means the real property described in **Exhibit B** on which the Building is situated.[27]

(p) *Landlord Work* is the portion of the Work described in the Work Letter (**Exhibit D**) to be performed by Landlord.

(q) *Landlord Parties* means (i) Landlord, (ii) Landlord's Mortgagee, (iii) the Building manager, and (iv) their respective shareholders, members, managers, partners, affiliates, subsidiaries, partners, directors, officers, employees, agents, and contractors.[28]

Antonio 1984, writ ref'd n.r.e.) (holding that landlord partially released lease guarantor by accepting a note from tenant for past due rent).

[27] ***Adequacy of Legal Description.*** The description of the premises necessary to enforce a lease as a conveyance differs from the description necessary to evict a tenant. A lease of land for more than one year is a conveyance of land and is subject to the statute of frauds. *Hoover v. Wukasch*, 254 S.W.2d 507, 508 (Tex. 1953). "A writing need not contain a metes and bounds property description to be enforceable; however, it must furnish the data to identify the property with reasonable certainty." *Texas Builders v. Keller*, 928 S.W.2d 479, 481 (Tex. 1996) (citing *Owen v. Hendricks*, 433 S.W.2d 164, 166 (Tex. 1968)). "To be sufficient, the writing must furnish within itself, or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty." *Morrow v. Shotwell*, 477 S.W.2d 538, 539 (Tex. 1972).

A contract providing for the sale or lease of an unidentified portion of a larger, identifiable tract does not reasonably identify the land for purposes of complying with the statute of frauds. *Morrow*, 477 S.W.2d at 540 (holding that "north acreage out of the 145.8 acre tract of the Jefferson McGrew Survey No. 245" is not sufficient); *see, e.g., Texas Builders,* 928 S.W.2d at 480 (holding that writing that identified 58,333 square feet available at 12050 Rojas did not satisfy statute of frauds with respect to lease for 16,667 square feet at 12050 Rojas and for 30,893 square feet at 12058 Rojas); *Matney v. Odom,* 210 S.W.2d 980, 982 (Tex. 1948) (holding that four (4) acres out of the East end of a ten-acre block on the P. Chireno Survey did not reasonably identify land); *Hereford v. Tilson,* 200 S.W.2d 985, 988-89 (Tex. 1947) (holding that description of part of larger tract as "the real property and buildings located at No. 1805 South Haskell, Dallas, Texas" did not satisfy statute of frauds); *Bayer v. McDade,* 610 S.W.2d 171, 172 (Tex. Civ. App.—Houston [1st Dist.] 1980, no writ) (holding that description of land as "50 acres, more or less out of the John H. Callihan survey, Abstract number 10, Harris County, Texas, located at Becker Cemetery Road and Grant Road" did not reasonably describe land). A street address, standing alone, does not reasonably identify the land for purposes of the statute of frauds. *Webb v. Eledge*, 678 S.W.2d 259, 262 (Tex. App.—Amarillo 1984, no writ). But a street address becomes sufficient if the realty can be identified with reasonable certainty by resort to extrinsic evidence explaining or clarifying data *within the framework of the writing. Id.*

Although the better practice is to include an adequate legal description of the property in the complaint in an eviction action, it is not required. Rule S10.3 of the Texas Rules of Civil Procedure only requires that "[t]he complaint shall describe the lands, tenements or premises, the possession of which is claimed, with sufficient certainty to identify the same…." A street address ordinarily satisfies Rule S10.3. *Stewart v. Breese,* 367 S.W.2d 72, 73 (Tex. Civ. App.— Dallas 1963, writ dism'd) (holding that "Route 1, Box 496, Old Seagoville Road, Seagoville, Texas" described the property with "sufficient certainty" to support a judgment); *Mitchell v. Citifinancial Mortg. Co.* 192 S.W.3d 882, 883 (Tex. App.—Dallas 2006, n.p.h.) (stating that street address is sufficiently certain to identify premises in a forcible detainer action).

[28] ***Vicarious liability*** means the liability of one person or entity for the acts or omission of another person or entity. Under Texas law, a principal "is vicariously liable for the torts of [its agents] committed in the course and scope of their employment. *GTE S.W., Inc. v. Bruce,* 998 S.W.2d 605, 617 (Tex. 1999).

Employer Liability for Acts of Employee. "To find that the employee acted within the scope of employment, the action of the employee must be: (1) within the general authority given him; (2) in furtherance of the employer's business; and (3) for the accomplishment of the object for which the employee was employed." *Williams v. United States,* 71 F.3d 502, 506 (5th Cir. 1995) (citation omitted); *see Leadon v. Kimbrough Bros. Lumber Co.,* 484 S.W.2d 567, 569 (Tex. 1972) ("it is not essential that the negligent act or omission should have been expressly authorized by the employer so long as it is in furtherance of the employer's business and for the accomplishment of the object for which the employee is employed."). Moreover, "[t]o be within the scope of employment, the conduct must be of the same general nature as that authorized or incidental to the conduct authorized." *Williams*, 71 F.3d at 506 (internal quotation marks and citations omitted.).

(r) Operating Costs [29] mean all reasonable and necessary, [30] direct and indirect, [31] non-duplicative, [32] costs and expenditures of every kind and character incurred, paid, or amortized [33] in

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Employer Generally Not Liable for Acts of Independent Contractor; Exceptions. An employer has no duty to ensure that an independent contractor performs its work in a safe manner. *Fifth Club, Inc. v. Ramirez,* 196 S.W.3d 788, 792 (Tex. 2006). But an employer can be held vicariously liable for the actions of an independent contractor if the employer retains some control over the manner in which the contractor performs the work that causes the damage. *Id.* In *Redinger v. Living, Inc.,* the Texas Supreme Court explained an exception to an employer's general non-liability for the acts of independent contractors:

> [o]ne who entrusts work to an independent contractor, but who retains the control of any part of the work, is subject to liability for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care.

689 S.W.2d 415, 418 (Tex.1985) (quoting RESTATEMENT (SECOND) OF TORTS § 414 (1977)); Tex. Civ. Prac. & Rem. Code § 95.003 (Westlaw 2016) (codifying *Redlinger's* requirement that property owner must exercise or return some control).. "The supervisory control must relate to the activity that actually caused the injury, and grant the owner at least the power to direct the order in which work is to be done or the power to forbid it being done in an unsafe manner." *Coastal Marine Serv. of Tex., Inc. v. Lawrence,* 988 S.W.2d 223, 226 (Tex. 1999). The requisite right of control is more than a general right to order the work stopped or resumed, to inspect its progress or to receive reports, to make suggestions or recommendations, or to prescribe alterations and deviations. *Id.* Such a general right is usually reserved to employers, but it does not mean that the contractor is controlled as to his methods of work, or as to operative detail. There must be such a retention of a right of supervision that the contractor is not entirely free to do the work in his own way." *Koch Ref. Co. v. Chapa,* 11 S.W.3d 153, 155 (Tex.1999) (quoting RESTATEMENT (SECOND) OF TORTS § 414 cmt. c (1965)). Employers can direct when and where an independent contractor does the work and can request information and reports about the work, but an employer may become liable for the independent contractor's tortious acts only if the employer controls the details or methods of the independent contractor's work to such an extent that the contractor cannot perform the work as it chooses. *Id*. at 155–56.

Contractually Altering Common Law Vicarious Liability Rules. This Lease uses the defined terms, such as Tenant Parties and Landlord Parties, in indemnities, waivers, insurance requirements, and other lease provisions to reallocate certain risks and costs each party would otherwise bear under common law vicarious liability doctrines. For example, Tenant agrees to indemnify and hold Landlord Parties harmless from acts and omissions of Tenant's independent contractors under circumstances in which Tenant probably would not be liable for its contractor's acts at common law. Other exculpatory provisions – the waiver of subrogation clause – exonerate Landlord and Tenant from certain liabilities to each other arising from specified acts and omissions of each party's employees without regard to whether the employee was acting within the course and scope of his employment at the time.

[29] ***Operating Costs.*** The first part of the definition of Operating Costs in this Lease – before the qualifiers were added – is fairly typical; in language both disarmingly general and breathtakingly overbroad, the definition incudes virtually every imaginable cost a landlord might incur in connection with owning and operating an office building. *See generally* Rutter & Leonard, *Don't Sign Blind,* at pp. 23—33 (discussing big-ticket issues and explaining important accounting issues in interpretation and administration of operating cost provisions). The second part of the definition, however, is atypical; it lists a number of exclusions from Operating Costs that may be out of reach to all but the most desirable tenants in all but the worst leasing markets.

Landlord's Objectives. The starting point for most negotiations over operating costs is the definition in the landlord's lease form. A landlord has two key objectives in drafting and negotiating operating cost provisions. The first objective is to recover from its tenants as much of the costs of owning, operating, and maintaining the building as it legitimately can. The second objective is uniformity, minimizing – if not eliminating – variations in the formulae for computing operating costs among leases in a multi-tenant facility. It is difficult enough to account for operating costs correctly using one formula. But it is very difficult to do so if modifications to the operating cost provisions in each lease create materially different formulae, although increasingly sophisticated building management and accounting software should reduce the difficulty.

Tenant's Objectives. A tenant also has several key but sometimes competing objectives. Tenant's first objective is limiting the amount of operating costs it must pay. One approach is negotiating changes in the definition of operating costs and in the formula used to compute them. Another approach is capping the landlord's ability to pass through increases in operating costs. For example, an operating cost provision that prohibits a landlord from passing through any capital expense, rather than requiring the landlord to amortize such costs, may incentivize a landlord to make economically inefficient repairs, or to continue to maintain inefficient or obsolete building mechanical systems, because expenseable repairs and maintenance are recoverable but capital expenditures are not. To achieve its objectives, a tenant (and its broker) must first understand the facilities and landlord's operations, then assess the tenant's negotiating position, and finally select

connection with owning,[34] operating, maintaining, protecting, repairing, replacing,[35] and managing the Building[36] or the Project, including, without limitation:

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the best means available to limit tenant's financial exposure in a way that acknowledges landlord's desire to recover legitimate operating costs and to achieve some semblance of uniformity among the pass through provision in its leases.

Mutual Objectives. A landlord and tenant share several mutual objectives. One is ensuring that the operating cost provisions clearly describe included and excluded costs, explain prorations, gross-ups, and other computational adjustments precisely, and treat operating costs items in a manner that is consistent with the treatment of the same items elsewhere in the lease. Another is giving both parties a stake, or at least some incentive, to minimize operating costs without compromising building operations.

[30] ***Qualifiers – "all" or "reasonable" costs.*** Some landlords resist a tenant's effort to insert subjective qualifications, such as *"reasonable,"* on landlord's right to recover *"all"* operating costs. Any generally subjective qualifying term (*e.g.*, reasonable; necessary, *etc*.) or a qualifying term that requires proof outside the lease (*e.g.,* usual and customary; normal; standard; consistent with regular practices of other operators of [first class] office buildings in the [geographic vicinity], *etc.*) may give tenant an opportunity to question or dispute the amount of an otherwise allowable charge.

[31] Generally speaking, ***direct costs*** are the actual out-of-pocket costs for the labor and material used to provide a particular good or service, while ***indirect costs*** include the costs of the personnel, materials, equipment, facilities, and other expenses (*i.e.,* the overhead) necessary to procure or deliver a particular good or service but which costs cannot be conveniently charged to providing that particular good or service. Cost accounting principles ordinarily should determine whether a particular expense is direct or indirect. If a lease permits landlord to charge a separate management fee and to include indirect costs in operating expenses, the lease may allow landlord to recover twice for some portion of the indirect (overhead) costs of operating and managing the building. *See, e.g.,* **Appendix I-E** *(*management fee calculation).

[32] The purpose of the qualifier – ***non-duplicative*** – is to limit landlord's opportunities for double dipping. In *Group Hosp. Servs., Inc. v. One &Two Brookriver Ctr.*, 704 S.W.2d 886 (Tex. App.—Dallas 1986, no writ), landlord charged tenant for both after-hours air conditioning and extraordinary electricity usage, but tenant refused to pay for afterhours HVAC, contending that landlord double-billed tenant by charging a flat fee for afterhours HVAC and for extraordinary electricity charges. In response, landlord contended that the air conditioning charge reflected replacement and maintenance costs and did not include electricity. *Id.* Three separate provisions in the lease addressed the allocation of electrical and HVAC costs. The operating cost provision required tenant to pay certain defined operating costs, including heating, cooling and utilities that exceeded base year operating costs. *Id.* at 888. The air conditioning provision required landlord to provide air conditioning only during normal business hours and allowed landlord to charge tenant $50 per hour for afterhours HVAC service. *Id.* And the extraordinary electricity usage provision allowed landlord to assess a separate charge for tenant's extraordinary electrical usage. *Id.* The judgment on the jury's verdict in favor of landlord allowed landlord to recover "both $50 per hour for operating the air conditioning system afterhours, plus the cost of the electricity consumed." *Id.* The court of appeals affirmed, observing that "[a]t most, Landlord's conduct increased the cost of afterhours electricity by 100%. Standing alone, the charge for afterhours electricity is a substantial sum, but in comparison to the entire transaction, the amount is small." *Id.* at 889.

[33] ***Operating Cost Accounting Issues.*** A landlord's accounting basis — accrual or cash — determines ***when*** an expense is incurred or recognized on a landlord's books. An entity using accrual basis accounting recognizes an expense when the expense is incurred (*i.e.,* when the entity becomes legally obligated to pay it). All GAAP accounting is done on an accrual basis, but not all accrual basis accounting is performed according to GAAP. Rutter & Leonard, *Don't Sign Blind,* at 24 fn. 3 (stating that landlords generally prefer undefined accrual basis accounting instead of more restrictive GAAP standards). A landlord using cash basis accounting incurs or recognizes an expense when landlord actually pays it. By definition, cash basis accounting is never performed according to GAAP. In most instances, a lease should specify a single, consistent criterion for recognizing expenses to minimize landlord's ability to manipulate the timing of expense recognition by using accrual basis recognition criteria for some expenses and cash basis criteria for others. Amortization of capital expenses spreads the initial capital expense over some period of time, such as the item's useful life, resulting in the recognition of the capital expense in in increments over time.

[34] ***Ownership costs,*** as opposed to operating costs, may include a variety of costs that do not benefit the property or the tenant directly. Different negotiations require different tactics, but it usually easier to delete "ownership" costs as a category of recoverable costs than to exclude all of the specific kinds of costs (*e.g.,* debt service, *etc.*) that a landlord might include in operating costs as a cost of "ownership."

(i) a management fee contribution equal to three percent (3%) of the amount computed accordance with the formula prescribed in paragraph X(x).[37]

(ii) all costs connected with procuring property, liability, and other insurance coverages required or permitted by this Lease[38] (including, without limitation, any payments made to satisfy any deductibles or self-insured retentions and the allocable cost of any blanket insurance policies);[39]

(iii) making available, providing, maintaining, inspecting, testing, repairing, replacing, changing, installing, servicing, cleaning, or evaluating any service, facility, amenity, or equipment serving any part of the Project (including, without limitation, utility; mechanical; electrical; plumbing; HVAC; gas; water and sewer; vertical transportation; fire prevention, warning, and control; access control; security; janitorial; window cleaning; and waste disposal; and landscaping),[40] and buying, renting, paying for, or

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[35] ***Replacements.*** "Certain capital expenditures, such as the replacement of a roof, HVAC equipment, elevators, *etc.* could be included in operating expenses if the definition of expense includes 'replacement.'" Rutter & Leonard, *Don't Sign Blind,* at fn. 2

[36] The definitions of the ***Building*** or ***Project,*** or similar terms, may include operating expenses for facilities (*e.g.*, a health club, or in a mixed-use development, restaurants or other disproportionately heavy users of utilities and other services), which tenant does not use or for which tenant is already paying market rate fees. If a tenant does not use or have the right to use these facilities, tenant justifiably may seek to exclude all or a portion of such costs from the definition of operating costs. If a tenant uses these facilities, such as an on-site health club, but already pays a market rate fee for their use, that tenant may seek to exclude the costs associated with operating such facilities on the ground that it is already paying fully for their use or to require the landlord to include in operating costs only the net costs of operating the facility (operating costs for the health club less revenue and deemed membership revenue of landlord give "free" memberships to employees of other tenants).

[37] ***Management Fees.*** A landlord's right to recover management fees is a matter of contract. In *Wilbur and Vill. Lane Ltd. v. Cinemark Corp.,* 4-00-00760-CV, 2002 WL 1041083 (Tex. App.—Houston [14th Dist.] May 23, 2002, no pet.) (not designated for publication). The lease authorized landlord to charge tenant for the cost paid to a third-party management company ***to supervise the common area***. Tenant refused to pay landlord's statement for management fees because management fees were not a "common facility expense," which the lease defined as "[a]ll liability insurance costs, all costs to maintain, repair, replace, supervise and administer common areas, parking lots, sidewalks, driveways and other areas used in common by the tenants or occupants of the entire shopping center, which costs may include fees paid to a third party in connection with same. *Id.* The court of appeals, based on the facts of the case and the terms of the lease, held that tenant was justified in its refusal to pay the management fee. *See supra* footnotes 31 (discussing direct, indirect, and overhead costs) and 32 (discussing limits on duplicative charges). **Appendix I.A** provides an example of an operating expense, gross-up, and management fee computation.

[38] A tenant should attempt to limit its landlord's unbridled discretion to procure insurance coverages.

[39] ***Insurance Deductibles as Operating Costs.*** Lower deductibles generally translate into higher insurance premiums. If a lease requires landlord to maintain low deductibles, tenant almost assuredly will pay higher insurance premiums as a component of operating costs throughout the lease term. If the lease allows landlord to maintain higher deductibles, each tenant, in the absence of a major covered loss, generally will pay lower insurance costs. But landlord's exposure to a major loss will rise. If such a loss occurs, what then? One approach is to allow landlord to pass through deductibles for losses caused by natural casualties (*e.g.*, storms, *etc.*) and to require landlord to recover deductibles for losses caused by the negligence or fault of tenant or another tenant from the responsible party. The latter part of this bargain, however, is somewhat at odds with a risk allocation scheme in which landlord and tenant each waive claims and their respective insurers' subrogation rights against the other party. In either case, tenant should seek hard limits on its exposure for landlord's deductibles (regardless of the amounts landlord chooses to carry) so that giving landlord the flexibility manage its insurance program as it sees fit does not result in a significant financial burden to tenant or inadvertently nullify the a substantial portion of the intended benefits of the claim and subrogation waiverse elsewhere in the lease.

[40] ***Amenities.*** Some office buildings lease space to restaurants, health clubs, and retail establishments, and some offices are located within mixed-use developments. Each use places different demands on building services. A restaurant, for example, typically uses far more water per square foot of occupied space than does an ordinary office tenant. In a lease for a mixed use facility, an operating cost provision that requires an office tenant to pay its *pro rata* share but does not segregate

otherwise incurring costs for any materials and supplies (*e.g.*, light bulbs and ballasts);[41] equipment and tools; floor, wall, and window coverings; personal property; required or beneficial easements; or service agreements furthering such purposes;

(iv) complying with any Applicable Law (including, without limitation, license, permit, and inspection fees, professional fees, and other costs of negotiating or contesting real estate taxes or any governmental impositions on the Project);

(v) direct costs of capital improvements, amortized or depreciated over the improvement's useful life determined in accordance with GAAP, plus interest on the un-amortized or un-depreciated balance at 2% over the prime rate published in THE WALL STREET JOURNAL on, or on publication date nearest, the date on which the cost was incurred, (A) if, but only if, the improvement is necessary to bring the Building into compliance with any Applicable Law enacted after the Effective Date of this Lease; and (B) if, but only to the extent that, measurable reductions in the direct costs of operating the Building in the calendar year in question exceed the cost of the improvement amortized in the same calendar year.[42]

But notwithstanding the foregoing, Operating Costs ***exclude*** the following items:[43]

EXCLUSION OF SEPARATE PASS THROUGH COSTS

(i) Electricity Costs;[44]

(ii) Real Estate Taxes;[45]

between office space and space occupied by consumers of higher levels of utilities and other building services, may, in effect, require the office tenants to subsidize operating costs properly attributable to other types of users.

[41] ***Light Bulbs and Ballasts.*** A landlord may charge each tenant separately for light bulbs and ballasts replaced in that tenant's premises or landlord may include the costs of replacing light bulbs and ballasts in all tenant spaces as an operating cost. If tenant pays a separate charge for landlord replacing light bulbs and ballasts in its own premises, the lease should exclude replacement of light bulbs and ballasts in other tenant spaces from operating expenses.

[42] ***Capital Expenses.*** An alternative to this actual cost reduction requirement is a clause that allows landlord to include, as an operating cost, the amortized cost of capital improvements made ***in a reasonable attempt*** to reduce those costs, plus interest on the unamortized cost of the improvement. With the latter type of clause, tenants take the initial financial risk if the capital investment does not produce actual cost savings, but tenants still receive a financial benefit from any actual cost savings realized. Landlord, on the other hand, has some disincentive to make unwise investments. Rent rates are set by the market. If a capital investment fails to produce actual cost savings, the stranded cost of an unproductive capital outlay will increase operating costs relative to other buildings, putting landlord at a competitive disadvantage and lowing landlord's profit margins on new leases.

[43] ***Operating Cost Exclusions.*** In many office lease forms, the literal definition of operating costs is so overbroad that an increasing number of landlords include a short list of inarguable exclusions. But, for a number of reasons, many landlords are reluctant to add significantly to their standard list. This Lease form includes some commonly requested exclusions. The annotations explain the basic rationales for and against them.

[44] When a lease separates electricity costs, tax costs, insurance costs, and other expense items from operating costs, the better drafting practice is to exclude explicitly the separate pass through cost categories, such as Electric Costs and Real Estate Taxes, from Operating Costs. *See supra* footnote 21 (discussing separate pass through of electricity costs). Phillip D. Weller & Craig Anderson, *It's Not Easy Being Green: Are Green Leases Really Green?*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2011 BERNARD O. DOW LEASING INSTITUTE (Sept./Oct. 2011). Weller and Anderson's paper describes the implementation of green leasing standards (*e.g.,* LEED, Energy Star, Green Globes, AHSRAE, Green Seal, Environmental Choice Program). The paper also provides examples of Green Default and Remedies, Cost "Saving" Green Installations, and Green Operating Expense Pass Through clauses.

(iii) Margin Tax Costs;[46]

EXCLUSION OF LEASING COSTS

(iv) leasing, advertising, and promotional costs;

(v) any rental and any associated costs, either actual or imputed, for the Landlord's management or leasing office;

(vi) relocation or takeover expenses, including, without limitation, lease buy out costs and expenses incurred by Landlord with respect to space located in another building;

(vii) real estate brokerage commissions;

(viii) attorneys' fees; other professional fees; entertainment expenses; listing fees; lease concessions and inducements; and other costs related to cleaning, showing, leasing, or making ready leasable space; demolition, construction, and related costs incurred in connection with the alteration and improvement of leasable space for, or in preparation for, occupancy;

EXCLUSION OF COSTS INCURRED TO BENEFIT OR TO PROCURE, OTHER TENANTS

(ix) any costs (including permit, license, and inspection fees) incurred renovating, improving, decorating, painting, or redecorating leasable space for tenants or other occupants or in vacant space (including the cost of alterations or improvements to Tenant's Premises or to the premises of any other tenant or occupant of the Building), and any cash or other consideration paid by Landlord on account of, with respect to, or in lieu thereof;

(x) costs incurred to provide non-Building Standard goods, services, or other benefits to one or more tenants or occupants of the Building (other than Tenant) without reimbursement;

(xi) costs incurred to furnish goods and services to any other tenant or occupant to the extent Tenant would be required to pay or reimburse Landlord as a charge separate from, or in addition to, payment of Operating Costs under the terms of this Lease;

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[45] Another discernible trend in many office-leasing markets is to segregate Real Estate Taxes from Operating Costs and to compute each expense category separately. This form illustrates the trend. One reason to separate the two is to simplify calculations when one category – Real Estate Taxes – is not subject to gross-up or requires different, or special, computation methodologies for truing up the base year. Sometimes, it is necessary to provide a "full assessment" formula for base year tax costs in a new or newly renovated building. Another, less common feature of this Lease, is that it provides a Base Year for Operating Costs but not for Real Estate Taxes. This purpose of this division is to illustrate typical gross lease calculations with the Operating Cost provisions and to illustrate the mechanics of a net lease with Real Estate Taxes.

Here is a typical example of a "full assessment" requirement from a modified, hybrid gross office lease that requires tenant to pay increases in real estate taxes over the amount of real estate taxes incurred, as if the building were "fully assessed," in the base year:

> If Real Estate Taxes are not fully assessed for the entire Base Year, then Real Estate Taxes for the Base Year shall be appropriately adjusted to an amount of "full assessment" (*i.e.*, as if the Building were eighty-five percent [85%] occupied and built out with Building Standard leasehold improvements and all tenants paying full market rents and otherwise adjusted in a manner methodologically consistent with any adjustments to Real Estate Taxes in the out year in question.

[46] **Appendix I.B** provides a sample clause that allows landlord to recover and gross-up the Texas's margin tax.

(xii) costs incurred to provide goods, services, or other benefits to other tenants or occupants for which (A) Landlord [actually receives] is entitled to reimbursement as an additional charge or rental over and above Base Rent (including any escalations), or (B) the other tenant or occupant is obligated to pay to a third-party;[47]

EXCLUSION OF LANDLORD'S COST OF BEING IN BUSINESS AS DISTINGUISHED FROM COSTS OF OPERATING THE PROJECT[48]

(xiii) costs incurred for Landlord's general corporate overhead and general administrative expenses;

(xiv) costs incurred for wages, salaries, bonuses and other compensation of any officer, executive, or employee of Landlord above the grade of building manager;

(xv) costs incurred to pay fees or dues, or to make cash or in-kind contributions, for political, charitable, industry association, or similar organizations;

(xvi) costs associated with owning, managing, and operating the entity constituting Landlord, including, without limitation, all costs incurred for: (A) the entity's tax and financial accounting; (B) legal services; (C) prosecuting or defending any claims or lawsuits with any mortgagee (except to the extent Tenant's acts or omissions are in issue); (D) selling, syndicating, financing, mortgaging, or hypothecating Landlord's interest in the Building; and (E) disputes between Landlord and its employees, building managers, lenders, contractors, tenants, and other occupants (including Tenant);[49]

(xvii) costs incurred to buy or rent furniture and office equipment for Landlord's management, security, engineering, or other offices of Landlord its leasing agents, management personnel associated with the Building;

(xviii) costs (other than routine maintenance costs) of any art work (such as sculptures or paintings) used to decorate the Building;

EXCLUSIONS OF COSTS INCURRED IN CONNECTION WITH REVENUE PRODUCING ACTIVITIES

(xix) all compensation paid to clerks, attendants, concierges, or other persons working in or managing commercial concessions operated by Landlord;[50]

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[47] Some leases only account for reimbursements landlord actually receives, effectively shifting from landlord to tenant the risk of another tenant's non-payment. A tenant should ask landlord to account for both reimbursements landlord actually receives, as well as those landlord is entitled to receive.

[48] Landlord incurs certain overhead costs conducting general business operations that are separate, in some senses, from the costs of directly operating and managing the building. The examples exclude the costs of administering landlord's business affairs as opposed to operating the building.

[49] Tenant may justify excluding attorneys' fees on the ground that the only fees landlord should recover from tenant are those landlord is entitled to recover under the provision for attorneys' fees in the default and remedies provisions of the lease, unless the expenditure directly benefits tenant. Tenant should not bear the expense of defending discrimination, wage and hour, partnership disputes, tax audits, and other claims asserted against landlord by third parties, by persons within landlord' organization, or by its owners.

[50] Tenant may justify excluding expenses of operating concessions within the building on the ground that landlord should credit revenue from operating concessions or providing amenities against the costs incurred.

(xx) costs associated with managing, repairing, maintaining, insuring or operating any parking structure including the cost of payroll for clerks, attendants and other persons, bookkeeping, parking insurance, parking management fees, tickets, striping and uniforms directly incurred in operating the parking garage;[51]

(xxi) costs of installing or, to the extent operational costs exceed those normally incurred for providing general office space, the cost of operating any specialty service, such as an observatory, broadcasting facility, luncheon club, or athletic or recreational club;

EXCLUSION OF COSTS AVOIDABLE BY LANDLORD'S EXERCISE OF DUE CARE

(xxii) costs incurred as a result of any Landlord Party's breach of any contractual, statutory, tort, or other legal duty to Tenant, to any other tenant, or to any third-party, [but nothing in this clause will preclude Landlord from recovering under any applicable insurance policy];

(xxiii) costs, penalties, and fines incurred by Landlord as a result of the violation by Landlord, or by any other tenant or occupant of the Building, of applicable Laws, [except reasonable and necessary costs incurred in any [successful] good faith contest of the alleged violation of Applicable Laws;

(xxiv) penalties, interest, or similar charges incurred as a result of any late payment by Landlord, including, without limitation, penalties for late payment of taxes, equipment leases, and other amounts owed by Landlord to any third party, [but Landlord may include in Operating Costs any late charge incurred by Landlord during any period Tenant is delinquent more than 30 days in paying all or any part of the Rent];

EXCLUSION OF EXCESS COMPENSATION
PAID TO RELATED PARTIES

(xxv) payments to any parent, subsidiary, or affiliate of Landlord for services (other than the management fee), or for goods, supplies or other materials, to the extent that the costs of such services, goods, supplies, or materials exceed the cost that would have been paid had the services, goods, supplies or materials been provided by parties unaffiliated with Landlord;

EXCLUSION OF SALE AND FINANCING COSTS

(xxvi) contributions to operating expense reserves, tenant improvement reserves, leasing commission reserves, capital improvement reserves, or any other reserve;

(xxvii) legal, auditing, consulting and professional fees paid or incurred in connection with negotiations for financings, refinancings, sales, or exchanges of the Project;

[51] A large multi-floor tenant negotiated an exclusion for operating expenses related to the underground parking garage. In its operating expense computation, landlord excluded only the costs paid to the valet parking operator. The lease literally excluded all expenses relating to the garage (including electricity, elevators, security, management fees related to parking revenues, administrative property management personnel overseeing the garage, insurance and property taxes). After a lease audit and negotiations, landlord reduced tenant's operating expenses by over $.50 per foot, per year based on the literal terms of the lease. Rutter & Leonard, *Don't Sign Blind,* at 24-25 (providing sample clause excluding parking garage operating costs).

(xxviii) payments of principal, interest, defeasance charges, or other charges in connection with any loan secured, in whole or in part, by the Building or the Project and payment of rent under any ground lease;

(xxix) depreciation, amortization, payments on any encumbrances on the Project and the cost of capital improvements or additions;

EXCLUSION OF COSTS ARISING FROM PRE-EXISTING PROPERTY CONDITIONS

(xxx) costs incurred to remediate mold or encapsulate, remove, or abate asbestos or Hazardous Substances present at the Project as of the Effective Date of this Lease.[52]

(xxxi) costs, capital or otherwise, incurred to correct or repair defects in the construction or design of the Project, to replace any defective equipment or building system serving the Project;

EXCLUSION OF GREEN CHARGES

(xxxii) costs of LEED certification and other Green programs or initiatives, ***except*** to the extent that the measurable reduction in Operating Costs exceeds to costs of the program or initiative.[53]

PARTIAL EXCLUSION OF CAPITAL EXPENSES

(xxxiii) capital expenses incurred to renovate, upgrade, alter, or improve the aesthetic appearance of the Building or the Project.[54]

[52] No Texas case apparently has decided the issue, but courts in other jurisdictions have held that a general repair covenant, even one that requires tenant to make structural repairs, ordinarily does not require the tenant to abate asbestos generally or to abate asbestos that has deteriorated due to ordinary wear and tear. *See Arnot Realty Corp. v. New York Tel. Co.*, 245 A.D.2d 780, 665 N.Y.S.2d 478 (N.Y. App. Div. 1998) (holding that tenant, who had duty to make all necessary structural repairs to leased premises, was not required to abate asbestos hazard on premises because asbestos hazard was not condition in need of repair); *Mittleman Props. v. Bank of California*, 886 P.2d 1061 (Ore. 1994) (stating that nothing in lease obligating tenant to keep premises in "good order and condition and to promptly make all necessary repairs" required tenant to remove asbestos that was not a current health hazard or in a state of disrepair). Asbestos is present in virtually all office buildings, even new ones, and friable asbestos (the dangerous form) is present in insulation used in many buldings built before the mid-1980s. *See* EPA—*Asbestos—General*, http://www.epa.gov/asbestos; *Corrosion Proof Fittings v. E.P.A.*, 947 F.2d 1201, 1215 (5th Cir. 1991) (concluding that EPA did not present sufficient evidence to justify its asbestos ban under the Toxic Substances Control Act because EPA failed (i) to consider all necessary evidence and (ii) to give adequate weight to statutory language requiring it to promulgate the least burdensome, reasonable regulation required to protect the environment). Especially in older buildings, tenant should protect itself expressly from liability and extra expensis arising from the demolition, renovation, and remediation of asbestos.

[53] *See* Weller & Anderson, *It's Not Easy Being Green*, (Appendix 1—Green Implementation Provisions), at pp. 5-16 (examples of green lease clauses). This paper describes the implementation of green leasing standards (*e.g.*, LEED, Energy Star, Green Globes, AHSRAE, Green Seal, Environmental Choice Program). The paper also explains, and provides examples of, clauses for Green default and remedies, cost "saving" Green installations, and Green operating expense pass throughs provisions.

[54] A tenant interested in leasing space in a building where landlord is undertaking, or plans to undertake, major renovations should seek to exclude from operating costs the capital expenses associated with making such improvements. Rental rates seem to be a more appropriate way to price these kinds of upgrades and to allow landlord to recover their costs.

CREDITS

Landlord and Tenant also agree that Operating Costs will be "net" only and, for this purpose, Operating Costs will be reduced by the amounts of any reimbursement, recoupment, payment, discount, credit, reduction, allowance or the like received by Landlord, or to which Landlord is, or may be, entitled, in connection with such operations,[55] including, without limitation:

(i) the amount of any discount or rebate given to Landlord or any affiliate of Landlord for goods or services included in Operating Costs;

(ii) reimbursements received for repairs, replacements, general maintenance, or other operating costs under insurance policies, warranties, or other contracts (including tenant leases);

(iii) any revenue from concessions operated by Landlord (*e.g.*, snack bar, restaurant, or newsstand, fitness facility, *etc.*) in the Project.

(s) *Parking Fees* are the amounts Landlord will be entitled to charge for any Tenant Party's right to use any parking facilities serving the Project,[56] plus any applicable taxes.[57] The initial monthly Parking Fee: (i) for each of the #### Reserved Spaces will be $XXX.xx and (ii) for each of the #### Unreserved Spaces will be $XXX.xx. Landlord will be entitled to increase the Parking Fees from time to time.

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[55] Rutter & Leonard, *Don't Sign Blind,* at 24 (garage operating costs includable only to the extent that costs exceed parking related revenue).

[56] A tenant should understand how landlord accounts for parking revenue and for the costs of operating parking facilities. Does landlord include (or does the lease grant landlord the right to include) in operating costs the expenses incurred to operate parking facilities? If so, does landlord credit parking revenues against such costs so that landlord only passes through operating costs in excess of parking revenues? Or, does landlord charge tenant parking fees and include in operating costs the costs to operate parking facilities without crediting parking revenues against such costs?

[57] ***Sales Taxes on Parking Revenue.*** Texas imposes a sales tax on parking services but not on rent. *See* TEX. TAX CODE § 151.0101; 34 § 3.315(d). If one lease gives free parking, but another one does not, "any monetary difference may be considered as evidence of the value of the parking" for purposes of assessing the sales tax. *See* 34 TEX. ADMIN. CODE § 3.315 (d).

Sales tax is due on parking and storage fees for a motor vehicle. Examples include parking meters, either private or municipally owned, fees, decals and permits for parking or storage in any lots or garages, impound fees, charges for valet parking services, and parking facility lease or rental. If the charge for parking and storage either includes a charge for transportation such as shuttle services, or is in addition to a separately stated charge for transportation, sales tax is due on the entire charge, including any separately stated charges for transportation, other than motor vehicle towing provided by licensed tow truck operators. 34 TEX. ADMIN. CODE § 3.315 (b).

A boot fee by a private parking lot or garage is subject to sales tax. 34 TEX. ADMIN. CODE § 3.315(c).

A contract for the lease or rental of real property may include motor vehicle parking and storage as part of the agreement. If a contract for the lease or rental of real property includes a charge for motor vehicle parking and storage, sales tax is due on the motor vehicle parking or storage charge. If one agreement includes motor vehicle parking, and another agreement for similar property does not, any monetary difference may be considered as evidence of the value of the parking. 34 TEX. ADMIN. CODE § 3.315 (d).

The person who provides the parking or storage service must pay sales or use tax on all taxable items that are purchased for use in providing the service. The service provider may make tax-free purchases of taxable services that are provided to the customer as an integral part of the motor vehicle parking and storage service. The service provider may also make tax-free purchases of tangible personal property that is transferred to the care, custody, and control of the customer. Examples include decals or ticket stubs that are transferred to the customer. *See* 34 Tex. Admin. Code §§ 3.285 (relating to Resale Certificate; Sales for Resale); § 3.315(e).

(t) *Permitted Use* means general office purposes and no other purpose.[58]

(u) *Premises* mean the space in the Building shown on **Exhibit A**, located on Floor **«FloorNumber»**, and designated as Suite «SuiteNumber». Landlord and Tenant stipulate that the *Rentable Area of the Premises* is «PremisesRentableArea» square feet even if this stipulated number is more or less than the actual number of square feet.[59] [But Landlord, within thirty (30) days after substantial completion of the improvements (defined term from Work Letter), will be entitled, but not required, to re-measure and revise the Rentable Area of the Premises in accordance with the Building Standard measurement methodology if Landlord, its architect, or its space planner determine that the Rentable Area of the Premises differs from the initial stipulation, and, upon any re-measurement, the revised measurement will be deemed the Rentable Area of the Premises.][60] Landlord and Tenant will sign and deliver a Commencement Letter (**Exhibit E**) confirming the revised Rentable Area of the Premises and — if requested by either party — a lease amendment.

(v) *Project* means the Land, the Building, any parking garage serving the Building, and all other improvements and facilities now or later located in the Building or on the Land.[61]

(w) *Real Estate Taxes* mean all real estate taxes, assessments, and other charges allocable to the Project that are imposed, assessed, charged, or levied by any present or future federal, state, county, municipal or other governmental entity, department, or subdivision; any quasi-governmental entity;[62] any community improvement, municipal utility, or other such district or authority that now or, in the future, on the Project or its operation (including the reasonable costs of contesting any of the same) or on Landlord as the

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[58] *See infra* [paragraph 5] (Use) an accompanying footnotes 97 and 98 (discussing use, permissive use, and continuous use).

[59] *See supra* footnotes 11—13 (summarizing area stipulations, basic BOMA measurement standards, and related measurement issues).

[60] This re-measurement clause is an alternative to stipulating to the initial Rentable Area. Stipulating to the Rentable Area is not possible when the lease is signed before landlord constructs the building, and it is not advisable when a lease for less than a full floor is signed before demising walls and other major tenant improvements are constructed. *See supra* footnotes 11 (discussing rentable area stipulations) and 12 (discussing 2010 BOMA measurement standards).

[61] *See supra* footnote 32 (discussing potentially duplicative operating cost allocations for parking and other amenities in office buildings).

[62] ***Real, Real Estate Taxes.*** "[A] leasehold estate is a real estate interest…." *Dallas Cent. Appraisal Dist. v. Jagee Corp.*, 812 S.W.2d 49, 51 (Tex. App.—Dallas 1991, writ denied). Yet, "[e]xcept for a narrow exception in the case of real property exempt from taxation, the leasehold is not independently taxed under Texas law, but its value is subsumed within the value of the fee simple estate and taxed entirely to the owner of the fee." *Cherokee Water Co. v. Gregg Cnty. Appraisal Dist.*, 773 S.W.2d 949, 955 (Tex. App.—Tyler 1989), *aff'd*, 801 S.W.2d 872 (1990). As a result, "[a] lessor, not a lessee, is responsible for taxes on the full value of the property." *Cherokee Water Co.*, 801 S.W.2d at 875; *Daugherty v. Thompson*, 9 S.W. 99, 101 (Tex. 1888) (superseded by statute as stated by *City of Beaumont v. Fertitta*, 415 S.W.2d 902 (Tex. 1967)); *Martin v. City of Mesquite*, 590 S.W.2d 793, 798 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.). This result is justified economically on the ground that "[t]he lessor's interests in the property are not just the future right to receive the property back at the end of term, but the present right to receive income in the form of rent." *Cherokee*, 801 S.W.2d at 875.

Reallocating Statutory Liability for Real Estate Taxes. A lessor and lessee, however, may contract for lessee to pay the taxes. *Dependable Motors, Inc. v. Smith*, 433 S.W.2d 933 (Tex. Civ. App.—Austin 1968, writ ref'd n. r. e.). While such a contract does not relieve a lessor-owner of ultimate responsibility to the taxing authority for the taxes, it does permit lessor-owner to seek appropriate remedies against lessee if lessee fails to perform its contractual obligation to pay the taxes. *A. J. Robbins & Co.*, 610 S.W.2d at 855-56; *Dependable Motors, Inc.*, 433 S.W.2d at 934. Absent a contractual obligation, however, a lessee has no responsibility for *ad valorem* taxes on privately owned leased realty. *Dependable Motors*, 433 S.W.2d at 934.

owner of the Project, whether or not such taxes or impositions are paid directly by Landlord,[63] but notwithstanding the foregoing, Real Estate Taxes ***exclude:***

(i) federal and state taxes on income, death taxes, franchise taxes imposed or measured on or by the net income, mortgage taxes, transfer taxes, and any taxes imposed or measured on or by the net income of Landlord from the operation of the Project;[64]

(ii) penalties, late fees, or other charges imposed upon Landlord non-payment, delinquent payment, under payment, or deficient reporting of taxes,[65]

(iii) any special or benefit assessment, development tax or impact fee levied in connection with the initial construction or subsequent alteration, redevelopment, remodel or expansion of the Building or Project;

(iv) any tax on the financing, refinancing, syndication, sale, exchange, or other transfer of all, or any part of, the Project;[66]

(v) *ad valorem* and other taxes on any tenant's personal property and on the value of the leasehold improvements in the Premises and in other leasable space in excess of the greater of $_____ per square foot or the then Building Standard allowance, and if any portion of such tax is assessed on the value of leasehold improvements in excess of this threshold, Landlord shall make an appropriate allocation of the *ad valorem* taxes allocated to the Project to give effect to this limitation on the amount of taxes includable in Real Estate Taxes.[67]

(vi) taxes payable by Landlord under Chapter 171 of the Texas Tax Code (*Texas Margin Tax*), as such statute may be amended or recodified from time to time (but only to the extent such amendment or recodification does not alter the fundamental premise of the Texas Margin Tax as a tax created and imposed in lieu of *ad valorem* taxes or is otherwise a non-substantive amendment or recodification).[68]

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[63] *See generally* Charles E. Gilliland, *The Texas Property Tax System*, TEXAS REAL ESTATE CENTER (Publication 1192) (July 2011) (comprehensively discussing interests subject to tax, valuation and appraisal process, assessments, collection procedures, and other features of Texas' real and personal property tax system), https://assets.recenter.tamu.edu/Documents/Articles/1192.pdf.

[64] When a lease separates operating costs from real estate taxes, consider whether the restrictions on landlord's right to pass through income and other taxes in the tax calculations should be applied to limit landlord's right to pass through such charges in the operating expense calculation.

[65] This exclusion prevents landlord from passing through as part of Real Estate Taxes the costs of its failure to exercise due care or to meet its financial obligations to taxing authorities. It also ensures that delinquency costs, which are also excluded from the definition of Operating Costs, stay excluded when the lease segregates operating costs and real estate taxes.

[66] This Lease allows landlord to recover its "ownership" expenses in Operating Costs, but the Lease excludes from Operating Costs expenses landlord incurs in connection with selling or financing the project. The purpose of excluding taxes on real estate sales and financing transactions is prophylactic. Texas does not presently impose a real estate tax on these transactions.

[67] This provision segregates, for tax purposes, Building Standard improvements from above building standard improvements. Tenant takes financial responsibility for Real Estate Taxes on its own above Building Standard improvements. Tenant should ensure that this type of clause also prevents landlord from passing through to tenant any taxes assessed on the value of other tenants' above building standard improvements.

[68] *See* **Appendix I.B.** (landlord oriented margin tax provision).

If any tax otherwise includable in Operating Expenses or Real Estate Taxes is payable in installments, then Landlord shall be deemed to have elected to pay such taxes in installments over the longest period permitted by law, and in such a case, Tenant shall only be obligated to reimburse Landlord for its share of each installment as it would otherwise be payable during the Term of this Lease.

(x) *Rent* means Base Rent, plus Tenant's Pro Rata Share of: (i) net Electricity Costs, (ii) net Real Estate Taxes, and (iii) any Excess Operating Costs, together with Parking Fees and all other sums of money owed to Landlord under this Lease.[69]

(y) *Rentable Area* of the Building means the total number of square feet in the Building as determined by Landlord or its architect, and *Rentable Area of the Premises* means the sum of the number of square feet: (i) within the demising walls of the Premises; (ii) within any other area in the Building designated for Tenant's exclusive use; and (iii) constituting Tenant's Pro Rata Share of the Common Areas and Service Areas in the Building as determined by Landlord, its architect, or its space planner. [70]

(z) *Rules and Regulations* are the Building Rules and Regulations (**Exhibit C**), as Landlord, from time to time, may amend them, but if any Building Rule conflicts with any term of this Lease, the applicable lease term will control.

(aa) *Security Deposit* initially is $XX,XXX.xx.[71]

(bb) *Service Areas* are those areas in the Building that are used for stairs, fire towers, elevator shafts, flues, vents, stacks, pipe shafts, vertical ducts, and other vertical penetrations (excluding any such area

[69] *See supra* paragraph 1(b) (Base Rent); paragraph 1(dd) (Tenant's Pro Rata Share); paragraph 1(k) (Electricity Costs); paragraph 1(w)1(k) (Real Estate Taxes); paragraph 1(r) (Operating Costs); paragraph 1(l) (Excess Operating Costs); paragraph 1(s) (Parking Fees); and paragraph 1(a) (Additional Rent).

[70] Rentable Area equals the Usable Area multiplied by a conversion factor — the R/U Ratio — that distributes service and common areas of a building. The usual rationale for using the Rentable Area to calculate a tenant's *pro rata* share of operating costs is to allocate equitably the costs of the common areas among all of the building's tenants. The ratio of the Rentable Area of the premises to the Rentable Area of the building will accomplish this more consistently than the ratio of the Usable Area of the premises to the Usable Area of the Building. The Rentable Area in many existing buildings may be 22% greater than the Usable Area. Some office buildings now under construction are claiming that the Rentable Area will be only 9% greater than the building's Usable Area. The lower R/U Ratios in these new buildings, together with more energy efficient insulation, HVAC, and other building systems, may reduce operating costs per usable square foot to compensate for apparent differences in rental rates. These different measures complicate rate and operating cost comparisons. The basic equation for converting Rentable Area to Usable Area, and *vice versa*, is:

RENTABLE AREA = USABLE AREA x R/U RATIO USABLE AREA = RENTABLE AREA / R/U RATIO

In common parlance, Usable Area, refers imprecisely to the area within the demising and any outer walls of the premises (*i.e.*, the space where an office tenant normally houses its people and things). One multi-tenant floors, usable square footage is the area inside the walls of the office (including recess entry and exit doors and structural columns). This common understanding of Usable Area is incomplete. Under the Standard Method for Measuring Floor Area in Office Buildings, ANSI/BOMA Z65.1-1996 (1996 BOMA Standard), Usable Area means office area, plus store area, plus building common area. Usable Area does not include Building Service Areas, such as building lobby and corridors; fire control center and equipment; restrooms and janitors' closets; mechanical, electrical and communications rooms and closets; truck loading, receiving and trash; or building management and maintenance.

BOMA's 2010 Floor Measurement Standard (ANSI/BOMA Z65.1 - 2010) defines usable area as "occupant area" plus "building amenity areas." Occupants include tenants as well as owner occupants, an important distinction for facility managers and some single tenant buildings. Building Amenity Areas include only those amenities that are convertible to Occupant Area and are not required by code or for the operation of the building. Shared conference rooms, exercise areas/fitness centers, child-care centers, and vending areas are classified as Building Amenity Areas.

[71] *See infra* paragraph 4 (Security Deposit).

reserved for Landlord or a particular tenant's exclusive use) and those areas outside the Building but serving the Project that are ***not*** available for the non-exclusive use or benefit of tenants generally or the public[72].

(cc) Tenant Parties are Tenant and its shareholders, members, partners, directors, officers, employees, agents, sublessees, licensees, invitees, and contractors.[73]

(dd) *Tenant's Pro Rata Share* means x.xxxx%, which is the Rentable Area of the Premises divided by the Rentable Area of the Building, expressed as a percentage.[74]

(ee) *Term* means the remaining portion of any partial month in which the Commencement Date occurs, plus the next «xxx» full calendar months, unless sooner terminated in accordance with this Lease.[75]

(ff) *Trade Fixtures* include Tenant's moveable furniture, equipment, and any signs within the Premises.[76] Trade Fixtures ***exclude*** any ~~permanent~~ leasehold improvements installed by Landlord in the

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[72] BOMA Office Building Standards use terms-of-art, such as Service Areas. These are also defined lease terms. Are the two defined terms identically defined? Should the terms be identical? If not, is it necessary to stipulate which term prevails in the event of any conflict, or that one definition (*e.g.,* the BOMA definition) prevails on measurement issues but that the defined Lease term prevails on all other issues (*e.g.,* concerning use of service areas).

[73] *See supra* footnote 28 (discussing common law vicarious liability doctrines and use of defined terms, such as Landlord Parties and Tenant Parties, to alter common law vicarious liability rules, especially in exculpatory, indemnity, and insurance provisions).

[74] Tenant's Pro Rata Share is applied to determine Tenant's obligation to reimburse Landlord for Electricity Costs (paragraph 1(k)); Real Estate Taxes (paragraph 1(w)); and Excess Operating Costs (paragraph 1(l)) *see also* paragraph 1(a) (Additional Rent).

[75] "[T]he word, ***term***, does not merely signify the time specified in the lease, but the estate also and interest that passes by the lease; and therefore the term may expire, during the continuance of the time, as by surrender, forfeiture and the like.'" *Davis v. Vidal*, 151 S.W. 290, 292 (Tex. 1912) (quoting 2 William Blackstone, *Commentaries* *448) (emphasis added). "A lease is a grant of an estate in land for a limited term, with conditions attached." *Holcombe v. Lorino,* 79 S.W.2d 307, 310 (Tex. 1935). "A lease for years must have a definite and certain time at which it begins and ends." *Nitschke v. Doggett*, 489 S.W.2d 335, 337 (Tex. Civ. App.—Austin 1972) (citing 3 THOMPSON ON REAL PROPERTY § 1088, at p. 309 (1959 Replacement) and RESTATEMENT OF THE LAW OF PROPERTY § 19, cmt. b (1936)), *judgment vacated and cause dism'd on other grounds*, 498 S.W.2d 339 (Tex. 1973). "This was the rule at common law, and, apparently, is still the law of this state." *Nitschke*, 489 S.W.2d at 337 (citing *Lea v. Hernandez*, 10 Tex. 137 (1853)); *see Hill v. Hunter*, 157 S.W. 247, 251-52 (Tex. Civ. App.—Austin 1913, writ ref'd) (citing *Bishop of Bath's Case*, 6 Coke 35 for the "principle that a lease must as to its duration be certain or refer to a certainty [as] thus tersely stated by the learned English jurist…: 'When a lease for years shall be made good by reference, the reference ought to be a thing which has express certainty at the time of the lease made, and not a possible or casual certainty[]'"and holding that "a lease of premises for a term 'as long as the tenant pays the rent' is, on account of the uncertainty of its duration, a tenancy at will."). "If a tenant is holding premises for no certain time as provided by a contract, he is merely a tenant at will." *Virani v. Syal*, 836 S.W.2d 749, 751 (Tex. App.—Houston [1st Dist.] 1992, writ denied); *see generally* Sir Edward Coke, *Commentary Upon Littleton* 45 (13th Ed. 1789) ("For regularly in every lease for years the term must have a certain beginning and a certain end…' [and] if one makes a lease [f]or [sic] so many years as he shall live, this is void *in praesenti* for the uncertainty.")

[76] At common law, ***trade fixture*** means an article (1) annexed to the realty by the tenant to enable the tenant properly or efficiently to carry on the trade, profession, or enterprise contemplated by the tenancy contract or in which he is engaged while he is occupying the premises, and (2) removable without material injury to the freehold. *Jim Walter Window Components v. Turnpike Dist. Ctr.*, 642 S.W.2d 3, 5 (Tex. App.—Dallas 1982, writ ref'd n.r.e.). The general rule is that in the absence of a contract between landlord and tenant to the contrary, a tenant may remove and take away trade fixtures at the end of his lease. *Eckstine v. Webb Walker Jewelry Co.*, 178 S.W.2d 532, 535-36 (Tex. Civ. App.—Fort Worth 1944, writ ref'd w.o.m.) (reasoning that improvements made by a vendor, mortgagor, or ancestor are made to enhance value of fee estate, while improvements made by a tenant are temporary, made for the purposes of trade, giving rise to a legal presumption that tenant who erects improvements on leasehold does not intend to contribute toward enhancement of landlord's reversion). *See* William M. Howard, *Time Within Which Tenant's Right to Remove Trade Fixtures Must Be Exercised*, 109 A.L.R.5th 421 (2003 & Supp. 2013); William M. Howard, *What Constitutes Trade Fixture—Modern Cases*, 107 A.L.R.5th 311

Premises or the Building; any floor, wall, or ceiling coverings (except throw rugs); interior walls or partitions; lighting fixtures; built-in book cases, cabinets, counters affixed to walls or floors; or anything else that is part of, or associated with, any electrical, plumbing, or mechanical system in or serving the Premises.

2. **LEASE GRANT**. On the terms expressed in this Lease, and other valuable consideration,[77] Landlord leases the Premises to Tenant, and Tenant leases the Premises from Landlord for the Term,[78] together with the non-exclusive right to use in common with other tenants of the building and their employees, customers, and invitees, the lobbies, stairways, toilet and sanitary facilities not located within any tenant's premises, and all other general common facilities in the Building, as well as sidewalks, docks, delivery areas, and parking areas, and all appurtenances thereto designated by Landlord from time-to-time for such non-exclusive use by tenants and other occupants.[79] By taking of possession of the Premises, Tenant (a) accepts

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(2003 & Supp. 2013). But the parties are generally free to alter common law rules governing the ownership of property at the end of the lease term. *Reader v. Christian*, 234 S.W. 155, 157 (Tex. Civ. App.—Beaumont 1921, writ ref'd) (stating that general rules of law pertaining to fixtures must yield to provisions of contract made by parties).

[77] As a general rule, reciting good and valuable consideration in a written contract is *prima facia* evidence that consideration supports the contract, but such recitals may be rebutted by parol evidence. *See Orbeck v. Alfei*, 276 S.W. 947, 948 (Tex. Civ. App.—Waco 1925, no writ). The traditional rule is that a consideration recited to have been paid or contracted for may be varied by parol, while the terms of a contract may not be, though the contract they disclose may be the consideration on which the act or obligation of the other party rests. *See D. Sullivan & Co. v. Schreiner*, 222 S.W. 314, 317 (Tex. Civ. App.—San Antonio 1920, writ ref'd). The traditional rule is subject to the exception that parol evidence is admissible and may be given effect to modify or explain the consideration for the contract, unless the recited consideration is contractual in its nature, in which case parol evidence is not admissible, or, if admitted, may not be given the intended effect. *Pope v. Mergenthaler Linotype Co.*, 131 S.W.2d 668, 670 (Tex. Civ. App.—San Antonio 1939, writ ref'd). When the stipulation as to consideration is contractual, it, like any other written contract, is the exclusive evidence, and cannot be varied by parol. *Id.*

The enforceability of a lease rarely depends on proving whether the $10 recited as nominal consideration was actually "in hand paid" or not. Since at least 2004, any concerns about similar recitals in renewal, expansion, or other options granted in a lease should be put to rest as well. In *1464-Eight, Ltd. v. Joppich*, 154 S.W.3d 101, 102 (Tex. 2004), the Texas Supreme Court incorporated section 87(1)(a) of the RESTATEMENT (SECOND) OF CONTRACTS into the common law of Texas applicable to option contracts. "[T]he Restatement (Second) has taken the position, adopted by some common law courts, that a *false recital* of nominal consideration is sufficient to support the irrevocability of an offer so long as the underlying exchange is fair and the offer is to be accepted within a reasonable time." *See* 3 Williston & Lord, A TREATISE ON THE LAW OF CONTRACTS § 7:23 (4th ed. 1992). The consideration for the lease is adequate to prevent a landlord from revoking its offer.

[78] ***Lease Grant.*** "A lease grants a tenant exclusive possession of the premises as against the owner." *H.E.Y. Trust v. Popcorn Express Co., Inc.*, 35 S.W.3d 55, 58 (Tex. App.—Houston [14st Dist.] 2000, pet. denied). "To create the relation of landlord and tenant, no particular words are necessary, but it is indispensable that it should appear to have been the intention of one party to dispossess himself of the premises and of the other to occupy them." *Brown v. Johnson*, 12 S.W.2d 543, 545 (Tex. Comm'n App. 1929); *see also De Leon v. Creely*, 972 S.W.2d 808, 812 (Tex. App.—Corpus Christi 1998, no pet.) (citing *Holcombe v. Lorino*, 79 S.W.2d 307, 310 (Tex. 1935) for proposition that lease is grant of an estate in land for a limited term, with conditions attached). A "real property license," however, is merely "a privilege to go on premises for a certain purpose, but does not operate to confer on, or vest in, licensee any title, interest or estate in such property." Concession agreements are generally construed to create only licenses. *H.E.Y. Trust*, 35 S.W.3d at 58.

[79] ***Appurtenances***. In this Lease, Landlord expressly grants certain specified appurtenant rights incident the grant of the leasehold estate to Tenant. *See* 1 FRIEDMAN ON LEASES, *Drafting and Negotiating Considerations for Appurtenances* §3:2.4, at 3-48 (express appurtenance clause in Lease is adapted from similar clause in Friedman). If a lease does not expressly grant tenant privileges to use what are commonly thought of as common areas outside the demised premises, the lease grant to tenant for the exclusive use of the premises also impliedly grants tenant a non-exclusive appurtenant right to use parts of the building for ingress and egress, common restroom facilities, and the like. 1 FRIEDMAN ON LEASES, *Appurtenances*, §3:2 (discussing access and other issues sometimes left to implication in commercial leases). One important consequence of an express grant of appurtenant rights is that an express grant ordinarily precludes implication of other or greater appurtenant rights. 1 FRIEDMAN ON LEASES, *Express Provisions for Appurtenances*, §3:2.1; *see Implied Appurtenant Rights*, §3:2.2 (explaining that lessee of dominant estate enjoys implied right to use easements appurtenant to the premises, such as the right to use elevators reasonably necessary to the use and enjoyment of the premises).

the Premises *AS IS*; (b) Waives any implied warranties of suitability, habitability, and fitness for a particular purpose;[80] (c) Waives all claims based on any defect in the Premises or the Project that could have been discovered by Tenant's reasonable inspection;[81] and (d) acknowledges that Landlord has fully performed its obligations under the Work Letter, except for Landlord's completion of any items of Landlord Work listed in the punch-list delivered to Landlord in accordance with the Work Letter (**Exhibit D**).

3. **RENT**. Except for any notice or demand expressly required in this Lease, Tenant must pay to Landlord–without any notice, demand, setoff, or deduction[82]—**Base Rent** and **Additional Rent**, and all other components of **Rent**.

License. In Texas, a license in real property is a privilege or authority given to a person, or retained by a person, to do some act or acts on the land of another, but such a license conveys no interest in, or title to, the real property. *Arant v. Jaffe*, 436 S.W.2d 169, 178 (Tex. Civ. App – Dallas 1968, no writ). Unless supported by consideration, a license is revocable at the will of the grantor. *Drye v. Eagle Rock Ranch, Inc.*, 364 S.W.2d 196 (Tex. 1962) (discussing Texas law on implied easements). Unlike an appurtenance, a license is not implied from landlord's grant of the leasehold. A license may be an appropriate means of handling certain peripheral rights, which landlord would prefer remain severable from tenant's use and enjoyment of the premises.

[80] *See* **Appendix II**, at ¶ I.B (extended discussion of implied warranty of suitability).

[81] To waive the implied warranty of suitability, an "as is" clause and disclaimer of the implied warranty of suitability should at least (1) clearly state that the tenant is accepting the premises "as is"; (2) provide the tenant the right to inspect the property and include an acknowledgement in the lease stating that the tenant has actually inspected the premises; (3) include an acknowledgement that the tenant is relying solely on its inspection of the premises; (4) clearly and unequivocally disclaim reliance on any representation by landlord; (5) state that including the "as is" provision is a material part of the consideration for the lease; (6) expressly disclaim the implied warranty of suitability; and (7) acknowledge that the tenant is familiar with the real estate transactions of the type contemplated by the lease. Summary adapted from Newtown, Anne, *"As Is" Provisions in Commercial Leases*, STATE BAR OF TEXAS ADVANCED REAL ESTATE STRATEGIES (October 2, 2008); *Italian Cowboy Ptrs., Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323 (Tex. 2011) (finding that tenant's fraudulent inducement claim was not barred by tenant's agreement that landlord did not make any representations outside the lease).

[82] ***Independent Covenants.*** At common law, "[t]he landlord's breach of a lease covenant did not relieve the tenant of his duty to pay rent for the remainder of the term because the tenant still retained everything he was entitled to under the lease—the right of possession. All lease covenants were, therefore, considered independent." *Davidow v. Inwood N. Prof'l Group--Phase I*, 747 S.W.2d 373, 375 (Tex. 1988) (citing 3 G. Thompson, THOMPSON ON REAL ESTATE §§ 1110, 1115 (1980)); *cf. Kamarath v. Bennett*, 568 S.W.2d 658, 659–60 (Tex. 1978)). Even if a tenant has the right to recover damages for its landlord's failure to make required repairs or to perform other covenants under the lease, a tenant, under traditional common law, did not have the right to reduce the amounts due and owing to its landlord under the lease by way of recoupment, offset, or abatement, unless the tenant first obtained a judgment or the lease expressly grants the tenant the right to do so. *Myers v. Ginsburg*, 735 S.W.2d 600, 603 (Tex. App.—Dallas 1987, no writ) (stating landlord's breach of covenant to repair did not excuse tenant's independent covenant to pay rent); *Cottrell v. Carrillon Assocs., Ltd.*, 646 S.W.2d 491, 494 (Tex. App.—Houston [1st Dist.] 1982, no writ) (same); *Ravkind v. Jones Apothecary, Inc.*, 439 S.W.2d 470, 471 (Tex. Civ. App.—Houston [1st Dist.] 1969, writ ref'd n.r.e.) (same); *Edwards v. Ward Assocs., Inc.*, 367 S.W.2d 390, 393 (Tex. Civ. App.—Dallas 1963, writ ref'd n.r.e.) (same). *But cf. Wilbur and Vill. Lane Ltd. v. Cinemark Corp.*, 2002 WL 1041083 (Tex. App.—Houston [14th Dist.] 2002, no pet.) (holding that tenant's obligation to pay pass through expenses was excused because management fee was not authorized in lease).

Davidow Defense to Payment of Rent. Texas courts consistently recognize one exception to the common law rule denying a tenant any right of offset for its landlord's breach. In *Davidow*, the Texas Supreme Court held that a landlord's breach of the implied warranty of suitability justifies the tenant "in abandoning the premises and discontinuing his rent payments." *Italian Cowboy Partners, Ltd.*, 341 S.W.3d at 344 (quoting *Davidow*, 747 S.W.2d at 377); *accord Gober v. Wright*, 838 S.W.2d 794, 798–99 (Tex. App.—Houston [1st Dist.] 1992, writ denied) ("[W]e upheld the jury's finding that the premises were unsuitable for their intended commercial purposes after June 2, 1988. This finding relieved lessees from their obligation to pay any rent after that date."), *abrogated on other grounds, State Farm Fire & Cas. Co. v. Morua*, 979 S.W.2d 616 (Tex. 1998). Texas courts have yet to strike the proper balance in certain remedial aspects surrounding the implied warranty of suitability. Until *Davidow*, vacating the premises was an element of a claim for constructive eviction. Under *Davidow*, tenant, though justified in abandoning the premises, need not vacate the premises as an element of its claim for breach of

(a) **Payment and Proration Base Rent and Additional Rent**. Unless otherwise expressly provided in this Lease, Tenant's Monthly Base Rent, plus one-twelfth (1/12th) of Landlord's Estimates of Additional Rent for that calendar year), plus any monthly Parking Fees will be due and payable, in advance monthly installments on or before the **1st** day of each calendar month. All components of Rent owed to Landlord will be prorated daily based on the actual number of days in any partial calendar month for which any Rent is due. Unless this Lease establishes a different time for payment, Tenant will pay any component of Rent (other than Base Rent and Tenant's Pro Rata Share of Excess Operating Costs, Real Estate Taxes, and Electricity Costs) within ten (10) days of Landlord's delivery of an invoice to Tenant stating the amount and describing the fee or charged.

(i) Electronic Payments. Tenant will transmit electronic payments of Base Rent and Landlord's Estimates of Additional Rent to the account designated in writing from time-to-time by Landlord and Landlord's Mortgagee.

(ii) Other Payments. Tenant may make other payment to Landlord's designated electronic payment address or at the payment address designated by Landlord on the signature page of this Lease or at another address designated in writing by Landlord from time-to-time in accordance with the notice provisions of this Lease

(iii) Change of Payment Address. Notice of any change in the payment address will be effective for any payment due more than twenty (20) days after the date Landlord delivers, or is deemed to deliver, such notice.

(b) **Excess Operating Costs; Tax Costs; Electricity Costs**. Once each calendar quarter after the Base Year, Landlord will be entitled to estimate of Tenant's Pro Rata Share of Excess Operating Costs, Real Estate Taxes, Electricity Costs, and any other recurring charges for the calendar year in question (*Landlord's Estimate of Additional Rent*), and by April 30th of the next calendar year, or as soon thereafter as practicable, Landlord will furnish Tenant a statement of Operating Costs, Real Estate Taxes, and Electricity Costs for the prior calendar year. If no uncured Default then exists (and no condition exists which, with the passage of time or giving of notice or both, would become a Default), Landlord will refund any overpayment to Tenant for the prior calendar year (or, at Landlord's option, apply such amount against Rent due or to become due). Tenant will pay Landlord, within **twenty-five (25)** days after demand as Rent, any underpayment for the prior calendar year. Landlord will be entitled to revise its estimate or alter its billing procedures from time to time.

(c) **Apportionment of Operating Costs; Adjustments**. If Landlord incurs Operating Costs for the Project, together with one or more other buildings or properties, whether pursuant to a reciprocal easement agreement, common area agreement ~~or otherwise~~, the shared costs and expenses shall be equitably prorated and apportioned by Landlord between the Project and the other buildings or properties in the Project.[83] If the Building is not at least 95% occupied during any calendar year or partial calendar year or if Landlord is not supplying services to at least 95% of the total Rentable Square Footage of the Building at any

the implied warranty. It seems incongruous that tenant's obligation to pay rent ends when landlord's breach begins but that tenant may then stay rent free almost indefinitely. Should the law leave tenant tenant free to use the space without paying rent or any other measure of compensation to landlord? Or should landlord, at least, be entitled to an offset against tenant's damages for the value of tenant's continuing use of the space, even if tenant's obligation to pay rent, as such, is supended by landlord's breach of this implied?

[83] This sentence requires Landlord to apportion equitably the costs between the Building and other buildings or properties in the Project. Ask for the apportionment methodology from landlord or its broker and understand the physical and operational features of the Project before accepting "equitable" as the only standard for policing landlord's cost allocations.

time during a calendar year or partial calendar year, costs that vary directly with occupancy and are properly includable in Operating shall be grossed up during any portion of the year in which occupancy of the Building is not at least 95% and Operating Costs will be determined as if the Building had been 95% occupied and Landlord had been supplying services to 95% of the Rentable Square Footage of the Building during that calendar year. The extrapolation of Operating Costs under this Section shall be performed by Landlord by adjusting the cost of those components of Operating Costs that vary directly with occupancy (*e.g.*, janitorial services provided for space occupied by tenants) of the Building using consistent accounting principles and industry recognized methods, which adjustments, in any case, do not result Landlord's entitlement to reimbursement of more than 100% of Operating Costs. Landlord shall use Tenant's Pro Rata Share of actual Operating Costs incurred or amortized in a calendar year, without gross up or other upward adjustments, to compute Landlord's management fee. Real Estate Taxes, fixed costs, insurance costs, and janitorial expenses for common areas, window washing, and other costs that do not vary directly with occupancy ***shall not*** be grossed up.

(d) **Audit Rights**. Within 120 days after Landlord furnishes its statement of Operating Costs, Tax Costs, and Electricity Costs for any calendar year (*Audit Election Period*), Tenant may, at its expense, elect to audit Landlord's Operating Costs, Real Estate Taxes, and Electricity Costs for such calendar year only (subject to Tenant's limited right to review 2 prior years as specified below), subject to the following conditions: (i) there is no uncured Default under this Lease; (ii) the audit shall be prepared by an independent certified public accounting firm of recognized national or regional standing; (iii) in no event shall any audit be performed by a firm retained on a "contingency fee" basis; (iv) the audit shall commence within 30 days after Landlord makes Landlord's books and records available to Tenant's auditor and shall conclude within 90 days after commencement or such longer period, not to exceed a total of 120 days for such audit, as may be reasonably necessary; (v) the audit shall be conducted during Landlord's normal business hours at the location where Landlord maintains its books and records and shall not unreasonably interfere with the conduct of Landlord's business; (vi) Tenant and its accounting firm shall treat any audit in a confidential manner and shall each execute a commercially reasonable confidentiality agreement for Landlord's benefit prior to commencing the audit; and (vii) the accounting firm's audit report shall, at no charge to Landlord, be submitted in draft form for Landlord's review and comment before the final approved audit report is delivered to Landlord, and any reasonable comments by Landlord shall be incorporated into the final audit report. Each party's audit rights and obligations will survive the expiration or termination of this Lease.

(i) Notwithstanding the foregoing, Tenant shall have no right to conduct an audit if Landlord furnishes to Tenant an audit report for the calendar year in question prepared by an independent certified public accounting firm of recognized national or regional standing prepared for another tenant in the Building, where such report addressed the accuracy of Landlord's calculation of Operating Costs utilizing substantially the same definition of Operating Costs as set forth herein, and Tenant finds no manifest error in such report.

(ii) This paragraph shall not be construed to limit, suspend, or abate Tenant's obligation to pay Rent when due, including Landlord's Estimate of Additional Rent. Landlord shall, at Tenant's option, either credit any overpayment determined by the final audit report against the next Rent due and owing by Tenant or, refund such overpayment directly to Tenant within 30 days of determination. Likewise, Tenant shall pay Landlord any underpayment determined by the final audit report within 30 days of determination.

(iii) If Tenant's audit reflects a discrepancy in the proper treatment of Operating Costs, which discrepancy exceeds **3%** of the amount charged by Landlord for the year in question (*Discrepant Item(s)*), Tenant shall be permitted to review, as part of the examination, review, inspection, audit up to two (2) prior years (other than the year of review or audit) of Landlord's books and records, but only as to the Discrepant Item(s). If Tenant does not give written notice of its election to audit Landlord's Operating

Costs during the Audit Election Period, Landlord's Operating Costs for the applicable calendar year(s) shall be deemed approved for all purposes, and Tenant shall have no further right to review or contest the same. The right to audit granted hereunder is personal to the initial Tenant named in this Lease and to any assignee under a Permitted Transfer (defined below) and shall not be available to any subtenant under a sublease of the Premises.[84]

(e) **Late Payment**. If Tenant fails to pay (i) any monthly installment of Base Rent by the **5th day** of the month when due; or (ii) any other component of Rent within **five (5)** days after demand or the due date specified in this Lease, Tenant must pay a **10%** late fee on the delinquent amount.[85] If Tenant is twice delinquent more than **five (5)** days in any payment of Base Rent or any other component of Rent, Landlord will be entitled to require Tenant to pay Rent (as estimated by Landlord) quarterly, in advance, in readily available funds (*e.g.*, in cash or by wire transfer, cashier's check, or money order). Landlord will apply all payments to fees, costs, interest, other sums due under the Lease, and then to the earliest accrued and unpaid Base Rent then outstanding in that order.

4. **SECURITY DEPOSIT**. Landlord will hold the Security Deposit,[86] without interest, to secure performance of Tenant's obligations under this Lease, but the Security Deposit is not an advance payment of Rent[87] or a measure of Landlord's damages for Tenant's breach of this Lease.

(a) Landlord may: (i) commingle the Security Deposit with Landlord's other funds;[88] (ii) from time to time, and without prejudice to any other remedy, use the Security Deposit to pay any delinquent

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[84] This lease form presents a typical office lease audit clause. It grants Tenant the right to audit and prescribes who can perform the audit, what expenses tenant is entitled to audit, when tenant is entitled to perform the audit, who pays for the audit, and what happens if tenant discovers discrepancies. Consider addressing other issues:

- Is tenant entitled to review gross-up and computation formulas and to access to landlord's electronic database?
- Is tenant entitled to review billings to other tenants, and revenue offsets, to determine whether landlord is complying with a covenant not to collect more than 100% of operating costs?
- Is the level of detail required in landlord's statements and reconciliation reports sufficient to permit tenant to determine if an audit is necessary?
- Is tenant's right to audit conditioned on payment of disputed charges?
- Is there a procedure for tenant to reserve rights or pay under protest?

[85] Despite cases holding that late charges in leases do not constitute interest for purposes of usury, "prudent lease practice is probably best served by including a usury savings provision in any clause providing for payment of a late charge." Phillip D. Weller, *Essence of Lease—Basic Concepts of Texas Leasing Law*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: THE LEASING INSTITUTE (April 1-2, 2004).

[86] ***Security Deposit.*** Section 93.004 of the Texas Property Code defines a security deposit as "any advance of money, other than a rental application deposit or an advance payment of rent, that is intended primarily to secure performance under a lease of commercial rental property." TEX. PROP. CODE § 93.004 (2013).

[87] ***Statutory Penalties on Tenant.*** Section 93.010(a) prohibits a tenant from treating its security deposit as an advance payment of the last month's rent. Section 93.010(a) provides that "the tenant may not withhold payment of any portion of the last month's rent on grounds that the security deposit is security for unpaid rent." Section 93.010(b) even imposes a statutory penalty on a tenant who attempts to do so, providing that "a tenant who violates this section is presumed to have acted in bad faith." Moreover, "[a] tenant who in bad faith violates this section is liable to the landlord for an amount equal to three times the rent wrongfully withheld and the landlord's reasonable attorney's fees in a suit to recover the rent." TEX. PROP. CODE § 93.010(b).

[88] ***Accurate Security Deposit Records.*** Texas's security deposit statute does not require a commercial landlord to segregate tenant security deposits; instead, it requires landlord to "keep accurate records of all security deposits." TEX. PROP. CODE § 93.008. Even though section 93.005(a) of the Property Code does not require a commercial landlord to segregate its tenants' security deposits, it attempts to ensure that each tenant's security deposit remains tenant's property when its landlord becomes insolvent; section 93.005(b) states that "the tenant's claim to the security deposit takes priority over the claim of any creditor of the landlord, including a trustee in bankruptcy." TEX. PROP. CODE § 93.005(b). One may

Rent or to satisfy Tenant's other obligations.[89] After any such use of the Security Deposit, Tenant must pay to Landlord, within five (5) days after demand, the amount necessary restore the Security Deposit.

(b) If Tenant is not in Default, and no condition exists, which, with the passage of time or notice or both, would constitute a Default when this Lease expires or terminates, Landlord will return[90] any

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question whether the legislature accomplished its purpose of protecting tenant security deposits by requiring landlords to keep records of security deposits as opposed to maintaining segregated accounts.

Security Deposits in Bankruptcy. Under Federal bankruptcy law, determining whether a security deposit remains the tenant's property or becomes property of a bankrupt landlord's bankruptcy estate—possibly subjecting these funds to claims of the landlord's creditors—depends on state law. In *Butner v. United States,* 440 U.S. 48 (1979), the Supreme Court held that:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving "a windfall merely by reason of the happenstance of bankruptcy." The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee in rents earned by mortgaged property. (citation omitted).

Id. at 55. When state law requires a landlord to segregate tenant security deposits, bankruptcy courts uniformly hold that these segregated funds remain the tenant's property and do not become part of the landlord's bankruptcy estate. *See In re Real Estate W. Ventures, L.P. v. Gingold, Trustee,* 170 B.R. 736 (Bankr. N.D. Ga. 1993). In that case, the bankruptcy court noted that under Georgia law, "[w]hen a landlord in Georgia receives funds from a tenant constituting a security deposit, he must give it special treatment." *Id.* at 743. The Georgia statute provided:

> Whenever a security deposit is held by a landlord or his agent on behalf of a tenant, such security deposit shall be deposited in an escrow account established only for that purpose…. The security deposit shall be held in trust for the tenant by the landlord or his agent….O.C.G.A. § 44-7-31.

Under this Georgia statute, any security deposits received from a tenant and placed in such an account had to be held in trust for the benefit of the tenant and did not become part of the landlord's bankruptcy estate. The court reasoned that this is so because any property held in trust for the benefit of a third party does not become part of the debtor's estate in bankruptcy. *See In re Real Estate W. Ventures*, L.P., 170 B.R. at 743-44 (citing *United States v. Whiting Pools, Inc*., 462 U.S. 198, 205 n.10 (1983); *T&B Scottdale Contractors, Inc. v. United States*, 866 F.2d 1372, 1376 (11th Cir.), *cert. denied*, 493 U.S. 846 (1989); *Wisconsin v. Reese (In re Kennedy & Cohen, Inc.)*, 612 F.2d 963, 965 (5th Cir.), *cert. denied*, 449 U.S. 833 (1980)). The court in *In re Real Estate W. Ventures, L.P*. also protected from creditor claims any tenant security deposits that the landlord commingled in its operating account because the court could identify as security deposits through deposit records. The court held that, despite the landlord's failure to comply with the Georgia statute, any traceable security deposits remained each tenant's property and did not become property of the landlord's bankruptcy estate. 170 B.R. at 743-44. To the extent that these cases rely on the existence of a segregation requirement under applicable state law, it is not entirely clear that the same result will obtain under the Texas statute, which merely requires accurate accounting. *Cf. In re Wayco, Inc.*, 947 F.2d 1330 (7th Cir. 1991) (stating that, under Wisconsin law, security deposit remains tenant's property until landlord suffers a compensable loss under lease).

[89] ***Deductions from Security Deposit.*** "Before returning a security deposit, the landlord may deduct from the deposit damages and charges for which the tenant is legally liable under the lease or damages and charges that result from a breach of the lease." TEX. PROP. CODE § 93.006(a). A landlord may apply a tenant's security deposit to actual damages caused by tenant's breach of the lease, even though the provisions in lease with respect to forfeiture of security deposit are penal and, therefore, are unenforceable as liquidated damage provisions. *See Harold C. Abramson, Trustee in Bankruptcy of the Estate of Flage's, Inc. v. Aaron Rashti*, 373 S.W.2d 699, 700-01 (Tex. App.—Fort Worth 1963, writ ref'd n.r.e.)

No Deduction for Normal Wear and Tear. But "[t]he landlord may not retain any portion of a security deposit to cover normal wear and tear." TEX. PROP. CODE § 93.006(b). "In this subsection, 'normal wear and tear' means deterioration that results from the intended use of the commercial premises, including breakage or malfunction due to age or deteriorated condition, but the term does not include deterioration that results from negligence, carelessness, accident, or abuse of the premises, equipment, or chattels by the tenant or by a guest or invitee of the tenant." TEX. PROP. CODE § 93.006(b).

[90] ***Successor Landlord Liability for Security Deposits.*** Section 93.007(b), in turn, states that "the person who no longer owns an interest in the rental premises remains liable for a security deposit received while the person was the owner until

unused portion of the Security Deposit to Tenant within **thirty (30)** days after the last to occur of: (i) the Expiration Date; (ii) payment of all Rent and any Damages; (iii) Tenant's surrender of the Premises in accordance with this Lease; and (iv) Landlord's receipt of Tenant's forwarding address.[91] Tenant's actual or attempted assignment, transfer, or encumbrance of the Security Deposit will not bind Landlord.

(c) **Standby Letter of Credit as Security Deposit**.[92] At Tenant's election, in lieu of a cash Security Deposit, Tenant may deliver an original standby letter of credit (*Letter of Credit*) in form and content satisfactory to Landlord.[93] The Letter of Credit, among other things, shall be:

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the new owner delivers to the tenant a signed statement acknowledging that the new owner has received and is responsible for the tenant's security deposit and specifying the exact dollar amount of the deposit. The amount of the security deposit is the greater of: (1) the amount provided in the tenant's lease; or (2) the amount provided in an estoppel certificate prepared by the owner at the time the lease was executed or prepared by the new owner at the time the commercial property is transferred." Section 93.007(c) makes an exception for some foreclosures, stating that "subsection (a) does not apply to a real estate mortgage lienholder who acquires title by foreclosure."

[91] ***Returning Tenant Security Deposits.*** In addition to any contractual duties, a landlord has a statutory duty to return a security deposit posted under a commercial lease entered into or renewed on or after September 1, 2001. *See* TEX. PROP. CODE §§ 93.004-011. A tenant also may recover statutory penalties if its landlord fails to comply with its statutory duties with respect to the tenant's security deposit. *See Id*. The Property Code now establishes the time periods within which a commercial landlord must refund a tenant's security deposit. Section 93.005(a) states that "the landlord shall refund the security deposit to the tenant not later than the 60th day after the tenant surrenders the premises and provides notice of the tenant's forwarding address under section 93.009." TEX. PROP. CODE § 93.005(a); *Jones & Gonzalez, P.C. v. Trinh*, 340 S.W.3d 830, 837 (Tex. App.—San Antonio 2011, no pet.) (stating that sixty-day period does not start until after tenant provides the landlord with a written statement of a forwarding address for the purpose of returning security deposit and that, given the penal nature of the statutory remedy, this requirement is strictly construed). Section 93.009(a) of the Property Code, in turn, actually establishes an exception to the landlord's obligation under section 93.005(a), providing that "the landlord is not obligated to return a tenant's security deposit or give the tenant a written description of damages and charges until the tenant gives the landlord a written statement of the tenant's forwarding address for the purpose of refunding the security deposit." Delay in providing a forwarding address, however, will not bar the tenant's claims for return of its security deposit. Section 93.009(c) provides that "the tenant does not forfeit the right to a refund of the security deposit or the right to receive a description of damages and charges for failing to give a forwarding address to the landlord."

Statutory Penalties on Landlord. In addition to establishing these time periods, the statute imposes penalties on a landlord for failing to timely return a security deposit and for failing to comply with the statute's other requirements. Section 93.011(a) states that " a landlord who in bad faith retains a security deposit in violation of this chapter is liable for an amount equal to the sum of $100, three times the portion of the deposit wrongfully withheld, and the tenant's reasonable attorney's fees incurred in a suit to recover the deposit after the period prescribed for returning the deposit expires." Failing to provide a written description also can lead to additional penalties. Section provides that "a landlord who in bad faith does not provide a written description and itemized list of damages and charges in violation of this chapter forfeits the right to withhold any portion of the security deposit or to bring suit against the tenant.

[92] Susan Fowler McNally, Carter Klien, and Michael Abrams, *Letters of Credit in Lease Transactions, Part II: Drafting Tips,* 16 PROBATE & PROPERTY NO. 6 (Nov./Dec. 2002), reprinted with permission at http://www.gilchristrutter.com/CM/Articles/article7.pdf. This article suggests that the specifications for the letter of credit (LC) from the landlord's perspective should, among other things: require a standby LC rather than a documentary or commercial LC; avoid specification of landlord's use of any funds drawn; prescribe simple draw conditions; allow partial draws; allow automatic renewal; permit transfers by the beneficiary.

[93] A letter of credit might provide a landlord greater security than a cash security deposit if the tenant files bankruptcy. The Fifth Circuit Court of Appeals has held that cap on a landlord's claim for lease rejection damages under Section 502(b)(6)) does not limit the landlord's right to draw amounts in excess of the cap under a letter of credit posted by tenant to secure its obligations under the lease unless and until the landlord makes a claim against the tenant-debtor's estate. *In re Stonebridge Technologies, Inc*., 430 F.3d 260, 270 (5th Cir. 2005); *see also In re Bldrs. Transport*, 471 F.3d 1178, 1193 fn. 12. (11th Cir. 2006), *cert. denied*, *Two Trees v. Builders Transport, Inc.*, 127 S. Ct. 2112, 167 L.Ed. 2d 814 (U.S. 2007) (stating that "we believe that our opinion is not in conflict with *Stonebridge Technologies Inc.*, which held that the filed claim of a lessor against the estate was a precondition to applying the damages cap under Section 502(b)(6)); *see also Solow v. PPI Enters., Inc. (In re PPI Enters., Inc.),* 324 F.3d 197 (3d Cir. 2003) (holding cap on rejection damages applies to letter of credit proceeds

(i) subject to the International Standby Practices 1998, International Chamber of Commerce Publication No. 590;

(ii) irrevocable and unconditional;

(iii) in an amount of equal to $_______________;

(iv) conditioned for payment solely upon presentation of the Letter of Credit and a sight draft;[94] and

(v) transferable one or more times by Landlord without the consent of Tenant.[95]

Tenant acknowledges and agrees that ~~Tenant~~ Landlord shall pay any and all costs or fees charged in connection with the Letter of Credit that arise due to: (A) Landlord's sale or transfer of all or a portion of the Building; or (B) the addition, deletion, or modification of any beneficiaries under the Letter of Credit. The Letter of Credit shall be issued by a member of the New York Clearing House Association or a commercial bank or trust company satisfactory to Landlord, having banking offices at which the Letter of Credit may be drawn upon in Dallas, Texas and a net worth at time of issuance of not less than $1 billion. The Letter of Credit cannot expire earlier than 12 months after the date of delivery thereof to Landlord and shall provide that same shall be

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when landlord files claims against tenant's debtor's estate); *Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.),* 306 B.R. 295 (9th Cir. 2004) (same). *See generally* Laura B. Bartell, *The Lease Cap and Letters of Credit: A Reply to Professor Dolan*, 120 Banking L.J. 828, 835-36 (2003) ("Unlike preference law, there is no provision of the Bankruptcy Code that allows the trustee to sue a lessor for receiving property, even property of the estate, merely because it exceeds the lease cap of Section 502(b)(6).").

[94] ***Presentment of a Letter of Credit*** may not be enjoined unless there is evidence of fraud by the beneficiary. *Philipp Bros. v. Oil Country Specialists, Ltd.*, 787 S.W.2d 38, 40 (Tex. 1990) (citing *Republic Nat'l Bank v. Northwest Nat'l Bank*, 578 S.W.2d 109, 112 (Tex. 1978)). To justify enjoining the presentment of a letter of credit, the fraud must be extreme. *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.*, 63 S.W.3d 561, 565-66 (Tex. App.—Austin 2001, no pet.).

A trial court may enjoin presentment only if "the wrong doing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served." *Philipp Bros.*, 787 S.W.2d at 40 (quoting *GATX Leasing Corp. v. DBM Drilling Corp.*, 657 S.W.2d 178, 182 (Tex. App.—San Antonio 1983, no writ)); *SRS Prods. Co. v. LG Eng'g Co.*, 994 S.W.2d 380, 38-85 (Tex. App.—Houston [14th Dist.] 1999, no pet.) (applying abuse-of-discretion standard to application to enjoin presentment and payment of letter of credit and stating that alleged wrongdoing must be "egregious, intentional, and unscrupulous"). *But see Goldome Credit Corp. v. University Sq. Apts*., 828 S.W.2d 505, 509 (Tex. App.—Amarillo 1992, no writ) (holding that presentment of documents signed by officer of corporation when corporation did not exist posed risk of double payment on debt, thereby constituting fraud, which vitiated transaction).

In *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.*, tenant sued to enjoin its landlord from presenting the letter of credit tenant provided as security for performance of its obligations under the lease in lieu of posting a security deposit. 63 S.W.3d 561, 566 (Tex. App.—Austin 2001, no pet.). Tenant argued that the acceleration clause in the lease operated as a penalty, was void as a matter of law, and should, therefore, constitute a material fraud justifying issuance of temporary injunction enjoining landlord from drawing on the letter of credit. *Id*. The court of appeals disagreed and dissolved the temporary injunction issued by the trial court. *Id*. The court of appeals, without analyzing whether the acceleration clause was, or was not, void as a penalty, reasoned that, even if the acceleration clause were unenforceable, it did not constitute a fraud sufficient to enjoin landlord from presenting the letter of credit. *Id*. at 566-67.

[95] The right to draw on a letter of credit may not be transferred or assigned unless the letter of credit is expressly designated as transferable or assignable. Tex. Bus. & Com. Code § 5.112 (Vernon 2013); *Temple-Eastex Inc. v. Addison Bank*, 672 S.W.2d 793, 796 (Tex. 1984) (holding that prohibition on transfer of letter of credit did not apply successor-beneficiary acquired the letter of credit as a "vertical" distributee upon the dissolution of its subsidiary); *Cobb Rest., L.L.C. v. Texas Capital Bank, N.A.*, 201 S.W.3d 175, 180 (Tex. App.—Dallas 2006, no pet.) (reversing and remanding summary judgment in favor of landlord because landlord did not prove successor landlord was a successor beneficiary by operation of law entitled to draw on the letter of credit).

automatically renewed for successive 12-month periods through a date which is not earlier than 60 days after the expiration date of this Lease, or any renewal or extension thereof, unless written notice of nonrenewal has been given by the issuing bank to Landlord and Landlord's attorney by registered or certified mail, return receipt requested, not less than 60 days prior to the expiration of the current period. If the issuing bank does not renew the Letter of Credit, and if Tenant does not deliver a substitute Letter of Credit at least 30 days prior to the expiration of the current period, then, in addition to its rights granted hereunder, Landlord shall the right to draw on the existing Letter of Credit. Notwithstanding the foregoing, if no Event of Default has occurred and is continuing, Landlord shall permit Tenant to cancel the Letter of Credit after Tenant has paid rent for 36 months. In an Event of Default, Landlord may use, apply, or retain the proceeds of the Letter of Credit to the same extent that Landlord may use, apply, or retain the cash Security Deposit, and in while any Event of Default continues, Landlord may draw on the Letter of Credit, in whole or in part, from time to time, at Landlord's election. If Landlord partially draws down the Letter of Credit, Tenant, within 10 days after Landlord gives Tenant notice thereof, will restore all amounts drawn by Landlord, or substitute cash security instead. Tenant hereby agrees to cooperate, at its expense, with Landlord to promptly execute and deliver to Landlord any and all modifications, amendments, and replacements of the Letter of Credit.[96]

5. USE. The Premises ~~shall~~ may[97] be used only for the Permitted Use and no other use.

(a) **Prohibited Uses**. Tenant ***must not*** use the Premises, or permit their use, for: (i) any illegal purpose; (ii) any activity that is dangerous to life, limb, or property; or (iii) any activity that, in Landlord's opinion, would create a nuisance, disturb other occupants of the Building, or increase insurance costs for Landlord or other occupants of the Building.[98] Tenant must not office more than one person for each 333 Rentable Square Feet in the Premises.

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[96] *See generally* Ken Miller, *Using Letters of Credit, Credit Default Swaps, and Other Forms of Credit Enhancements in Net Lease Transactions*, 4 VA. L. & BUS. REV. 45 (2009) (discussing letters or credit and other credit enhancement techniques for leases that secure credit tenant loans); Frederick L. Klein, *Beneficiaries Beware: Standby Letters of Credit Are Not Bullet Proof*, Real Estate Alert (19 Feb 2009), http://apps.americanbar.org/buslaw/committees/CL190000pub/newsletter/200907/klein.pdf (last downloaded July 7, 2013); Nancy Ann Connery, *Letters of Credit in Real Estate Transactions*, NEGOTIATING THE SOPHISTICATED REAL ESTATE DEAL 2008: HIGH-STAKES STRATEGIES IN CHALLENGING TIMES: PRACTICING LAW INSTITUTE COURSE HANDBOOK (2008); Susan Fowler McNally, Carter Klien, and Michael Abrams, *Letters of Credit in Lease Transactions, Part I: Advantages to Landlord and Landlord's Lender*, 16 PROBATE & PROPERTY No.4 (July/Aug. 2002), reprinted with permission at www.gilchristrutter.com/**CM**/**Articles**/article8.**pdf**.

[97] ***Use v. Continuous Operations.*** "Apart from the question of liability for waste, it seems that the tenant is under no obligation, in the absence of specific provision therefor, to occupy or use, or continue to use, the leased premises, even though one of the parties, or both, expected and intended that they would be used for the particular purpose to which they seemed to be adapted or constructed." *Weil v. Anne Lewis Shops, Inc.*, 281 S.W.2d 651, 654 (Tex. Civ. App.–San Antonio 1955, writ ref'd) (citing cases and holding that clauses similar to one in question, which stated "the premises are rented 'for occupation and use as ladies', misses' and children's ready to wear and accessories and not otherwise[,]'… have been construed in many cases, and it has never been held to be an agreement to occupy and use the demised premises, but only to restrict the purposes for which the premises may be used"). *Id.* at 654 (citing *Palm v. Mortgage Inv. Co.*, 229 S.W.2d 869, 873-74 (Tex. Civ. App.—El Paso 1950, writ ref'd n.r.e.); *San Antonio Brewing Ass'n v. Brents*, 39 Tex. Civ. App. 443, 88 S.W. 368 (1905, writ ref'd) (stating that use clause, which provided "'[i]t is understood that the building is leased to the lessee for the purpose of conducting a first-class saloon,'" did not restrict tenant's right to use premises for any other purpose, and, therefore, law barring sale of liquor at premises did not excuse tenant's performance under lease). Unless the lease clearly and expressly requires the tenant to use and occupy the premises, a clause permitting the tenant to use for a specified purpose does not obligate the tenant to use the premises at all, much less to use them for the permitted use described in the use clause.

[98] ***Permissive Uses, Prohibited Uses.*** As a general rule, a tenant is entitled to use its premises for any lawful use, without interference from its landlord, so long as that use: (1) is not expressly prohibited in the lease; *see Sinclair Ref. Co. v. McElree*, 52 S.W.2d 679, 681 (Tex. Civ. App.—Dallas 1932, no writ) (stating that lease term authorizing use of premises for a specific purpose, without restricting their use for other purposes, is permissive simply, and does not limit use to stated use);

(b) **Floor Loads**. Tenant must not place any load upon any floor of the Premises exceeding the maximum load per square foot as determined by Landlord or its structural engineer. Landlord may limit the weight and prescribe the position of all safes, files, and heavy objects that Tenant places in the Premises, and Tenant must deliver written notice to Landlord and receive Landlord's written consent before placing any such items in the Premises.

(c) **Compatible Use**. Tenant (i) will install, operate, and maintain its business machines and equipment so as not to transmit noise or vibration to the Building, (ii) will conduct its business and control Tenant Parties in such a manner so as not to interfere with, annoy, or disturb other occupants or Landlord's management of the Building, (iii) will not commit waste on the Premises or permit others to do so; and (iv) will conduct its operations in the Building and within the Premises to minimize: (A) direct and indirect energy consumption and greenhouse gas emissions; (B) water consumption; (C) the material entering the waste stream; and (D) negative impacts on the indoor air quality of the Building and the Premises, but non-performance or deficient performance of the subpart (c)(iv) will not be a breach or Default entitling Landlord to exercise and right or remedy under this Lease.[99]

(d) **Parking**.[100] During the Term, Tenant may use in accordance with this Lease and any Rules and Regulations from time to time promulgated by Landlord or the manager of the parking facilities **«ReservedSpacesNumber»** Reserved Spaces and **«UnreservedSpaceNumber»** Unreserved Spaces in locations designated, and at rates set, by Landlord from time to time, and Tenant must pay the Parking Fees for its right to use of each of these spaces. Landlord will be entitled to: (i) issue access control devices and use access control methods it deems necessary; (ii) impose fines of up to **$25** on Tenant for each violation of applicable Parking Rules and Regulations or the unauthorized use of parking facilities by any Tenant Party; (iii) make reasonable charges to replace previously issued access control devices; and (iv) increase the Parking Fees from time to time on **thirty (30)** days prior written notice to Tenant. Within **fifteen (15)** days of Landlord's written request, Tenant must furnish Landlord a current list of persons using Tenant's spaces, including each user's name and the make, and license number of each user's vehicle. If Landlord does make any space (or other alternate space) available for Tenant's use, Tenant's sole and exclusive remedy will be abatement of the Parking Fees (prorated daily) for that space for each day it or an alternate space is unavailable. **LANDLORD WILL HAVE NO LIABILITY TO ANY TENANT PARTY FOR ANY CLAIM ARISING FROM ANY TENANT PARTY'S ACT OR OMISSION IN CONNECTION WITH THE USE OF ANY PARKING FACILITY SERVING THE PROJECT, AND TENANT WILL INDEMNIFY AND DEFEND LANDLORD FROM ALL CLAIMS AGAINST LANDLORD ARISING FROM ANY TENANT PARTY'S ACT OR OMISSION ARISING IN CONNECTION WITH THE USE OF ANY PARKING FACILITY SERVING THE PROJECT.**

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(2) is not prohibited by necessary implication from the terms of the lease, *see Id.* (holding that, while lease in question did not expressly restrict use of property to listed use, "its language is instinct with that idea, and, when considered in connection with the subject-matter of the contract and the surrounding circumstances, it is obvious that whether or not the intention of the parties was to restrict the use of the premises to the purpose named is a question of fact, to be determined on final trial."); or (3) does not constitute waste or involve destruction of the premises. *See* ANNOT., *Provision in Lease as to Purpose for Which Premises Are to Be Used as Excluding Other Uses*, 86 A.L.R.4TH 259, at § 2(a) (1991 & updated 2013); *King's Court Racquetball v. Dawkins*, 62 S.W.3d 229, 233-35 (Tex. App.–Amarillo 2001, no pet.) (discussing waste, harmonizing tenant's right to alter premises with express obligation to surrender premises in good repair, and holding that express right "to alter, reconstruct, rebuild and modify the premises without restriction" did not entitle tenant to demolish interior of premises and leave it in that demolished state); and *see generally* 3 FRIEDMAN ON LEASES, *Restrictions on Tenant's Use* § 27.3.

[99] Weller & Anderson, *It's Not Easy Being Green*, Appendix 1-- Green Implementation Provisions, at p. 3 (discussing default and remedies applicable to green leasing provisions).

[100] ***Parking***. A landlord's agreement in a lease to supply parking, even parking on other property owned by landlord, is enforceable by way of damages, if the agreement cannot be specifically enforced. 1 FRIEDMAN ON LEASES, *Express Parking Rights* §3:2.1[A]. If a lease grants tenant the exclusive use of parking in an identified area, landlord cannot appropriate the parking in the designated area for its own use, even though landlord offers adequate alternative parking to tenant. *Maquardt & Roche/Mediz & Hackett, Inc. v. Riverbend Exec. Ctr., Inc.*, 74 Conn. App. 412, 812 A.2d 175 (Conn. App. Ct. 2003). *See supra* footnote 79 (discussing parking as an appurtenance to demise of office space).

6. **ENTRY BY LANDLORD**. Landlord Parties may enter the Premises at all reasonable hours (and, in emergencies, at any time, by any means Landlord may deem proper, and without liability) to inspect the Premises; to show the Premises to prospective purchasers, mortgagees, tenants, or insurers; and to inspect, clean, repair, or alter the Premises.[101] No such entry will entitle Tenant to any compensation or to any reduction in Rent.[102]

7. **BASIC SERVICES**. Landlord will[103] furnish these Building Standard services to Tenant during the Term:[104]

(a) hot and cold water at those points of supply provided for general use of tenants in the Building;

(b) heat or air conditioning (HVAC) during Tenant's Normal Business Hours, and Landlord will supply, at Tenant's sole cost, HVAC during other than Tenant's Normal Business Hours if Tenant delivers its written request to Landlord before 1:00 p.m. on the preceding Business Day. Landlord is entitled to determine, from time to time, its cost to supply additional HVAC, and Tenant must pay that cost, on demand, as Rent;[105]

(c) routine maintenance of electric lighting and replacement of light bulbs and ballasts in Common Areas and Service Areas;

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[101] ***Entry by Landlord.*** Absent a lease provision granting the landlord the right to reenter the premises for such purposes, the tenant enjoys the exclusive right of possession, even as to the landlord. *Cleveland v. Milner*, 170 S.W.2d 472, 475 (Tex. 1943) (citing *Brown v. Johnson*, 12 S.W. 2d at 545). So strong is the lessee's possessory right that a lessor cannot maintain an action for trespass of for injury or damage to the premises while the lessee is in exclusive possession of the premises, unless the damages lessen the value of the lessor's reversionary interest. *Gulf Colorado & Santa Fe Ry. Co. v. Francis Smith*, 3 Tex. Civ. App. 483, 23 S.W. 89 (Tex. Civ. App.—Houston 1893, no writ). Only the person rightfully in actual and exclusive possession of land may recover for trespass committed upon his possession. *Id.* At common law, however, a landlord could enter the premises during the term to "view waste" — *i.e.*, to view damage to the landlord's reversionary interest. *See generally Ferris v. State*, 640 S.W.2d 636, 638 (Tex. App.—El Paso 1982, pet. denied) (discussing, in a criminal case, landlord's common law right to view waste as authorization for landlord to consent to search of tenant's premises by law enforcement and holding that tenant had no legitimate expectation of privacy because tenant failed to pay rent for a month and one half).

[102] *See* **Appendix III.B**. (Lessons on Mitigation of Damages from Other Jurisdictions)

[103] Some office lease forms attempt to qualify landlord's obligation to provide building services with phrases such as will endeavor to furnish, will use good faith efforts to furnish, will use commercially reasonable effort to furnish, *etc*. A tenant should seek to avoid "effort" standards.

[104] ***No Common Law Obligation to Provide Services.*** Absent a covenant in a lease obligating the landlord to provide services, the landlord has no obligation to provide any services to the tenant. *See Lynch v. Ortleib*, 70 Tex. 272, 8 S.W. 15(1888) (there is no implied warranty on the part of the lessor that the building is sound or strong or fit for the purposes for which it is rented); *Cameron v. Calhoun-Smith Distrib. Co.*, 442 S.W.2d 815, 816 (Tex. Civ. App.—Austin 1969, no writ). *But see Davidow*, 747 S.W.2d at 373 (establishing implied warranty of suitability for commercial leases); Thomas M. Fleming, Annotation, *Implied Warranty of Fitness or Suitability in Commercial Leases—Modern Status*, 76 A.L.R.4th 928 (2011).

[105] ***Temperature Specifications.*** In *Shaker & Associates, Inc. v. Med. Technologies Grp., Ltd*., 315 Ill. App.3d 126, 132, 733 N.E.2d 865, 870-71 (2000), the lease provided that "[a]s long as the Tenant is not in default of the Lease, Landlord shall "provide a temperature and humidity condition which, in Landlord's reasonable discretion or by governmental regulation, is necessary for the comfortable occupancy of the Building." But the lease excuses the landlord from supplying HVAC in accordance with this standard in three circumstances: "Notwithstanding the foregoing, Landlord shall not be responsible for temperature and humidity variations in the Premises which are caused by Tenant's not meeting or exceeding a density factor of one person per one hundred square feet of the Premises, a connected electrical loan of 2½ watts per square foot of the Premises for lighting and Tenant's failure to close building standard blinds or draperies when the sun is shining into the Premises." The court found that landlord was responsible for temperature and humidity variations as long as tenant had enough people in the office, enough lighting, and kept the blinds closed, but the court denied tenant's counterclaim and affirmative defense as based on pleading defects.

(d) janitorial service Sunday through Thursday in accordance with the specifications in **Exhibit G**;[106]

(e) exterior window washing at lease XX times per year or more frequently if reasonably necessary;

(f) nonexclusive passenger elevator service sufficient for ingress and egress to the Premises;[107]

(g) nonexclusive freight elevator service;

(h) light and fluorescent bulb replacements for light fixtures in the Premises, and Tenant must pay Landlord the cost of any replacement bulbs, on demand, as Rent; and

(i) access control devices or codes allowing Tenant access to the Building during other than Tenant's Normal Business Hours.

Unless expressly provided otherwise in this Lease, or paid for separately by Tenant, the cost of furnishing all Building Standard services to Tenant will be included as part of Operating Costs. Landlord will install, calibrate, operate and maintain building mechanical and operating systems in accordance with all applicable Sustainability Standards, ANSI/ASHRAE/IESNA standards, or applicable energy codes, whichever is more stringent, including the identification and correction of any operational deficiencies[108]

8. **ELECTRICAL SERVICES**. Landlord will furnish Building Standard electrical service to the Premises.[109] Building Standard electrical service means that service required to operate Building Standard lighting and ordinary amounts and types of office equipment as reasonably determined by Landlord.[110] Tenant will not use electrical services that differ from or exceed Building Standard without obtaining Landlord's prior

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[106] Weller & Anderson, *It's Not Easy Being Green,* Appendix 1-- Green Implementation Provisions, at pp. 8-10 (examples of green cleaning clauses and green janitorial specifications).

[107] *See supra* footnote 79 (discussing use of elevators as appurtenance to demise of premises).

[108] Weller & Anderson, *It's Not Easy Being Green,* Appendix 1-- Green Implementation Provisions, at pp. 4-6 (examples of green building operating and performance standards). It's easy to be green in the abstract. Who can object to being green? The real issue is whose green $$$ pays for being green. It is one thing to impose green performance standards throughout a lease, but it is quite another thing for landlord and tenant to agree on the remedies for any failure to meet these standards or to deal with the fallout if compliance ends up being more costly than anticipated. An economically efficient approach to green requirements is to sanction green initiatives if, but only to the extent, that one party being green doesn't increase net costs for the other party. It's easy to manage being green when both parties save green $$$ or the green party is being green on its own nickel.

[109] The green movement has changed the approach to electricity service specifications. At one time, a tenant's primary, if not exclusive concern, was to ensure that landlord agreed to supply electrical services sufficient for tenant's operations. Now landlord may seek to justify limits on electrical capacity serving the premises to comply with supposed green imperatives. Tenant should exchange these requirements for cost and efficiency.

[110] Electrical capacity decisions and specifications are subject to increasing regulation. Chapter 388 of the Texas Health and Safety Code mandates the adoption of energy efficiency performance standards for commercial buildings. TEX. HEALTH & SAFETY CODE ANN. § 388.003(b) (Vernon 2013). If the State Energy Conservation Office (SECO) determines that the energy efficiency provisions of the latest published edition of the International Energy Conservation Code (IECC) for commercial energy efficiency and air quality is equivalent to or more stringent than the May 1, 2001, IECC, SECO, by rule, may adopt and substitute in the energy code the equivalent or more stringent editions. TEX. HEALTH & SAFETY CODE ANN. § 388.003(b-1). Moreover, if SECO adopts the latest published edition of the IECC into the energy code, SECO shall establish an effective date for the new editions that is no earlier than nine months after the date of adoption. TEX. HEALTH & SAFETY CODE ANN. § 388.003(b-1). On May 30, 2014, the International Code Council (ICC) issued its latest edition of the IECC, http://publicecodes.cyberregs.com/icod/iecc/2015. ICC releases a new edition every three years.

written consent, which consent will not be unreasonably withheld, conditioned, or delayed, so long as the non-standard service requested by Tenant does not place excessive loads on Landlord's existing electrical capacity or result in a down grade of any green building certification issued to Landlord or any other tenant in the Building.[111]

(a) On **thirty (30)** days written notice, Landlord — unless prohibited by Applicable Law – will be entitled, at Tenant's sole cost, to install a sub-meter for the Premises, and, in that event, Tenant must continue paying Tenant's Pro Rata Share of Electricity Costs, except that Landlord will credit any separate payments to Landlord for the sub-metered use of Building Standard electricity for the Premises.[112]

(b) Landlord, at Tenant's expense, will be entitled to measure Tenant's actual electrical consumption in the Premises by a survey conducted by a reputable consultant selected by Landlord or by a separate meter or separate meters installed, read, and maintained by Landlord, and, in either event, Tenant must pay Landlord any non-Building Standard electrical use, within **five (5)** days after demand, as Rent, unless Tenant pays it directly to its electric service provider. [113]

9. **SERVICE TERMS**. Landlord will be entitled, from time to time, to select and change any provider of Building Standard and non-Building Standard utility services, electrical services, or any other service furnished by Landlord.

(a) Tenant may make written requests for any non-Building Standard service. Landlord may withhold, condition, or — on not less than **thirty (30)** days prior written notice to Tenant — revoke its consent to furnish any non-Building Standard service if, in Landlord's sole judgment, it (i) would damage or injure the Premises or the Project; (ii) would create a dangerous or hazardous condition; (iii) would entail material alteration or repair to any part of the Project; (iv) would disturb or interfere with the operation of other facilities or equipment in, or any other occupant's use of, the Project; (v) would increase Landlord's insurance or other costs to operate the Building; or (vi) would otherwise be detrimental to the Project, to other occupants, or to Landlord. In no event will Landlord be liable to any Tenant Party for withholding, conditioning, or revoking its consent to any non-Building Standard service.

(b) On not less than **thirty (30)** days prior written notice to Tenant, Landlord — unless prohibited by Applicable Law — may discontinue making its facilities available for electrical service to the Premises. If Landlord gives this notice, Tenant, at its sole cost, may buy electrical service to the Premises from a legally qualified electric service provider.

(c) Tenant will cooperate with Landlord and any service provider at all times, and Tenant will allow any Landlord Party or any service provider reasonable access to the Building's electric lines, cables, feeders, risers, wiring, electrical panels, and any other equipment or machinery within, or accessed from, the Premises.

(d) Tenant will cooperate with Landlord's efforts to operate and maintain the Building in an environmentally responsible, fiscally prudent, safe work environment;

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[111] EJ Makela, JL Williamson & EB Makela, *Comparison of Standard 90.1-2010 and 2012 ICC With Respect to Commercial Buildings*, US DEPT. OF ENERGY BLDG. TECHNOLOGIES PROGRAM (September 2011) (2012 IECC rev. 90.1-2010 IECC), https://www.iccsafe.org/gr/Documents/IECC-Toolkit/2012IECC_ASHRAE%2090%201-10ComparisonTable.pdf.

[112] This provision anticipates the need to adjust the formulae for calculation of Tenant's Pro Rata Share of Electricity Costs if meters or sub-meters are installed during the Term, and Landlord begins to invoice Tenant's electrical usage in the Premises, or other tenants' electrical usage in their premises, as a separate charge.

[113] *See, e.g., Group Hosp. Servs. v. One & Two Brookriver Ctr.*, 704 S.W.2d 886 (Tex. App.—Dallas 1986, no writ) (interpreting similar electrical cost provision in commercial lease and allowing landlord to charge for after-hours HVAC and electrical costs associated with supplying such HVAC service).

(i) Landlord shall operate and maintain the Building and the Premises to minimize: (A) direct and indirect energy consumption and greenhouse gas emissions; (B) water consumption; (C) the material entering the waste stream; (D) negative impacts on the indoor air quality of the Building and the Premises; and

(ii) Landlord shall use reasonable efforts (including the promulgation of appropriate Building Rules and Regulations) to cause other tenants of the Building to conduct their operations in the Building and their premises in conformity with the Building Standard environmental performance objectives established by Landlord from time-to-time.[114]

(e) No change, interruption, or malfunction of any utility service, electrical service, or of any service furnished by Landlord will: (i) constitute an actual or constructive eviction, a disturbance of Tenant's use or occupancy of the Premises, or a breach of Landlord's obligations under this Lease; (ii) render any Landlord Party liable or responsible for any loss or damage Tenant may sustain because the quantity or character of any service changes, becomes unavailable, or becomes unsuitable; (iii) relieve Tenant of any obligation under this Lease (including, without limitation, the obligation to pay any component of Rent), or (iv) entitle Tenant to any set-off, abatement, recoupment, or other reduction in any component of Rent, but notwithstanding the exculpations from liability in this subpart (e), Tenant, as its sole and exclusive Claim and remedy, will be entitled to an equitable diminution of Base Rent during and to the extent Tenant's use of, or access to, the Premises and Common Areas essential to Tenant's Permitted Use of the Premises is prevented or materially impaired, ~~if a court of competent jurisdiction finds in a final, unappealable judgment that Landlord's gross negligence or willful misconduct caused the service interruption, and that service interruption prevented or impaired Tenant's Permitted Use of the Premises~~ for more than **five (5)** consecutive Business Days, **AND TO THE FULLEST EXTENT ALLOWED BY APPLICABLE LAW, TENANT WAIVES ALL OTHER CLAIMS AGAINST LANDLORD PARTIES ARISING FROM INTERRUPTION OF ANY UTILITY SERVICE, ELECTRICAL SERVICE, OR ANY OTHER SERVICE FURNISHED BY LANDLORD**. Landlord will use reasonable commercial diligence to restore any interrupted service this Lease requires Landlord to provide, and Landlord will use commercially reasonable diligence to minimize any service disruptions for scheduled maintenance, repairs, inspections, and tests.[115]

10. **GRAPHICS**. Landlord, at its cost, will supply and install Building Standard letters and numerals on the exterior of the Premises naming Tenant and identifying Tenant's suite number, and Tenant will not allow any other graphics to be visible from outside the Premises, unless Landlord gives its prior written consent. In addition, if Landlord consents to Tenant's use of any other letters, numerals, or graphics,

[114] Weller & Anderson, *It's Not Easy Being Green*, Appendix 1-- Green Implementation Provisions, at pp.6—8 (sample lease provisions for general operating standards, utilities and services, HVAC, minimum energy efficiency standards, and lighting controls).

[115] The original provision exculpates Landlord for damages claims for virtually all service interruptions, but it provides Tenant, as its sole and exclusive remedy in-lieu-of any damage claims, extraordinarily limited abatement rights if Landlord's gross negligence causes the service interruptions. An abatement clause for a service interruption, among other things, should prescribe: (a) the events that trigger tenant's abatement rights and any applicable exceptions; (b) the time period, if any, before abatement begins; (c) the maximum duration of any interruption before tenant's other remedies (*e.g.*, liquidated damages, actual damages, or termination rights), if any, become available. When the exculpatory provisions in this paragraph are read together with its final sentence, this paragraph arguably converts the "Landlord will provide" service performance standard into a "Landlord will use reasonable commercial diligence" performance standard. The appearance of landlord's obligation may be preserved, but tenant's remedies for breach condition or limit tenant's remedies in a way that landlord's obligation is more illusory than real.

Tenant must pay all costs associated with their acquisition, installation, and removal, and all costs to restore the Premises and any other part of the Building to their condition before such installation.[116]

11. **IMPROVEMENTS BY LANDLORD**. Except for installing Building Standard graphics and performing Landlord Work (as defined in the Work Letter (**Exhibit D**)), Landlord will have no obligation to make other additional or improvements to the Premises or the Project.[117]

12. **MAINTENANCE AND REPAIR BY LANDLORD**. Landlord will[118] maintain the Building and Common areas in good repair and working order[119] at least equivalent to comparable multi-tenant office

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[116] Office leases typically offer tenant mention in the building directory and prescribe Building Standard signage for tenant's on multi-tenant floors. A full floor tenant usually negotiates for the right to depart from Building Signage standards for signage on its own floor. Even larger tenants negotiate for building signage, monument signage or both.

[117] The Work Letter deserves its own annotated form, and this annotated lease does not attempt a comprehensive treatment of the subject. The purpose of this Lease provision is to disclaim any obligation on the part of Landlord to make any additional improvements (as opposed to maintaing and reparing existing improvements) to the Building or to make any improvements to the Premises, other than installing the improvements described as Landlord Work in the Work Letter and Building Standard graphics.

[118] ***Common Law Repair and Maintenance Doctrines***. The common law, and most commercial leases, distinguish between landlord's duty to repair and maintain the leased premises, over which tenant ordinarily is presumed to have exclusive possession and control, as opposed to landlord's duty to repair common areas and other facilities over which landlord retains possession or control. In the absence of an agreement to the contrary in a lease for space in a multi-tenant building "consisting of a number of different apartments… divided among several tenants, each one of whom takes a distinct portion and none of [whom] rent the entire building, the rule must then be applied so as to make each tenant responsible only for so much [of the building] as his lease includes, leaving the landlord liable for every part of the building not included in the actual holding of any one tenant." *O'Connor v. Andrews*, 16 S.W. 628, 629 (Tex. 1891).

Generally speaking, "[a]bsent a covenant, or evidence of concealment or misrepresentation, the landlord [is] not liable for a latent structural defect…*within premises* that causes damage to tenant's property." *American Exch. Nat'l Bank v. Swope & Mangold*, 46 Tex. Civ. App.64, 101 S.W. 872, 873 (Tex. Civ. App. 1907, no writ). However, when the landlord retains possession or control of portion of leased premises, the landlord, in absence of any agreement to contrary, has implied duty to tenant to maintain retained portion of premises "so as not to damage the tenant." *McCreless Props., Ltd. v. F. W. Woolworth Co.*, 533 S.W.2d 863, 866 (Tex. Civ. App.–San Antonio 1976, writ ref'd n.r.e.).

A landlord has an ***implied contractual duty*** – even when a lease is silent – to its tenant, as well as a legal duty to third parties sounding in tort, to keep common areas and other facilities within the landlord's control in good repair and condition. *Brown v. Frontier Theatres, Inc.*, 369 S.W. 2d 299, 303 (Tex. 1963) (holding that when landlord retains possession or control of portion of leased premises, landlord is charged with duty of ordinary care in maintaining portion retained so as not to damage tenant); *Lang v. Henderson*, 215 S.W.2d 585, 588 (Tex. 1948) (stating that when landlord breaches duty to maintain common area or facility, landlord is liable to tenant who suffers injury due to defects in facilities over which landlord retains possession or control). *See* **Appendix II** (discussing, in greater detail, common law rules, replacement of common law doctrines (including doctrine of independent covenants) with implied warranty of suitability, and waivers of implied warranty of suitability).

[119] ***Perform v. Pay***. At common law, a covenant to make repairs is distinct from the covenant to pay for them, and an agreement to pay for a repair does not itself impose an active duty to make a repair. *National Living Ctrs., Inc. v. Cities Realty Corp.*, 619 S.W.2d 422, 424 (Tex. App.—Texarkana 1981, no writ) (stating that "[a] covenant to pay for repairs is distinct from the covenant to make repairs, and such an agreement does not impose upon the landlord any active duty to repair…" and holding that clause providing "any alterations or repairs, required for said licensing will be at the expense of the Lessor…" did not impose affirmative duty on landlord to make needed repairs). A provision that one party shall bear the expense of repair is not ambiguous, and the fact that it fails to state which party shall have the affirmative duty to make those repairs does not render it ambiguous.

Ordinarily, a landlord who voluntarily makes repairs is not estopped from claiming that it had no such duty. The fact that a landlord voluntarily or gratuitously makes repairs constitutes neither an admission or evidence of a duty to make such repairs, nor does it operate to create a new or collateral agreement to do so. *Yarbrough v. Booher*, 174 S.W.2d 47, 48-49 (Tex. 1943); *Morton v. Burton-Lingo Co.*, 150 S.W.2d 239, 241(Tex. 1941) (stating that lessor is not bound to make repairs or to pay for repairs that may have been made by the lessee and that "[t]he mere relation of landlord and tenant creates no

buildings in the Central Business District of Big City, Texas, taking into account age, size, design, and other relevant operating factors and make repairs to and perform maintenance upon: (a) structural and exterior elements of the Building;[120] (b) standard mechanical (including HVAC), electrical, plumbing and fire/life safety systems serving the Building generally;[121] (c) Common Areas;[122] (d) the roof of the Building;[123] (e) exterior windows of the Building; and (f) elevators serving the Building. Landlord shall promptly make repairs (taking into account the nature and urgency of the repair) for which Landlord is responsible. If any of the foregoing maintenance or repair is necessitated due to the acts or omissions of any Tenant Party, Tenant, subject to paragraph shall pay the costs of such repairs or maintenance to Landlord within **thirty (30)** days after receipt of an invoice, together with an administrative charge in an amount equal to 15% of the cost of the repairs.

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obligation on the part of the landlord to repair or keep in repair the leased premises"); *Kallison v. Ellison*, 430 S.W.2d 839, 840 (Tex. Civ. App.—San Antonio 1968, no writ) (stating that evidence of repairs gratuitously undertaken by the lessor is not sufficient, standing alone, to establish the existence of an agreement to repair).

The implied warranty of suitability seems incompatible with the common law rule distinguishing between a landlord's covenant to pay for repairs and a covenant to make repairs. *Davidow*, 747 S.W.2d at 373 (Tex. 1988) (holding that "there is an implied warranty of suitability by the landlord in a commercial lease that the premises are suitable for their intended commercial purpose. This warranty means that at the inception of the lease there are no latent defects in the facilities that are vital to the use of the premises for their intended commercial purpose and that these essential facilities will remain in a suitable condition. If, however, the parties to a lease expressly agree that the tenant will repair certain defects, then the provisions of the lease will control.").

[120] In *7979 Airport Garage, L.L.C. v. Dollar Rent A Car Sys., Inc.*, 245 S.W.3d 488 (Tex. App.—Houston [14th Dist.] 2007, pet. denied), the landlord agreed to "keep the foundation, the exterior walls (except plate glass windows, doors, door closure devices, window and door frames, molding, locks and hardware and painting or other treatment of the interior surface of exterior walls) and roof of the Leased Premises in good repair. *Id*. at 493. Landlord contended that the lease unambiguously required landlord to repair the foundation, exterior walls, and roof, and required [tenant] to bear the cost of any other repair or replacement, regardless of its nature." *Id*. at 500. The court of appeals disagreed with landlord's contention, stating that "the only reasonable interpretation of the relevant language is that the landlord must make structural repairs…, and must repair the foundation, exterior walls, and roof, even if the damage to these areas is not physical or structural (for example, if the damage is merely cosmetic). *Id*. at 501; *Mangold*, 101 S.W. at 873 (stating that "[a]bsent a covenant, or evidence of concealment or misrepresentation, the landlord [is] not liable for a latent structural defect" ***within the premises*** that causes damage to tenant's property).

[121] In *Chen v. RB&RB Investments, Inc.*, the landlord and tenant both became aware of defective wiring. *Chen v. RB & RB Invs., Inc.*, 14-02-00178-CV, 2003 WL 297674 (Tex. App.–Houston [14th Dist.] Feb. 13, 2003) (unpublished opinion). That wiring caused a fire a few weeks after the parties became aware of the defect. Each party claimed the other party was liable for the fire damage because it was the other party's responsibility to fix the defective wiring. The maintenance and repair covenant in the lease recited:

> Landlord shall keep the foundation, the exterior walls… and the roof of the Leased Premises in good repair.…
> Tenant shall… make all needed repairs… except for repairs required to be made by Landlord under this section.

In support of its conclusion that this clause "unambiguously placed the duty to repair electrical wiring on [tenant][,]" the court of appeals noted that the lease only required landlord to repair "structural components of the premises," and it recited that tenant had examined the premises and accepted them "AS IS." In addition, tenant had presented no evidence that the defective wire was located in an "exterior" wall, which landlord was obligated to maintain, as opposed to an "interior" wall, which the lease required tenant to maintain.

[122] *Andrews*, 16 S.W. at 629; *Lang v. Henderson*, 215 S.W.2d 585, 588 (Tex. 1948) (stating that when landlord breaches duty to maintain common area or facility, landlord is liable to tenant who suffers injury due to defects in facilities over which landlord retains possession or control).

[123] *Cf. Dalkowitz Bros. v. Schreiner*, 110 S.W. 564, 565 (Tex. Civ. App. 1908, no writ) (holding that, although a landlord had no express or implied duty at common law to tenant to repair leaky roof in a single tenant building, once landlord undertook a repair, landlord was required to use due care and was, therefore, liable for damage to tenant's property caused by a leak in new roof).

Landlord has no duty to Tenant to repair or maintain any part of the Premises,[124] except for repair or restoration of damage to any nonstructural improvements incident to performing any necessary repairs to, or maintenance of, the Building's exterior and load-bearing walls, floors (but not floor coverings), and roof. Tenant will promptly notify Landlord of the need for any such repairs or maintenance.[125]

[*Italian Cowboy Rider* – ENFORCEABLE AS IS CLAUSE][126]

13. **MAINTENANCE, REPAIRS, AND ALTERATIONS BY TENANT**. Tenant, at its sole cost, must keep the Premises clean, healthful, and in good repair and condition,[127] reasonable wear and tear excepted[128] (including,

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[124] Under the traditional common law rule, a landlord was not required to make any repairs (including structural repairs) to the premises during the lease term, unless the lease expressly obligated landlord to do so. As the Texas Supreme Court put it nearly 70 years ago:

> The tendency of modern decisions is not to imply covenants which might and ought to have been expressed, if intended. A covenant is never implied that the [landlord] will make any repairs. The obligation to make repairs is a very important element of a lease contract. The parties were free to contract with respect to this obligation as they desired.

Yarbrough, 174 S.W.2d at 49; *see also Medlin v. Havener*, 98 S.W.2d 863, 864 (Tex. Civ. App.–Fort Worth 1936, no writ) (stating that "in the absence of a special contract to the contrary, and in the absence of fraud and deceit inducing the [tenant] to believe the landlord would make such repairs, the [landlord] is under no implied obligation to the [tenant] to keep the rented premises in a condition safe and suitable for the uses to be made of the demised premises by the [tenant]." Thus, at common law, a landlord generally had no implied duty to tenant (in contract or implied from the parties' relationship) or to third parties (in tort for premises liability) to keep the premises in good condition, absent either the express obligation to do so in the lease or landlord's exercise of control of conditions within the premises. *Johnson County Sheriff's Posse, Inc. v. Endsley*, 926 S.W.2d 284, 285 (Tex. 1996) (holding that landlord has no duty to tenant or its invitees for dangerous conditions in leased premises, unless landlord: (1) makes negligent repairs; (2) conceals defects in premises of which landlord is aware; or (3) retains control over that portion of premises where a defect or unsafe condition causes injury). Moreover, if a landlord repairs the premises without the express obligation to do so, the fact that landlord made those repairs does not create an ongoing obligation to do so. *Morton v. Burton-Lingo Co.*, 150 S.W.2d 239, 240 (1941); *Stacks v. Rushing*, 518 S.W.2d 611, 612-13 (Tex. Civ. App.–Dallas 1975, no writ).

[125] At common law, the destruction of the improvements on leased property did not relieve the tenant of its obligation to pay rent or give the tenant the right to terminate the lease. *Mitchell's Inc. v. Nelms,* 454 S.W.2d 809, 813 (Tex. Civ. App.—Dallas 1970, writ ref d n.r.e.). Many leases preserve this result, expressly denying abatement of rent if tenant's negligence causes a casualty loss. Ask to delete this clause or, at a minimum, limit its application to tenant's gross negligence or intentional misconduct. More often than not, landlord will agree to do so. After all, tenant usually pays its *pro rata* share of cost of the insurance policy covering lost rental income. Deleting such a clause, however, will only ensure that the tenant's rent abates while the premises are untenantable.

To ensure that tenant will not have to pay landlord or its property insurer to rebuild the building when one of tenant's employees leaves a coffee pot on and burns down the building, tenant's counsel must slip on the belt (ensure that landlord waives its claims against the tenant for such property damage); pull on the suspenders (ensure that landlord's insurance carrier waives its subrogation rights); and put on the overcoat (ensure that tenant has not indemnified landlord or agreed to pay landlord for such property damage elsewhere in the lease). In addition, if tenant's negligence causes a large casualty loss, tenant and its counsel should pray that landlord did not compromise on its insistence on those "unreasonably" high coverage limits for tenant's liability policy. Other tenants in the building probably won't have, or will have waived, any damage claims against landlord, but those same tenants may well have claims against the tenant whose employee forgot to turn off the coffee pot.

[126] *See* **Appendix II, I.B**. (Waiver of Implied Warranty of Suitability).

[127] In the absence of express repair and surrender covenants, a tenant has an implied obligation not to commit waste. *R.C. Bowen Estate v. Continental Trailways, Inc.*, 256 S.W.2d 71, 72 (Tex. 1953) (citing *Camden Trust Co. v. Handle*, 26 A.2d 865 (N.J. 1942)); *King's Court Racquetball v. Dawkins*, 62 S.W.3d 229, 233 (Tex. App.—Amarillo 2001, no pet.) (stating that covenant against waste is "the implicit duty of a tenant to exercise reasonable care to protect the leased premises from injury other than by ordinary wear and tear"); *In re D.H. Overmyer Co.*, 12 B.R. 777, 785-86 (Bankr. S.D.N.Y. 1981) (applying Texas law), *aff'd,* 30 B.R. 823 (S.D.N.Y. 1983) (stating that "[a] tenant, at common law, *in the absence of an express covenant or a*

without limitation, all fixtures, plumbing, and interior plate glass; carpet or other floor covering; interior partitions; doors; any demising walls; communications, computer, and other cabling exclusively serving Tenant's equipment; supplemental air conditioning units, private showers and kitchens (including all plumbing and other facilities exclusively serving the Premises or Tenant). If Tenant fails to maintain, repair, or replace such items, Landlord may perform Tenant's obligations, and Tenant must pay Landlord's costs of doing so, within five (5) days after demand, as Rent. Tenant, at its sole cost, must repair or replace any damage to any part of the Project caused by any Tenant Party.

(a) Unless Tenant obtains Landlord's prior written consent, Tenant will not alter, add to, or improve the Premises or any other part of the Project.[129] Before beginning any alteration, addition, or

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statutory duty, has the obligation to make leasehold repairs coextensive merely with the duty imposed upon him not to permit or commit waste.…") (emphasis added).

"***Waste*** is an injury to the reversionary interest in land caused by the wrongful act of a tenant or other party rightfully in possession, and [it] is primarily distinguishable from trespass in that trespass is an injury to land caused by the act of one not rightfully in possession." *R.C. Bowen Estate*, 256 S.W.2d at 72; *Dawkins*, 62 S.W.3d at 232 (stating that "to constitute waste, the act allegedly causing it must be wrongful"); *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 753 (Tex. App.—El Paso 2000, no pet.) (stating that "[w]aste also includes injury resulting from a failure to exercise reasonable care in preserving the property"); *Erickson v. Rocco*, 433 S.W.2d 746, 751 (Tex. Civ. App.—Houston [14th Dist.] 1968, writ ref'd n.r.e.).

The ***implied covenant against waste*** arises from the landlord-tenant relationship, and unless superseded by an express covenant, obligates the tenant "to make such repairs as are necessary to preserve the property in the condition in which it was when rented, reasonable wear and tear excepted[.]" *R. C. Bowen Estate*, 256 S.W.2d at 72-73 (citing *Norman v. Stark Grain & Elevator Co.*, 237 S.W. 963, 965 (Tex. Civ. App.—Dallas 1922, writ ref'd); *Great A. & P. Tea Co. v. Athens Lodge No.* 165, 207 S.W. 2d 217, 226 (Tex. Civ. App.—Fort Worth 1947, writ ref'd n.r.e.); *Texas Co. v. Gibson*, 88 S.W. 2d 757 (Tex. Civ. App.—Beaumont 1935), *rev'd on other grounds*, 116 S.W. 2d 686 (1938)). *See generally* C. R. McCorkle, Annot., *Liability of Tenant for Damage to the Leased Property Due to His Acts or Neglect*, 10 A.L.R.2d 1012 (1950 & 2013) (covering cases in which landlord seeks to recover damages for specific injuries to property due to tenant's own acts or negligence as distinguished from cases in which tenant's liability is predicated upon breach of duty to keep property in repair or to return it in good condition); C. Jhong, ANNOT., *Measure of Damages in Landlord's Action for Waste Against Tenant*, 82 A.L.R.2d 1106 (1962 & Supp. 2013) (covering cases dealing with landlord's measure of damages resulting from tenant's violation implied duty to care for leased property as distinguished from cases concerned with damages resulting from violation of express covenant to keep property in repair, to use it for a certain specific purpose, or to return it in good condition). The implied covenant against waste is not a promise "to repair generally, but to so use the property as to avoid the necessity for repairs, as far as possible.… It has never been so construed as to make a tenant answerable for accidental damages, or to bind him to rebuild, if the buildings are burned down or otherwise destroyed by accident." *United States v. Bostwick*, 94 U.S. 53, 68 (1876).

[128] An ***exception for reasonable wear and tear*** in tenant's express repair covenant reiterates the common law limitation on the implied covenant against waste. Because waste requires that the tenant commit a wrongful act or fail to exercise ordinary care in preserving the property, waste does not include deterioration resulting from ordinary wear and tear, accident, or other causes that are not the fault of the tenant. *R C. Bowen Estate*, 256 S.W.2d at 72-73; *Norman*, 237 S.W. at 965 (holding that tenant was not liable to landlord for cost of rebuilding granary under express covenant obligating tenant "to take good care of the property and not suffer any waste" because jury found granary collapsed due to "act of god" rather than tenant's negligence); *Great A. & P. Tea Co.*, 207 S.W. 2d at 226; *Texas Co.*, 88 S.W. 2d at 757.

[129] ***Unauthorized alterations*** or changes in the premises constitute waste. *Dawkins*, 62 S.W.3d at 232 (holding tenant liable for waste and rejecting tenant's contention that demolishing improvements was not wrongful because lease extension permitted tenant to "alter, reconstruct, rebuild and modify the premises without restriction."); *Mayer v. Texas Tire & Rubber Co.*, 223 S.W. 874, 875 (Tex. Civ. App.—Fort Worth 1920, no writ). A lease term permitting tenant to assign or sublet the premises may create a limited exception to a general prohibition on altering the premises without landlord's consent. In *Mayer*, landlord sued to enjoin its tenant from subdividing the space for a subtenant. *Id*. at 875. The lease permitted tenant to sublease all or a part of the premises without landlord's consent. And while the lease required tenant to make all repairs to the premises, it prohibited tenant from altering the premises without landlord's consent. The court of appeals affirmed the trial court's decision to dissolve a temporary restraining order, which had briefly prohibited tenant from subdividing the premises for its subtenant. In support of its ruling, the court of appeals stated:

improvement, and as a condition to obtaining Landlord's consent, Tenant must furnish Landlord with: (i) plans and specifications reasonably acceptable to Landlord; (ii) names and addresses of contractors reasonably acceptable to Landlord; (iii) copies of contracts; (iv) necessary permits and approvals; (v) evidence of contractor's and subcontractor's insurance (to include coverage against such risks, in such amounts and with such companies as Landlord may require); and (vi) payment and performance bonds, letters of credit, or other security, all in form and amount satisfactory to Landlord.

(b) All such improvements, alterations or additions will be constructed in a good and workmanlike manner using Building Standard materials or other new materials of equal or greater quality approved, in advance, by Landlord and must comply with Applicable Laws.

14. **MECHANIC'S LIENS**. Tenant will not permit any mechanic's or other lien to be placed upon any part of the Premises or the Project.[130] Unless Tenant obtains Landlord's specific written consent, Tenant will have no right, power, or authority to procure any material or service that would give rise to any mechanic's or other lien on the any part of the Premises or the Project.[131] If any person asserts such a lien or claim against any

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> We think the stipulation in the contract of lease between the plaintiff and the defendants, according to the defendants the right to sublet the premises in part or in whole, carried with it the right of the [tenant] to make, or permit the making of, such changes and additions in the building as were reasonably necessary to the use of the building by such tenants, provided such changes did not constitute a substantial change in the structural quality of the building, and where the additions could be removed at the expiration of the lease without injury to the building.

223 S.W. at 875 (citing *Cawker v. Trimmel*, 143 N.W. 1046, 1047 (Wis. 1913) (stating that "[o]rdinarily the word 'alteration' as applied to a building means a substantial change therein[]") and *Kresge v. Maryland Cas. Co.*, 143 N.W. 668, 669 (Wis. 1913) (holding that policy covered damage to vestibule and doors constructed on a building, even though policy excluded "[a]dditions to or alterations in, or the construction of any building or structure, or elevator…" from coverage)).

[130] In 2011, the Texas legislature enacted significant changes to the time periods and procedures governing the perfection and enforcement of mechanic's liens. *See* Steven E. Kennedy, *Construction Liens: What's New, What Can Hurt You*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2012 CONSTRUCTION LAW CONFERENCE (September 13-14, 2012) (summarizing 2011 amendments to Chapter 53 of the Texas Property Code); *see* TEXAS PROP. CODE § 53.057 (changing time periods for retainage notices), § 53.103 (eliminating thirty day safe harbor for owners), § 53.107 (requiring general contractor to notify subcontractors of termination of general contract), Chapter 53, Subchapter L (mandating use of statutory lien release forms), § 53.056 (overturning holding in *Don Hill Const. Co. v. Dealers Elec. Supply Co.*, 790 S.W.2d 805, 807 (Tex. App.—Austin 2004, no writ) that, in certain circumstances, second tier derivative claimant could perfect a lien without giving required statutory notices under prior version of § 53.056). Mr. Kennedy's article summarizes the technical filing requirements under the revised mechanic's lien laws.

[131] Texas "courts have long held that a mechanic's and materialman's lien attaches to the interest of the person contracting for construction. Thus, if a lessee contracts for construction, the mechanic's lien attaches only to the leasehold interest, not to the fee interest of the lessor." *Diversified Mortg. Invs. v. Lloyd D. Blaylock Gen. Contractor, Inc.*, 576 S.W.2d 794, 805 (Tex. 1978); *Schneider v. Delwood Ctr., Inc.*, 394 S.W.2d 671, 673-74 (Tex. Civ. App.—Austin 1965, writ ref'd n.r.e.) (citing cases and holding that no rights ordinarily accrue in favor of a mechanic or materialman against owner of leased premises, or owner's title to premises, as a result of contracts with lessee). Texas courts also have long recognized a corollary to the ordinary rule. When a tenant contracts with a mechanic or materialman as the owner's authorized agent, a mechanic's lien will attach to the landlord's fee. *Rosen v. Peck*, 445 S.W.2d 241, 243 (Tex. Civ. App.—Waco 1969, no writ); *see also Triad Home Renovators, Inc. v. Dickey*, 15 S.W.3d 142, 145 (Tex. App.—Houston [14th Dist.] 2000, no pet.) (applying ordinary rule and distinguishing *Rosen*). In *Rosen*, lessee was in default in paying rent to lessor (Rosen) and delinquent in paying a third party (Peck) for air conditioning improvements, but lessor was effectively in control of both lessee and the premises. *Rosen*, 445 S.W.2d at 244-46. The trial court found that lessor controlled collection of sublease rents payable to lessee, as sub-landlord, and the disbursement of that sub-rent; that lessor effectively controlled the sublease contracts with lessee's subtenants; that lessor directed lessee's activities on the premises; that lessee, for all practical purposes, served as lessor's manager-caretaker of the premises; and that lessor authorized and required lessee to make all necessary repairs and improvements. *Rosen*, 445 S.W.2d at 246. Lessee, the court of appeals concluded, was nothing more than a local management agent furnishing services to lessor for a compensation, under the domination of lessor, without any real, substantial control over the use of the properties. *Rosen*, 445 S.W.2d at 246.

part of the Premises or the Project as a result of the claimant's dealings with Tenant, Landlord may discharge or bond around such claim or lien, and Tenant must pay Landlord, on demand as a component of Rent, any resulting costs (including attorneys' fees) incurred by Landlord.

15. **ASSIGNMENT AND SUBLETTING**.[132] Tenant will not sell, assign,[133] sublease,[134] mortgage,[135] encumber, license, or otherwise transfer (collectively, transfer) any right or interest in this Lease or any part of

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[132] In some office leasing transactions, the review periods, submission requirements, approval standards, and other procedures for seeking and granting approval of subleases and assignments are heavily negotiated issues. In others, these issues are touched on lightly, if at all. A number of these articles examine the mechanics and practical issues involved in negotiating the terms of assignments and subleases in greater depth. Most of these articles also provide sample provisions permitting certain transfers. *See generally* Christine Mikulich & Reid C. Wilson, *Assignments/Subleasing: Legal and Practical Issues*, STATE BAR OF TEXAS: 27TH ANNUAL ADVANCED REAL ESTATE LAW COURSE (July 7-9, 2005); T. Andrew Dow, *Assignment and Subletting - Balancing Landlord and Tenant Desires (With Forms and Sample Provisions)*, STATE BAR OF TEXAS 25TH ANNUAL ADVANCED REAL ESTATE LAW COURSE (July 10-12, 2002); Robert Harms Bliss, *Drafting Disasters Case Study #1: Lease Assignments*, STATE BAR OF TEXAS: 13TH ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (March 6 - 8, 2002); Bernard O. Dow, *Assignment, Subleasing, Expansion Option and Right of First Refusal Aspects of Commercial Leases*, SMU SCHOOL OF LAW: REAL ESTATE LAW – LEASES IN DEPTH (1991); Thomas M. Whelan, *Subleasing*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2009 BERNARD O. DOW LEASING INSTITUTE (April 2-3, 2009).

[133] ***Assignment v. Sublease***. "The difference between an assignment and a sublease is a question of law "to be determined from the estate granted by the instrument." *Davis v. Vidal*, 105 Tex. 444, 151 S.W. 290, 292 (Tex. 1912). "'An assignment is properly a transfer, or making over to another, of the right one has in any estate; but it is usually applied to an estate for life or years. And it differs from a lease only in this: That by a lease one grants an interest less than his own, reserving to himself a reversion; in an assignment he parts with the whole property, and the assignee stands to all intents and purposes in the place of the assignor.'" *Davis*, 151 S.W. at 292 (quoting 2 William Blackstone, *Commentaries* at *327).

Assignment of Part of Premises. An assignment thus occurs when tenant parts with all of its leasehold estate for all time under all conditions, and a sublease occurs when tenant retains any part of the estate for any period-of-time under any condition. *Amco Trust, Inc. v. Naylor*, 159 Tex. 146, 317 S.W.2d 47, 50 (Tex. 1958). Even so, "[a]n assignment, rather than a sublease, exists as to a part of the leasehold premises transferred when the tenant parts with all of its leasehold estate for all time under all conditions as to that part of the premises." *Forrest v. Durnell*, 26 S.W. 481, 482 (Tex. 1894) (stating that "[t]he relation of landlord and tenant strictly does not exist unless there be a reversionary interest in the former, and out of this arises the distinction between assignments and under-leases. If a lessee parts with his whole term in all the rented premises, no reversionary interest remains in him, and a person taking through him is an assignee, liable to pay rent to the landlord as the original lessee contracted to pay.").

Liability of Assignee. If a lessee rents portions of its premises to different persons for the entire term, "then such persons, to the extent of their several holdings, are also assignees, and in so far liable to the lessor, just as was the original lessee." *Forrest*, 26 S.W. at 482; *Marathon Oil Co. v. Lambert*, 103 S.W.2d 176, 181(Tex. Civ. App.—Dallas 1937, writ dism'd) (quoting *Gulf, C. & S.F. Ry. Co. v. Settegast*, 15 S.W.228, 229 (Tex. 1891) for rule that "[w]hen the lessee conveys his entire term in the whole or apart of the demised premises it is an assignment of the lease; but when he lets the premises for a less time than the period of his unexpired term it is an under-lease.").

[134] ***Privity*** is a key to understanding many of the practical differences between the obligations (if any) a transferee of a prime tenant owes to the prime landlord under an assignment as opposed to a sublease. A lease establishes both privity of estate and privity of contract between the landlord and the original tenant. *Kelley Mfg. Co. v. Rohrt*, 344 S.W.2d 904, 906 (Tex. Civ. App.—Dallas 1961) ("[a] lease contract...is of a dual nature. It creates both a privity of estate and a privity of contract. Cessation of the privity of the estate brought on by the wrong of the tenant does not necessarily relieve the tenant of his contractual obligation under the lease agreement to pay rent."), *rev'd on other grounds*, 349 S.W.2d 95 (Tex. 1961); *see also Walker's Case*, 76 Eng. Rep. 676, 679, 3 Coke's Rep. *22a, *22b (K.B.1587) ("In every lease for years, there is a contract between lessor and lessee."); W. Holdsworth, A HISTORY OF ENGLISH LAW 272 (1927) (rent is a contractual obligation to pay for the use of the land).

Privity of estate arises from the conveyance of the right to exclusive possession, by the party entitled to exclusive possession, to another party, and during the period privity of estate exists, it gives rise to an implied obligation to pay rent and to perform any other covenants that run with the land. *Cauble v. Hanson*, 224 S.W. 922, 923-24 (Tex. Civ. App.—El Paso 1920), *aff'd*, 249 S.W.175 (Tex. 1923); *see Brown v. Johnson,* 12 S.W.2d at 545 ("one of the essentials of a valid leasing of

the Premises.[136] Any transfer, without Landlord's prior written consent, which consent will not be unreasonably withheld, conditioned, or delayed,[137] will be a Default under this Lease, and Landlord - in its sole discretion and in addition to its other remedies – may declare void any such transfer.[138]

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premises, whereby the relation of landlord and tenant is established, is that exclusive possession of the premises rightfully belonging to one party is transferred to another, and thus the relation of landlord and tenant is established.”).

Privity of contract arises from the covenants in a lease, and it binds the parties in contractual privity with each other to perform those covenants. As the El Paso Court of Appeals explained in *Cauble v. Hanson*, the creation or destruction of privity of estate – which depends on the presence or absence of a reversion in the transferor of the leasehold – and the creation or destruction of privity of contract—which depends on the parties’ agreements –determine the different rights and duties of the parties affected by an assignment or subleasing transaction. *Cauble*, 224 S.W. at 923-24. A lessor cannot sue a subtenant on the original lessee's covenant to pay rent, unless the subtenant has assumed that obligation, for there is neither privity of estate nor of contract. *See Tinsley v. Metzler*, 44 S.W.2d 820, 821 (Tex. Civ. App.—El Paso 1931, writ dism'd w.o.j.) (citing *Giddings v. Felker*, 7 S. W. 694 (Tex. 1888); *Davis v. Vidal*, 151 S. W. 290 (Tex. 1912)).

[135] ***Leasehold Mortgage is a Sublease***. A leasehold mortgage is treated as a sublease because the security interest, which terminates upon satisfaction of the debt, is a type of reversion. *Amco Trus*t, 317 S.W.2d at 51. As a result, a leasehold mortgagee, who takes possession of the leased premises as a mortgagee-in-possession, does not become liable as an assignee for payment of rent under the terms of the lease. *Amco Trust*, 317 S.W.2d at 51 (declining to decide “whether there is any other theory upon which [a leasehold mortgagee-in-possession] might be responsible for either the stipulated or a reasonable rental during the time it occupie[s] the [leased premises.]”). In addition, absent assumption of the lease, a purchaser of the tenant’s leasehold at foreclosure of a leasehold mortgage does not automatically become liable as an assignee of the lease, at least as long as there are vendor’s liens or superior titles in favor of any previous assignors in the chain of title. *Amco Trust*, 317 S.W.2d at 51; A*rmstrong Forest Prods. v. Redempco, Inc*., 818 S.W.2d 446, 450-51 (Tex. App.–Texarkana 1991, no writ).

[136] ***Statutory Prohibition on Assignment and Subletting***. By statute, Texas law prohibits assignment of subletting without the landlord’s consent. “During the term of a lease, the tenant may not rent the leasehold to any other person without the prior consent of the landlord.” TEX. PROP. CODE § 91.005 (2013). This statutory prohibition on “renting” is part of every real property lease in Texas, *Reynolds v. McCullough*, 739 S.W.2d 424, 429 (Tex. App.—San Antonio 1987, writ denied), and the prohibition encompasses assigning, subletting, and mortgaging a tenant’s leasehold estate. *Gulf, C. & S.F. Ry. Co. v. Settegast*, 15 S.W. 228, 230 (Tex. 1891) (holding that assignments and subleases “are equally within the evil which was sought to be remedied” by statute prohibiting tenant from “renting” leased premises); *Lawther v. Super X Drugs of Texas, Inc.*, 671 S.W.2d 591, 594 (Tex. Civ. App.—Houston [1st Dist.] 1984, no writ) (holding that statutory predecessor to section 91.005 prohibits assignments as well as subleases); *American Nat’l Bank & Trust Co. v. First Wisconsin Mtg. Trust*, 577 S.W.2d 312 (Tex. Civ. App.—Beaumont 1979, writ ref’d n.r.e.); *Reynolds*, 739 S.W.2d at 429 (holding that section 91.005 prohibits mortgaging tenant’s leasehold without landlord’s consent).

[137] ***Consent Not to Unreasonably Withheld Consent Means Not to Arbitrarily Withhold***. This phrase, or something like it, often finds its way into commercial leases. In *B.M.B. Corp. v. McMahan’s Valley Stores*, 869 F.2d 865 (5th Cir. 1989), the Fifth Circuit stated that the specific terms of a lease determine whether, and under what circumstances, a landlord may have a duty not to unreasonably withhold its consent to a sublease.

> It thus appears that under Texas law, the reasonableness of a refusal to consent to an assignment or sublease is determined by reference to the terms and conditions of the original lease. This is consistent with the position of the Second Restatement of Property that refusing a sublease or assignment is reasonable when based on the lessee’s ability or inability to pay the rent and perform the other obligations contained in the lease. Under such an approach, it is unreasonable for the landlord to condition consent to a transfer on a change in the terms and conditions of the original lease. Commercial reasonableness thus is determined by reference to the provisions negotiated in the original lease between the landlord and tenant, not by reference to what the landlord later finds most economically advantageous.

Id. at 868-69. If the lease requires a landlord not to unreasonably withhold its consent to an assignment or sublease, Texas courts appear to apply an arbitrary standard to determine what is unreasonable. *See Mitchell’s, Inc. v. Nelms*, 454 S.W.2d 809, 813-14 (Tex. App.–Dallas 1970, writ ref’d n.r.e.) (citing *Webb v. Dameron*, 219 S.W.2d 581, 584 (Tex. Civ. App.—Amarillo 1949, writ ref’d n.r.e.) for proposition that decision is arbitrary when it is made without fair, solid and substantial cause or reason and that a mistaken or wrong decision is not necessarily arbitrary and stating that “what constitutes the elements of unreasonableness in the act of withholding consent presents a question not simple in resolution”); *Grossman v. Barney*, 359

(a) Landlord's consent to any transfer will not waive its rights, and it will not estop Landlord from exercising its rights, with respect to any other actual or proposed transfer, and Landlord's consent to any transfer will not relieve Tenant or any Guarantor of any liability to Landlord under this Lease or otherwise.[139]

(b) Tenant may request, in writing, Landlord's consent to a proposed transfer and that request must include: (i) the name of the proposed transferee; (ii) the nature and character of the transferee's business; (iii) the term, use, rental rate, and all other material terms of the proposed transfer; and (iv) audited financial statements or other evidence of the proposed transferee's assets, liabilities, net cash flow, operating history, and other evidence Landlord may reasonably request to evaluate the financial capacity of the proposed transferee to perform its obligations.

(c) Within **thirty (30)** days after its receipt of the required and any other information requested, Landlord either (i) will consent to, refuse its consent to, or conditionally consent to, the proposed transfer; or (ii) upon entering into a lease with the proposed transferee, will terminate this Lease. If Tenant does not receive written notice of Landlord's decision within thirty (30) days after the later of the date Landlord receives written notice of the proposed transfer or the date Landlord receives all of the required information and any requested information, Landlord will be deemed to have refused its consent to the proposed transfer, leaving this Lease and any Guaranty in full force and effect.[140] Tenant will pay, on demand as **Rent**, all costs and expenses (including attorneys' fees, if any) that Landlord may incur in connection with Landlord's review of any request for consent.

(d) Tenant will pay to Landlord all rent and other consideration Tenant receives in excess of the Rent payable under this Lease within five (5) days after Tenant receives it. If Tenant fails to pay any such sum when due, Landlord may contact any transferee and require that transferee to make all payments due under the transfer directly to Landlord.

S.W.2d 475, 476 (Tex. Civ. App.–San Antonio 1962, writ ref'd n.r.e.) (finding that lessor's refusal to consent to sublease under clause providing that "sublessee must be 'acceptable to lessor'" was not arbitrary, even though lessee, who was already in default of its lease, offered to guaranty sublease); *cf. Travis-Williamson Cnty. Water C. & I. Dist. v. Page*, 358 S.W.2d 158, 162 (Tex. Civ. App.–Austin 1962), *aff'd in part and rev'd in part*, 367 S.W.2d 307 (Tex. 1963) (stating that arbitrary refusal to act must be capricious, despotic, tyrannical, bound by no law, and performed without regard to principles). *See generally* 1 FRIEDMAN ON LEASES § 7.3.4[D][3].

[138] ***Effect of Tenant's Prohibited Transfer on Option Rights***. Depending on the terms of the lease, a tenant who assigns or sublets the premises in breach of the lease also may forfeit its right to exercise any options granted in the lease. In *Zurita v. Lombana*, No. 01-01-0104-cv, 2003 WL 21027140 (Tex. App.–Houston [1st Dist.] 2003, pet. denied) (unpublished), the court of appeals considered "whether [tenant] had a right to exercise the extension option in the lease or whether [tenant] had forfeited that right by subleasing a portion of the premises." The extension option provided that "Tenant's rights under this option shall terminate if…Tenant assigns its interest in the lease or sublets any portion of the premises." By contrast, under the default provision, tenant would have been entitled to 10 days to cure a default for violating the sublease provision before landlord would have been entitled to exercise its remedies for default under the lease. The court of appeals also declined to graft onto the automatic option termination provision the notice and cure requirements in the default clause. Instead, the court of appeals held that the tenant forfeited its option by violating the prohibition on subletting, reasoning that the lease expressly provided that the option "shall terminate" automatically if the tenant entered into a sublease, that the lease option did not contain any notice provision, and that, unlike the default provision in that lease, the option did not provide an opportunity for the tenant to cure by terminating the sublease.

[139] An assignment with lessor's consent does not release the original lessee from its obligation to pay rent. *Martinez v. Ball*, 721 S.W.2d 580, 581 (Tex. App.—Corpus Christi 1986, no writ); *Shooman v. McAughan*, 404 S.W.2d 665, 667 (Tex. Civ. App.—Eastland 1966, no writ); *Carter v. Stovall*, 291 S.W.2d 411, 413 (Tex. Civ. App.—Amarillo 1956, writ ref'd n.r.e.). The original lessee, in effect, stands as a guarantor of the assignee's performance of the original lease.

[140] A tenant is entitled to recover damages for breach of a landlord's covenant not to unreasonably withhold its consent to a transfer. *Mitchell's, Inc.*, 454 S.W.2d at 813-14; *see* 1 FRIEDMAN ON LEASES § 7.3.4[E]. And under some circumstances, a tenant may specifically enforce the landlord's promise. 1 FRIEDMAN ON LEASES § 7.3.5.

(e) A transfer will be deemed to occur if the person or persons who own or have voting control of **50%** or more of Tenant on the Effective Date cease to own Tenant during the Term, unless at least **80%** of Tenant's voting stock is listed on a national security exchange or owned by another corporation whose voting stock is so listed.[141]

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[141] ***Ownership Changes***. Section 91.005 of the Texas Property Code, however, may not prohibit some ownership changes and business restructurings. As a result, most leases, to one extent or another, contractually prohibit changes in the form of the tenant entity and significant changes in the entity's ownership structure. Section 91.005 probably does not prohibit the owners of a tenant business entity, like a corporation or limited partnership, from buying and selling their ownership interests. A *bona fide* sale of shares by a shareholder, for example, ordinarily would not affect the rights or liabilities of the corporation and, therefore, would not be considered a prohibited assignment or sublease under the statute. Unless the lease prohibits, or limits, ownership changes by a tenant doing business as a corporation, limited partnership, or other business entity, such changes are not prohibited by section 91.005.

Incorporation of Partnership In *A. Harris & Co. v. Campbell*, the tenant, a general partnership, entered into a lease that expressly required its landlord's consent to any assignment or sublease. 87 S.W. 365, 366 (Tex. Civ. App.—Dallas 1916, no writ). The tenant partnership later incorporated without the landlord's consent. That corporation then asked the landlord to consent to a sublease to a third party. The landlord refused, and the corporation sued the landlord for unreasonably withholding its consent to the sublease. Because the landlord did not consent to the partnership's incorporation, which the court of appeals called an "assignment of the lease," the corporation was not in privity with the landlord, and, as a result, the corporate successor could not assert a claim against the landlord for any breach of the landlord's covenant not to unreasonably withhold its consent to the sublease.

Corporate Conversion to Another Business Entity. Section 91.005 may not prohibit a conversion from a corporation to another form of business entity. The Texas Business Organizations Code allows a business entity to convert to another form of entity. TEX. BUS. ORG. CODE § 10.106 (2013). "When a conversion takes effect:

> (1) the converting entity continues to exist without interruption in the organizational form of the converted entity rather than in the organizational form of the converting entity;
>
> (2) all rights, title, and interests to all property owned by the converting entity continues to be owned, subject to any existing liens or other encumbrances on the property, by the converted entity in the new organizational form without:
>
> (A) reversion or impairment;
>
> (B) further act or deed; or
>
> (C) any transfer or assignment having occurred;
>
> (3) all liabilities and obligations of the converting entity continue to be liabilities and obligations of the converted entity in the new organizational form without impairment or diminution because of the conversion;
>
> (4) the rights of creditors or other parties with respect to or against the previous owners or members of the converting entity in their capacities as owners or members in existence when the conversion takes effect continue to exist as to those liabilities and obligations and may be enforced by the creditors and obligees as if a conversion had not occurred;

Id. § 10.106 (2013). No case directly addresses whether the Business Organizations Code trumps section 91.005 of the Property Code, as the author suspects, or *vice versa*.

Corporate Dissolution. A corporate dissolution may not constitute a prohibited assignment or sublease. In *Nardis Sportsware v. Simmons*, the lease granted the corporate tenant a purchase option, but it also prohibited the tenant from assigning or subletting. 218 S.W.2d 451(Tex. 1949). During the lease, the corporate tenant dissolved, and a former director and 50% shareholder of the corporation sought to exercise the dissolved corporate tenant's purchase option. The Texas Supreme Court allowed the distributee of the corporate tenant's assets to exercise the purchase option:

> There is no provision in the lease that a dissolution of the corporation would terminate the lease. In the absence of such a provision, whatever rights and claims arose under the covenant became a part of the assets of the corporation when it was dissolved, and were to be disposed of in accordance with the terms of [the corporate dissolution statutes].

Nardis, 218 S.W.2d at 455. To avoid the result in *Nardis*, the lease should define dissolution of tenant's business entity as a prohibited assignment or sublease. But this is not the only drafting solution. The default provisions should define tenant's

(f) Tenant's transfer of any interest in this Lease, or in the Premises, in violation of this Lease, will be a Default under this Lease and will entitle Landlord to terminate this Lease and any option or other right granted Tenant by this Lease.[142]

16. **TENANT'S INSURANCE**.[143] Tenant, at its sole cost, must procure and maintain the following insurance coverages throughout the Term on the forms specified in this Lease or on other forms approved by Landlord in its reasonable discretion:

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dissolution as an event of default and condition tenant's right to exercise any options or other preferential rights on the absence of such a default.

[142] ***Ratification***. A landlord's subsequent agreement, acquiescence, or ratification may validate an otherwise prohibited assignment or sublease. *Edwards v. Worthington*, 118 S.W.2d 328, 333 (Tex. Civ. App.—Amarillo 1938, no writ); *cf. Nardis Sportswear*, 218 S.W.2d at 454 (stating that "accepting the rents after the dissolution of the corporation and the assignments of the lease clearly disclose that it was not his intention to forfeit the lease"). A landlord may waive a lease term prohibiting assignments and subleases without landlord's consent. *Liberty Sign Co. v. Newsom*, 426 S.W.2d 210, 214 (Tex.1968); *Jackson v. Knight*, 194 S.W. 844, 846 (Tex. Civ. App.—Amarillo 1917, writ ref'd); *Fair W. Bldg. Corp. v. Trice Floor Coverings*, 394 S.W.2d 707, 708 (Tex. Civ. App.—Fort Worth 1965, no writ); *Casto v. Johnson*, 392 S.W.2d 591, 593 (Tex. Civ. App.—Waco 1965, writ ref'd n.r.e.).

[143] ***Insurance and Indemnity***. The insurance and indemnity provisions in this Lease, like those in many lease forms currently in circulation, use obsolete terms and concepts, which, like cockroaches feasting on old crumbs in the dark corners of a dirty cupboard, thrive without regular housecleaning. There are several reasons to annotate obsolete insurance and indemnity provisions. One is the hope that annotating typical, though somewhat dated, insurance and indemnity provisions will help practitioners – who negotiate, draft, revise, and comment on such leases in quotidian practice of real estate law – convince their fellow practitioners to cleanse these stale terms and concepts from their lease forms. A second reason, related to the first, is the need to consider updates to address recent statutory changes (the anti-indemnity statute governing construction contracts and the statute governing the issuance and content of insurance certificates) and ISO's issuance of revised policy forms and endorsements. The third reason is that Bill Locke has already presented the state-of-the-art annotated form of insurance and indemnity provisions for commercial leases. *See* William H. (Bill) Locke, ANNOTATED INSURANCE SPECIFICATIONS: STATE BAR OF TEXAS: ADVANCED REAL ESTATE LAW COURSE (July 7-9, 2011) (discussing insurance provisions in basic office and retail lease forms contained in the Texas Real Estate Forms Manual of the State Bar of Texas). My modest ambition for the annotations of the insurance and indemnity provisions in this lease form is to stake out the locations of the old land mines in the minefield, point out the locations of some new ones, and to direct the reader to other authors, like William Locke, Aaron Johnston, Charles Comiskey, who wrote the manuals on how to disarm these IEDs (insurance explosive devices). If anything in the annotations is insightful or helpful, the credit should go to Messrs. Locke, Johnston, Comiskey, among others, from whom much is borrowed. If anything is amiss, the responsibility is mine alone.

William H. Locke, *Leases and Property Insurance*, ACREL MID-YEAR LEASE AND INSURANCE COMMITTEES (March 2012); *Annotated Insurance Specifications*, STATE BAR OF TEXAS: 33rd ANNUAL ADVANCED REAL ESTATE LAW COURSE (July 7-9, 2011); *Annotated Risk Management Provisions (Focus on Texas Real Estate Forms Manual's Retail Lease)*; *Allocating Extraordinary Risk in Leases: Indemnity/Insurance/Releases and Exculpation (Including a Review of the Risk Management Provisions of the Texas Real Estate Forms Manual's Office Lease)*; *Risk Management and Shifting of Extraordinary Risk: Contractual Provisions for Indemnity, Additional Insureds, Waiver of Subrogation and Exculpation*, STATE BAR OF TEXAS: ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (2007, 2003, 2002) and ANNUAL ADVANCED REAL ESTATE LAW COURSE (2006); *Additional Insured Endorsements to Liability Policies: Typical Defects and Solutions*, STATE BAR OF TEXAS: ADVANCED REAL ESTATE DRAFTING COURSE (2008); and *CGL Coverage of Defective Work*, ACREL Fall Program (October 2009); *Distress and Insurance*, ACREL Fall Program (October 2010); *Insurance Issues in Distressful Times*, STATE BAR OF TEXAS: ADVANCED REAL ESTATE DRAFTING COURSE (2011).

Aaron Johnston, Jr., *Using the Other Party's Liability Insurance*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2012 BERNARD O. DOW LEASING INSTITUTE (October 3 & 24, 2012); Aaron Johnston, Jr. and Charles E. Comiskey, *Insurance and Indemnity in Lease Transactions*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2005 BERNARD O. DOW LEASING INSTITUTE (April 15 & 29, 2005); Aaron Johnston, Jr. and Charles E. Comiskey, *Builder's Risk and Commercial Property Insurance: What to Require in Your Forms*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 39TH ANNUAL WILLIAM W. GIBSON, JR. MORTGAGE LENDING INSTITUTE (September 8-9 – October 6-7, 2005);

Charles E. Comiskey, *Running with Scissors – Inherently Dangerous Insurance Drafting Practices*, STATE BAR OF TEXAS: 26TH ANNUAL CONSTRUCTION LAW CONFERENCE (March 26, 2013).

(a) **General Liability Insurance**.[144] ~~Comprehensive~~ ~~Public liability~~ Commercial general liability insurance (*CGL*):[145] (i) on form ISO CG 00 01 04 13 (or, if Tenant has more than 1 location covered by a policy having a general aggregate limit, ISO form amendment Aggregate Limits of Insurance Per Location CG 25 04);[146] (ii) on an occurrence basis;[147] (iii) with general aggregate limits of at least a **$2,000,000** ~~combined single limit~~;[148] (iv) having these unmodified endorsements[149] on Tenant's CGL and on any umbrella liability policy:[150]

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[144] ***Insurance*** means a contract under which a company in the business of insuring against losses undertakes to defend a party against, and compensate the party for, loss from a specified contingency or risk for a specified period of time in consideration for the payment by the insured party of a premium. The purchaser of an insurance policy, in effect, pays a sum certain (the premium) today to transfer to the insurer the risk that the purchaser will have to pay a larger, but presently unknown amount of money, if certain events cause certain losses in the future. Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 1.

[145] ***Liability insurance*** is a form of third party insurance that compensates a party injured by tortious acts or omissions of an insured. The current standard form of liability insurance is ***commercial general liability***. Pubic liability and comprehensive general liability are obsolete liability policy forms that are no longer in use, except in real estate forms badly in need of updating. ISO commercial general liability forms are considered industry standard. In April 2013, ISO issued revised coverage forms, 2013 Commercial General Liability Coverage Form (Occurrence) CG 00 01 04 13, along with numerous revised optional coverage forms and endorsements. *See* **Appendix IV** (Selected 2013 ISO CGL Form Revisions.)

Exclusion from Coverage of Property You Own, Rent, Occupy in CGL Liability Policy. The insuring agreement in a CGL policy is invoked when (a) bodily injury or property damage (b) is caused by an "occurrence," (c) which takes place in the "policy territory," (d) but only if the bodily injury or property damage occurs during the policy period, regardless of when the claim is made. But the standard ISO form of CGL liability policy ***does not*** cover tenant for damage to landlord's building or property caused by the negligence of tenant or its employees. *U.S. Fire Ins. Co. v. Liss*, 357 So. 2d 1356, 1357 (La. Ct. App. 1978). The standard printed exception in the CGL form for damage to property ***excludes*** from coverage "property damage…to property you own, ***rent, or occupy*** including any costs or expenses incurred by you, or any other person, organization or entity, for repair, replacement, enhancement, restoration or maintenance of such property for any reason, including prevention of injury to a person or damage to another's property[.]" *Id*. A primary purpose of this exclusion "is to prevent the insured from using a liability insurance policy as if it provided property insurance." *See also Dryden Oil Co. of New England, Inc. v. Travelers Indem. Co.*, 91 F.3d 278, 284 (1st Cir. 1996) (stating that it is a "well-settled [rule] that [a] policy does not extend any greater coverage to an additional insured[,]" unless the endorsement naming additional insured contains language suggesting that the endorsement alters the nature of coverage, declarations, or exclusions).

Tenant's Liability Insurance Does Not Protect Tenant from Negligent Damage to Landlord's Property. This damage to property exclusion delivers an unwelcome surprise to many a tenant who believes its CGL policy provides coverage when tenant, or one of its employees, accidentally causes damage to landlord's property. Absent an exculpatory provision in the lease, a tenant is liable to its landlord when tenant's negligence causes damage to landlord's building. *Nagorny v. Gray*, 261 S.W.2d 741, 743 (Tex. Civ. App.—Galveston 1953, no writ) (holding tenant liable for fire damage to landlord's building proximately caused tenant's negligence). Basic liability insurance affords a tenant almost no protection against damages tenant causes to its landlord's property.

[146] ***Designated Locations Endorsement***. Optional endorsement CG 25 04 13 Designated Location(s) General Aggregate makes available a separate general aggregate limit attributable only to operations at the designated location. Losses that are not attributable to a single location are subject to the General Aggregate or Products/Completed Operations Aggregate limit. "Location" means premises involving the same or connecting lots, or premises whose connection is interrupted only by a street, roadway, waterway or right-of-way or a railroad.

[147] ISO CGL forms define an "***occurrence***" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions."

[148] ***Combined single limit*** is an obsolete term. The concept of a single combined coverage limit – the limit of coverage for any combination of different types damages resulting from an occurrence – is now incorporated into the standard CGL form, but the old terminology has been abandoned.

[149] ***Toward Precise but Flexible Insurance Specifications***. In many instances, insurers take a substantive insurance concept and then, for some legitimate reason, change its name or change the way policy documents implement the concept. Cross-liability is a case in point. Cross-liability refers to the loss exposure created when one insured under a policy sues another. At one time, insurers used an endorsement to protect an insured from "cross-liability." Insurers have abandoned this technique, changed the name of the concept to "separation of insureds," and now, instead of using an endorsement, protect the insured from the same loss exposure through a policy condition stating that coverage will apply "separately to

(A) ISO additional insured form CG 20 11 for premises leases designating Landlord Parties[151] as additional insureds without modification;[152] (B) ISO waiver of subrogation form CG 24 04 10 in favor of Landlord Parties;

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each insured against whom a claim is made or suit is brought." This is all well and good until a landlord or tenant review, the insurance requirements in their 32 year-old base lease, which have not been updated in any of the prior 16 amendments. The old form is specific enough. It commands tenant to obtain a cross-liability endorsement, which was readily available in 1981 when the parties negotiated the base lease. But the command is not flexible. In the effort to be precise, it specifies the means – obtain an endorsement – to achieve the end – protection against a certain type of harm from a particular cause or circumstance using a term-of-insurance-art whose life span was much shorter than the parties' lease. In this regard, Mr. Locke's ***Supplement to Insurance Addendum in the Annotated Insurance Specifications*** is as good as it now gets, and it gets pretty good. *See* Locke, *Annotated Insurance Specifications*, at 48-58. The supplemental addendum specifies coverages, limits, and protections in precise terms, but it relies on landlord's discretion to approve forms of coverage to preserve the desired flexibility as forms change.

Other Insurance. ISO revised the Other Insurance Condition in its Supplemental Extended Reporting Period endorsements (CG 27 10 and CG 27 11). The revised endorsements delete the "by endorsement" requirement to allow an insurer to extend additional insured status within its policy language without an endorsement. The new endorsement states the named insured's coverage will be excess over any other primary insurance that designates the insured as an additional insured whether such addition is by endorsement or by any other means.

Primary and Noncontributory – Other Insurance Condition. ISO describes the 2013 version of CG 20 01 Primary and Noncontributory—Other Insurance Condition as an optional endorsement. This endorsement adds the other insurance condition of the CGL policy coverage for an additional insured on a "primary and noncontributory" basis. The insurer will provide primary coverage to an additional insured, and the insurer will not seek contribution from other insurance available to the additional insured, provided the additional insured is a named insured on the other insurance. This endorsement is activated only if the named insured to these terms in a written contract or agreement. "The practical effect of using this endorsement is to allow 'primary and noncontributory' to be shown on a certificate of insurance, a frequent demand of an additional insured. Because, absent this new endorsement, the ISO CGL does not use the phrase 'primary and noncontributory,' representing this condition on the certificate of insurance is problematic if not prohibited." Craig F. Stanovich, *The 2013 Edition of the CGL Policy*, IRMI Online, https://www.irmi.com/articles/expert-commentary/2013-edition-of-the-cgl. ISO maintains that this endorsement has no impact on coverage.

[150] An ***umbrella liability policy*** has its own insuring agreement and exclusions, which may not be the same as those in the liability policy. An umbrella policy may: (i) provide liability limits above the scheduled limits in the primary liability policy; (ii) provide "drop down" coverage – become primary coverage – if losses exceed aggregate limits under the underlying liability policy; and (iii) afford coverage for claims not covered by underlying policies (if not also excluded by the umbrella liability policy) subject to a self-insured retention. Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 17.

[151] Unlike named insured status, ***additional insured*** status does not provide automatic coverage for the officers, directors, and partners of the additional insured, unless the categories of persons are specifically listed as additional insureds. *See, e.g., Sturgill v. Kubosh Ins. Co. of Am.*, No. 01-95-01529-cv, 1996 WL 665552 (Tex. App.—Houston [1st Dist.] Nov. 14, 1996, n.p.h.) (stating that additional insured provision covering "employees" of additional insured does not cover "volunteer" assisting additional insured). In April 2013, ISO revised a number of additional insured endorsements used in connection with leasing transactions and construction of tenant improvements:

- 2013 Additional Insured Owners, Lessees Or Contractors—Automatic Status When Required In Construction Agreement With You CG 20 33 04 13
- 2013 Additional Insured Managers Or Lessors Of Premises – CG 20 11 04 13
- 2013 Additional Insured – Owners, Lessees or Contractors–Automatic Status for Other Parties When Required in Written Construction Agreement (CG 20 38 13). This endorsement extends additional insured status to an upper tier party if required by a contract, even if the Additional Insured is not a direct party to the contract. A work letter may require landlord or tenant to require general contractor to require lower-tier subcontractors to provide additional insured coverage to landlord and tenant, neither of which is a party to the GC's contract with its subcontractor. This endorsement extends additional insured status to landlord without a specific listing. An additional premium applies to this endorsement and varies by company.

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[152] ***Additional insured*** status and ***indemnification*** are independent risk-transfer techniques, each serving as a separate coverage contract. To achieve the intended benefits of each technique, however, additional insured status requirements should complement applicable indemnity provisions. Benefits of additional insured status include:

- The additional insured is an insured under the policy. An additional insured has the right to contact the insurer and to make a claim, but it is not required to notify the named insured of its intent to do so.
- Each insured, including each additional insured, is entitled to a separate defense, and the defense costs are outside of, or in addition to, the limits of the policy, until the insurer fulfills its obligations under the policy. An insured is entitled to defense against any "suit" alleging damages arising out of covered bodily injury or property damage, unless and until the insures pays the full limit in settlement or on a judgment for damages.
- Additional insured status, under a proper endorsement, may provide coverage for the concurrent or sole negligence of the additional insured.
- No fair notice rules currently apply to additional insured requirements, reducing the likelihood of litigation to enforce to enforce them.

But simply requiring "***additional insured status***," without referring to a particular form or specifying substantive requirements, is virtually meaningless. Numerous additional insured endorsements litter the endorsement landscape. Specify and review additional insured endorsements with four questions in mind:

- Who is designated an additional insured?
- What kind of negligence is transferred?
- What kind of operations are covered?
- What exclusions, if any, are added?

Comiskey, *Running with Scissors*, at p. 5. Comiskey recommends designating specific ISO endorsements when drafting insurance specifications in contracts. *See also* Jack P. Gibson and W. Jeffrey Woodward, *Questions and Answers on Additional Insured Issues–Part I*, IRMI Online (July 2009), https://www.irmi.com/articles/expert-commentary/questions-and-answers-on-additional-insured-issues-part-1 (discussing (i) scope of coverage); and Gibson & Woodward, *Questions and Answers on Additional Insured Issues–Part II*, IRMI Online (July 2009), https://www.irmi.com/articles/expert-commentary/questions-and-answers-on-additional-insured-issues-part-2 (discussing (ii) additional insured requirements as a risk transfer strategy, (iii) other insurance, (iv) certificate of insurance, and (v) other issues).

2013 Additional Insured Endorsements. ISO revised 24 of its 31 additional insured endorsements. Some of the revisions insert limitations incorporating applicable state anti-indemnification statutes into the insurance contract. These revisions substantively alter coverage in three ways.

One, the revised endorsements afford an additional insured coverage "*only to the extent provided by law*." Numerous states, including Texas, prohibit upstream parties (contractors and owners) from requiring downstream parties (subcontractors) to indemnify upstream parties for the upstream parties' own negligence or fault. *See* TEX. INS. CODE § 151.102 (2013). Some states also prohibit upstream contractors from requiring a downstream subcontractor to name upstream parties as an additional insured with respect to the upstream party's own negligence. Texas's Anti-Indemnity Statute provides:

> Except as provided by Section 151.103, a provision in a construction contract, or in an agreement collateral to or affecting a construction contract, is void and unenforceable as against public policy to the extent that it requires an indemnitor to indemnify, hold harmless, or defend a party, including a third party, against a claim caused by the negligence or fault, the breach or violation of a statute, ordinance, governmental regulation, standard, or rule, or the breach of contract of the indemnitee, its agent or employee, or any third party under the control or supervision of the indemnitee, other than the indemnitor or its agent, employee, or subcontractor of any tier.

TEX. INS. CODE § 151.102 (2013). Section 151.102 does not apply to a provision in a construction contract that requires a person to indemnify, hold harmless, or defend another party to the construction contract or a third party against a claim for the bodily injury or death of an employee of the indemnitor, its agent, or its subcontractor of any tier." *Id.* § 151.103.

Two, the coverage afforded the additional insured *will be no broader* than the coverage the named insured is required to provide the additional insured by a contract or agreement. Thus, a lease provision requiring a party to name the other as an additional insured may reduce coverage but will not expand it.

Three, the *maximum liability* of the insurer to an additional insured will be the *lesser of* the amount of coverage required by the contract or agreement or the policy limits. The revised endorsement expressly provides that it will not

and (C) a contractual liability endorsement [specify current and appropriate ISO form] ~~covering all liabilities assumed by Tenant by way of indemnity in this Lease~~[153] ~~broad form contractual liability endorsement~~[154] contractual liability insurance applying to the indemnification agreement[155] and (v) ~~deleting the contractual claim exclusion for personal injury and advertising injury.~~[156]

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increase the policy limits shown in the declarations. If the contract requires lower limits that the policy provides, the insurer benefits, not the insured.

The CG 20 33 endorsement also amends the "Who is an Insured" provision, adding as an additional insured any person or organization for whom the named insured is performing operations when the parties agree in a written agreement to add such person or organization as an additional insured. General contractors often require subcontractors (named insureds) to provide additional insured status to upstream parties (*e.g.*, the general contractor and the project owner). Because the subcontractor (the named insured) ordinarily does not contract directly with the project owner, the current CG 20 33 may not confer additional insured status on an upstream party with whom the named insured is not in privity. The new CG 20 38 endorsement provides additional insured status to those parties whom the named insured is obligated in writing in a contract or agreement to name as an additional insured under their policy. This broadens coverage.

Some of the 2013 revised ISO additional insured forms, which are potentially useful in leasing transactions, include: Additional Insured—Owners, Lessees Or Contractors—Scheduled Person Or Organization (CG 20 10 04 13), Additional Insured—Managers Or Lessors Of Premises (CG 20 11 04 13), Additional Insured—Mortgagee, Assignee Or Receiver (CG 20 18 04 13), Additional Insured—Owners Or Other Interest From Whom Land Has Been Leased (CG 20 24 04 13), Additional Insured—Designated Person Or Organization (CG 20 26 04 13), Additional Insured—Co-owner Of Insured Premises (CG 20 27 04 13), Additional Insured—Engineers, Architects Or Surveyors (CG 20 31 04 13), Additional Insured—Engineers, Architects Or Surveyors Not Engaged By The Named Insured (CG 20 32 04 13), Additional Insured—Owners, Lessees Or Contractors—Automatic Status When Required In Construction Agreement With You (CG 20 33 04 13), and Additional Insured—Owners, Lessees Or Contractors—Completed Operations (CG 20 37 04 13).

[153] As a practical matter, tenant cannot obtain ***contractual liability insurance*** that satisfies the deleted requirement in this Lease. *See* Comiskey, *Running with Scissors*, at p. 4. Contractual liability insurance only covers what it covers, and to the extent that an indemnity is broader than the coverage afforded by the policy, contractual liability insurance proceeds will not be available to fund the uncovered portion of any indemnified losses. Contractual liability insurance simply is a funding mechanism for only the portion of the indemnification obligation that is within the scope of: "(1) a series of definitions to (2) an exception to (3) an exclusion to (4) the coverage provision in a CGL for bodily injury and property damage liability only. ***In other words, contractual liability insurance applies to allegations of bodily injury and physical injury to tangible property, and nothing else***." Comiskey, *Running with Scissors*, at p. 4. And when it is provided, contractual liability coverage is subject to the limits of liability stated in the policy. *Id.*

The 2013 version of the Amendment of Insured Contract (CG 24 26) redefines "insured contract" in a manner that may eliminate coverage for a landlord indemnitee's *sole* negligence. To the extent insurance is no longer available to fund an obligation to indemnify a landlord for its sole negligence, tenant should consider excluding landlord's sole negligence from the scope of any relevant indemnities in the lease. *See Marathon Ashland Pipe Line LLC v. Maryland Cas. Co.*, 243 F.3d 1232, 1240 (10th Cir. 2001) (Wyoming law) (stating that "we conclude this policy language does not limit coverage to the additional insured's vicarious liability"); *Admiral Ins. Co. v. Trident NGL, Inc.*, 988 S.W.2d 451, 455 (Tex. App.—Houston [1st Dist.] 1999, pet. denied) (holding that, because the accident occurred while employee of contractor (the named insured) was on the premises of customer (the additional insured), the liability (absent any negligence on the part of the named insured) for injuries to the employee of the named insured "arose out of the [named insured's] operations," and, therefore, was covered by the endorsement designating the named insured's customer as an "additional insured"); *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 254 (10th Cir. 1993) (Kansas law) (finding that additional insured endorsement, which stated "[t]he "Persons Insured" provision is amended to include as an insured the person or organization named below *but only with respect to liability arising out of operations performed for such insured by or on behalf of the named insured*," was ambiguous as to whose negligence was excluded from coverage and holding that "the additional insured endorsement does not limit the policy's coverage to cases where [the additional insured] is held vicariously liable for [the named insureds'] negligence").

[154] Blanket or broad form contractual liability coverage ended in 1986. Comiskey, *Running with Scissors*, at p. 1.

[155] ***Contractual Liability and Policy Limits***. In a GCL policy, the insurer agrees to defend its insured, and the cost of this defense does not count against the insured's policy limits. But an insurer has no duty to defend an insured's indemnitee under a CGL policy. If the terms of an indemnity obligate the indemnitor to defend its indemnitee, the insurer's cost of defending the indemnitee is deemed to be "damages" that count against the policy limits of the insured-indemnitor.

(b) **Workers' Compensation and Employer Liability Coverage**. Workers' Compensation insurance (not any alternative form of coverage) for at least the applicable statutory limit; and employer's liability (or equivalent coverage under commercial umbrella) with at least a **$1,000,000** limit for each accident, for bodily injury by accident, and at least a **$1,000,000** limit for each employee for bodily injury by disease. Each such policy must waive subrogation in favor of Landlord Parties on endorsement form WC 429394 (Texas only) or ISO form WC 000313 (all other states).[157]

(c) **Property Insurance**. ~~Fire and extended coverage, vandalism and malicious mischief, and special extended coverage~~[158] ~~or all risk~~[159] special form property insurance:[160] (i) on ISO form CP 10 30 (or

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"How do you fix this? By requiring the proper type of additional insured coverage." Comiskey, *Running with Scissors*, at p.4.

[156] This "contractual claim" exclusion no longer exists. Comiskey, *Running with Scissors*, at p. 1.

[157] ***Workers' Compensation***. Leases often require each party to carry workers' compensation insurance in an effort to create a practical buffer between the employer's obligation (as an indemnitor under the lease) to indemnify the other party to the lease if the indemnitor's employee asserts a claim against the other party. Workers' compensation statutes limit an injured employee's recovery against his or her employer; as a result, landlord or tenant, as the case may be, should ensure that the indemnification provisions allocate financial responsibility for any damages in excess of the workers' compensation coverage to the appropriate party (ordinarily the employer of the injured employee). Locke, *Annotated Insurance Specifications*, at p. 119.

[158] ***Obsolete CGL Terms***. In 1986, the insurance industry ceased using phrases "fire insurance," "extended coverage," "vandalism and malicious mischief," and "special extended coverage." New terms, "basic causes of loss," "broad causes of loss," and "special causes of loss," replaced the older terms and forms. Comiskey, *Running with Scissors*, at p. 2.

[159] ***Obsolete & Risky – "All Risk."*** Most of the insurance industry no longer describes coverage as all risk or even "all risk" due to court decisions holding that "all risk" falsely represents to ignorant, unthinking, and credulous insureds that their policy does not exclude, condition, or limit the scope of coverage in any way. Comiskey, *Running with Scissors*, at p. 3; *see, e.g.*, *Brown & Brown of Texas, Inc. v. Omni Metals, Inc.*, 317 S.W.3d 361, 372 (Tex. App.—Houston [1st Dist.] 2010, pet. denied) (affirming, after epic legal battle, judgment on jury verdict awarding treble damages to insured who ignored the following disclaimer on the insurance certificate: [THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS ON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES DESCRIBED BELOW]; who admitted he did not read insurance policy; and who instead "reasonably" relied on the "false and misleading" representation by the insurance agent and in the certificate that the policy covered "all risks").

[160] ***Property Insurance***. Unlike the ISO liability form, there is no universally recognized standard property insurance policy form. The only way to ensure a policy conforms to the lease, or *vice versa*, is to review them both. ISO commercial property insurance is a form comprised of the following documents combined to make the policy:

- Declarations Page (ISO form IL 00 19, or a variation)
- Common Policy Conditions (IL 00 17)
- One of 3 Causes of Loss Forms: CP 10 10 (Basic), 10 20 (Broad) or 10 30 (Special)
  - ***Basic Causes of Loss*** Form CP 10 10 covers: fire, Lightning, Explosion, Windstorm or hail, Smoke, Aircraft or vehicles, Riot or civil commotion, Vandalism, Sprinkler leakage, Sinkhole collapse, and Volcanic action
  - ***Broad Causes of Loss*** Form CP 10 20 covers losses covered by the Basic Form, plus: Breakage of glass; Falling objects; Weight of snow, ice, or sleet; Water damage from leaking appliances; Collapse from specified causes
  - ***Special Causes of Loss*** Form CP 10 30 covers all perils, except as excluded, plus Collapse from specified causes
- Commercial Property Conditions (CP 10 90);
- Building and Personal Property Coverage Form;
- Additional limits and optional coverages,
- endorsements describing property covered;
- Loss payee endorsements; and
- ISO form CP 00 10.

equivalent business owner's policy); (ii) with no exclusions, except the standard printed exclusions;[161] (iii) for 100% of the replacement cost of Tenant's furniture, fixtures, and equipment and all above-Building Standard improvements or alterations to the Premises, regardless of who paid for them;[162] (iv) waiving subrogation in favor of Landlord Parties; and (v) having these unmodified endorsements: (A) Landlord Parties shown as "insured as their interests may appear;"[163] and (B) ordinance or law coverage.[164]

(d) **Business Income and Extra Expense Coverage**. Business income and extra expense coverage for at least **six (6)** months of Tenant's income[165] and expenses with a waiver of subrogation in favor of Landlord Parties.

The ISO property policy for leased premises allows the parties to waive the insurer's rights in advance by a waiver of claims in the lease. The ISO property policy also allows *landlord* to waive the insurer's subrogation right even after a loss. *See* William H. Locke, Jr., *Leases and Property Insurance*, ACREL MID-YEAR LEASING AND INSURANCE COMMITTEES (March 2012); **Appendix IV**—Selected List of 2013 ISO Property Form Revisions. *See infra* footnote 169 (***business personal property*** in tenant's property insurance policy includes "the named insured's ***use interest as tenant in improvements and betterments*** (for example, fixtures, alterations, installations or additions to a structure occupied but not owned by the named insured which are acquired or made at the expense of the named insured but are not legally removable by the named insured); leased personal property for which the named insured has a contractual responsibility to insure; and personal property of others that is under the care, custody or control of the named insured and located in or on the Premises.").

[161] Christopher J. Boggs, ISO Commercial Property Changes – Part 2 – Cause of Loss Form Changes (March 22, 2013) (summarizing cause of loss form changes, including changes to standard printed exclusions for Earth Movement, Water, Wear and Tear–Special Form, Ordinance and Law, http://www.mynewmarkets.com/articles/181480/iso-commercial-property -changes-part-2-cause-of-loss-form-changes.

[162] The 2000 edition of ISO form CP 00 10 clarifies how the replacement cost option applies to tenant improvements and betterments. This property is not considered personal property of others, and is, therefore, covered on a replacement cost basis as if the replacement cost option has been elected. If tenant improvements and betterments are not repaired or replaced, or are not repaired or replaced "as soon as reasonably possible after the loss," the covered property will be valued at the insured's original cost as outlined in the form's valuation condition. Tenant's insurer will not pay for loss to tenant improvements and betterments if, and to the extent, someone else (such as the landlord or landlord's insurer) pays for repairs or replacement. *See infra* footnote 169 (stating definitions of ***Building*** and ***Business Personal Property*** in commercial property insurance policy).

[163] Property insurance additional insured endorsements use the phrase "as their interests may appear" to limit the additional insured's recovery rights to covered property with respect to which the additional insured has an interest. Without this limitation, the insurer could include the additional insured on all policy proceed checks when the policy covers multiple properties. Under the CP 12 19, the building owner is an additional insured with respect to the coverage provided for direct physical damage to the building, and any covered loss is adjusted with, and payable to, both the tenant, as the first named insured (the insured whose name is listed first in the Declarations), and to the building owner, as an additional insured. Locke, *Annotated Insurance Specifications*, at p.137.

[164] ***Ordinance or Law Exclusion***. The 2013 revisions alter the standard printed exclusion for changes in ordinance or law. The new exclusion applies to the enforcement of "*or compliance with*" (added wording) laws and ordinances; "enforcement" is not required for the exclusion to apply. The phrase "the minimum standards of" replaces the phrase "enforcement of" in "e." under Additional Coverages. "The term 'compliance' seems to indicate that the insured is voluntarily complying with the current ordinance or law – which is a requirement of the permitting process anyway. So, punitive 'enforcement' is not required for the exclusion to apply – and it never did. The phrase 'enforcement of' is replaced with 'the minimum standards of….' Again, there is no change in coverage or intent, simply recognition of the 'required voluntary' nature of complying with a jurisdiction's building codes. Thirteen coverage forms are altered by this modernization." Boggs, *ISO Commercial Property Changes – Part 2 – Cause of Loss Form Changes, supra* footnote **161**.

[165] The same causes of loss that invoke tenant's property insurance coverage also invoke coverage for tenant's business income and extra expense coverage. The insuring agreement in the 2000 ISO edition of the ***business income and extra expense*** coverage form alters the definition of "***premises***" for insured tenants to make clear that the insuring agreement affords coverage for income loss that results from damage to property in other portions of the building (or on other portions of the site), even if the property in the insured tenant's space is not damaged.

(e) **Policy Forms and Additional Requirements**. Each of Tenant's insurance providers must maintain ratings of Best's Insurance Guide A/VIII or Standard & Poor Insurance Solvency Review A-, or better, and be admitted to engage in the business of insurance in the State or Commonwealth in which the Building is located, and each of Tenant's policies must: (i) be primary — with all policies of Landlord and Landlord's lien holders being excess, secondary, and noncontributing; (ii) require Tenant's insurance provider to give Landlord and Landlord's Mortgagees at least **thirty (30)** days prior written notice of any cancellation, nonrenewal, or material modification;[166] and (iii) not have a deductible or self-insured retention in excess of **$10,000**. Tenant must reinstate the full aggregate limit of any policy reduced below 75% of any aggregate limit required in this Lease and maintain any other insurance coverages that Landlord or Landlord's Mortgagees may require. Landlord also may require Tenant to procure and maintain its insurance coverages on other forms or with other endorsements.

(f) **Evidence of Property Insurance**. Before the Effective Date, and at least thirty (30) days before the expiration of policy, Tenant must deliver to Landlord proof of (a) Liability insurance on ACORDTM Form 25 (2010/05); (b) Certificates of Liability Insurance for liability coverages on ACORDTM Form 28 (2009/12); (c) Evidence of Commercial Property Insurance for property coverages; and (d) for property insurance for which the policy has not yet been issued, Tenant must provide an ACORDTM Form 75 (2010/04) Insurance Binder.[167]

17. **LANDLORD'S INSURANCE**. Landlord must procure and maintain in force these insurance coverages: (a) CGL with a combined single limit for bodily injury and property damage of not less than **$2,000,000** for each occurrence resulting from the operations of Landlord and its employees within the Building;[168] and (b) special form property insurance covering the Building, Building Standard leasehold

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[166] ***Notice Requirements.*** A tenant cannot comply with this notice requirement as written. Only two forms of notice endorsements are in current use. Texas currently permits a "***notice of cancellation or material change***" endorsement. While "material change" is not defined, an insurance company is unlikely to rewrite its endorsement to meet the definition of "material" in a lease. Most states, other than Texas, only permit a "notice of cancellation" endorsement. Comiskey, *Running with Scissors*, at 2. Insurers do not provide "***notice of nonrenewal***" endorsements. Comiskey explains that a change in any term, condition, or verbiage in a policy at the time of renewal means the renewal technically is no longer a renewal. A notice of non-renewal endorsement would require the insurer to send a non-renewal notice with each policy change, no matter how minor, and insurers generally are unwilling to commit to such a burden and expense. Comiskey, therefore, recommends deleting contractual requirements calling for "nonrenewal" endorsements. Comiskey, *Running with Scissors*, at 2.

[167] The parties to a lease should not rely on ACORD Certificate of Insurance and ACORD Evidence of Insurance forms to confirm coverages, exclusions, and deductibles. W. Rodney Clement, Jr., *Is a Certificate of Commercial Property Insurance a Worthless Document?* PROBATE & PROPERTY 46 (May/June 2010); and Alfred S. Joseph III and Arthur E. Pape, *Certificates of Insurance: The Illusion of Protection*, PROBATE & PROPERTY 54 (Jan./Feb. 1995). In 2011, the Texas Legislature removed any good reason to try to use such certificates, essentially prohibiting insurance companies from issuing meaningful insurance certificates. TEX. INS. CODE ANN. § 1811.051 (Vernon 2013). A "property or casualty insurer or agent ***may not issue*** a certificate of insurance or any other type of document purporting to be a certificate of insurance if the certificate or document alters, amends, or extends the coverage or terms and conditions provided by the insurance policy referenced on the certificate or document. Morevoer, a "certificate of insurance or any other type of document may not convey a contractual right to a certificate holder." *Id.* § 1811.051(b). Under this statute, an insurance certificate cannot change coverage or convey an enforceable right to a certificate holder. Put another way, the legislature outlawed the work of the bar over two decades to find ways to ensure certificate holders received the coverage promised in leases and other real estate documents. But, in defense of insurance companies, it is impossible for actuaries to quantify and price premiums if insurance agents and other parties can alter the insurance contract after the insurance policy is priced and paid for by passing around improperly completed insurance certificates.

[168] ***Property Manager's Liability Coverage***. The revised 2013 ISO CG 22 70 real estate property management endorsement provides that, with respect to liability arising out of the named insured's management of property for which the named insured is a real estate manager, the insurance provided is ***excess*** over any other valid and collectible insurance. This revision is intended to clarify but not alter existing coverage.

improvements, and all machinery, equipment, and other personal property that Landlord uses in connection with the Building,[169] for the full replacement value of this real and personal property; ordinance or law coverage;[170] with a deductible not to exceed $25,000.[171]

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[169] ***Landlord's Property Insurance***. This Lease requires Landlord to obtain property insurance for the Building but does not require Landlord to insure its Business Personal Property. Because landlord's property insurance covers the Building, the completed additions, and the machinery, equipment, and personal property used to operate and maintain the Building, tenant may not benefit from a lease provision requiring landlord to insure landlord's personal property.

The term, ***Buildings***, as used in commercial property insurance policies, means a building or structure and includes completed additions, fixtures, permanently installed machinery and equipment, and personal property owned by the named insured and used to maintain or service the Building (for example, fire extinguishers and floor coverings), but the term Buildings excludes land, water or lawns; foundations machinery or boilers, if the foundations are below the lowest basement floor, or the surface of the ground, if there is no basement; bridges, roadways, walks, patios or other paved surfaces; bulkheads, pilings, piers, wharves or docks, underground pipes, flues or drains; retaining walls not part of the building; and costs of excavations, grading, backfilling or filling.

The term, ***Business Personal Property***, as used in such policies, means personal property located within the Building and personal property out in the open within 100 feet of the Building, and includes furniture and fixtures; machinery and equipment; stock (merchandise held in storage or for sale, raw materials and in-process or finished goods); all other personal property owned by the named insured and used in its business; labor, materials, or services furnished by the named insured on the personal property for others; the named insured's ***use interest*** as tenant in improvements and betterments (for example, fixtures, alterations, installations or additions to a structure occupied but not owned by the named insured which are acquired or made at the expense of the named insured but are not legally removable by the named insured); leased personal property for which the named insured has a contractual responsibility to insure; and personal property of others that is under the care, custody or control of the named insured and located in or on the Premises. Business Personal Property excludes from coverage accounts, bills, currency, money, notes, securities; automobiles held for sale; personal property while airborne or waterborne; and electronic data.

[170] ***Ordinance or Law Coverage –CP 04 05***. The ordinance or law exclusionary wording in the Cause of Loss—Special Form (CP 10 30) adds the phrase, "*or compliance with*," as it relates to building codes. Ordinance or Law Coverage endorsement (CP 04 05) removes the term "*enforcement of*" in favor of the "to comply with" an ordinance or law requirement. These changes "modernize terminology" but supposedly do not change coverage. The same wording change applies to: the Functional Building Valuation endorsement (CP 04 38); seven business income endorsements; all five Dependent Property endorsements; the educational institutions endorsement; and the Ordinance or Law – Increased Period of Restoration (CP 15 31) endorsement. The base form ISO property insurance form limits such coverage to the lesser of $10,000 or 5% of the policy limits. ISO CP 04 05 increases the standard limits.

[171] ***Wichita City Lines v. Puckett***. A lease provision that requires landlord to procure property insurance covering the premises does not – standing alone – preclude landlord's insurer from exercising its subrogation rights under landlord's policy or exonerate tenant from liability for its own negligence. In *Wichita City Lines v. Puckett*, the lease stated that "[Landlord] agrees to carry his own insurance against loss by fire, etc., on the entire building." 295 S.W.2d 894, 899 (Tex. 1956). The Texas Supreme Court held that this clause did not make tenant a beneficiary of landlord's policy:

> The provision by its terms imposed no obligation on the [landlord] to take out any insurance to protect himself or the [tenant]. No amount of insurance is stipulated nor does one find any of the specific terms to be expected if the provision was designed to protect the [tenant]. Furthermore, the lease provided in the event of fire that should the [landlord] deem the building unfit of occupancy, he could decide not to repair but to remodel or rebuild and terminate the lease. This seems inconsistent with any intention in the insurance provision to protect the interest of the [tenant].

Id. at 898-99 (distinguishing *Orr v. Vandygriff*, 251 S.W. 2d 573 (Tex. Civ. App.—Waco 1952, no writ) on ground that tenant in *Orr* was not obligated to pay to repair damage caused by "purely accidental fire" and was not seeking to construe lease provision as exemption from tenant's own negligence).

Publix Theatres Corp. v. Powell. But a landlord cannot require its tenant to carry and pay for property insurance on landlord's property and still sue tenant for damage covered by tenant's property insurance. In *Publix Theatres Corp. v. Powell*, tenant agreed to carry fire insurance on the leased building with a solvent insurance company with any loss payable to landlord. 71 S.W. 2d 237, 241-42 (Tex. 1934). The building burned, landlord collected the insurance, and landlord then sued tenant for negligence to collect again for the fire damage. The Texas Supreme Court rejected landlord's overreach,

declaring "that to permit the landlord to keep the insurance money and also to collect from the [tenant] would be a double recovery not sanctioned by the law when the [tenant] had already provided for payment of the damages through the insurance he had contracted and paid for." *Id*.

Neither *Wichita City Lines* nor *Public Theatres Corp.* directly answers the question of pressing concern to a landlord of, or a tenant in, a multi-tenant office building in which landlord buys property insurance for the building and tenants ratably reimburse landlord by paying operating expense pass-throughs. If a tenant's negligence damages landlord's property, and landlord's insurer pays the claim, is landlord's insurer free to pursue a subrogation claim against the negligent tenant who paid its ***pro rata*** share of the premiums as a pass-through expense?

The cases across the country take at least three paths to two different destinations. *See* Robert Vanneman Spake, Jr., *The Roof Is on Fire: When, Absent an Agreement Otherwise, May A Landlord's Insurer Pursue A Subrogation Claim Against A Negligent Tenant?*, 63 WASH. & LEE L. REV. 1743, 1751 (2006).

"First, some courts adopt a case-by-case method of analysis, favoring an individualized decision-making process that fails to provide stability and predictability." Vanneman Spake, *The Roof is on Fire*, at 1752 fn. 31 (citing *Rausch v. Allstate Ins. Co.*, 882 A.2d 801, 814-15 (Md. 2005) (adopting a "middle approach" employing a case-by-case analysis); *Union Mut. Fire Ins. Co. v. Joerg*, 824 A.2d 586, 589-90 (Vt. 2003) (same); *Bannock Bldg. Co. v. Sahlberg*, 887 P.2d 1052, 1056 (Idaho 1994) (same); *Middlesex Mut. Assr. Co. v. Vaszil*, 873 A.2d 1030, 1033-34 (Conn. App. Ct. 2005), *rev'd and remanded*, 900 A.2d 513 (Conn. 2006) (same); *Fire Ins. Exch. v. Hammond*, 99 Cal. Rptr. 2d 596, 600-01 (Cal. Ct. App. 2000) (same)). This approach allows subrogation claims against a negligent tenant in some cases and denies them in others. *See, e.g.*, *Underwriters of Lloyds of London v. Cape Publ'ns, Inc.*, 63 So. 3d 892, 895-96 (Fla. Dist. Ct. App. 2011) (stating that "although each approach is supported by persuasive policy rationales, this court concludes that the parties are in the best position to allocate the risk of loss for fire damage and, therefore, adopt[s] the case-by-case approach); *State Farm Florida Ins. Co. v. Loo*, 27 So. 3d 747, 752 (Fla. Dist. Ct. App. 2010) (concluding, as a matter of law, that landlord's insurer may proceed with its subrogation action against tenant because parties did not, in "*unequivocal terms,*" intend to limit tenant's liability for negligent acts where one lease provision indicates that if the property is damaged by fire that is not caused by tenant's negligence, landlord will repair damages and tenant will not be required to pay rent while premises are untenantable, but another prohibits tenant from keeping "dangerous, inflammable, or explosive" materials on the leased premises, and no lease provision: (1) exculpates tenant from liability for its own negligence; (2) requires landlord to maintain insurance for benefit of tenant; or (3) shifts any loss incurred as a result of tenant's negligence to landlord).

"Second, other courts employ a 'no-subrogation' rule, invoking differing rationales." Vanneman Spake, *The Roof is on Fire*, at 1752. One rationale for the no-subrogation, ***Sutton Rule,*** invokes the legal fiction that a tenant is the implied co-insured of its landlord. *Id*. at fn. 32 (citing *Sutton v. Johdahl*, 532 P.2d 478, 482 (Okla. Civ. App. 1975) and stating that tenant is an implied coinsured and, as a result, an insurer cannot pursue subrogation claim against tenant, even if tenant negligently damages the insured structure and thereby causes loss); *Tri-Par Invs., L.L.C. v. Sousa*, 680 N.W.2d 190, 198-200 (Neb. 2004) (same); *North River Ins. Co. v. Snyde*r, 804 A.2d 399, 403-04 (Me. 2002) (same); *Peterson v. Silva*, 704 N.E.2d 1163, 1165-66 (Mass. 1999) (same); *Community Credit Union v. Homelvig*, 487 N.W.2d 602, 604-05 (N.D. 1992) (same); *GNS P'ship v. Fullmer*, 873 P.2d 1157, 1163-64 (Utah Ct. App. 1994) (same); *United Fire & Cas. Co. v. Bruggeman*, 505 N.W.2d 87, 88-90 (Minn. Ct. App. 1993) (same); *Lexington Ins. Co. v. Raboin,* 712 A.2d 1011, 1016-17 (Del. Super. Ct. 1998) (same). Another primary rationale for the *Sutton Rule* in the landlord-tenant context is that it comports with parties' reasonable expectations and discourages economic waste, namely duplicate or overlapping coverages and payment of multiple premiums to insure the same risks. Vanneman Spake, *The Roof is on Fire*, at 1752 (citing *DiLullo v. Joseph*, 792 A.2d 819, 822-23 (Conn. 2002) (rejecting *Sutton's* presumption that a tenant is a co-insured, but following *Sutton's* result because a tenant, especially in multi-unit structures, would be required to insure the replacement cost of the entire building, a cost which may likely prove untenable). *See generally* Aleatra P. Williams, *Insurers' Rights of Subrogation Against Tenants: The Begotten Union Between Equity and Her Beloved*, 55 DRAKE L. REV. 541, 548 (2007) (discussing national split in authority and explaining that *Sutton Rule* invokes the legal fiction that a tenant is a co-insured of its landlord to bar landlord's insurer from pursuing subrogation claims against a negligent tenant on 3 grounds: (1) the parties' reasonable expectations do not include a subrogation claim against a tenant; (2) the parties' insurable interests overlap, so that multiple coverage results in economic waste; and (3) commercial realities are such that landlords consider costs of insurance and pass these costs on to tenants).

"Finally, some courts adopt a '*pro-subrogation*' rule, permitting the insurer's subrogation claim against a negligent tenant, thus upholding traditional subrogation law." Vanneman Spake, *The Roof is on Fire*, at 1752 fn. 34 (citing *Page v. Scott*, 567 S.W.2d 101, 103-04 (Ark. 1978) (rejecting the co-insured legal fiction). "In rejecting the co-insured legal fiction the court noted that the market sets rent prices, not component costs. *Id.* The court also found that lessor and lessee have separate interests in the property, each of which may be separately insured. *Id*. Finally, the court concluded that, absent an agreement otherwise, when landlord is entitled to recover damage caused by a negligent tenant, landlord's insurer is

18. **INDEMNITIES AND WAIVERS**.[172]

(a) **Definitions**. For purposes of this Lease:

(i) **Beneficiary** is the intended recipient of another party's Indemnity, Waiver, or obligation to Defend.

(ii) **Claims** means all liabilities, claims, damages (including consequential damages), losses, penalties, litigation, demands, causes of action (whether in tort of contract, in law or at equity, or otherwise), suits, proceedings, judgments, disbursements, charges, assessments, and expenses (including attorneys' and experts' fees and expenses incurred in investigating, defending, or prosecuting any litigation, claim, or proceeding);

(iii) **Defend** means to defend with counsel reasonably acceptable to the indemnified party at no cost to that party;

(iv) **Indemnify** means to indemnify, and hold free and harmless from and against.[173]

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entitled to pursue a subrogation claim. *Id. See also Osborne v. Chapman*, 574 N.W.2d 64, 67-68 (Minn. 1998) (rejecting the co-insured legal fiction); *Neubauer v. Hostetter*, 485 N.W.2d 87, 89-90 (Iowa 1992) (same); *Zoppi v. Traurig*, 598 A.2d 19, 21-22 (N.J. Super. Ct. Law Div. 1990) (same); *Regent Ins. Co. v. Econ. Preferred Ins. Co.*, 749 F. Supp. 191, 195 (C.D. Ill. 1990) (same).

[172] ***Indemnity*** agreements, like many other contracts, operate to transfer risk between parties. *See Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508 (Tex. 1993); *U.S. Rentals, Inc. v. Mundy Serv., Corp.*, 901 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1995, no writ). Because indemnification of a party for its own negligence is an extraordinary shifting of risk, the Texas Supreme Court has applied fair notice requirements to such indemnity agreements. *Littlefield v. Schaefer*, 955 S.W.2d 272, 274 (Tex. 1997); *Dresser*, 853 S.W.2d at 508 (indemnity against "all" claims does not include indemnittee's own negligence unless indemnitee's own negligence is specifically and expressly stated). The fair notice requirements include the express negligence doctrine and the conspicuousness requirement. *Dresser*, 853 S.W.2d at 508 (citing E*nserch Corp. v. Parker*, 794 S.W.2d 2, 8 (Tex. 1990)). The fair notice requirements are not applicable, however, when the indemnitee establishes that the indemnitor possessed actual notice or knowledge of the indemnity agreement. *Dresser*, 853 S.W.2d at 508 n. 2; *Mundy*, 901 S.W.2d at 793. In other words, an indemnitor's actual notice or knowledge of the indemnity agreement makes it unnecessary for the indemnitee to prove conspicuousness. *Dresser*, 853 S.W.2d at 510-11; *Cate v. Dover Corp*., 790 S.W.2d 559, 560-62 (Tex. 1990); *Goodrich Tire & Rubber Co. v. Jefferson Constr*., 565 S.W.2d 916, 918-920 (Tex. 1978) overruled on other grounds by *Dresser*, 853 S.W.2d at 509; *Mundy*, 901 S.W.2d at 792-93.

[173] "***Indemnify***," in simplest terms, means to shift the risk of a loss from a liable person to another. Johnston and Comiskey explain indemnity this way: an indemnity is "an undertaking by one party to a contract to protect the other party against a hurt, loss, or damage and to compensate the other party if the hurt, loss, or damage actually occurs. An indemnity is an affirmative obligation in the sense that one party assumes the liability, which otherwise would be borne by another party in the absence of the indemnity. An indemnity creates a contractual cause of action against the indemnitor. Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 1. "Indemnification is an agreement between the indemnitor and the indemnitee. Insurance plays no direct role whatsoever in that agreement. An obligation to defend, indemnify and hold harmless another party for risks other than those prescribed by law is a voluntary assumption of those risks by the indemnitor. The indemnitor has agreed to be liable for those risks." Comiskey, *Running with Scissors*, at p. 3.

Chapter 33 of the Texas Civil Practice and Remedies Code. Texas's comparative negligence statute abrogates common law indemnity. TEX. CIV. PRAC. & REM. CODE ch. 33. *See* William H. Locke, *Risk Management Through Contractual Provisions for Indemnity, Additional Insureds, Waiver of Subrogation, Limitation, Exculpation and Release*, STATE BAR OF TEXAS: 13th ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (March 6, 2002) (thoroughly discussing at pages 9-16 Texas' comparative negligence statutes and indemnity).

As a general rule, Texas law allows contractual indemnities. Except for indemnities covered by anti-indemnification legislation, the scope of potential risks transferable by indemnity includes the indemnitee's joint, concurrent, sole, strict, and gross negligence and "any and all liabilities including fines, penalties, and all other associated expenses." Comiskey, *Running with Scissors*, at p. 3.

(v) **Injury** means (A) harm to or impairment or loss of property or its use, (B) harm to or death of a person, or (C) "personal and advertising injury" as defined in the form of liability insurance Tenant is required to maintain.

(A) **Landlord's Insurable Injury** is any Insurable Injury occurring outside the Premises and caused or suffered by a Landlord Party.

(B) **Tenant's Insurable Injury** is any Insurable Injury occurring in or outside the Premises and caused or suffered by a Tenant Party.

(vi) Waive means to knowingly and voluntarily relinquish a right[174] or release another party from liability for a Claim;[175]

(b) **Tenant's Performance Indemnities**. **TO THE FULLEST EXTENT PERMITTED BY LAW AND THIS LEASE, TENANT WILL INDEMNIFY AND DEFEND LANDLORD PARTIES AGAINST ALL CLAIMS ARISING OUT OF: (i) ANY ACT OR OMISSION OF ANY TENANT PARTY (INCLUDING, WITHOUT LIMITATION, TENANT'S CONDUCT OF BUSINESS IN THE PREMISES ANY RESULTING INCREASE IN THE PREMIUM FOR ANY INSURANCE POLICY OR COVERAGE CARRIED BY LANDLORD; (ii) ANY TENANT PARTY'S ALLEGED OR ACTUAL VIOLATION OF, OR FAILURE TO COMPLY WITH, ANY APPLICABLE LAW; AND (iii) ANY BREACH, VIOLATION OR NONPERFORMANCE OF ANY OBLIGATION OF TENANT UNDER THIS LEASE; OR (iv) ANY MISREPRESENTATION CONNECTED WITH THIS LEASE MADE BY TENANT OR ANY GUARANTOR.**

(c) **Tenant's Indemnities for its Insurable Injuries**. **TO THE FULLEST EXTENT PERMITTED BY LAW AND THIS LEASE, TENANT WILL INDEMNIFY AND DEFEND LANDLORD PARTIES AGAINST ALL CLAIMS ARISING OUT OF ANY ACTUAL OR ALLEGED TENANT'S INSURABLE INJURY.**

(d) **Landlord's Indemnities**. **TO THE FULLEST EXTENT PERMITTED BY LAW AND SUBJECT TO THE LIMITATIONS ON LANDLORD'S LIABILITIES IN THIS LEASE (INCLUDING, WITHOUT LIMITATION, PARAGRAPH 19, LANDLORD WILL INDEMNIFY AND DEFEND TENANT PARTIES AGAINST ALL CLAIMS ARISING OUT OF ANY INSURABLE INJURY SUFFERED BY A THIRD PARTY IN THE COMMON AREAS OR SERVICE AREAS TO THE EXTENT IT WAS ACTUALLY OR ALLEGEDLY CAUSED BY THE NEGLIGENCE OR WILLFUL MISCONDUCT OF ANY LANDLORD PARTY, BUT LANDLORD WILL HAVE NO OBLIGATION TO INDEMNIFY OR DEFEND ANY CLAIM FOR WHICH ANY LANDLORD PARTY IS TO BE INDEMNIFIED UNDER THIS LEASE.**

(e) **Waivers**. **TO THE FULLEST EXTENT PERMITTED BY LAW AND THIS LEASE, (i) TENANT WAIVES ALL CLAIMS AGAINST LANDLORD PARTIES ACTUALLY OR ALLEGEDLY ARISING FROM: (A) TENANT'S INSURABLE INJURIES; (B) ANY INSURABLE INJURY TO ANY TENANT PARTY NOT CAUSED BY A LANDLORD PARTY; OR (C) ANY BUSINESS INTERRUPTION OR TENANT'S LOSS OF USE OF THE PREMISES, AND (ii) LANDLORD WAIVES ALL CLAIMS AGAINST TENANT PARTIES ACTUALLY OR ALLEGEDLY ARISING FROM DAMAGE OR LOSS OF ANY TENANT PARTIES' TANGIBLE PROPERTY.**

(f) **Scope of Indemnities and Waivers**.[176] **ALL INDEMNITIES, WAIVERS, AND OBLIGATIONS TO DEFEND IN THIS LEASE: (i) WILL BE ENFORCED TO THE FULLEST EXTENT PERMITTED BY LAW FOR THE**

[174] In case law, ***waiver*** is an intentional relinquishment or surrender of a right that, at the time, is known to the party. *Sun Exploration & Prod. Co. v. Benton*, 729 S.W.2d 35, 37 (Tex. 1987); *The Praetorians v. Strickland*, 66 S.W.2d 686, 689 (Tex. Comm'n App. 1933, judmt adopted).

[175] Johnston and Comiskey explain the concept of ***waiver*** in the context of insurance and indemnity provisions in more practical terms. "A '***waiver***" refers to an agreement by one party to a contract not to hold the other party responsible as to certain types of liability arising out of the transaction. A waiver is negative in nature in the sense that it operates to bar any cause of action on the released matter. Waivers are sometimes referred to as '***releases***' or '***exculpations***.'" Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 1 (emphasis added).

BENEFICIARY'S BENEFIT, REGARDLESS OF ANY EXTRAORDINARY SHIFTING OF RISK,[177] AND EVEN IF THE CLAIM IS CAUSED BY THE ACTIVE OR PASSIVE, SOLE, JOINT, CONCURRENT, OR COMPARATIVE NEGLIGENCE OR TORT[178] OF THE BENEFICIARY, OR LIABILITY WITHOUT FAULT OR STRICT LIABILITY[179] IS IMPOSED ON, OR ALLEGED AGAINST, THAT

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[176] ***Indemnities*** come in three classifications: (1) ***limited***, (2) ***intermediate***, or (3) ***broad***.

- A ***limited indemnity*** requires indemnitor to indemnify indemnitee *only to the extent indemnitor is at fault or negligent*. This class of limited indemnity is the most favorable for an indemnitor.
  - Example: Subcontractor will indemnify Contractor against all claims arising out of bodily injuries or property damages which occur during the performance of the Subcontract, *but only to the extent caused in whole or in part by the negligent acts or omissions of Subcontractor*.
  - A limited indemnity does not involve an extraordinary shifting of risk, is not subject to the express negligence rule, and need not be conspicuous.
- An **intermediate indemnity** requires indemnitor to assume all liability, except for the sole negligence of indemnitee.
  - Example: Landlord gives Tenant an intermediate indemnity in Section xxx:
  - An intermediate indemnity involves an extraordinary shifting of risk, and to be enforceable, must satisfy the express negligence rule and should be conspicuous.
  - *Pitfall*: If, for instance, tenant agrees to indemnify Landlord against liability arising out of any injury or damage occurring in the premises, unless the injury or damage was caused by the gross negligence or willful misconduct of Landlord, the negative inference that the landlord will be indemnified for its ordinary negligence probably will not be enforced.
- A **broad form indemnity** requires indemnitor to assume the entire risk of loss, including the sole negligence of the indemnitee.
  - This class of broad form indemnity is the most favorable for an indemnitee.
  - A broad form indemnity, like an intermediate indemnity, also involves an extraordinary shifting of risk, and to be enforceable, must satisfy the express negligence rule and should be conspicuous.

See Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at pp. 2-6 (also discussing reasons for using indemnities, drafting considerations, and potential pitfalls).

[177] ***Express Negligence Test***. "The express negligence rule is a rule of contract interpretation that applies specifically to agreements to indemnify another party for the consequences of that party's own negligence." *Quorum Health Res., L.L.C. v. Maverick Cnty. Hosp. Dist.*, 308 F.3d 451, 459 (5th Cir. 2002). Under the express negligence rule, contracting parties seeking to indemnify one party from the consequences of its own negligence must express that intent in specific terms, within the four corners of the document. *Ethyl Corp. v. Daniel Const. Co.*, 725 S.W.2d 705, 707-08 (Tex. 1987). The Texas Supreme Court adopted this rule in recognition of the fact that "indemnification of a party for its own negligence is an extraordinary shifting of risk." *Id; Dresser*, 853 S.W.2d at 508. The essential rationale for the express negligence rule is fair notice. *Dresser*, 853 S.W.2d at 506. Consistent with this rationale, Texas requires that any indemnity subject to the express negligence rule must be conspicuous. *Dresser*, 853 S.W.2d at 511.

[178] ***Tort liability*** means liability that arises out of the negligent or willful violation by one party of a duty imposed by case law or statute but excludes duties imposed by contract. Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 1 (emphasis added). The distinction between tort and contract liability is important for many reasons, including the types and measures of available damages, the injured party's right to recover attorneys' fees from the breaching party, and in some instances, the extent and scope of insurance coverage. *See* James E. Wren, *Applying the Economic Loss Rule in Texas*, 64 BAYLOR L. REV. 204 (2012); Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASHINGTON & LEE L. REV. 523, 534-35 (2009), quoted in *Sharyland Water Supply Corp. v. City of Alton*, 354 S.W.3d 407, 415 (Tex. 2011); William Powers, Jr. & Margaret Niver, *Negligence, Breach of Contract, and the "Economic Loss" Rule*, 23 TEXAS TECH. L. REV. 477, 478 (1992); *see also Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 12-13 (Tex. 2007) (warning that economic loss doctrine is not a universally "useful tool for determining insurance coverage").

[179] ***Strict liability*** means "liability imposed on a party by legislative or judicial action regardless of fault. Strict liability typically applies to situations which are inherently dangerous. For instance, a lion tamer would be held liable if one of his lions attacked an audience member although the lion tamer's negligence may not have contributed to the attack." Johnston & Comiskey, *Insurance and Indemnity in Lease Transactions*, at p. 2.

BENEFICIARY,[180] BUT NOT TO THE EXTENT THAT A COURT-OF-COMPETENT-JURISDICTION'S FINAL AND UNAPPEALABLE JUDGMENT FINDS THAT THAT BENEFICIARY'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT CAUSED THE CLAIM,(ii) ARE INDEPENDENT OF, AND WILL NOT BE LIMITED BY, EACH OTHER OR ANY INSURANCE OBLIGATIONS IN THIS LEASE (WHETHER OR NOT COMPLIED WITH); AND (iii) WILL SURVIVE THE EXPIRATION OR TERMINATION OF THIS LEASE UNTIL ALL CLAIMS AGAINST THE BENEFICIARY ARE TIME-BARRED UNDER APPLICABLE LAW. NOTWITHSTANDING ANY EXTRAORDINARY SHIFTING OF RISK, LANDLORD AND TENANT EACH EXECUTED THIS LEASE IN MATERIAL RELIANCE ON THE INCLUSION OF EACH INDEMNITY AND WAIVER IN THIS LEASE.

(g) **Landlord's Reliance**. In reliance on Tenant's Indemnities and Waivers in this Lease, and on Tenant's agreement to obtain and maintain in force the insurance coverages required by this Lease, Landlord will not carry primary insurance for Tenant's Insurable Injuries. Tenant acknowledges that: (i) if Landlord had been required to carry primary insurance for the risks allocated to Tenant, the Basic Rent would have been higher; (ii) Tenant is not relying upon Landlord or Landlord’s insurance, but is instead relying on: (A) Tenant's insurance policies and any additional insurance Tenant may elect to carry for Claims covered by Tenant's insurance, (B) Tenant's own funds for any deductibles, self-insured rententions, or losses exceeding Tenant's insurance coverages; and (C) third parties — other than Landlord Parties — for any Claims or Liabilities arising from acts or omissions of third parties except to the extent covered by Landlord's Indemnity. Tenant's failure to self-insure (if permitted by Landlord) or to take out or maintain any insurance policy or coverage required under this Lease will be a defense to any Claim asserted by any Tenant Party against Landlord by reason of any loss sustained by that Tenant Party that would have been covered by any such required policy.

19. **Limitations of Landlord's Liability**. Landlord's liability for any act or omission or for breach of any obligation under this Lease will be recoverable exclusively from the proceeds of a judicial sale conducted after execution and levy against Landlord's interest in the Building, the proceeds of any insurance policy (subject to all Waivers of Claims and rights of Subrogation in this Lease, and the proceeds of any sale, exchange, or transfer of Landlord’s interest in the Building (subject to existing liens); and Tenant Waives: (a) all other rights of recovery against Landlord and its other assets; and (b) all Claims against any Landlord Party for consequential, incidental, or punitive damages (including, without limitation, lost profits and business interruption) allegedly suffered by any Tenant Party as a result of Landlord’s breach of this Lease. No Landlord Party will have personal liability under this Lease or be personally liable for any judgment or deficiency for any breach of this Lease.

20. **Casualty Damage**.[181] If a fire or other casualty damages any part of the Premises, Tenant will give prompt, written notice to Landlord. If (a) any casualty damages the Building, and the Building, in

[180] In *Houston Light’g & Power Co. v. Atchison, Topeka, & Santa Fe Ry. Co.*, the Texas Supreme Court extended the express negligence doctrine adopted in *Ethyl Corp.* to cases in which the indemnitee is charged with strict liability. 890 S.W.2d 455, 459 (Tex. 1994). The court supplied two general reasons for its holding. First, contracts indemnifying an indemnitee against the consequences of strict liability involve an extraordinary shifting of the risk and may have great financial impact on the parties. Thus, fairness, the court reasoned, dictates against imposing liability on an indemnitor unless the agreement clearly and specifically expresses the intent to encompass strict liability claims. Second, requiring parties to state expressly their intent to indemnify against strict liability claims prevents drafters from “devising novel ways of writing provisions which fail to expressly state the true intent of those provisions” and concealing that intent through the use of ambiguous language. *Id.* at 458-59; *Ethyl*, 725 S.W.2d at 707. Based on the thousands of citing references to these cases, the adoption of the express negligence rule apparently has failed to reduce the number of lawsuits brought to construe ambiguous indemnity agreements. *Ethyl*, 725 S.W.2d at 708.

[181] This casualty damage provision is potentially inadequate in many respects. For one, Tenant does not have termination rights. Subpart (b) requires Landlord to rebuild the Building to the condition it was in before the casualty, but Landlord’s obligation to rebuild also stops when the insurance proceeds run out. What happens if the insurance proceeds run out before the Building is restored to the required condition? This Lease doesn’t say. Subpart (c) abates Tenant’s rent,

Landlord's sole discretion, requires substantial alteration or reconstruction (whether or not the Premises are damaged), (b) Landlord's Mortgagee requires Landlord to use the insurance proceeds payable as a result of that casualty toward the mortgage debt, or (c) there is a material uninsured loss to the Building, Landlord will be entitled to terminate this Lease by giving Tenant written notice of such termination within **ninety (90)** days after the date of such fire or other casualty.[182]

(a) If Landlord does not elect to terminate this Lease within that time, Landlord thereafter will use reasonable diligence to restore the Building and Landlord Work (except that Landlord will not be responsible for delays beyond Landlord's control) to substantially the same condition as they were in immediately before the casualty. But Landlord will not be required to spend more than the insurance proceeds Landlord actually receives as a result of the casualty to restore the Building and Landlord Work.[183]

(b) Immediately after Landlord notifies Tenant to begin restoring or replacing Tenant's Improvements and Trade Fixtures, Tenant, at its sole cost, will use reasonable diligence to do so. Except for the costs (to the extent of insurance proceeds received by Landlord) of restoring Landlord Work, Tenant must pay all costs of reconstructing or restoring the Premises, and Tenant must give Landlord satisfactory evidence of Tenant's ability to pay such costs before Landlord will have an obligation to begin restoring the Premises.[184]

(c) Landlord, beginning on the date of the casualty, will allow Tenant a fair diminution of Base Rent and Additional Rent during the time, and to the extent, that ~~the Premises are unfit for occupancy~~ Tenant's use of, or access to, the Premises, Common Areas, and parking facilities necessary to the convenient use of the Premises for the Permitted Use is prevented or materially impaired, but Tenant will be entitled to this allowance only if the damage did not the result from the negligence or misconduct of any Tenant Party.[185]

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unless Tenant caused the casualty, which may leave tenant paying rent for space it cannot use, even if Landlord waived its property damage claims and caused its insurer to waive its subrogation claims.

[182] Many leases deny abatement of rent or hold tenant liable if tenant causes a casualty loss. Ask to delete this clause or, at a minimum, limit its application to tenant's gross negligence or intentional misconduct. More often than not, landlord will agree to do so. After all, tenant paid for its *pro rata* share of the policy. Deleting such a clause, however, will only ensure that tenant's rent abates while the premises are untenantable. To ensure that tenant will not have to pay landlord or its property insurer to rebuild the building when one of tenant's employees leaves a coffee pot on and burns down the building, tenant's counsel must ensure that landlord waives its claims against tenant for such property damage, that landlord's insurance carrier waives its subrogation rights, and that tenant has not indemnified landlord for such damages elsewhere in the lease. And, in the event tenant's negligence causes a large casualty loss, tenant and its counsel should pray that landlord did not compromise on its insistence on those "unreasonably" high coverage limits for tenant's liability policy. The other tenants in the building probably won't have, or will have waived, any claims against the landlord, but those tenants may well have claims against the tenant whose employee forgot to turn off the coffee pot.

[183] ***Responsibility for Restoration of Building***. An office lease should address: (a) the timing, sequence, and conditions on landlord's obligation, if any, to restore the building and the premises; (b) deadlines and other requirements for notifying tenant of landlord's decision to rebuild or not; (c) tenant options in response to landlord's decision (*e.g.*, terminate); (d) *force majeure* events that will excuse landlord's performance or defer deadlines to notify tenant of decisions and to complete landlord's scope of work; (e) the effect of lender's decisions and the availability, or lack of availability, of insurance proceeds; (f) the diligence with which restoration must be pursued and any time periods within which restoration of the building must be completed; and (g) tenant's rights and remedies if landlord fails to meet estimated completion deadlines.

[184] ***Responsibilities for Restoration of Premises***. An office lease should address: (a) the timing, sequence, and scope of each party's restoration work; (b) the scope and extent of each party's financial responsibility; (c) any conditions on each party's obligation to proceed; and (d) the diligence with which restoration must be pursued and any time periods within which restoration must be completed.

[185] ***Abatement of Ren***t. At a minimum, an office lease should address whether: (a) Tenant is entitled to abatement; (b) the conditions triggering the entitlement (loss of use or access); (c) when abatement begins and ends; (d) any conditions or limitations on the amount; and (e) any events under which abatement is disallowed.

21. **CONDEMNATION**.[186] If the whole, or a substantial part, of the Premises or the Building is condemned or taken for any public or quasi-public use by law, ordinance, or regulation; by eminent domain; or by private purchase in lieu thereof,[187] then Landlord, in its sole discretion, will be entitled either: (a) to terminate this Lease effective when any such condemnation or taking occurs;[188] or (b) to abate Rent for the portion of the Premises physically taken or condemned, or rendered unusable or inaccessible as a result of the taking, beginning on the day the physical taking or condemnation occurs. If Landlord does not elect to terminate this Lease, Landlord, at is sole cost and not as an Operating Cost, will restore the Premises and Common Areas reasonably necessary for Tenant's convenient use of, or access to, the Premises to replicate, as nearly as possible, the size, quality, quantity, configuration, and access to the Premises, parking, elevators, and amenities enjoyed by Tenant before the taking.[189] All compensation awarded for any such taking or condemnation of the real property, or sale proceeds in lieu thereof, will be Landlord's property,[190] and Tenant

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[186] ***Condemnation***, like casualty, raises innumerable issues that impact other provisions throughout an office lease.

[187] ***Tenant Shares Condemnation Award***. A tenant is entitled, as a matter of law, to share in a condemnation award when part of its leasehold interest is condemned, unless the lease terminates or tenant waives its right to share in the condemnation award. *Texaco Ref. & Mktg., Inc. v. Crown Plaza Grp.*, 845 S.W.2d 340, 342 (Tex. App.—Houston [1st Dist.] 1992, no writ). If, however, a lease provides that it terminates upon condemnation, tenant has no interest in the condemnation award. *Evans Prescription Pharmacy v. County of Ector*, 535 S.W.2d 704, 705-06 (Tex. Civ. App.—El Paso 1976, writ ref'd); *see also Fort Worth Concrete Co. v. State*, 416 S.W.2d 518, 521 (Tex. Civ. App.—Fort Worth 1967, writ ref'd n.r.e.) (stating that "[a] tenant whose lease provides for its termination upon the taking of the leased premises for a public use is entitled to no compensation when it is condemned.").

"[I]t is well established that the parties have the right to contract for the termination of a lease in the event of condemnation. *Evans Prescription Pharmacy v. County of Ector*, 535 S.W.2d 704, 705-06 (Tex. Civ. App.—El Paso 1976, writ ref'd); *Norman's, Inc. v. Wise*, 747 S.W.2d 475, 477 (Tex. App.—Beaumont 1988, writ denied) (stating, with emphasis in original, that "the parties have *freedom of contract* in this regard"). Even so, Texas law does not favor clauses effecting the forfeiture of tenant's leasehold interest on condemnation; as a result, Texas courts will construe a lease covenant to avoid forfeiture of tenant's leasehold estate in the event of a taking "if its language and the circumstances possibly permit." *Norman's, Inc.*, 747 S.W.2d at 477.

In sum, two well-settled principles determine a landlord's and tenant's rights and obligations when a leasehold interest is taken by condemnation: (1) if the lease does not terminate upon condemnation, tenant is entitled to share in the condemnation award with landlord, unless tenant waives its right to share in the award; and (2) if the lease automatically terminates upon condemnation, tenant has no compensable interest. *Motiva Enters., LLC v. McCrabb*, 248 S.W.3d 211, 215 (Tex. App.—Houston [1st Dist.] 2007, pet. denied).

[188] ***Termination of Lease Bars Tenant's Right to Share Condemnation Award***. This clause is virtually identical to the condemnation clause at issue in *J.R. Skillern, Inc. v. Levison*, 591 S.W.2d 598 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.). In this clause, Landlord reserves the option to terminate the Lease in the event of a complete or "substantial" taking, and Landlord's exercise of this option purports to be discretionary. Despite landlord's discretionary termination option, the court of appeals in *J.R. Skillern, Inc*. held that "the better rule" is that a total taking results in automatic termination of a lease and, as a consequence, that a landlord is not required to notify its tenant of landlord's election to terminate. *J.R. Skillern, Inc.*, 591 S.W.2d at 599 (stating ironically that parties are entitled to contract for termination of lease upon condemnation); *see Motiva Enterprises, LLC*, 248 S.W.3d at 214.

[189] Most leases address temporary and partial takings separately.

[190] A lessee is entitled, as a matter of law, to share in a condemnation award when part of its leasehold interest is lost by condemnation. *Elliott v. Joseph*, 351 S.W.2d 879, 883-84 (Tex. 1961). *See Texaco Ref, and Mktg., Inc.*, 845 S.W.2d at 342. This is "fundamental" Texas law. *Colley v. Carleton*, 571 S.W.2d 572, 574 (Tex. Civ. App.—Corpus Christi 1978, no writ). To apportion damages between a landlord and tenant when real property subject to a leasehold is taken, Texas follows the undivided-fee rule.

> In condemnation proceedings, where there are different estates in the property or where the property is under a lease to a third party, the valuation of the various estates or leasehold interest is usually determined by ascertaining the market value of the property with the improvements thereon as though owned exclusively by one party, and, in the absence of damages to other property not taken, this ordinarily determines the extent of the liability of the party condemning the property. Such amount, when so determined, should then be apportioned among the lessee and the owners of the various estates in the land.

Waives any claim thereto, ***but*** Tenant does not Waive, and reserves to itself, (i) any portion of such award or proceeds allocated to the taking of, or damage to, Tenant's Trade Fixtures, (ii) an separate award to Tenant that does not reduce Landlord's award for the taking of real property, including, without limitation, compensation for the taking, loss, or damage to Tenant's moveable equipment, fixtures, moving expenses,[191] and interruption of Tenant's business, and (iii) any special damages suffered by Tenant.[192]

22. **SUBORDINATION**. Tenant accepts this Lease ***subject to***: any ground lease or mortgage, deed of trust, or security interest (collectively, encumbrance) that now or later may affect title to the Premises, the Building, or any part of the Project (including, without limitation, any renewal, modification, refinancing, or extension of any encumbrance),[193] all recorded instruments affecting title;[194] and all Applicable Laws.

State v. Ware, 86 S.W.3d 817, 823 (Tex. App.—Austin 2002, no pet.); *City of Waco v. Messer*, 49 S.W.2d 822, 823 (Tex. Civ. App.-Waco 1932), *rev'd on other grounds*, 78 S.W.2d 169 (Tex. 1935); *see also Urban Renewal Agency v. Trammel*, 407 S.W.2d 773, 774 (Tex.1966). Moreover, "[i]t is well settled in Texas that when the entire leasehold is taken the measure of damages is the value of the use and occupancy of the leasehold for the remainder of the tenant's term, ***plus*** the value of the right to renew if such right exists, *less* the agreed rent which the tenant would pay for the use and occupancy, such values to be determined by the usual 'willing seller-buyer rule.'" *Luby v. City of Dallas*, 396 S.W.2d 192, 198 (Tex. Civ. App.—Dallas 1965, writ ref'd n.r.e.) (stating "in determining such value[,] *no consideration should be given* to the value of the business of the tenant, or the trade-name thereof, or the profits or losses thereof, or the tenant's personal property on the premises, or the expense of moving such personal property. These things are held to be immaterial and inadmissible as shedding no light on the value of the real property being condemned."); *Reeves v. City of Dallas*, 195 S.W.2d 575, 581–82 (Tex. Civ. App.-Dallas 1946, writ ref'd n.r.e) (stating that "land, lease, and all other conflicting claims on the property condemned must be determined as if all the property was in a single ownership").

[191] *G.P. Show Prod., Inc. v. Arlington Sports Facilities Dev.*, 873 S.W.2d 120, 123 (Tex. App.—Fort Worth 1994, no pet.) (stating that term "property owner," as used in section 21.042 of the Texas Property Code, includes a lessee for years and that lessee is entitled to separate award for moving expenses).

[192] Tenant's reservation of contractually undefined "special damages" upon termination of the lease as a result of a condemnation did not preserve tenant's right to recover its lost future "leasehold advantage." *Motiva Enters., LLC v. McCrabb*, 248 S.W.3d 211, 215-16 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) (stating that in condemnation proceedings "special damages" is a term-of-art).

The following ALR annotations collect and explain decisions allowing and denying both landlords and tenants recovery of different types and measures of damages in condemnation proceedings *See generally Eminent Domain: Measure And Elements of Lessee's Compensation for Condemnor's Taking or Damaging of Leasehold*, 17 A.L.R.4th 337 (1982 & Supp. 2013) (reporting cases allowing and denying tenant compensation for fixtures, improvement, equipment, machinery, moving expenses, and other damages separate from taking of real property); Kurtis A. Kemper, *Elements and Measure of Compensation in Eminent Domain Proceeding for Temporary Taking of Property*, 49 A.L.R.6th 205 (2009 & Supp. 2013) (reporting cases allowing and denying tenant compensation for temporary takings); Jay M. Zitter, *Validity, Construction, and Effect of Statute or Lease Provision Expressly Governing Rights and Compensation of Lessee Upon Condemnation of Leased Property*, 22 A.L.R.5th 327 (1994 & Supp. 2013).

[193] This provision effectively abrogates the implied covenant of quiet enjoyment. *HTM Rest., Inc. v. Goldman, Sachs & Co.*, 797 S.W.2d 326, 328 (Tex. App.—Houston [14th Dist.] 1990, writ denied) (holding that express covenant stating "Lessee accepts this lease and the leased premises in their entirety subject to any deeds of trust, security interests, or mortgages which might now or hereafter constitute a lien upon the building or improvements therein or on the leased premises" precludes lessee's claim for breach of implied covenant of quiet enjoyment when landlord's lender foreclosed as a result of landlord's failure to pay mortgage).

If a tenant actually occupies the premises under a recorded or unrecorded lease that antedates a mortgage, the lease is superior to the mortgage, and tenant's rights under the lease are not affected by a foreclosure. *F. Groos & Co. v. Chittim*, 100 S.W. 1006, 1010 (Tex. Civ. App. —1907, no writ) (stating that tenant's occupancy is notice to mortgagee of prior lease). But the foreclosure of a mortgage lien extinguishes a lease executed after, or subordinated to, that lien. *United Gen. Ins. Agency v. American Nat'l Ins. Co.*, 740 S.W.2d 885, 886 (Tex. App.—El Paso 1987, no writ). Even so, a purchaser-at-foreclosure, by accepting lease payments from the tenant of the foreclosed-on mortgagor, may ratify a lease that otherwise would have been extinguished by foreclosure. *Id.* at 886 (stating that if tenant offers rent, and purchaser-at-foreclosure accepts it,

(a) Tenant irrevocably agrees that the owner, holder, or trustee of any encumbrance and any purchaser-at-foreclosure, grantee of any deed-in-lieu of foreclosure, or other such transferee (*Landlord's Mortgagee*) will be entitled to subordinate this Lease to its encumbrance, or *vice versa*, at such times and on such terms as Landlord's Mortgagee may deem appropriate, and no further instrument of subordination will be required to effect this self-operative entitlement.

(b) Tenant irrevocably attorns to any purchaser-at-foreclosure, grantee of any deed-in-lieu of foreclosure, or other such transferee, and Tenant recognizes any such purchaser, grantee, or transferee as Landlord under this Lease.[195] No further instrument will be required to effect Tenant's attornment.

(c) Tenant, within five (5) days of demand, will sign and deliver to Landlord's Mortgagee any instruments in recordable form that Landlord's Mortgagee may request, to effect, ratify, or reaffirm Tenant's subordination or attornment, and Tenant irrevocably appoints Landlord — whose power and appointment is coupled with an interest — as its attorney-in-fact to execute any such instrument in Tenant's name, place and stead if Tenant does not timely sign and deliver any requested instrument of subordination or attornment or estoppel certificate.

(d) Tenant will not unreasonably withhold, delay, or defer its consent to reasonable modifications of this Lease requested in connection with any financing or refinancing of any part of the Project, so long as the requested modifications do not adversely affect Tenant's use of the Premises or increase Basic Rent.[196]

23. **ESTOPPEL CERTIFICATES**. Within 5 business days after Landlord's written request, Tenant will sign and deliver a recordable, written statement certifying that (a) this Lease is unmodified and in full force and effect (or, if there have been any modifications, that this Lease, as so modified, is in full force and effect); (b) Landlord is not in breach of any obligation to Tenant (or, if Tenant claims such a breach then exists, specifying the nature of each such breach); and (c) Tenant has paid all Rent (including any specific components of Rent) through a specified date or dates; and (d) certifying to the status of any other matters related to this Lease or its performance.

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purchaser-at-foreclosure may impliedly agree to continue lease); *ICM Mortgage Corp. v. Jacob*, 902 S.W.2d 527 (Tex. App.—El Paso 1994, writ denied).

[194] Robert Harms Bliss, *Affirmation of Leases after Foreclosure*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2012 BERNARD O. DOW LEASING INSTITUTE (2012).

[195] *F. Groos & Co.*, 100 S.W. at 1010 (stating tenant "has every right against his new landlord that he had under the lease against the original lessor, and he who acquired the reversion at the foreclosure has every right against [the tenant] that the lessor had under the lease"). The right of the grantee, however, to the rent, is subject to all the equities or just demands of the tenant or other encumbrances of which the grantee had notice affecting and controlling the payment of the rent. *Groos & Co.*, 100 S. W. 1006; *B.F. Avery & Sons' Plow Co. v. Kennerly*, 12 S.W.2d 140 (Tex. Comm'n App. 1929, judgm't adopted) (holding that foreclosure of prior deed of trust extinguishes lease entered into after mortgage).

[196] Holly E. Magliolo, *Texas Annotated Subordination, Non-Disturbance and Attornment Agreement*; Brian C. Rider, *The Unappreciated Subordination, Non-disturbance, and Attornment Agreement: Why Are Those Provisions in There?*, STATE BAR OF TEXAS – 15TH ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (March 11-12, 2004); J. Kenneth Kopf, *The Disturbing Intricacies of Non-disturbance: A Detailed Examination of SNDA's and Estoppel Certificates*, STATE BAR OF TEXAS – 14th ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (March 6-7, 2003); Robert A. McCulloch, *Leases: Lender's Interests and Concerns*, CLE INTERNATIONAL NEGOTIATING LEASES CONFERENCE (September 28-29, 2002) (giving lenders' perspective on use of subordination, non-disturbance, and attornment agreements in leasing); Susan A. Coleman, *Subordination, Non-Disturbance, and Attornment Agreements: Tenant's Interests and Concerns*, CLE INTERNATIONAL NEGOTIATING LEASES CONFERENCE (1998) (giving tenants' perspective on SNDA's and including a well-done tenant oriented SNDA form).

24. **DEFAULT**. The occurrence of any one or more of the following events is a ***Default***:[197]

(a) Tenant fails to pay where and when due any **Base Rent,**[198] **any component of Additional Rent, Landlord's Estimate of any component of Additional Rent**,[199] or any other component of Rent and that failure continues for **five (5)** days (*Monetary Default*); but the first two (2) such failures during any 12 consecutive month period will not constitute a Monetary Default if Tenant pays the delinquent amount, plus any applicable late fee, within three (3) Business Days of Landlord's delivery of written notice to Tenant.[200]

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[197] The parties' right to craft default and remedies provisions, though broad, is not unlimited. Courts construe lease covenants to avoid forfeitures and express reluctance to terminate a lease for breach of a "mere covenant," unless the lease terms demonstrate clearly that the parties intended tenant's performance of that covenant to be a condition to its continued rights under the lease. *Parten v. Cannon,* 829 S.W.2d 327, 330 (Tex. App.—Waco 1992, no writ) (citing *Rogers v. Ricane Enters., Inc.*, 772 S.W.2d 76, 79 (Tex. 1989)); *G. C. Murphy Co. v. Lack*, 404 S.W.2d 853, 858 (Tex. Civ. App.—Corpus Christi 1966, writ ref'd n.r.e.). Because of their harsh operation, conditions are not favorites of the law. *Sirtex Oil Indus., Inc. v. Erigan*, 403 S.W.2d 784, 787 (Tex. 1966); *Hohenberg Bros. Co. v. George E. Gibbons & Co.*, 537 S.W.2d 1, 3 (Tex. 1976). Thus, when the parties' intent is doubtful, or when a condition would impose an absurd result, Texas courts prefer construing contract terms as covenants rather than conditions. *Hohenberg Bros*., 537 S.W.2d at 3.

Conditions v. Covenants. The main purpose of a default provision in a commercial lease is to turn a variety of "mere covenants" into conditions that will justify landlord's termination of the lease or exercise of other contractual remedies if its tenant fails to satisfy one or more of the specified conditions. "In order to determine whether a condition precedent exists, the intention of the parties must be ascertained; and that can be done only by looking at the entire contract." *Criswell v. European Crossroads Shopping Ctr., Ltd*., 792 S.W.2d 945, 948 (Tex. 1990); *Hudson v. Wakefield*, 645 S.W.2d 427, 430 (Tex. 1983); *Gallup v. St. Paul Ins. Co.*, 515 S.W.2d 249 (Tex. 1974) (stating that strongest indication of what a contract requires is determined by what its words plainly state).

Phrasing of Conditions. "In order to make performance specifically conditional, a term such as 'if,' 'provided that,' 'on condition that,' or some similar phrase of conditional language must normally be included." *Criswell,* 792 S.W.2d at 948 (citing *Landscape Design v. Harold Thomas Excavating*, 604 S.W.2d 374, 377 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.)). "If no such language is used, the terms will be construed as a covenant in order to prevent a forfeiture. While there is no requirement that such phrases be utilized, their absence is probative of the parties' intention that a promise be made, rather than a condition imposed." *Criswell*, 792 S.W.2d at 948 (citing *Hohenberg Bros*., 537 S.W.2d at 3). The events triggering a defined *Default* should be phrased as conditions rather than covenants.

[198] A landlord did not have the right at common law to terminate lease because its tenant failed to pay rent. *Buffalo Pipeline Co.*, 694 S.W.2d at 598; *Shepherd*, 182 S.W.2d at 1011-12 (stating that breach of covenant to pay rent does not breed "forfeiture of possession" by tenant or right of possession by landlord); *Dillingham v. Williams*, 165 S.W.2d 524, 526 (Tex. Civ. App.—El Paso 1942, writ ref'd w.o.m.) (holding that landlord did not have common law right to terminate lease because tenant failed to pay rent).

[199] ***Default in Payment of Estimated Operating Costs***. When a lease allows landlord to estimate and then bill tenant for estimated expenses, the lease should delineate the consequences of tenant's failure to pay landlord's estimates in order to avoid technical arguments about whether it is possible for tenant to be in default for nonpayment of an estimated as opposed to an actual charge. Even when landlord's contractual rights a remedies are seemingly clear, a landlord should exercise caution in declaring a default based solely on tenant's failure to pay estimated charges, especially when *bona fide* disputes exist as to the amount, computation, or propriety of the estimated charge. On the other hand, once tenant is in default in paying base rent, tenant may not be able to rely on ordinary procedural prerequisites to its other payment obligations. *Cf. Rokalor, Inc. v. Connecticut Eating Enters., Inc.*, 18 Conn. App. 384, 392, 558 A.2d 265, 270 (Conn. App. Ct. 1989) (holding that tenant's breach of its obligation to pay base rent excused landlord's "remaining duties under the lease, including presenting bills for taxes and other expenses").

[200] ***Equity***. In the proper circumstances, equity may relieve a tenant of a forfeiture for breach of tenant's obligation to make certain payments within a specified period after demand. In *Caranas v. Jones*, the lease required lessee to pay certain *ad valorem* taxes and subjected tenant's leasehold to forfeiture if lessee failed to do so after lessor's demand. 437 S.W.2d 905, 907 (Tex. Civ. App.—Dallas 1969, writ ref'd n.r.e.). Lessee's premises were part of a larger tax parcel; *ad valorem* taxes on the premises were not separately rendered or assessed; lessor had allowed unpaid *ad valorem* taxes to accumulate from year-to-year; lessor failed to furnish lessee with tax statements during this period; and then, after disputes between the same parties arose over issues under a different lease, lessor sent a letter demanding payment of an indefinite amount of

(b) Tenant does not vacate the Premises immediately upon the expiration or termination of this Lease.[201]

(c) Tenant or any Guarantor: (i) becomes insolvent;[202] (ii) makes a transfer in fraud of creditors; (iii) makes an assignment for the benefit of creditors;[203] or (iv) admits, in writing, its inability to pay its debts as they become due;

(d) Tenant or any Guarantor: (i) commits an act of bankruptcy; (ii) files a petition under the United States Bankruptcy Code or under any other similar Federal or state law;[204] (iii) is adjudged bankrupt; or (iv) is named in pleading or motion filed in any court proposing to reorganize or adjudicate as a bankrupt Tenant or any Guarantor, and that pleading or motion is not discharged or denied within **thirty (30)** days after its filing.[205]

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delinquent *ad valorem* taxes without providing documentation of the true amount of taxes owed under the lease in question. Lessee professed its willingness to pay the correct amount, and once the trial court determined the correct amount, lessee promptly paid the taxes owed. The court of appeals, finding that lessee "had the right to know the true amount of taxes due" and that lessor was not damaged, held that it would be inequitable under the circumstances to enforce a forfeiture of the lease against lessee. *Caranas*, 437 S.W.2d at 907. If landlord's motives are suspect, its conduct egregious, tenant's conduct beyond reproach, the consequences of forfeiture inequitable, and payment promptly forthcoming, equity likely will intervene.

[201] ***Reasonable Time to Remove Improvements***. "Under the law in Texas, and in many other jurisdictions, a tenant who reserves to himself the right to remove improvements placed upon the leased premises by him at the expiration of the lease has a reasonable time after the expiration thereof in which to remove such improvements." *A & M Petroleum Co. v. Friar*, 152 S.W.2d 470, 471 (Tex. Civ. App.—El Paso 1941, no writ) (citing *Wright v. MacDonnell*, 30 S.W. 907 (Tex. 1895); *Terry v. Crosswy*, 264 S.W. 718 (Tex. Civ. App.—Beaumont 1924, no writ); *Meers v. Frick-Reid Supply Corp*., 127 S.W.2d 493, 496 (Tex. Civ. App.—Amarillo 1939, writ dism'd)). What constitutes a reasonable time in such cases depends on the facts and circumstances in each individual case. *A & M Petroleum Co.*, 152 S.W.2d at 471 (citing *Schneider v. Bulger*, 194 S.W. 737 (Mo. App. 1917) and *Updegraff v. Lesem*, 15 Colo. App. 297, 62 P. 342 (1900)). "The necessary and reasonable time consumed in the removal of improvements from the premises in such cases constitutes no part of the rental period in the absence of a specific provision in the contract to the contrary, and for which the tenant is not liable for rents." *A & M Petroleum Co.*, 152 S.W.2d at 471.

Tenancy-at-Sufferance. A tenant who remains in possession of the premises after termination of the lease, or beyond the reasonable period for removing improvements tenant reserved the right to remove, occupies "wrongfully" and is said to have a tenancy at sufferance. *See Robb v. San Antonio St. Ry*., 18 S.W. 707, 708 (Tex. 1891); *International & G.N.R. Co. v. Ragsdale*, 2 S.W. 515, 517 (Tex. 1886). Under the common law holdover rule, a landlord may elect to treat a holdover tenant as either a trespasser or as a tenant holding under the terms of the original lease. *Howeth v. Anderson*, 25 Tex. 557, 572 (1860).

[202] Under the Texas UCC, "***insolvent***" means: (A) having generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute; (B) being unable to pay debts as they become due; or (C) being insolvent within the meaning of the federal bankruptcy law. TEX. BUS. & COM. CODE § 1.201(b)(23) (2013).

[203] "***Insolvency proceeding***," under the Texas UCC, "includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved." TEX. BUS. & COM. CODE § 1.201(b)(22) (2013).

[204] *Cf. Riverside Props. v. Teachers Ins. & Annuity Ass'n*, 590 S.W.2d 736, 738 (Tex. Civ. App.—Houston [14th Dist.] 1979, no writ) (stating, in case enforcing contractual right of mortgagee to appointment of receiver, that "'the express agreement of the mortgagor is an equity that should not ordinarily be ignored'"); *Barclays Bank v. Superior Court*, 69 Cal. App.3d 593, 137 Cal. Rptr. 743, 748 (Cal. Ct. App. 1977)).

[205] ***Ipso Facto Clauses***. "As a matter of statute, the question whether a bankruptcy default clause should be treated as an invalid *ipso facto* clause depends on whether the contract at issue is an executory contract or unexpired lease. *In re Gen. Growth Props., Inc.*, 451 B.R. 323, 329 (Bankr. S.D.N.Y. 2011) (citing 11 U.S.C. § 365(e)(1)). *Ipso facto* clauses are invalid *per se* in an executory contract or unexpired lease. *Id.*; *In re Lehman Bros. Holdings Inc*., 452 B.R. 31, 39 (Bankr. S.D.N.Y. 2011) (stating that "[i]t is now axiomatic that *ipso facto* clauses are unenforceable in bankruptcy."); *In re Peaches Records & Tapes, Inc.*, 51 B.R. 583, 590 (B.A.P. 9th Cir. 1985) (stating consolidation of bankruptcy petitions filed by tenant-debtor and guarantor triggers application of 11 U.S.C. § 365(e)(1) and prevents termination of master lease and sublease under *ipso facto* clauses).

(e) A receiver or trustee is appointed for all or substantially all of the assets of Tenant or any Guarantor (i) in any proceeding brought by Tenant or any Guarantor; or (ii) in any proceeding brought against Tenant or any Guarantor, and the receiver or trustee (A) is not discharged within thirty (30) days after its appointment, or (B) Tenant or any Guarantor consents to, or acquiesces in, its appointment.

(f) Tenant's leasehold estate is taken in execution, by writ, or by other process in any action against Tenant.

(g) The liquidation, termination, dissolution, forfeiture of right to do business, or death of Tenant or any Guarantor.[206]

(h) Tenant fails or refuses to deliver any instrument required under paragraph 22 or paragraph 23 within five (5) days after written request.

(i) Tenant fails to comply with any other term of this Lease, and Tenant either does not begin the cure of its failure within **ten (10)** days after Landlord delivers written notice to Tenant of its failure or thereafter fails to pursue such cure with reasonable commercial diligence to completion within not more than XX days after Landlord's delivery of initial written notice.

(j) Tenant fails to take possession of and occupy the Premises within thirty (30) days after the Commencement Date,[207] ~~or Tenant fails to continuously use the Premises for their Permitted Use~~.[208]

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[206] ***Forfeiture of Corporate Charter as Default***. Under section 171.251 of the Texas Tax Code, "the comptroller shall forfeit the corporate privileges: … of a corporation for failure to file a report within 45 days of notice or failure to pay assessed franchise taxes within 45 days of becoming due." TEX. TAX CODE ANN. § 171.251 (Vernon 2013). Forfeiture automatically (1) denies the corporation the right to sue or defend in a court of this state; and (2) renders each director or officer of the corporation liable for a debt of the corporation as provided in section 171.255. TEX. TAX CODE ANN. § 171.251. The comptroller also has discretionary authority to "forfeit the right of a taxable entity to transact business in this state." TEX. TAX CODE § 171.252(a). Upon the comptroller's certification, the Secretary of State may then forfeit the corporate charter. TEX. TAX CODE § 171.309. Forfeiture of a corporate charter for non-payment of taxes acts as a dissolution of the corporation. *In re ABZ Ins. Servs.*, Inc., 245 B.R. 255, 257-58 (Bankr. N.D. Tex. 2000). But forfeiture of a corporate charter for failure to pay franchise taxes does not extinguish the corporation's existence as a legal entity as long as it retains the statutory right to reinstate its charter. *Isbell v. Gulf Union Oil Co.*, 209 S.W.2d 762, 764 (Tex. 1948). A corporation which has forfeited its charter may be resurrected by paying its delinquent taxes. *Lighthouse Church of Cloverleaf v. Texas Bank*, 889 S.W.2d 595, 600 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

[207] ***Effect of Tenant's Failure to Take Possession***. Although a lease is both a contract and a conveyance of a leasehold interest in land, it need not convey a present interest. *Arthur Treacher's Fish & Chips of Fairfax, Inc. v. Chillum Terrace Ltd. P'ship*, 327 A.2d 282, 287-88 (Md. 1974). A tenant acquires no possessory estate until the term commences and tenant enters upon the land; thus, at common law, a landlord-tenant relationship does not begin until tenant enters into possession, and landlord becomes entitled to rent. 327 A.2d at 287 (citing *E. I. DuPont de Nemours & Co. v. Zale Corp*., 462 S.W.2d 355, 358 (Tex. Civ. App.—Dallas 1970), *appeal after reversal and rendition*, 494 S.W.2d 229 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.)).

> Under the common law, until the lessee enters, he has no estate (in land), but only an *interesse termini*, a right to enter. *Interesse termini* applies in two situations, where the term stated in the lease has commenced but the lessee has not taken possession, and where there is a lease to take effect in the future. Thus, one who is a lessee under a validly executed lease to commence in the future immediately becomes the owner of a future interest, a right of entry, which will ripen into a possessory estate when the term commences and when the lessee enters. The lessee acquires no possessory estate until the term commences and he enters upon the land.

Arthur Treacher's Fish & Chips, 327 A.2d at 287 (citing *Upton v. Toth,* 36 Cal.App.2d 679, 98 P.2d 515, 519 (1940); *Howard v. Manning*, 79 Okla. 165, 192 P. 358, 12 A.L.R. 819 (1920); *Simon v. Kirkpatrick*, 141 S.C. 251, 139 S.E. 614, 54 A.L.R. 1348 (1927); *E. I. DuPont de Nemours & Co.*, 462 S.W.2d at 35; 49 AM. JUR.2d, *Landlord and Tenant* § 15 (1970)).

A contract to lease creates a future possessory estate, a leasehold to commence *in futuro*. *Motels of Md. v. Baltimore Cnty.*, 223 A.2d 609, 614 (Md. 1966) (stating equitable interest in land passes to prospective tenant under a contract to make a

(k) Tenant abandons, deserts, or vacates a substantial portion of the Premises.[209] Tenant will be conclusively presumed to have abandoned the Premises when Tenant, or any person acting on its

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lease). This may occur when a lease contains words of present conveyance, but the term of the lease does not begin until a future date. *Motels of Md.*, 223 A.2d at 614 (noting that rule applies in cases in which landlord agrees to build improvements and rent is to commence when improvements are competed). The grantee acquires an estate in land; but it is a future interest, not a present possessory interest. *Id.*, 327 A.2d at 287. As a consequence, when a tenant breaches its lease agreement by failing to enter into possession, that tenant cannot be held liable for rent. "Rent is an incident of the leasehold estate[,]" and, in such a circumstance, lessee's "leasehold estate never comes into existence as a present possessory interest." *Arthur Treacher's Fish & Chips*, 327 A.2d at 287; *Simon*, 139 S.E. at 617 (stating that when lessee refuses to take possession when premises are tendered, lessee could not be held liable for rent, since lessor-lessee relationship never commenced and tenant's possessory estate never comes into existence, but lessee is liable on the "contract facet of the lease" for breach of contract and appropriate contract damages). But this does not leave landlord without a remedy. Because the lease, before tenant enters into possession, creates a future leasehold interest, but one that never becomes possessory, "an allowance for unpaid rent is not a proper remedy.... Nevertheless, the lease agreement is also a contract, the breach of which entitle[s] [lessor] to damages appropriate to such cases." *Arthur Treacher's Fish & Chips*, 327 A.2d at 287; *Simon*, 139 S.E. at 617.

Some courts hold that, as a general rule, the appropriate measure of damages in cases in which a proposed tenant breaches either a lease before commencement of its term or a contract to make a lease is "that the proposed lessor may recover the excess, if any, of the agreed rent over the reasonable rental value of the premises as of the date of the breach." *Simon*, 139 S.E. at 617; *Jefferson Realty v. United States Rubber Co.*, 222 So.2d 738, 742 (Fla. 1969); *Cooper v. Aiello*, 107 A. 473, 475 (1919); *Dickerson v. Menschel*, 188 App. Div. 547, 177 N.Y.S. 376, 381 (1919); *Branning Mfg. Co. v. Norfolk-S. Ry. Co.*, 121 S.E. 74, 79-80 (Va. 1924); *Oldfield v. Angeles Brewing & Malting Co.*, 113 P. 630, 631 (Wash. 1911); 49 AM.JUR.2d, *Landlord and Tenant*, § 23 (1970); *see H. S. & D. Inv. Co. v. McCool*, 9 P.2d 809, 811 (Or. 1932); *Massie v. State Nat'l Bank*, 11 Tex. Civ. App. 280, 32 S.W. 797, 798 (1895) (discussing measure of damages when tenant breaches contract to enter into lease). Most authorities adopting this damage measure also allow lessor to recover "those special damages which the proposed lessor may plead and prove to have resulted from the breach." *Arthur Treacher's Fish & Chips*, 327 A.2d at 287.

Other courts hold that the correct damage measure in such cases is the difference between the rent reserved and what the proposed lessor is able to obtain by the exercise of reasonable diligence following the breach. *Post v. Davis*, 7 Kan. App. 217, 52 P. 903, 905 (1898); *Ocean City Co. v. Johnstone*, 110 N.J. Law 596, 598, 166 A. 307, 309 (1933); *Cooper v. Aiello*, 107 A. at 475; *Amick v. Metropolitan Mortg. & Sec. Co.*, 453 P.2d 412, 417 (Alaska 1969). The Maryland Supreme Court resolved the conflict by ignoring it, siding with two courts that "flatly equated reasonable rental value with the sum which the lessor, by the exercise of reasonable diligence, could have obtained as a rental from others during the entire term of the lease." *Arthur Treacher's Fish & Chips*, 327 A.2d at 287.

> With the support of two courts and the tacit authority of three others, and finding none to the contrary, we are persuaded to define reasonable rental value as that sum which the proposed lessor, by the exercise of reasonable diligence, could have obtained or did obtain as a rental from others during the entire term of the lease.

Arthur Treacher's Fish & Chips, 327 A.2d at 287-88; Kent Altsuler, *A Landlord's Duty to Mitigate in Texas: What If You Build It, and They Don't Come?*, HOUSTON LAW. J. 26-27 July/Aug. 2011), http://www.nathansommers.com/content/documents/docs/THL_a_landlord_duty_SepOct11.pdf. Mr. Altsuler asks: "Can the landlord argue that she has no duty to mitigate because the tenant never took possession in the first place?" Of course she can. After all, lawyers belong to "a society of men [and women] among us, bred up from their youth in the art of proving, by words multiplied for the purpose, that white is black, and black is white, according as they are paid." Jonathan Swift, *Gulliver's Travels* 248 (Oxford Univ. Press 1977). "To this society all the rest of the people are slaves." But it is probably not a very good argument. The measures of damages in such cases presume reasonable mitigation efforts.

[208] Unless the lease clearly and expressly requires the tenant to use and occupy the premises, a clause permitting the tenant to use for a specified purpose does not obligate the tenant to use the premises at all, much less to use them for the permitted use described in the use clause.

[209] ***Abandon, Desert & Vacate***. To the extent a lease deems a tenant to be in breach of the lease if it deserts or vacates the premises, Texas cases recognize that "[t]he ordinary meanings of 'abandon' and 'vacate' are different…," and, accordingly, the cases hold that the proof to establish a tenant abandoned, as opposed to merely vacated, the premises is different. *PRC Kentron, Inc. v. First City Ctr. Assocs. II*, 762 S.W.2d 279, 282 (Tex. App.—Dallas 1988, writ denied) (J. Hecht).

"'***[V]acate***'…means to make vacant, and vacant, in turn means 'being without content or occupant.'" 762 S.W.2d at 282 (emphasis added). *Cf. Phoenix Assur. Co. v. Shepherd*, 137 S.W.2d 996 (Tex. 1990) (stating, in an insurance

behalf, has removed, is removing, or is preparing to remove (other than in the normal course of business) substantial amounts of goods, equipment, fixtures, or other property from the Premises without Landlord's prior written consent, and this presumption will supersede Section 93.002 of the Texas Property Code to the extent of any conflict.[210]

Tenant's failure to comply with any term of this Lease more than twice during any consecutive **twelve (12)** month period will be an independent **Default**. Landlord will not be required to give more than **one (1)** informative notice of **Default** during the Term, and this limit on Landlord's obligation to provide any notice will override any contrary term in this Lease otherwise requiring Landlord to give notice or opportunity to cure.

25. **REMEDIES**. Landlord's remedies[211] are cumulative and not exclusive.[212] If a ***Default*** occurs, Landlord — without prejudice to any other legal,[213] equitable, or contractual right or remedy — will be entitled

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coverage case, that "vacant" means deprived of contents or empty); *Germania v. Anderson*, 463 S.W.2d 24, 25 (Tex. Civ. App.—Waco 1971, no writ); *Knoff v. United States Fidelity*, 447 S.W.2d 497, 501 (Tex. Civ. App.—Houston [1st Dist.] 1969, no writ).

Desert is not synonymous with the term vacate. *Scot Props. v. Wal-Mart Stores*, 138 F.3d 571, 573 (5th Cir. 1998). In *Scot*, the Fifth Circuit Court of Appeals, relying on the distinction between vacate and desert articulated by Justice Hecht in *PRC Kentron, Inc*., stated that "'vacate' sets up a lower standard than 'desert'…. '[D]esert' contains an element of 'intent to forsake' which is more fully suggested by the term 'abandon.'… 'Vacate' does not contain that element." *Scot*, 138 F.3d at 573-74.

"'***[A]bandon***' includes an element of intent present only to a lesser extent in the meaning of `vacate.'… [T]he principal meaning of abandon is `to cease to assert or exercise any interest, right, or title especially with the intent of never reasserting it.'" 138 F.3d at 573-74. "An essential element of abandonment is the intention to abandon, and such intention must be shown by clear and convincing evidence; while abandonment may be shown by circumstances, the circumstances must consist of some definite act showing an intent to abandon. Nonuse alone is insufficient to show abandonment, without being long, continuous, and unexplained." *City of Anson v. Arnett*, 250 S.W.2d 450, 454 (Tex. Civ. App.–Eastland 1962, writ ref'd n.r.e). A tenant who closes its business and moves out of the premises, but who continues to pay rent, has not "abandoned" the premises. *See Lucky v. Fidelity Union Life Ins. Co*., 339 S.W.2d 956, 958 (Tex. Civ. App.–Dallas 1960, no writ).

A default for vacating or deserting the premises is related to, and should be harmonized with, the typical use clause in an office lease. If tenant's continuous use and occupancy of the office premises is not essential, and the parties do not intend to impose a covenant of continuous use and occupancy, or to treat tenant's cessation of occupancy as a breach as long as tenant continues to pay rent, the use clause, default provisions, and insurance provisions should be harmonized to effect the parties' intent. If the use provision states that the tenant ***may*** use the premises for office purposes, but the default provisions treats deserting or vacating the premises as an event of default, the permissive use clause conflicts with the implied premise of a default provision – tenant must continuously occupy the premises and its failure to do so is a breach of its obligation to do so. A default for abandonment does not give rise to the same conflict, but it does not necessarily add anything when non-payment of rent is a default.

[210] Section 93.002(e) of the Texas Property Code permits a landlord to dispose of a tenant's personal property without foreclosing on it. Under this section, "[a] landlord may remove and store any property of a tenant that remains on premises that are abandoned." TEX. PROP. CODE § 93.002(e). In addition to exercising any other rights, a landlord "may dispose of the stored property if the tenant does not claim the property within 60 days after the date the property is stored." *Id*.; *see infra* footnote 213 (cumulative remedies).

[211] Although the Texas UCC is not directly applicable, its definition of "***remedy***" captures the intended meaning of the term in most leases. "Remedy means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal." TEX. BUS. & COM. CODE § 1.201 (Vernon 2013). At common law, however, landlord's remedies for tenant's breach of a lease covenant were quite limited. *See generally Davidow*, 747 S.W.2d at 375 (citing 3 G. Thompson, THOMPSON ON REAL ESTATE §§ 1110, 1115 (1980) for proposition that, at common law, "[a]ll lease covenants were therefore considered independent…" and explaining significance of conveyancing as rationale for independent covenants); *Cantile v. Vanity Fair Props*., 505 S.W.2d 654, 657 (Tex. Civ. App.—San Antonio 1973, writ ref'd n.r.e.) (discussing historical basis for treating covenants in leases as independent covenants). Under the doctrine of independent covenants, tenant's failure to perform a

to exercise any one or more of the following remedies,[214] using lawful force if necessary or appropriate,[215] without further notice or demand:[216]

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lease covenant, even the covenant to pay rent, generally did not excuse landlord from its obligation to honor the covenant of quiet enjoyment. 2 FRIEDMAN ON LEASES, *Default by Tenant –General* § 16.1, at n. 2.

[212] ***Cumulative Remedies***. Even though a lease may state that landlord's remedies are both alternative and cumulative, a court may limit landlord's ability to exercise cumulative remedies if they are "clearly inconsistent" or would "permit[] the lessor a measure of recovery far in excess of just compensation." *Cf. American Lease Plan v. Ben-Kro Corp*., 508 S.W.2d 937, 943 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ ref'd n.r.e.) (holding, in a case involving a personal property lease, that landlord could elect to treat tenant's failure to pay rent as continuing breach and sue on lease for monthly rental payments or treat it as an anticipatory breach and sue for damages but that landlord could not repossess leased property and sue for unaccrued rents as they came due). *Buffalo Pipeline Co*., 694 S.W.2d at 598; *Walling v. Christie & Hobby, Inc.*, 54 S.W.2d 186, 188 (Tex. Civ. App.—Galveston 1932, no writ); *compare Christie, Mitchell and Mitchell Co. v. Selz*, 313 S.W.2d 352, 354 (Tex. Civ. App.—Fort Worth 1958, writ dism'd) (holding, in suit by landlord against defaulting tenant for all rents scheduled for payment after date of surrender, that provision requiring tenant to pay unaccrued rents in event of surrender was unenforceable as "mere penalty" when landlord relet premises for almost twice original tenant's monthly rent) *with Stonehenge Sq. Ltd. P'ship. v. Movie Merchs*., 715 A.2d 1082, 1083-84 (Pa. 1998) (upholding Pennsylvania rule that allows landlord to recover under rental acceleration clause without reducing rents to present value and without attempting to mitigate its damages but that prevents landlord from occupying or reletting during term covered by accelerated rents).

[213] ***Landlord's Common Law Remedies***. A landlord did not have the right, at common law, to reenter the premises, to terminate the lease, or to recover unaccrued rent before it came due or damages for non-payment of unaccrued rent when a tenant failed to pay rent, unless the lease provided the landlord with these remedies or the tenant committed an anticipatory breach of the lease. In the absence of an anticipatory breach or an express contractual remedy, a landlord, at common law, could (i) treat the contract as binding (*i.e*., continue to recognize the tenant's right to occupancy and sue for rent as it came due through the earlier of the termination or surrender of the lease or the date of trial), (ii) sue to cancel the lease and repossess the premises, or (iii) in the event the tenant failed to perform any covenant (other than the covenant to pay rent) sue for damages resulting from the tenant's breach. *Buffalo Pipeline Co.*, 694 S.W.2d at 598 (stating that landlord did not have common law right to terminate lease because tenant failed to pay rent); *Shepherd v. Sorrells*, 182 S.W.2d 1009, 1011-12 (Tex. Civ. App.—Eastland 1944, no writ) (stating that breach of covenant to pay rent does not breed "forfeiture of possession" by tenant or right of possession by landlord); *Dillingham v. Williams*, 165 S.W.2d 524, 526 (Tex. Civ. App.—El Paso 1942, writ ref'd w.o.m.) (holding that landlord did not have common law right to terminate lease because tenant failed to pay rent); *see* 2 FRIEDMAN ON LEASES, *Default by Tenant–General* § 16.1, at n. 2 (stating that, at common law, "[n]either nonpayment of rent not breach of covenant by tenant divested the estate so created or revested landlord with a right of possession. His remedy was to sue for rent or breach of covenant, but with no right to dispossess.").

[214] ***Forfeiture v. Rescission***. A landlord may terminate a lease, or tenant's right to possession, pursuant to an express forfeiture provision. *Rohrt v. Kelley Mfg. Co.,* 349 S.W.2d 95, 97-98 (Tex. 1961). Forfeiture is a contractual penalty distinct from the equitable remedy of rescission:

> A forfeiture is a penalty provided by the terms of the agreement for a breach of a covenant in the agreement. Rescission, on the other hand, is an equitable remedy that terminates a lease by force of law and is independent of any provision of the lease agreement. The practical effect is the same: the tenant's obligation to pay rent ends at the time of forfeiture or rescission.… A corollary of this rule is that the tenant's obligation to pay rent continues until such an event occurs.

Miller v. Vinyard, 765 S.W.2d 865, 867 (Tex. App.—Austin 1989, writ denied).

[215] The phrase "***by force if necessary***" does not mean what many landlords believe it does. A landlord cannot reenter or repossess the premises if doing so will breach the peace. *Gulf Oil Corp. v. Smithey,* 426 S.W.2d 262 (Tex. Civ. App.—Dallas 1965, writ dism'd). Landlord's counsel should consider placing the adjective "***lawful***" before the noun ***force*** to prompt her landlord client to call its counsel before doing something ***unlawful*** and inadvertently incurring ***awful*** liabilities. *See, e.g., Gill Savs. Ass'n v. Chair King, Inc*., 783 S.W.2d 674, 676 (Tex. App.–Houston [14th Dist.] 1989) (affirming trial court judgment against landlord for $144,309 in actual damages, $355,277 in punitive damages, and $54,862 in attorneys' fees for wrongful self-help eviction), *aff'd in part and modified in part per curiam*, 797 S.W.2d 31 (Tex. 1990) (affirming judgment on liability, reinstating trial court's award of attorneys' fees, and remanding for new trial on damages), o*n remand sub nom., Resolution Trust Corp. v. Chair King, Inc*., 827 S.W.2d 546 (Tex. App.—Houston [14th Dist.] 1992, no writ).

(a) Terminate this Lease or any of Tenant's rights under this Lease,[217] with or without reentering or repossessing the Premises, and without relinquishing any contractual or other right to recover Damages.[218]

(b) Terminate Tenant's right to occupy all or any part of the Premises — without terminating this Lease — and with or without reentering or repossessing the Premises.

(c) Recover unpaid Rent[219] and any Damages;[220]

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[216] As a general rule, one party's total breach of contract relieves the other party of its obligation for further performance. Even though the non-breaching party's obligations may cease, the contract survives for purposes of measuring damages. Under these rules of contract law, landlord may recover damages after its tenant abandons the premises and ceases to pay rent, and tenant's breach also will excuse landlord from complying with certain contractual prerequisites—such as presenting a bill—to the landlord's right to recover taxes, expenses, and other damages. *Cf. Rokalo*, 18 Conn. App. at 392 (holding that tenant's breach of its obligation to pay base rent excused landlord's "remaining duties under the lease, including presenting bills for taxes and other expenses").

[217] "***Equitable relief*** will not be granted in declaring a forfeiture, for only the plain language of the contract will permit such drastic relief." *G. C. Murphy Co.*, 404 S.W.2d at 858 (stating that "[t]he courts do not favor forfeitures and unless compelled to do so by language that will admit to no other construction, forfeiture will not be enforced."). To be effective, "an option to terminate must be exercised in strict accordance with its terms.…" *Taco Boy, Inc. v. Redelco Co.*, 515 S.W.2d 319, 322 (Tex. Civ. App.—Corpus Christi 1974) (citing *Vidor v. Peacock*, 145 S.W. 672 (Tex. Civ. App.—San Antonio 1912, no writ)).

Courts sometimes invoke equity to relieve a tenant of a forfeiture, even though the terms of the lease seem to allow one. *See, e.g., Inn of the Hills, Ltd. v. Schulgen & Kaiser*, 723 S.W.2d 299, 301 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.) (citing *Jones v. Gibbs*, 130 S.W.2d 265 (Tex. 1939) and stating that "[i]n cases of mere neglect in fulfilling a condition precedent of the lease, which do not fall within accident or mistake, equity will relieve when the delay has been slight, the loss to the lessor small, and when not to grant relief would result in such hardship to the tenant as to make it unconscionable to enforce literally the condition precedent of the lease"). *But see, e.g., Reynolds-Penland Co. v. Hexter & Lobello,* 567 S.W.2d 237, 239-40 (Tex. App.—Dallas 1978, writ dism'd by agr.) (stating that equity will not intervene to prevent a forfeiture and that neglect is not grounds for waiving a condition precedent); *Crown Const. Co. v. Huddleston*, 961 S.W.2d 552, 557-59 (Tex. App.—San Antonio 1997, no pet.) (noting that Dallas Court of Appeals has refused to apply disproportionate forfeiture doctrine but that San Antonio Court of Appeals has recognized doctrine).

The Fifth Circuit Court of Appeals reaffirmed the vitality of a venerable Texas common law doctrine permitting equity to intervene to relieve a forfeiture in case of "mere neglect." *In re Eldercare Props. Ltd*., 568 F.3d 506, 521 (5th Cir. 2009) (approving equitable intervention to relieve tenant of forfeiture of extension option). According to the court of appeals, the Texas Supreme Court adopted in *Sirtex Oil Indus., Inc. v. Erigan* the following "equitable rule approved by th[e] court in *Jones[:]*"

> In cases of mere neglect in fulfilling a condition precedent of a lease, which do not fall within accident or mistake, equity will relieve when the delay has been slight, the loss to the lessor small, and when not to grant relief would result in such hardship to the tenant as to make it unconscionable to enforce literally the condition precedent of the lease.

In re Eldercare Props. Ltd., 568 F.3d at 521 (quoting *Reynolds-Penland Co.*, 567 S.W.2d at 242 (Guittard, C.J., dissenting) and analyzing *Sirtex Oil Indus., Inc. v. Erigan*, 403 S.W.2d 784, 788 (Tex. 1966) and *Jones v. Gibbs*, 130 S.W.2d 265, 272 (Tex. 1939)).

[218] By successfully terminating a lease, a landlord relinquishes any right to recover unaccrued rents "as if the termination date were the date originally fixed for the expiration of the term… of the lease." *Rohrt*, 349 S.W.2d at 97-98.

[219] *See supra* footnotes 4 – 5 (discussing differences between rent, as such, and damages).

[220] In *Speedee Mart, Inc. v. Stovall*, the Amarillo Court of Appeals identified, what it called, the four "common law remedies" available to a landlord upon a tenant's anticipatory breach.

- landlord could decline to repossess, elect instead to keep the lease in full force and effect, and sue month-to-month for contractual rent as it came due;
- landlord could treat tenant's conduct as an anticipatory breach, repossess the property for its own purposes, and recover the present value of future lease payments less the reasonable market value for the unexpired term;

(d) Change or pick the locks,[221] access codes, or other access control devices,[222] and take any other self-help, without liability for any resulting damages, or take judicial action to exclude Tenant and other occupants from the Premises.[223]

- landlord could treat tenant's conduct as an anticipatory breach, repossess the premises, relet to another tenant for the benefit of the original tenant, and recover from the original tenant the difference between the rent under the original lease and the rent under the new lease; and
- landlord could declare the lease forfeited, thus relieving tenant of the obligation to pay unaccrued rent.

664 S.W.2d 174, 177 (Tex. App.—Amarillo 1983, no writ) (citing *Maida,* 473 S.W.2d at 651 (summarizing "alternatives available to a landlord when the tenant, without justification, abandons the leased premises and stops paying the rent due… ***[u]nder the language of the usual lease contract***"). Even though *Speedee Mart* states these four "common law remedies [are] available unless the parties contract otherwise[,]" it is probably more accurate to say that these four remedies were not available at common law unless the lease so provided. Of *Speedee Mart's* four "common law remedies," only half of the first – suing on the rent as it comes due – has an untainted common law pedigree. The others trace their origins to contractual remedies arising "***[u]nder the language of the usual lease contract***." The true nature of the *Speedee Mart* Four is probably academic given the number of cases, and rank of the courts, citing *Speedee Mart*. *See, e.g., Austin Hill Country Realty, Inc*., 948 S.W.2d at 300 (citing *Speedee Mart* for proposition that "Texas courts have regarded the landlord as having four causes of action against a tenant for breach of the lease and abandonment."). But to the extent that a landlord's remedies for anticipatory breach depend, at least in part, on the terms of the lease, the terms of the lease present an opportunity to shape the parties' rights and remedies to their needs and the imperatives of the transaction. *See Id.* (holding that "when exercising the option to maintain the lease in effect and sue for rent as it becomes due following the tenant's breach and abandonment, the landlord has a duty to mitigate only if (1) the landlord actually reenters, or (2) ***the lease allows the landlord to reenter the premises without accepting surrender, forfeiting the lease, or being construed as evicting the tenant.***"); *but see* TEX. PROP. CODE § 91.006(a) ("A landlord has a duty to mitigate damages if a tenant abandons the leased premises in violation of the lease.").

[221] ***Self-Help***. Chapter 93 of the Texas Property Code authorizes a landlord to lockout a tenant — but only for non-payment of rent — as a self-help alternative to judicial eviction. Under section 93.002 of this chapter, "[a] commercial landlord may not intentionally prevent a tenant from entering the leased premises except by judicial process unless the exclusion results from… changing the door locks of a tenant who is delinquent in paying at least a part of the rent." TEX. PROP. CODE ANN. § 93.002(c)(3). Before changing the door locks, a landlord or its agent "must place a written notice on the tenant's front door stating the address and telephone number of the individual or company from which a new key may be obtained." TEX. PROP. CODE ANN. § 93.002(f). But, a landlord is only required to provide a new key during the tenant's regular business hours and then "only if the tenant pays the delinquent rent." TEX. PROP. CODE ANN. § 93.002(f) (Vernon Supp. 2000). The terms of the lease, however, will supersede the requirements of section 93.002 "to the extent of any conflict." TEX. PROP. CODE ANN. § 93.002(h).

[222] ***Lockout***. Every lockout does not terminate the lease or tenant's obligation to pay unnacrued rents. *Martinez v. Ball*, 721 S.W.2d 580 (Tex. App.—Corpus Christi 1986, no writ). In this case, tenant contended its liability for unaccrued rents ceased because landlord evicted tenant from the premises by changing the locks after tenant failed to pay rent. *Id*.at 581. The court of appeals rejected tenant's contention because the evidence showed tenant paid rent the following day and landlord allowed tenant to return to the premises. *Id*.at 581. "To constitute an eviction, or constructive eviction, the tenant must be permanently deprived of the premises." *Id.* at 581 (citing *Charalambous v. Jean Lafitte Corp*., 652 S.W.2d 521, 526 (Tex. App.—El Paso 1983, writ ref'd n.r.e.)).

[223] ***Breach of the Peace***. A landlord cannot lawfully lockout a tenant if doing so would breach the peace, effectively giving its tenant a veto over a self-help eviction. *See* TEX. PROP. CODE § 93.002(c) and (h). In *Gulf Oil Corp. v. Smithey*, for example, landlord entered the premises by picking the locks after tenant failed to pay rent. Even though the lease expressly allowed landlord to re-enter the premises in the event of a default by tenant, and even though the lease excused landlord from liability for damages for any act or omission of the landlord in connection with such re-entry, the court of civil appeals held the landlord's reentry was unlawful. 426 S.W.2d 262 (Tex. Civ. App.—Dallas 1965, writ dism'd). The court of civil appeals stated:

> The provisions in a lease giving the lessor the right to re-enter upon default of the tenant,…without notice to, or the consent of, the tenant…and even over his protests, are recognized as valid, provided such rights are exercised peaceably and without force or violence…. Here, the plaintiff was not present; it was not shown that he even knew the re-entry or repossession were to be attempted, or that he had any knowledge thereof until [the

(e) Remove and store (at Tenant's sole cost) any property on the Premises.[224]

(f) Sue for eviction,[225] specific enforcement, equitable relief, rent, damages, or any other available remedy.

(g) Apply the Security Deposit in any manner permitted by this Lease, and increase the amount of the Security Deposit.[226]

> landlord's] agents had already forced their way into the building by picking the lock. Having locked the building, [the tenant] must be considered as being in possession thereof and of the equipment situated therein. He had not been informed that [the landlord] had declared the lease terminated, if in fact it had done so, or that his right of occupancy was being challenged…. [W]e hold that entry into the building by picking the lock was not peaceable but by force and violence.

Id. at 265; *see also Embry v. Bellaire Corp.*, 508 S.W.2d 469 (Tex. Civ. App.—Austin 1974, writ ref'd n.r.e.) (stating that "one who is entitled to possession of land, but who is not in possession, may not forcibly take possession from another…."). The real rule seems to be that if a person entitled to possession can make peaceable entry upon the land, that person may resort to peaceable means, short of force, as will render impracticable the further occupation of the land by the other person. What force means, in a particular case, however, is in the eye of the beholding fact finder. *See, e.g., Design Ctr. Venture,* 748 S.W.2d 469; *Martinez v. Ball*, 721 S.W.2d 580 (Tex. App.—Corpus Christi 1986, no writ); *McVea v. Verkins*, 587 S.W.2d 526, 531 (Tex. Civ. App.—Corpus Christi 1979, no writ), *Houck v. Kroger Co.*, 555 S.W.2d 803 (Tex. Civ. App.—Houston [14th Dist.] 1977, writ ref'd n.r.e.); *Salpas v. State*, 462 S.W.2d 71 (Tex. App.—El Paso 1982, no writ); *Harris v. Panhandle & S.F. Ry. Co.*, 163 S.W.2d 647 (Tex. Civ. App.—El Paso 1942, writ ref'd w.o.m.); *Kuhn v. Palo Duro Corp*., 151 S.W.2d 894 (Tex. Civ. App.—Texarkana 1941), *rev'd on other grounds*, 161 S.W.2d 778 (Tex. 1942); *Chrone v. Gonzales*, 215 S.W.368 (Tex. Civ. App.—San Antonio 1919, no writ); *Henderson v. Beggs*, 207 S.W.565 (Tex. Civ. App.—Fort Worth 1918, no writ).

[224] The ***right to reenter*** premises upon default and grant of contractual lien alone do not grant the landlord the right to take possession of a tenant's personal property. *McVea*, 587 S.W.2d at 531 (Tex. Civ. App.—Corpus Christi 1979, no writ) (holding landlord liable for conversion for seizing tenant's property). Moreover, absent a contrary lease provision, a landlord has a duty to care for the personal property a tenant leaves on the premises after a tenant abandons the premises. *Alsbury v. Linville*, 214 S.W. 492 (Tex. Civ. App. 1919, writ dismissed w.o.j.). And, a landlord may be liable for conversion if the landlord wrongfully assumes control over personal property that a tenant leaves on the premises.

Conversion is the wrongful exercise of dominion and control by a person over the property of another. *Waisath v. Lack's Stores, Inc*., 474 S.W.2d 444, 446 (Tex. 1971); *Killian v. Trans Union Leasing Corp*., 657 S.W.2d 189, 192 (Tex. App.—San Antonio 1983, writ ref d n.r.e.). Conversion is complete when a person unlawfully and wrongfully exercises dominion and control over the property of another to the exclusion of the possessory rights of the owner or of another person entitled to possession. *Killian*, 657 S.W.2d at 192; *Campos v. Investment Mgmt. Props., Inc*., 917 S.W.2d 351(Tex. App.—San Antonio 1996, no writ) (holding that when the landlord was legally authorized to remove the property from the premises and did so in compliance with TEX. PROP. CODE ANN. § 24.0061, there was not conversion because there was no wrongful assumption of control over the tenant's property); *McVea*, 587 S.W.2d at 530-31. In general, the damages in an action for conversion are measured by the sum of money necessary to compensate the plaintiff for all actual losses or injuries sustained as a natural and proximate result of the defendant's wrong. *Groves v. Hanks*, 546 S.W.2d 638 (Tex. Civ. App.— Corpus Christi 1977, writ ref d n.r.e.). Thus, compensation for the injury is the result to be obtained, and while the wrongdoer is not allowed to profit from his own wrongdoing, the same rule should apply to the aggrieved party. *Kennan v. Death*, 258 S.W.2d 145 (Tex. Civ. App.—Amarillo 1953, writ ref d n.r.e.). Even if the tenant does not grant the landlord a contractual lien, section 93.002(e) of the Texas Property Code permits a landlord to dispose of a tenant's personal property without foreclosing on it. This section provides that "[a] landlord may remove and store any property of a tenant that remains on premises that are abandoned." TEX. PROP. CODE ANN. § 93.002(e). In addition to exercising any other rights, a landlord "may dispose of the stored property if the tenant does not claim the property within 60 days after the date the property is stored." TEX. PROP. CODE ANN. § 93.002(e). If tenant granted landlord a contractual lien on tenant's personal property, the Texas UCC permits landlord, as a secured creditor, to use self-help to take possession of personal property secured by the contractual lien, unless the security agreement expressly prohibits the creditor-landlord from doing so or taking the property will breach the peace. TEX. BUS. & COM. CODE § 9.609; *but see McVea*, 587 S.W.2d at 531.

[225] Thomas M. Whelan, *Commercial Landlord's Remedies for Tenant's Breach*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2005 BERNARD O. DOW LEASING INSTITUTE (April 2005).

(h) Cure Tenant's Default, and, if Landlord does so, Tenant must reimburse Landlord within thirty (30) days after Landlord delivers an invoice for any expenses Landlord incurred effecting compliance with Tenant's obligations.

(i) Withhold or suspend any payment that this Lease would otherwise require Landlord to make.[227]

(j) Withhold or suspend any service Landlord would otherwise be required to provide unless prohibited by Applicable Law.[228]

(k) Charge interest on any amount not paid when due from the due date through the date of its payment at the **Default Rate**, which is the lesser of **18%** per annum or the highest rate permitted by Applicable Law.[229]

(l) Recover — but only if Tenant fails to pay Base Rent, and Landlord terminates this Lease or Tenant's right of possession with more than **twelve (12)** months remaining in the Term — **Liquidated Rental Damages** for the period after any such termination equal to 12 times the monthly Base Rent (including Parking Fees and Landlord's estimate of Tenant's Pro Rata Share of Electricity Costs and Excess Basic) in lieu of any other contractual or legal measure of damages (including reletting costs) *for Tenant's non-payment of Base Rent*,[230] and the parties agree this is a reasonable estimate of Landlord's damages for such a breach given the uncertainty of future market rental rates and of the duration of any vacancy but not a limitation on Landlord's right to recover rent or damages not caused by Tenant's non-payment of Rent.[231]

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[226] *See supra* p. 22-35, ¶ 4 (Security Deposit and Letter of Credit) and accompanying footnotes.

[227] The right to withhold payment can be important during the construction of tenant improvements.

[228] Reserving the right to suspend services can be useful to encourage compliance. Termination is a sledgehammer. It sometimes helps to have carrots and sticks as well in landlord's enforcement tool chest or lunch box.

[229] ***Usury***. Several courts of appeals have held that, because a rental or lease agreement is not a "lending transaction," the usury statute does not apply to late charges assessed on overdue rental payments. *Potomac Leasing Co. v. Housing Auth.*, 743 S.W.2d 712, 713 (Tex. App.—El Paso 1987, writ denied); *Brokers Leasing Corp. v. Standard Pipeline Coating Co.*, 602 S.W.2d 278, 281 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e); *Apparel Mfg. Co. v. Vantage Props, Inc.*, 597 S.W.2d 447, 448-49 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.); S*outhwest Park Outpatient Surgery, Ltd. v. Chandler Leasing Div.*, 572 S.W.2d 53, 55 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ); *Maloney v. Andrews*, 483 S.W.2d 703 (Tex. Civ. App.—Eastland 1972, writ ref'd n.r.e.).

[230] ***Liquidated Damages***. In *Stewart v. Basey*, the Texas Supreme Court held that an agreement, made in advance of breach fixing the damages therefor, is not enforceable as a contract and does not affect the damages recoverable for breach, unless: (i) the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and (ii) the harm caused by the breach is one that is incapable or very difficult of accurate estimation. 245 S.W.2d 484, 487 (Tex. 1952). In sum, a liquidated damage provision must be a "reasonable forecast of just compensation for the harm that is caused by the breach." *Id*. at 486. To meet this prong of the test, the amount stipulated must be a reasonable forecast of the damages resulting from each breach that triggers the remedy. Different breaches may require different remedies. Simply put, the punishment should fit the crime.

[231] ***Defects in Acceleration Clauses***. Many leases contain, and some landlords think they want, the right to terminate the lease and to recover accelerated rents as liquidated damages in the event of *any* default. The cases, however, suggest a more discriminating approach. In *Stewart v. Basey*, the supreme court held that the landlord could not enforce the tenant's purported obligation to pay liquidated damages equal to $150 per month times the number of months remaining after termination of a lease with a monthly rental of $325. *Id*. at 485. The supreme court reasoned that the clause was a penalty because the payment could be triggered by the tenant's breach of any covenant in the lease, and the tenant's obligation to make the payment did not depend upon termination of lease. *Id*. at 485. The right to liquidated damages should not be triggered by any breach, without regard to its importance or materiality or the foreseeable damages resulting from the particular breach. It ordinarily would not be reasonable, for example, to forecast the same amount of damages for a tenant's breach of a covenant to repair the premises and for breach of the covenant to pay rent.

(m) Exercise all other remedies available to Landlord at law or in equity (including, without limitation, injunctive and other extraordinary remedies).

Damages include, without limitation, all actual, direct,[232] incidental, and consequential damages,[233] court costs, interest, and attorneys' fees arising from Tenant's breach of the Lease (including, without limitation, the cost of (A) recovering possession, (B) removing and storing Tenant's and any other occupant's property, (C) reletting (including, without limitation, the costs of brokerage commissions and cleaning, decorating, repairing, or altering the Premises for a substitute tenant or tenants), (D) collecting any money owed by Tenant or a substitute tenant, (E) repairing any damage caused by any Tenant Party, (F) performing any obligation of Tenant under the Lease, (G) any other loss or cost incurred by Landlord as a result of, or arising from, Tenant's breach of the Lease or Landlord's exercise of its rights and remedies for such breach, (H) any contractual or liquidated types or measures of damages specified in this Lease, and (I) any other type or measure of damages recoverable for any particular breach under Applicable Law.

Rental Deficiency is a contractual measure of Damages for Tenant's non-payment of Rent measured by either the: (A) **Actual Rental Deficiency**, which is the difference (never less than zero) between (1) the Base Rent due for, and other **Rent** allocable under this Lease to, each month beginning with the first month with respect to which Landlord receives rent from reletting the Premises, and (2) the proceeds, if any, that Landlord actually collects from any substitute tenant for any part of the Premises in each corresponding month in which the Term and the term of the substitute tenant's lease overlap, or (B) **Market Rental Deficiency**, which is the present value[234] — discounted at **6%** simple annual interest — of the difference (never less than zero) between (1) the **Rent** otherwise due under the Lease during any period after Tenant's breach in which Landlord may elect to recover this damage measure, and (2) the **Fair Rental Value** of the Premises during that period, ***plus*** any costs incurred in connection with any actual or attempted reletting and any other **Damages**. In determining the **Market Rental Deficiency**, the **Fair Rental Value** will be the total rent that a comparable tenant would pay for comparable space in a building of substantially equivalent quality, size, condition, and location, considering rental rates and concessions then prevalent in the marketplace, the remaining lease term, the expected vacancy, and any other relevant factors. An independent [MAI appraiser] [licensed real estate broker] selected by Landlord will determine the Premises' Fair Rental Value, and that determination will conclusively bind the parties in any computation of the Market Rental Deficiency.

Unless Landlord delivers signed, written notice thereof to Tenant, no act or omission by any Landlord Party will constitute Landlord's acceptance of surrender of the Premises,[235] termination of Lease, or an actual or

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[232] Rentals, which landlord would have received under the lease, and not from a collateral contract, are ***direct damages***. *Hoppenstein Props., Inc. v. McLennan Cnty. Appraisal Dist.*, 341 S.W.3d 16, 21 (Tex. App.—Waco 2010, pet. denied).

[233] ***Consequential damages*** may include some but not all claims for lost profits. *Cherokee Cnty. Cogeneration Ptrs, L.P. v. Dynegy Mktg. & Trade*, 305 S.W.3d 309, 314 (Tex. App.-Houston [14th Dist.] 2009, no pet.). "Lost profits are damages for the loss of net income to a business measured by reasonable certainty." *Miga v. Jensen*, 96 S.W.3d 207, 213 (Tex.2002); *accord Cherokee Cnty. Cogeneration Prtnrs.*, 305 S.W.3d at 314; *Mood v. Kronos Prods., Inc.*, 245 S.W.3d 8, 12 (Tex. App.—Dallas 2007, pet. denied). "Lost profits may be in the form of direct damages, that is, profits lost on the contract itself, or in the form of consequential damages, such as profits lost on other contracts or relationships resulting from the breach." *Mood*, 245 S.W.3d at 12; *accord Cherokee Cnty. Cogeneration Prtnrs.*, 305 S.W.3d at 314.

[234] "***Present value***," as defined in the Texas UCC, "means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into." TEX. BUS. & COM. CODE § 1.201(b)(28) (Vernon 2103).

[235] In Texas, ***surrender*** of a leasehold interest means that a tenant yields the leasehold estate to its landlord so that the leasehold estate comes to an end by the mutual agreement of landlord and tenant. *Arrington v. Loveless*, 486 S.W.2d 604, 607 (Tex. Civ. App.—Fort Worth 1972, no writ). The agreement may be expressed or implied. *Edward Bankers & Co. v. Spradlin*, 575 S.W.2d 585, 586–87 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ). If the tenant vacates the premises and the

constructive eviction of Tenant (including, without limitation, Tenant's delivery of keys to any Landlord Party or Landlord's repossession, reentry, or reletting of the Premises).[236]

NO LANDLORD PARTY WILL BE LIABLE FOR ANY CLAIM BY ANY TENANT PARTY ARISING FROM ANY ACT OR OMISSION OF ANY LANDLORD PARTY IN THE EXERCISE OF ANY RIGHT REMEDY FOR TENANT'S DEFAULT UNDER THIS LEASE, INCLUDING WITHOUT LIMITATION, CLAIMS ARISING FROM A LANDLORD PARTY'S OWN NEGLIGENCE OR STRICT LIABILITY.

26. **MITIGATION**.[237] Landlord will have no duty to mitigate if Tenant does not leave the vacated Premises and any improvements in the same condition as they were in when Landlord delivered them to Tenant, reasonable wear and tear excepted. In lieu of any other obligation to mitigate damages arising from Tenant's failure to pay Rent or its abandonment of the Premises in breach of this Lease, Landlord — beginning not more than **sixty (60)** days after Tenant physically vacates the Premises and continuing until the Premises have been relet — will market the Premises for lease through Landlord's leasing agents or outside real estate brokers and include the Rentable Area of the Premises in Landlord's regularly published advertising (if any) of available space in the Building, and Tenant will remain liable for all Rent and other Damages, except to the extent that Tenant pleads and proves — by clear and convincing evidence — that Landlord did not do these things and that Landlord's failure caused an avoidable and quantifiable increase in Landlord's damages for unpaid Rent.

(a) In addition, Landlord — without breaching any duty to mitigate — may, among other things, (i) relet other vacant space in the Building before reletting the Premises, and Tenant will not be entitled to have any proceeds from reletting such vacant space credited against any amounts due Landlord under this Lease;[238] (ii) refuse to relet to any prospective tenant who does not meet Landlord's then current leasing guidelines;[239] or (iii) offer or agree to relet the Premises, or any part of the Premises, (A) for its then fair rental value (regardless of whether the rental rate is more or less than the rent stipulated in this Lease);[240] (B) for a

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landlord accepts possession, then an implied agreement to terminate the lease may be established. *Id*. at 585; see *Christie, Mitchell and Mitchell Co. v. Selz*, 313 S.W.2d 352, 354 (Tex. Civ. App.—Fort Worth 1958, writ dism'd) (holding, in suit by landlord against defaulting tenant for all rents scheduled for payment after date of surrender, that provision requiring tenant to pay unaccrued rents in event of surrender was unenforceable as "mere penalty" when landlord relet premises for almost twice original tenant's monthly rent).

[236] *Myers v. Ginsburg*, 735 S.W.2d 600, 603 (Tex. App.—Dallas 1987, no writ) (stating tenant surrendered premises to landlord when landlord asked tenant for keys and to refrain from entering premises or removing any equipment); *Hurwitz v. Kohm*, 594 S.W.2d 643 (Mo. Ct. App. 1980) (holding that landlord's demand that tenant return keys and remove equipment from premises was neutral on issue of whether landlord intended to relet for its own account or as agent for tenant).

[237] *See* **Appendix III**, at ¶I.A (failure to mitigate).

[238] Courts in other jurisdictions are split on whether a landlord, who relets for more than the abandoning tenant's rent, must credit the excess rents from reletting in one period against a rental deficiency in another period or against the landlord's other damages. Some courts require such credits. See, e.g., *Dalamagas v. Fazzina*, 414 A. 2d 494, 495 (Conn Super. Ct. 1979) (reasoning that, if excess rents received in one period are not credited to deficiency in another, landlord will be in better position than it would have been in had breach not occurred, thus contravening principle that damages for breach of contract should put innocent party in same position as it would have been had contract been performed); *Wanderer v. Plainfield Carton Corp*., 531 N.E.2d 630 (Ill. App. Ct. 1976) (holding that excess rent must be credited against other damages, including reletting costs). An older Texas case does not. *Maida*, 473 S.W.2d at 652-63 (awarding landlord unpaid rents to date of trial, less the proceeds of reletting through the date of trial, plus renovation costs associated with reletting).

[239] **Appendix III**, at ¶ B.3.a. Courts view favorably promptly hiring a real estate broker to market the premises after the tenant abandons them. Hiring a broker is not always essential. Even so, it is highly recommended. One court has even suggested that hiring a broker is all that is required to satisfy the duty to mitigate.

[240] **Appendix III**, at ¶ B.4.b. Other jurisdictions are split on whether a landlord may relet, or seek to relet, the premises for more than the abandoning tenant's rent without breaching the duty to mitigate. Some jurisdictions hold that reletting,

shorter or longer term than the term then remaining under this Lease;[241] (C) on terms different from those in this Lease (including, without limitation, lease concessions comparable to those then being offered for comparable space in light of market conditions and the other terms of the substitute lease); and (D) with cosmetic improvements made to the Premises, but Landlord will not be obligated to make any improvements to the Premises for a substitute tenant,[242] unless Tenant pays such costs to Landlord, in advance, of Landlord's agreement to make them. The terms of any substitute tenant's lease will not effect a surrender of this Lease.[243]

(b) No rent collected from a substitute Tenant for any month in excess of the Rent due under the Lease for that month will be credited or offset against unpaid Rent for any other month or any other Damages. Landlord and Tenant stipulate that the mitigation requirements expressed in paragraph 26 of this Lease are objectively reasonable under the circumstance. **TO THE FULLEST EXTENT PERMITTED BY LAW, TENANT WAIVES ANY OTHER OBLIGATION BY LANDLORD TO MITIGATE ITS DAMAGES AFTER TENANT FAILS TO PAY RENT OR VACATES OR ABANDONS THE PREMISES.**

27. **EXPIRATION, TERMINATION, SURRENDER, AND HOLD OVER**. If Tenant holds over or continues to occupy the Premises after the expiration or termination of this Lease or of Tenant's right of possession, Tenant will: (a) do so as a tenant-at-sufferance; and (b) pay an amount (on a per month basis without reduction for partial months during the holdover) equal to 150% of the greater of: (i) the sum of the Base Rent and the Additional Rent due and payable for the last full calendar month immediately preceding the holdover; or (ii) the fair market gross rental for the Premises. In addition to Tenant's obligation to pay holdover rent, Tenant's holdover occupancy otherwise will be subject to, and Tenant will be liable for and obligated to perform, all of Tenant's obligations under this Lease.

(a) No holding over by Tenant or payment to Landlord after the expiration or termination of this Lease will renew or extend this Lease,[244] or prevent Landlord from recovering immediate possession of the Premises by summary proceedings or otherwise.

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or attempting to relet, at a rental rate higher than that in an abandoning tenant's lease does not bar, as a matter of law, a landlord's claim for damages. Other jurisdictions hold that a commercial landlord may breach its duty to mitigate by seeking to relet the premises for significantly more than the rent stipulated in the defaulting tenant's lease, at least when seeking higher rent inhibits or delays reletting.

[241] **Appendix III**, at ¶ B.4.a. Under traditional surrender rules, a landlord risked accepting its tenant's surrender of the lease — and thus forfeiting any right to recover rent or damages— by reletting or attempting to relet for a longer term than the term remaining on the abandoning tenant's lease. Most states adopting the duty to mitigate have rejected such a rule, believing it to be incompatible with a landlord's duty to mitigate. As one court noted, reletting or attempting to relet for a longer or shorter term should not, of itself, bar the landlord's claim for damages as a matter of law, for to insist that the landlord relet only for the unexpired term of the lease might well inhibit its marketability, particularly when a short term remained on the original lease.

[242] **Appendix III**, at ¶ B.3.d (landlord may make cosmetic renovations — without acquiescing to its tenant's abandonment (*i.e.*, accepting surrender) — in an effort to secure another tenant and recover the costs of those renovations). Courts may draw a line limiting the extent of the improvements a landlord can complete without acquiescing in its tenant's abandonment.

[243] **Appendix III**, at ¶ B.4 (cases point to important instances in which duty to mitigate may be incompatible with the traditional rules of surrender).

[244] ***Implied Renewal.*** As a general proposition, renewal of a lease by holding over without the execution of a new agreement constitutes an extension of the original lease as to all of its original terms. *City of San Antonio v. French*, 80 Tex. 575, 16 S.W. 440 (1891). Ordinarily, a renewal of a lease pursuant to an absolute option exercisable by paying the rent for the extended term amounts to an extension of the existing lease, and not a new lease. *Compare Haddad v. Tyler Prod. Credit Ass'n*, 212 S.W.2d 1006 (Tex. Civ. App.—Texarkana 1948, writ ref'd n.r.e.); and S*pringfield Fire & Marine Ins. Co. v. Republic Ins. Co.*, 262 S.W. 814 (Tex. Civ. App.--Dallas 1924, no writ) *with Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798 (Tex. 1967); *see also Ask Enters., Inc. v. Johnson Model Beddin*g, 155 Ga. App. 294, 270 S.E.2d 709 (Ga. Ct. App. 1980); *Med-Care Assocs., Inc. v. Noot*, 329 N.W.2d 549 (Minn. 1983); *Dubinsky Realty, Inc. v. Vactec, Inc.*, 637 S.W.2d 190 (Mo. Ct. App. 1982). Some courts

(b) Notwithstanding any limitation on, or exculpation from, any liability or damages elsewhere in this Lease, if (i) Landlord delivers written notice to Tenant that Landlord has entered into a lease of, or is in active negotiations of a letter of intent to lease, all or any portion of the Premises, and (ii) Tenant fails to vacate the Premises after expiration of the Lease within 30 days after Landlord delivers written notice to Tenant of such lease or negotiations of such a letter of intent, and (iii) Tenant's holdover beyond such 30 day period prevents, delays, or hinders Landlord's timely preparation, or delivery of the Premises, or any portion thereof, for another occupancy by another tenant, then Tenant will be liable for all Landlord's damages (INCLUDING CONSEQUENTIAL AND INCIDENTAL DAMAGES), if any, resulting from any holdover or occupancy after the expiration of this thirty day period, **AND TENANT WILL INDEMNIFY AND DEFEND LANDLORD PARTIES AGAINST ANY AND ALL CLAIMS ARISING FROM TENANT'S FAILURE TO TIMELY VACATE THE PREMISES.**[245]

(c) When this Lease expires or is terminated, Tenant must immediately: (i) surrender any keys, electronic ID cards, and other access control devices to Landlord at the place then fixed for the payment of Rent; (ii) remove all Tenant's Trade Fixtures and other Required Removables from the Premises; (iii) turn over to Landlord the Premises in broom or vacuum clean condition; (iv) leave the Premises and any improvements to the Premises in good order and repair[246] [in substantially the same condition as they were when Landlord delivered them], ordinary wear and tear excepted;[247] and (v) deliver the Premises to Landlord free of any and all Hazardous Materials and Contamination (except for any Hazardous Materials or Contamination existing on the Premises before the Effective Date).

(d) Any and all alterations, additions, and improvements to the Premises, all attached furniture, equipment and fixtures,[248] and any unattached and movable equipment, furniture, trade fixtures[249] or other personalty which was acquired with funds provided by or on behalf of Landlord will become the property of Landlord upon the expiration or termination of this Lease.[250] In addition, all other personal

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distinguish between renewals and extensions, holding that extensions continue the original lease, whereas renewals ordinarily amount to new leases. *See* 49 AM. JUR. 2d, *Landlord and Tenant* § 141 (1995). Texas apparently has never recognized this distinction. *See Haddad*, 212 S.W.2d at 1008 (citing authorities). Moreover, it is not the nomenclature of the right to extend the lease that determines whether it is an extension or a renewal, but the intention or expectations of the parties. *See* 49 AM. JUR.2d, *Landlord and Tenant* § 143 (1995).

[245] ***Holdover Indemnity.*** Even when the lease generally exculpates landlord and tenant for liability to the other for consequential, incidental, and punitive damages, landlord should preserve the right to recover consequential and incidental damages if tenant holds over after expiration of the lease. If landlord has leased the space to another tenant, tenant's holdover may prevent timely delivery of the space to the next tenant or prevent landlord from starting demolition or delay the start of construction on tenant improvements. Because the failure to deliver the premises is one of the few dependent covenants that would justify a tenant in terminating a lease, landlord should seek to hold tenant financially responsible for its failure to vacate the premises upon expiration of the lease. Tenant should seek to require landlord to give tenant notice and allow tenant a reasonable period to vacate before tenant is at risk for consequential damages.

[246] **Appendix II** – *Repair & Maintenance*, at art. III (discussing interpretations of good order and repair and similar standards in maintenance, repair, and surrender provisions).

[247] **Appendix II** – *Repair & Maintenance*, at art. III (discussing proof and other issues when surrender provision requires tenant to return premises in the same condition as when received).

[248] "A ***fixture*** is broadly defined as something that is personal in nature but so annexed to realty as to become part of the realty." *Fenlon v. Jaffee*, 553 S.W.2d 422, 428 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.). Texas courts apply a three-part test "to determine whether a chattel has become an immovable fixture[:]" (1) is the chattel in question actually or constructively annexed to the realty? (2) Is there "a fitness or adoption of the article to the uses or purposes of the realty with which it is connected?" And (3) did the party annexing the chattel intend that it "should become a permanent accession to the freehold?" *Id*. at 428.

[249] *See supra* footnote 76 (explaining general common law rules regarding ownership and removal of trade fixtures).

[250] The contractual terms of the lease ordinarily determine the ownership of personal property in the premises at the expiration of the lease. *Alexander v. Cooper*, 843 S.W.2d 644 (Tex. App.—Corpus Christi 1992, writ). When contracting parties define the terms they employ, "the courts are not at liberty to disregard these definitions and substitute other meanings."

property of Tenant that remains in the Premises after the termination of this Lease will, at Landlord's option, (i) be deemed abandoned; or (ii) become the property of Landlord. Landlord may require Tenant to remove such fixtures, furniture, trade fixtures, equipment, improvements, alterations, additions and personal property as designated by Landlord (*Required Removables*) at Tenant's sole cost. If Tenant fails to remove the Required Removables, Tenant will pay Landlord on demand all costs incurred in removing, storing, or disposing of the Required Removables. Tenant will be responsible for repairing any damage to the Premises or the Project resulting from the removal of any Required Removables or Tenant's personal property.[251]

28. **TENANT REMEDIES**. Landlord will not be in breach of this Lease if Landlord begins promptly and pursues with reasonable commercial diligence the cure of its failure to meet any ~~material~~ obligation under this Lease within thirty (30) days after Landlord receives written notice from Tenant specifying Landlord's failure. Except as otherwise expressly provided in this Lease, Tenant will have no right to terminate or rescind this Lease or to abate, set-off, or withhold any payment of Rent as a result of Landlord's breach of this Lease. Except as otherwise expressly provided in this Lease, Tenant Waives all rights to terminate or rescind this Lease for Landlord's breach, and Tenant agrees that its sole and exclusive remedy for any breach will be a suit for damages, specific performance, or injunction. Tenant waives all liens in Landlord's property, and before exercising any remedy for Landlord's breach, Tenant will give Landlord's Mortgagee written notice specifying Landlord's breach and at least thirty (30) days right to cure that breach.[252]

Fulton v. Texas Farm Bureau Ins. Co., 773 S.W.2d 391, 392 (Tex. App.—Dallas 1989, writ denied); *Hart v. Traders & Gen. Ins. Co.*, 487 S.W.2d 415, 417-18 (Tex. Civ. App.—Fort Worth 1972, ref'd n.r.e.). The parties are generally free to alter common law rules governing the ownership of property at the end of the lease term. *See Reader v. Christian*, 234 S.W. 155, 157 (Tex. Civ. App.—Beaumont 1921, writ ref'd) (stating that general rules of law pertaining to fixtures must yield to the provisions of the contract made by the parties"). For example, the general rule that a tenant may remove and take away trade fixtures at the end of the lease is subject to agreements to the contrary. *Neely v. Jacobs*, 673 S.W.2d 705, 707-08 (Tex. App.—Fort Worth 1984, no writ); *Eckstine v. Webb Walker Jewelry Co.*, 178 S.W.2d 532, 535 (Tex. Civ. App.—Fort Worth 1944, writ ref'd w.o.m.).

[251] ***Tenant's Liability for Removal of Fixtures***. The traditional common law rule exculpates a tenant for non-negligent damage to its landlord's freehold incident to tenant's removal of fixtures that the lease authorizes the tenant to remove. In *Gulf Oil Corp. v. Horton*, the court of appeals, quoted the general rules stated in several treatises:

> If there is a stipulation clearly giving to the tenant the right to remove annexations of a named character, the fact that the removal will result in injury to the leased premises, is immaterial. The language of the stipulation may, however, call for a different construction.
>
> Where the tenant is given the right to make improvements and remove them during the term, the right to remove includes the right to do such damage to the freehold as such removal will naturally cause, and the tenant is liable only for such damages as are unnecessarily or wantonly caused by him.
>
> Where authority is given a tenant to remove machinery he has put in it is implied that he may do such damage to the freehold in making the removal as in the exercise of ordinary care was necessary.

143 S.W.2d 132, 134 (Tex. Civ. App.—Amarillo 1940, no writ). Because these rules run counter to contemporary commercial expectations, care should be taken to define the extent of tenant's responsibility to make ordinary repairs incident to the removal of its fixtures and to harmonize these repair obligations with other lease terms dealing with the same subject matter.

[252] ***Tenant Remedies***. Tenant should negotiate for a better menu of remedies for its landlord's defaults. Tenant has a statutory lien for damages arising from landlord's breach. TEX. PROP. CODE ANN. § 91.004 (Vernon 2013) ("(a) If the landlord of a tenant who is not in default under a lease fails to comply in any respect with the lease agreement, the landlord is liable to the tenant for damages resulting from the failure. (b) To secure payment of the damages, the tenant has a lien on the landlord's nonexempt property in the tenant's possession and on the rent due to the landlord under the lease."). This clause requires Tenant to waive its statutory lien. Tenant should seek self-help and offset rights if landlord fails to perform maintenance and repair obligations. Tenant also should seek to expand the circumstances in which tenant is entitled to abate rent. Note that the last sentence in this paragraph seems to require Tenant to provide notice to Landlord's Mortgagee before filing suit against Landlord for breach, which arguably is the only remedy the base clause (before modification) makes available to Tenant.

29. **QUIET ENJOYMENT**.[253] So long as Tenant is not in Default (after any applicable notice and cure period has expired), Landlord will not disturb Tenant's possession of the Premises,[254] except in accordance with this Lease.[255]

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[253] ***Leasehold Owner Policy Endorsement T-4*** is available to insure tenant's leasehold estate. If a covered matter results in an "Eviction," the insured claimant has the right to have its Leasehold Estate and Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term. A primary consideration in determining whether to procure such insurance is the amount of its own money tenant is investing in tenant improvements.

The endorsement also covers a number of additional items of loss to the extent the items are not included in the valuation of the insured estates or interests: (a) the reasonable cost of removing, relocating, and repairing any Personal Property damaged by removal or relocation; (b) rent or damages payable to the true owner of paramount title for use and occupancy of the land prior to the Eviction; (c) any rent tenant must continue to pay to its lessor after an Eviction; (d) the fair market value of any lease or sublease made by the insured as lessor; (e) damages the insured must pay to its lessee's or sublessees; (f) reasonable costs to secure a replacement leasehold; and (g) the actual cost incurred by the insured for completed leasehold improvements, less any salvage value, including hard and soft costs (*e.g.*, architectural fees, costs and interests on loans, *etc.*).

Stewart Title Company's virtual underwriter explains the policy definitions, the mechanics of coverage, and the items that must be "fully ascertained and complied with" in connection with the insurance of a leasehold estate. This underwriting guide, which, among other things, covers title issues, enforceability issues (*e.g.*, a definite commencement date, definite term, subordination, *etc.*) is helpful in not only evaluating the need to procure leasehold insurance in a given instance but also in reviewing the host of issues that affect enforceability of a lease in virtually every instance. A lease must be recorded to be insurable. *See* Virtual Underwriter, Underwriting Manual, *11.04 Leasehold Insurance*, http://www.vuwriter.com/en/underwriting-manuals/2013-7/UMTX00000144.html (last visited January 28, 2017).

The Texas Department of Insurance also publishes a web-based version of the Basic Manual of Title Insurance, which is a reliable source for current forms and rules. *See Texas Dept. of Title Insurance, Title Insurance Basic Manual* https://www.tdi.texas.gov/title/titleman.html (last visited January 28, 2017).

[254] ***Implied Covenant of Quiet Enjoyment***. "[E]very lease of land, in the absence of express language to the contrary, raises an implied covenant that the lessee shall have the quiet and peaceful enjoyment of the leased premises." *L-M-S Inc. v. Blackwell*, 233 S.W.2d 286, 289 (Tex 1950); *see also* RESTATEMENT (SECOND) OF PROPERTY § 4.3 (1977). Usually implied from the terms lease or demise, this implied covenant "means that the lessee… shall not be evicted or disturbed by the lessor… , or by persons deriving title from [lessor], or by virtue of a title paramount to [lessor's], ***but expresses or implies no warranty against the acts of strangers***." *Thomas v. Brin*, 85 S.W. 842, 845 (Tex. Civ. App. 1905, no writ) (emphasis added). When a lease contains an express warranty of quiet enjoyment, the express clause governs and abrogates any implied warranty of quiet enjoyment. *HTM Restaurants, Inc. v. Goldman, Sachs & Co.*, 797 S.W.2d 326, (Tex. App.—Houston [14th Dist.] 1990, writ denied) (holding that foreclosure by landlord's lender did not breach express covenant stating "Lessee accepts this lease and the leased premises in their entirety subject to any deeds of trust, security interests, or mortgages which might now or hereafter constitute a lien upon the building or improvements therein or on the leased premises"); *Thomas*, 85 S.W. at 845 (holding that express covenant that lessor "warrants to the said [lessee] the use and possession of said lands this [that] is in cultivation during the time above mentioned, and agrees to indemnify him in the event he is deprived of the use and possession of same" is equivalent of "covenant on the part of the lessor which would have been implied in the absence of such provision"). *Cf. Exxon Corp. v. Atlantic Richfield Co.*, 678 S.W.2d 944, 947 (Tex. 1984).

Landlord's Title. The fact that the landlord does not have title does not give rise to a claim for breach of the implied warranty. The general and well-established rule is that a tenant cannot dispute its landlord's title while in possession under a leasehold granted by its landlord. *See, e.g., Lorino v. Crawford Packing Co.*, 175 S.W.2d 410, 415 (Tex. 1943). In other words, "a tenant is estopped to deny its landlord's title or to claim adversely to the landlord, and it is immaterial whether the landlord had title at the time the lease was entered." *Rockport Shrimp Coop v. Jackson*, 776 S.W.2d 758, 760 (Tex. App.—Corpus Christi 1989, writ denied). "The reason for the rule is that the tenant, having reaped all the benefits from the lease agreement, may not dispute the authority of the person from whom those benefits are derived." *Lorino*, 175 S.W.2d at 417. A tenant also is estopped from denying the title of those who succeed to the original lessor's title "because it is the title under which the tenant enters that relates to the estoppel and not the individual owner of the title." *Rockport*, 776 S.W.2d at 760. But the general rule does not apply when the purpose of the suit is not only to recover possession but also to establish title. *See Lorino*, 175 S.W.2d at 417; *McKie v. Anderson*, 78 Tex. 207, 14 S.W. 576, 576 (1890). For this exception to apply, however, the tenant must itself claim superior title over the landlord. *McKie*, 14 S.W. at 577 (stating it is incumbent upon the

30. RESERVATIONS BY LANDLORD. In addition to its other rights, Landlord, in its sole discretion, may: (a) change the name of the Building or the Project; (b) change the location of entrances and exits to the Building, the Project, and any parking facilities; (c) place signs on the Building, in Common Areas, or elsewhere on the Project's grounds; (d) change the Building's street address; (e) take any reasonable measures for the safety and protection the Premises, the Building, the Project, or their occupants; (f) sell, mortgage, assign, or transfer the Building and this Lease; (g) have pass keys to the Premises; (h) repair, alter, add to, improve, build additional stories on the Building or build other facilities on the Project; (i) run necessary pipes, conduits, and ducts through the Premises; (j) carry on any work, repairs, alterations or improvements in, on or about the Building or its vicinity, and, during any such work, temporarily close or obstruct doors, entryways, public space, and corridors in the Building; (k) interrupt or temporarily suspend Building services and facilities; (l) change the arrangement and location of entrances or passageways, doors and doorways, corridors, elevators, stairs, toilets, or other public parts of the Building; and (m) grant to anyone the exclusive right to conduct any business or render any service in or to the Building, unless that grant would preclude Tenant's Permitted Use of the Premises.

31. TRANSFERS BY LANDLORD. Landlord may transfer its rights, interests, and obligations under this Lease and in any part of the Project. Upon any such transfer, (a) the transferor Landlord will be released from any ~~further~~ obligations accruing under this Lease after the effective date of the transfer; (b) the transferor Landlord will transfer the unused balance of any Security Deposit to the transferee; and (c) Tenant will attorn to the transferee as its Landlord and look solely to the transferee Landlord to perform any obligations of Landlord accruing on or after the effective date of the transfer.

32. TAXES ON TENANT'S PROPERTY. Tenant will be liable for, and will promptly pay, all taxes on personal property, furniture, improvements, additions, or fixtures that any Tenant Party places or keeps in the Premises. If any tax for which Tenant is liable is levied or assessed against Landlord or Landlord's property,

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tenant to prove a superior title with which it is connected); *Rockport*, 776 S.W.2d at 761 ("The exception permits a tenant of one who has no title to acquire the superior title and show title in itself."). A tenant holding a mere leasehold estate cannot claim a right to the exception because "superior title must be in the tenant itself." *Id*.

Elements of Breach of Covenant of Quiet Enjoyment. The elements of a claim for breach of the covenant of quiet enjoyment and constructive eviction are the same: (1) an intention of the landlord that the tenant no longer enjoy the premises; (2) a material act by the landlord that substantially interferes with the intended use and enjoyment of the premises; (3) the act permanently deprives the tenant of the use and enjoyment of the premises; and (4) the tenant abandons the premises within a reasonable time after the commission of the act. *Lazell v. Stone*, 123 S.W.3d 6, 12 (Tex. App.—Houston [1st Dist.] 2003, pet. denied); *Coleman v. Rotana, Inc*., 778 S.W.2d 867, 872 (Tex. App.—Dallas 1989, writ denied); *see also Goldman v. Alkek*, 850 S.W.2d 568, 571–72 (Tex. App.—Corpus Christi, 1993 no writ) (holding that lessee "was not required to prove the traditional elements of a breach of the warranty of quiet enjoyment" under express covenant providing lessee "shall lawfully and quietly hold, occupy, and enjoy the leased premises during the term of this lease without hindrance or molestation of Lessor" in case in which lessee claimed lessor's knowing demands for payments to which lessor was not entitled breached terms of express covenant).

[255] *HTM Rests., Inc., d/b/a Charley T's v. Goldman, Sachs & Co.*, 797 S.W.2d 326 (Tex. App.—Houston [14th Dist.] 1990, writ denied) illustrates the importance to the landlord of a clause subordinating the lease to any existing mortgagees. In that case, the tenant sued the landlord for breach of the covenant of quiet enjoyment after the landlord's lender foreclosed on its mortgage, thus extinguishing the lease. But, the lease stated:

> Lessee accepts this lease and the leased premises in their entirety subject to any deeds of trust, security interests, or mortgages which might now or hereafter constitute a lien upon the building or improvements therein or on the leased premises….

When the lease containing this provision was executed, the deed of trust in favor of the lender had been recorded for five years. The tenant thus executed the lease with the knowledge that the deed of trust existed and that any lease provision was subordinate to the mortgage. Accordingly, the court of appeals found that tenant's action for breach of the covenant of quiet enjoyment, which was based on its landlord's failure to make the mortgage payments, was not a viable cause of action because the implied covenant was precluded by the express terms of the lease.

Landlord may pay the tax, or, if the assessed value of Landlord's property is increased by inclusion of any Tenant Party's personal property, furniture, or fixtures in the Premises, Landlord may pay the tax attributable to such valuation increase, and, in either case, Tenant must reimburse Landlord for such tax payments within five (5) days after Tenant receives written demand from Landlord.

33. **SUBSTITUTION OF SPACE**. Unless and until Tenant ~~occupies~~ leases at least 50% of the Rentable Floor Area on the floor on which the Premises are located,[256] Landlord reserves the right, at Landlord's sole cost, to relocate Tenant from the Premises to comparably sized and improved space (*Relocation Space*) within the Building no more than once during the Term after giving Tenant at least **thirty (30)** days prior written notice.[257]

(a) Relocation Space Requirements. The Relocation Space must: (i) have at least the same number 10' by 15' window offices; (ii) have direct elevator lobby exposure for the main entrance of the Premises; (ii) have a main conference room at least 32' (window exposure) x 20' on the North side of the Building; (iii) be on the xxth floor or above; (iv) have tenant finishes and facilities reasonably comparable in quality, quantity, layout, and configuration as the Premises; and (v) contain no fewer usable square feet within its demising walls than the Premises at the time of the relocation.[258]

(b) Relocation Concessions. Landlord relocates Tenant, Landlord, at its sole cost, will: (i) pay the actual, reasonable costs of physically relocating Tenant's personal property, furniture, fixtures, and equipment in the Premises to the Relocation Space, (ii) abate Base Rent for the three (3) months following the relocation to compensate Tenant for the inconvenience and disruption to its business operations, (iii) cause the Relocation Space to be certified according to the same generally recognized Green building ratings systems and standards as the Premises,[259] and (iv) pay the following costs: (A) wiring and cabling for Tenant's communications, computer, and special HVAC systems; and (B) replicating features of the Premises that Tenant installed as a reasonable accommodation to any employee of Tenant.

(c) Effects of Relocation. A relocation will not terminate or otherwise affect this Lease, but effective as of the date Landlord tenders the Relocation Space in the required condition for Tenant's occupancy: (i) the defined term, Premises, will refer to the Relocation Space; and (ii) the Rentable Area of the Relocation Space will be deemed to be the same as was the Rentable Area of the Premises (at the time immediately before the relocation) for purposes of computing Base Rent and Additional Rent (the Rentable Area of the Relocation Space, as determined by Landlord using the then current Building Standard measurement standard and methodology, will be used to recalculate Tenant's monthly Base Rent at the same Base Rental Rate provided in the Lease and Tenant's Pro Rata Share for purposes of computing Rent and Additional Rent and for determining any other charge, right, or entitled in which the Rentable Area of the Premises is an independent variable). Each party will promptly execute and deliver an appropriate amendment to this Lease reflecting the changes in this Lease affected by the relocation, but the failure or refusal to execute or deliver such an amendment will not limit or impair the effectiveness of the Lease or the relocation.

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[256] This provision revokes Landlord's right to relocate Tenant if Tenant leases at least 50% of the space on the floor where the Premises are located. The term "leases," rather than "occupies," reduces the likelihood of disputes if, for example, a tenant leased more than 50% of the space on a floor but did not occupy a substantial portion of the space for some reason.

[257] This provision limits the number of times that Landlord may relocate Tenant. A tenant also may seek to limit landlord's right to relocate Tenant late in the term or to obtain a termination right, exercisable at tenant's option, if landlord desires to relocate tenant with fewer than a specified number of months remaining in the term.

[258] This clause lists requirements of its existing space and the features Tenant desires to have replicated in any relocation space. Tenant should consider any benefits or features unique to its premises to ensure that those benefits are not lost in a relocation.

[259] *See Waller & Anderson* (discussing green issues).

34. <u>**TENANT'S AUTHORITY**</u>. If Tenant is a corporation (including any form of professional association), limited liability company, partnership (general or limited), or other form of organization other than a natural person, then Tenant and each person executing this Lease on behalf of Tenant covenants, warrants and represents that: (a) Tenant — in accordance with Tenant's organizational documents — has duly authorized that person to execute and deliver this Lease; (b) this Lease is binding on Tenant according to its terms; (c) Tenant is duly organized and legally existing in the state of its organization, and is qualified to do business in the State of Texas; (d) upon request, Tenant will provide Landlord with true and correct certified copies of Tenant's organizational documents (including any amendments) and any authorizations for Tenant to enter into the Lease; and (e) Tenant's execution and delivery of this Lease will not breach, or cause a default under, any mortgage, deed of trust, lease, loan, credit agreement, partnership agreement, or other contract.

35. <u>**BUILDING RULES AND REGULATIONS**</u>. Tenant must comply, and cause all other Tenant Parties, to comply with the Building Rules and Regulations adopted or altered by Landlord from time to time. These rules will apply generally to tenants, but Landlord will be entitled to change or Waive (with respect to any tenant) any Building rule or regulation so long as it does not materially interfere with Tenant's Permitted Use of the Premises or Common Areas.[260] Tenant's breach of any Building rule or regulation, at Landlord's option, may constitute a Default.

36. <u>**COMPLIANCE WITH APPLICABLE LAWS**</u>. Tenant, at its sole cost, must comply with all applicable laws; ordinances; rules; regulations; court orders; judgments; decrees; police, fire, and sanitary codes; and any other requirements, present and future (<u>*Applicable Laws*</u>), adopted by any governmental authority, board of fire underwriters, utility company, property association, or other such entity, relating to (a) **Hazardous Materials**, on or (b) the condition, use, or occupancy of, any part of the Premises or the Project. Landlord represents and warrants that the Premises and the Building comply with all Applicable Laws as of the Effective Date of this Lease.[261] The obligations in this paragraph will survive the expiration or termination of this Lease.

(a) <u>*Hazardous Materials*</u> mean any toxic, flammable, reactive, or corrosive substance now or hereafter regulated by any Applicable Law, including, without limitation, any substance (i) defined as a hazardous waste, extremely hazardous waste, hazardous substance, hazardous material, or regulated substance, or (ii) requiring special use, handling, storage, or disposal under any Applicable Law.

(b) <u>*Contamination*</u> means any release or disposal of Hazardous Materials affecting the improvements, facilities, soil, groundwater, air, or other element pertaining to the Project that could result in a Claim against any Landlord Party or in a fine, use restriction, cost recovery lien, remediation requirement, or other imposition against any Landlord Party or any part of the Project. A **Claim** arising from Contamination

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[260] A tenant should ensure that the provision authorizing landlord to promulgate and administer building rules and regulations provides that the terms of the lease prevail over any conflicting rules and regulation and that landlord must give tenant notice of any change before it becomes effective. Landlord should avoid obligating itself to treat all tenants equally, or to apply the rules to all tenants identically, in every respect.

[261] ***Compliance with Applicable Laws.*** A Landlord may resist representing to a tenant that the building complies with all applicable laws or that it complies with any specific law. While a landlord cannot avoid its obligations to the government to comply with applicable laws, it can limit its risk of contractual liability to its tenants by refusing to represent that the building complies with every jot and tittle of every applicable law. As a compromise, however, some landlords will represent that they have no current actual knowledge of any violation of specific laws — *e.g.*, the ADA — or that they have no current actual knowledge of any condition affecting the building — *e.g.*, Hazardous Material Contamination — that would violate any environmental law. These types of representations may provide information that is useful to a tenant's decision to lease or not lease space in a particular building, but these representations do not necessarily protect tenant from paying the cost of remedying the condition if landlord did not know the condition existed and other provisions of the lease allow landlord to recover the costs of complying with applicable laws. Excluding the expenses incurred to comply with existing laws or to remedy conditions that existed before the effective date of the lease can keep a tenant from having to pay these costs as part of Operating Costs.

includes, without limitation, the loss of or restriction on the use of any part of the Project, any adverse impact on marketing or leasing space, and all costs of site investigation, remediation, removal, and restoration, claims settlement, attorneys' fees, consultant fees, and expert fees).

(c) Tenant will not bring, or permit any Tenant Party to bring, any Hazardous Material on the Project (except for *de minimus* amounts of household cleaning and office products used, kept, and disposed of in compliance with all Applicable Laws). If Tenant becomes aware of any other Hazardous Materials on the Premises, Building, or the Project, Tenant will notify Landlord immediately.

(d) If any Contamination occurs as a result of the act or omission of any Tenant Party, Tenant, at its sole cost, will comply with all Applicable Laws relating to the Contamination and will promptly take all actions necessary to return any contaminated or affected property or facilities on or adjoining the Project to their condition before such Contamination. Before Tenant remediates any Contamination, Tenant must obtain Landlord's written approval and any required governmental approvals. In addition, **TENANT WILL INDEMNIFY AND DEFEND LANDLORD PARTIES FROM ANY CLAIMS ARISING FROM CONTAMINATION CAUSED IN WHOLE OR IN PART BY ANY TENANT PARTY'S ACT OR OMISSION**.[262] But Tenant will not indemnify, defend, or be liable to Landlord for any Claim arising from any Contamination existing on the Project before the Effective Date.

(e) Landlord, its agents, and its representatives[263] will be entitled to (but they will not be required to) inspect the Premises at any time to monitor Tenant's compliance with Applicable Laws. If Landlord reasonably believes Tenant is not in compliance, Landlord may notify Tenant of Tenant's non-compliance, and, if Tenant does not cure its non-compliance within **thirty (30)** days, Landlord — at Tenant's sole cost plus a **15%** administrative fee — may enter the Premises and remedy any non-compliance or Contamination. Landlord will use reasonable efforts to minimize any resulting interference with Tenant's business, but Landlord will not be liable for any such interference.

(f) Landlord represents to Tenant that, except as disclosed in the Environmental Site Assessment (ESA), Landlord has no current actual knowledge, without any duty of inquiry, of the presence of any Hazardous Materials on the Project. Tenant represents that it has reviewed the ESA, that Landlord disclaims any representation or warranty about the accuracy of the information reported in the ESA, that Landlord has given Tenant the opportunity to conduct its own investigation of the environmental condition of the property, including interior air quality, and that Tenant is relying on its own independent investigation and

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[262] Comprehensive Environmental Response, Compensation and Liability Act (**CERCLA**) permits parties to enter contracts affirmatively to insure or to indemnify against CERCLA liability. *See, e.g. Beazer East, Inc. v. Mead Corp*., 34 F.3d 206 (3rd Cir.1994); *Smith Land & Improvement Corp. v. Celotex Cor*p., 851 F.2d 86, 90 (3rd Cir.1988). CERCLA specifically authorizes such contracts.

> (1) No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section.
>
> (2) Nothing in this subchapter, including the provisions of paragraph (1) of this subsection, shall bar a cause of action that an owner or operator or any other person subject to liability under this section, or a guarantor, has or would have, by reason of subrogation or otherwise against any person.

42 U.S.C. § 9607(e)(1)-(2).

[263] "***Representative,***" under the Texas UCC, means a person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate." TEX. BUS. & COM. CODE § 1.201(b)(33).

is not relying on any representation, warranty, or statement by any Landlord Party in making its decision to enter into this Lease.[264]

37. AMERICANS WITH DISABILITIES ACT AND TEXAS ARCHITECTURAL BARRIERS ACT. Tenant, at its sole cost, will (a) comply with all requirements of the Americans with Disabilities Act (Public Law 101-336 (July 26, 1990)) [*ADA*][265] and the Texas Architectural Barriers Act (Texas Gov. Code §§ 469.001-.208 (2009) [*Texas Act*][266] applicable to the Premises and to any improvements or other facilities within the Premises; (b) be solely responsible for any reasonable accommodations[267] within, or alterations to,[268] the Premises required to accommodate any Tenant Party; and (c) be solely responsible for any reasonable accommodations or alterations to the Project required for a Tenant Party if Landlord would not otherwise be required to make the additional accommodation or alteration under generally applicable provisions of the ADA or the Texas Act. Landlord will only be responsible for: (i) making readily achievable changes in Common Areas;[269] and (ii) for modifying

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[264] *See supra* footnote 261.

[265] The **ADA** is divided into three titles. Title I prohibits discrimination on the basis of disability in employment. Title II prohibits discrimination on the basis of disability by State and local governments. And Title III prohibits discrimination on the basis of disability in public accommodations and commercial facilities. Americans with Disabilities Act of 1990 (ADA), 42 U.S.C. §§ 12101-12213.

ADA Regulations. Title III's implementing regulations are set forth in 5 C.F.R. Part 36 Nondiscrimination on the Basis of Disability in Public Accommodations and Commercial Facilities (Sept. 15, 2010), https://www.ada.gov/regs2010/titleIII_2010/titleIII_2010_regulations.htm (last visited January 28, 2017).

ADA Guidelines. The Department of Justice (DOJ) also publishes a number of guidelines and FAQ's that explain the regulations. Americans with Disabilities Act ADA Title III Technical Assistance Manual Covering Public Accommodations and Commercial Facilities (Title III Assistance Manual), http://www.ada.gov/taman3.html (technical assistance manual addresses the requirements of Title III of the Americans with Disabilities Act, which applies to public accommodations, commercial facilities, and private entities offering certain examinations and courses).

[266] *See also* 2012 Texas Accessibility Standards (effective March 15, 2012), TEX. HEALTH & SAFETY CODE Subchapter D, Section 341.069, http://www.license.state.tx.us/ab/abtas.htm (last visited January 28, 2017).

[267] Americans with Disabilities Act: Questions and Answers, US Equal Employment Opportunity Commission and US Dept. of Justice – Civil Rights Division (ADA – Q&A) (May 2002), http://www.ada.gov/q%26aeng02.htm (last visited January 28, 2017); (***Q***. "What is 'reasonable accommodation?' ***A***. Reasonable accommodation is any modification or adjustment to a job or the work environment that will enable a qualified applicant or employee with a disability to participate in the application process or to perform essential job functions. Reasonable accommodation also includes adjustments to assure that a qualified individual with a disability has rights and privileges in employment equal to those of employees without disabilities.").

[268] ADA – Q&A ("***Q.*** Must an employer modify existing facilities to make them accessible?... ***A.*** Under Title I, an employer is [*sic*] not required to make its existing facilities accessible ***until*** a particular applicant or employee with a particular disability needs an accommodation, and then the modifications should meet that individual's work needs. However, employers should consider initiating changes that will provide general accessibility, particularly for job applicants, since it is likely that people with disabilities will be applying for jobs. The employer does not have to make changes to provide access in places or facilities that will not be used by that individual for employment-related activities or benefits.").

[269] ***Title III*** of the ADA prohibits discrimination against a person in a place of public accommodation. 42 U.S.C.A. § 12182(a). One form of prohibited discrimination is the failure "to make ***reasonable accommodations*** in policies, practices, or procedures when such modifications are necessary to afford such... accommodations to individuals with disabilities." 42 U.S.C.A. § 12182(b)(2)(A)(i). The policy modification requested must be reasonable. S*ee Johnson v. Gambrinus Co./ Spoetzl Brewery*, 116 F.3d 1052, 1059 (5th Cir.1997) (stating that "requested modification is reasonable in the general sense, that is, reasonable in the run of cases" and would not "fundamentally alter the nature of the public accommodation."). Another form of prohibited discrimination is the failure to "remove architectural barriers ... that are structural in nature, in existing facilities,… where such removal is ***readily achievable***." 42 U.S.C.A § 12182(b)(2)(A)(iv). "Readily achievable—that which is "easily accomplishable and able to be carried out without much difficulty or expense"—is determined by looking at factors such as the nature and cost of the action required for the removal of the barrier; the overall financial resources of the facility; the overall size of the business; the number of persons employed at the site; the effect on expenses and resources; safety

policies, practices, or procedures applicable to all tenants to the extent required under Title III of the ADA. No term of this Lease authorizes, or should be construed as authorizing, Landlord or Tenant to violate the ADA or the Texas Act.[270]

38. **TELECOMMUNICATIONS**.[271] Tenant, at its sole cost, may order and use telephone and other wired telecommunications services in accordance with rules and regulations adopted by Landlord from time to time,[272] but Tenant must obtain Landlord's prior written consent to Tenant's use of services of a telephone or telecommunications service provider who is not then providing service to the Building.[273] Unless Landlord

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requirements that are necessary for safe operation; and the impact otherwise of the action upon the operation of the site." *Lewis v. Dallas Soundstage, Inc.*, 167 S.W.3d 906, 913 (Tex. App.—Dallas 2005, no pet.) (citing 42 U.S.C.A. § 12181(9)). *See generally* John A. Bourdeau, V*alidity, Construction, and Application of § 302 of Americans with Disabilities Act (42 U.S.C.A. § 12182), Prohibiting Discrimination on Basis of Disability by Owners or Operators of Places of Public Accommodation*, 136 A.L.R. Fed. 1 (1997 & Supp. June 2013) (section 12(a) (places held not to be places of public accommodation)).

The ADA requires that all new construction of places of public accommodation, as well as of "commercial facilities" such as office buildings, be accessible. Moreover, if an alteration in a place of public accommodation or commercial facility is begun after January 26, 1992, that alteration must be readily accessible to and usable by individuals with disabilities in accordance with the ADA to the maximum extent feasible. The ADA places the legal obligation to remove barriers or provide auxiliary aids and services on both the landlord and the tenant. But the landlord and the tenant may decide by lease who will actually make the changes and provide the aids and services, but both remain legally responsible. ADA Title III Technical Assistance Manual Covering Public Accommodations and Commercial Facilities, https://www.ada.gov/taman3.html (last visited January 28, 2017).

[270] "Both the landlord who owns the building that houses a place of public accommodation and the tenant who owns or operates the place of public accommodation are public accommodations subject to this part. As between the parties, allocation of responsibility for complying with the obligations of this part may be determined by lease or other contract." 28 C.F.R. § 36.201(b) (emphasis in original).

[271] Depending on tenant's telecommunications needs and on landlord's existing facilities, the relatively basic telecommunications provisions in this lease may not address tenant's telecommunications needs or landlord's operational or financial concerns. J. Scott Craig's paper provides useful checklists covering telecommunications issues and a sample Telecommunications Rider addressing more comprehensively telecommunications issues in office leasing transactions. J. Scott Craig, *Landlord Checklists for Telecom Issues in Office Leases,* THE UNIVERSITY OF TEXAS SCHOOL OF LAW: 2009 BERNARD O. DOW LEASING INSTITUTE (April 2-3, 2009).

Glossary of Telecommunications Terms, TEXAS LEGISLATIVE COUNCIL (2005), https://www.yumpu.com/en/document/view/30850264/glossary-of-telecommunications-terms-texas-legislative-council (last visited January 28, 2017).

[272] ***PURA***. The Texas Public Utility Regulatory Act (PURA) requires building owners to grant telecommunication service providers access to the building owner's property upon a tenant's request. *See* TEX. UTIL. CODE §§ 54.259, 54.260, and 54.261 (2013). The Texas Public Utilities Commission (PUC) has promulgated regulations implementing PURA's forced access requirements. To ensure that each tenant can exercise its right "to choose the provider of its telecommunications services," 16 TEX. ADMIN. CODE § 26.129(d)(1) (2013), the PUC requires that building owners treat "telecommunications utilities" on a nondiscriminatory basis. *See* 16 TEX. ADMIN. CODE § 26.129.

Forced Access and Takings. PURA's forced access provisions implicate Federal and state takings law. To the extent a PUC order compels a building owner to cede physical space to a telecommunications utility, the PUC order constitutes a taking. *See Loretto v. Teleprompter Manhattan CATV Corp*., 458 U.S. 419, 441 (1982) (affirming traditional rule that a permanent physical occupation of property by a television cable is a taking). PURA authorizes the PUC "to determine 'reasonable' and 'nondiscriminatory' compensation when the parties cannot agree." *Texas Bldg. Owners & Mgrs. Ass'n, Inc. v. Pub. Util. Comm'n of Tex.*, 110 S.W.3d 524, 532 (Tex. App.—Austin 2003, pet. denied) (upholding constitutionality of PURA's takings and just compensation powers).

[273] ***Permitted Conditions on Access***. Under the PUC's implementing regulations, a property owner may: (i) impose a condition on the requesting carrier that is reasonably necessary to protect: (A) the safety, security, appearance, and condition of the property; and (B) the safety and convenience of other persons; (ii) impose a reasonable limitation on the time at which the requesting carrier may have access to the property to install telecommunications equipment; (iii) impose a reasonable limitation on the number of such requesting carriers that have access to the property, if the property owner can demonstrate a space constraint that requires the limitation; (iv) require a requesting carrier to agree to indemnify the

otherwise requests or consents in writing, Tenant's telecommunications equipment must be located in the Premises and the telephone closet(s) on the floor(s) on which the Premises are located.[274] Landlord has no obligation to maintain Tenant's telecommunications equipment, wiring, or other infrastructure, and if any such service is interrupted, curtailed, or discontinued, Landlord will have no obligation or liability to Tenant.

(a) Landlord — upon reasonable prior notice to Tenant — will be entitled to interrupt or turn off telecommunications facilities for any emergency, to repair the Building, or to install telecommunications or other equipment for the Building's other occupants or users.

(b) By the expiration or termination of this Lease, Tenant, at its sole cost, will remove all telecommunications equipment and other facilities for telecommunications transmittal (including wiring, cabling, switches, and other routing equipment) installed in the Premises or on the Project for Tenant's use. But Landlord will be entitled, upon written notice to Tenant given no later than five (5) days before the Term expires, to require Tenant to abandon and leave in place — without payment to Tenant or credit against Rent — any and all telecommunications wiring, related infrastructure, and selected components thereof, whether located in the Premises or elsewhere in the Building.[275]

(c) Tenant will not use any wireless communications equipment (other than cellular telephones), antennae, or satellite receiver dishes within the Premises or on the Project without Landlord's prior written consent.

(d) If any Tenant Party's telecommunications service, transmitters, or receivers interfere with Landlord's or another occupant's telecommunications services or equipment, Tenant will promptly eliminate any such interference or, if Tenant cannot eliminate it, stop using the equipment or service causing such interference. Tenant assumes liability for all Claims related to such interference.

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property owner for damage caused installing, operating, or removing telecommunications equipment; (v) require a tenant or requesting carrier to bear the entire cost of installing, operating, or removing telecommunications equipment; and (vi) require requesting carrier to pay compensation that is reasonable and nondiscriminatory among such telecommunications utilities. 16 TEX. ADMIN CODE § 26.129(d)(2)(A).

[274] ***Non-Discriminatory Access***. A property owner may not: (i) prevent the requesting carrier from installing telecommunications equipment on the property upon a tenant request; (ii) interfere with the requesting carrier's installation of telecommunications equipment on the property upon a tenant request (PURA §§ 54.259, 54.260, and 54.261); (iii) discriminate against such requesting carrier regarding installation, terms, or compensation of telecommunications equipment to a tenant on the property; (iv) demand or accept an unreasonable payment of any kind from a tenant or the requesting carrier for allowing the requesting carrier on or in the property; or (v) discriminate in favor of or against a tenant in any manner, including rental charge discrimination, based on the identity of a telecommunications utility from which a tenant receives telecommunications services. 16 TEX. ADMIN CODE § 26.129(d)(2)(B).

[275] Section 645(F) of the 2008 NEC requires that abandoned cables be removed unless they are contained in a metal raceway. The 2011 NEC deleted the word “metal.” What is the significance of this change? Cables in raceways both metallic and nonmetallic will not be required to be removed thereby treating metallic and nonmetallic raceways the same. *Changes of Interest to Data/Comm Cabling Contractors*, USERS AND CODE ENFORCEMENT OFFICIALS, COMMUNICATIONS CABLE & CONNECTIVITY ASS’N, http://o.b5z.net/i/u/10069179/f/CCCA_2011_NEC_White_Paper_11-04-2010_1_.pdf (last visited January 28, 2017). To negotiate cabling issues, it is helpful to understand the types, quantities, and location of cabling in place, especially in second-generation space; tenant’s additional cabling requirements; and the manner of distribution throughout the space and routing through the building to assess how to allocate the costs of installing and removing cabling.

39. **LANDLORD'S LIEN**.[276] To secure payment of Rent, Tenant grants to Landlord a continuing security interest in all of Tenant's goods, wares, equipment, fixtures,[277] furniture, inventory, accounts, contract rights, chattel paper, and its other personal property (*Collateral*) situated in the Premises or in the Building.[278]

(a) Tenant will not remove, or allow others to remove, the Collateral from the Premises or the Building without Landlord's prior written consent. But Tenant may remove Collateral in the ordinary course of business before a Default. If a Default occurs, Landlord will be entitled to exercise any or all rights and remedies under the Uniform Commercial Code or otherwise provided in this Lease or by law.[279] Landlord may sell any or all of the Collateral at public or private sale upon **ten (10)** days' notice to Tenant, and Tenant

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[276] ***Dealing with Tenant's Personal Property***. A landlord has three basic options when a delinquent tenant either does not, or will not, remove personal property from the premises. One option is obtaining a writ of possession and having the tenant's property moved and stored. Another option is enforcing its statutory or contractual landlord's lien. The final option is treating any personal property left on the premises as abandoned and then disposing of that property in accordance with section 91.003 of the Texas Property Code. Before selecting any of these options, a prudent landlord should ensure that the manner of disposition does not wrongfully impair the ownership or lien rights of a third party.

Statutory Lien. The Texas Property Code grants "[a] person who leases or rents all or part of a building for nonresidential use… has a preference lien on the property of the tenant or subtenant in the building for rent that is due and for rent that is to become due during the current 12-month period succeeding the date of the beginning of the rental agreement or an anniversary of that date." TEX. PROP. CODE § 54.021.

A landlord's statutory lien has two major drawbacks for a landlord. It only secures a limited amount of rent, *FDIC v. Sears, Roebuck & Co.*, 743 S.W.2d 772, 773 (Tex. App.—El Paso 1988, no writ) (citing *Allen v. Brunner*, 75 S.W. 821, 822 (Tex. Civ. App. 1903, no writ)), and the lien may be enforced only by judicial process. TEX. R. CIV. P. 610-20; *Jarrell v. U.S. Realty Corp.*, 270 S.W. 1079, 1081 (Tex. Civ. App.—Fort Worth 1925, no writ) (explaining that if no primary suit is properly filed, distress warrant is void).

The principal drawback, from a tenant's perspective, is that this statutory lien automatically attaches to the tenant's tangible personal property, *see* TEX. PROP. CODE §§ 54.021, 54.023; *Granville v. Rauch*, 335 S.W.2d 799, 803-04 (Tex. Civ. App.—Austin 1960, no writ), and it exists unless landlord waives it. *Cf. United States v. Truss Tite, Inc.*, 285 F. Supp. 88 (S.D. Tex. 1968). A tenant should consider seeking a waiver of landlord's statutory lien.

[277] "'***Fixtures***' means goods that have become so related to particular real property that an interest in them arises under the real property law of the state in which the real property is located." TEX. BUS. & COMM. CODE §9.102(41) and TEX. BUS. & COMM. CODE §2A.309(a)(1). Under revised Article 9, a landlord still perfects its contractual security interest by filing a fixture financing statement in the jurisdiction where the goods are located. *See* TEX. BUS. & COMM. CODE § 9.301(3)(A).

[278] Revised Article 9 of the Texas UCC governs the creation and enforcement of contractual landlord's liens. *Bank of N. Am.*, 551 S.W.2d at 65 (explaining that Article 9 governs contractual but not statutory landlords' liens. *Bank of N. Am. v. Kruger*, 551 S.W.2d 63, 66 (Tex. Civ. App.—Houston [1st Dist.] 1977, writ ref'd n.r.e.) (citing *Industrial State Bank v. Oldham*, 221 S.W.2d 912, 913 (Tex. 1949)). A contractual lien may be created in a lease by language sufficient to create a security interest. TEX. BUS. & COM. CODE § 9.201(a) (Texas UCC) (stating that, except as otherwise provided, security agreement is enforceable according to its terms) and § 9.109(11) (stating that Article 9 applies to the creation of contractual security interest).Because of the drawbacks of statutory landlord's liens, a contractual lien is sometimes a better — but not foolproof — way for a landlord to obtain and enforce a security interest in a tenant's personal property and fixtures. The following discussion is not a comprehensive treatment of Article 9; instead, it touches on a few basic issues commonly encountered in creating and enforcing contractual landlord's liens.

[279] The Texas UCC permits a secured creditor to use self-help to take possession of personal property secured by the creditor's lien, unless the security agreement expressly prohibits the creditor from doing so or taking the property will breach the peace. TEX. BUS. & COM. CODE § 9.609. Even if a lease grants the landlord the right to repossess the property subject to its contractual lien, a landlord cannot hold the property indefinitely without sale, credit, or payment of any surplus by which the value of the seized property exceeds the amount of past due rent. TEX. BUS. & COM. CODE § 9.610 (stating that every aspect of disposition must be reasonable); *Myers*, 735 S.W.2d 605 (Tex. Civ. App.—Dallas, no writ).

stipulates that this notice is adequate and reasonable. This contractual lien supplements any statutory or other lien in favor of Landlord.[280]

(b) By Tenant's execution and delivery of this Lease to Landlord, Tenant authorizes Landlord to any financing statement necessary to perfect Landlord's security interest in the Collateral.[281]

(c) Tenant warrants and represents that (i) the Collateral has not been purchased or used for personal, family, or household purposes; and (ii) the lien in the Collateral constitutes a first and superior lien. Tenant will not allow any other lien in the Collateral without Landlord's prior written consent.[282]

40. **NOTICES**. All notices, demands, requests, and other communications required or permitted by this Lease must be:[283] (a) in writing; (b) delivered to the party's designated representative at the party's address on its signature page of this Lease, or to another person, or at another address, designated in a notice delivered in a manner permitted by this paragraph; and (c) delivered (i) in person (*e.g.*, hand delivery by courier or overnight delivery service),[284] (ii) by email with the subject line stating in all capital letters NOTICE RE LEASE BETWEEN LANDLORD (by name) and TENANT (by name) and LOCATION: RESPONSE REQUIRED] ~~(ii) by facsimile transmittal (*fax*),~~ or (iii) by United States mail, registered or certified, postage fully prepaid, return receipt requested. Any notice given by ~~fax~~ email also must be given by another means permitted by this paragraph. Notice delivered in person, by email ~~fax~~, or by mail will be effective when actually received, and any properly mailed notice (even if not actually received) will be will be deemed received on the **3rd** day after its deposit in a regularly maintained receptacle for the United States mail.

41. **MISCELLANEOUS**. The following provisions are not immaterial because they are included in this paragraph of this Lease.

(a) **Entire Agreement; Amendments**. This lease constitutes the entire agreement between Landlord and Tenant with respect to the subject matter of this Lease, and no prior understanding, representation, promise, or agreement will be binding upon either party.[285] No change in any term of this Lease

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[280] This Lease is silent on the existence, or waiver, of landlord's statutory lien. Even so, a landlord may waive its statutory lien rights by electing to rely exclusively on its contractual lien. *Cf. United States v. Truss Tite, Inc*., 285 F. Supp. 88 (S.D. Tex. 1968).

[281] *See* Article 9 of the Texas UCC allows a creditor to file a financing statement without the debtor's signature if the debtor authorizes the creditor to do so. TEX. BUS. & COM. CODE § 9.509(a)(1). By signing a lease that includes a contractual lien, a tenant automatically authorizes its landlord to file a financing statement consistent with the security interests granted in the lease. *See* TEX. BUS. & COM. CODE § 9.509(b).

[282] Harriet Anne Tabb, *Short But Not Sweet: The Landlord's Subordination Agreement*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW: WILLIAM W. GIBSON, JR. MORTGAGE LENDING INSTITUTE (September 2008). **Appendix V** is an updated version of her Short Form of Subordination Agreement.

[283] ***Notice Traps for the Unwary***. Landlord should ensure that it does not inadvertently terminate the lease by careless wording of its demand letters. Most leases, and many cases, recognize a distinction between terminating the lease (which usually terminates landlord's right to unaccrued rent) and merely terminating the tenant's right to possession (which, in principle, does not terminate the landlord's right to unaccrued rent or damages). *Compare Cavalcade Oil Corp. v. Samuel*, 746 S.W.2d 842, 843-44 (Tex. App.—El Paso 1988, writ denied) (holding that reference to termination of lease in demand letter did not result in forfeiture of landlord's right to recover unaccrued rent) *with Rohrt v. Kelley Mfg. Co.*, 349 S.W.2d 95, 96-99 (Tex. 1961) (holding that landlord could not recover unaccrued rent because landlord sent letter to tenant announcing landlord's intention to "declare the lease forfeited" if the tenant did not pay past due rent).

[284] *See, e.g., Crown Const. Co. v. Huddleston*, 961 S.W.2d 552, 556-57 (Tex. App.—San Antonio 1997, no pet.) (stating "*delivery in person*" requirement in notice provision in lease mandated hand to hand delivery and was not satisfied by taping notice on door).

[285] This ***merger*** clause, which disclaims representations, but does not disclaim reliance on representations, is not sufficient, by itself, to bar a claim for fraudulent inducement. *Italian Cowboy Partners*, 341 S.W.3d at 340-43 (holding tenant's

will be effective, and no subsequent agreement concerning the subject matter of this Lease, will be enforceable, unless Landlord and Tenant each sign and deliver to the other a written instrument evidencing the change or agreement.[286]

(b) **Attorneys' Fees**. In any suit or other dispute between Landlord and Tenant or any Guarantor, the prevailing party[287] will be entitled to recover its reasonable attorneys' fees, court costs, and other litigation expenses.[288]

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fraudulent inducement claim is not barred by tenant's agreement that landlord did not make any representations outside the lease). "[A] written contract containing a merger clause ***can be avoided*** for antecedent fraud or fraud in its inducement and… the parol evidence rule does not stand in the way of proof of such fraud." *Dallas Farm Mach. Co. v. Reaves*, 1 307 S.W.2d 233, 239 (Tex. 1957) (emphasis added) (citing *Bates v. Southgate*, 308 Mass. 170, 31 N.E.2d 551, 558 (Mass. 1941)); *accord* RESTATEMENT (SECOND) OF CONTRACTS § 214 cmt. c (1981) ("Such invalidating causes [including fraud] need not and commonly do not appear on the face of the writing. They are not affected even by a 'merger' clause."). In *Reaves*, the supreme court quoted approvingly the "sound public policy" supporting the rule that an ordinary merger clause will not preclude fraud or fraudulent inducement claims:

> The same public policy that in general sanctions the avoidance of a promise obtained by deceit strikes down all attempts to circumvent that policy by means of contractual devices. In the realm of fact it is entirely possible for a party knowingly to agree that no representations have been made to him, while at the same time believing and relying upon representations which in fact have been made and in fact are false but for which he would not have made the agreement. To deny this possibility is to ignore the frequent instances in everyday experience where parties accept, often without critical examination, and act upon agreements containing somewhere within their four corners exculpatory clauses in one form or another, but where they do so, nevertheless, in reliance upon the honesty of supposed friends, the plausible and disarming statements of salesmen, or the customary course of business. To refuse relief would result in opening the door to a multitude of frauds and in thwarting the general policy of the law.

307 S.W.2d at 239 (quoting *Bates*, 31 N.E.2d at 558). Four decades after *Reaves*, the Texas Supreme Court recognized an exception to this rule. In *Schlumberger Tech. Corp. v. Swanson*, the supreme court held "that a release that clearly expresses the parties' intent to waive fraudulent inducement claims, or one that disclaims reliance on representations about specific matters in dispute, can preclude a claim of fraudulent inducement." 959 S.W.2d 171, 181 (Tex.1997). "In other words, fraudulent inducement is almost always grounds to set aside a contract despite a merger clause, but in certain circumstances, ***it may be possible for a contract's terms to preclude a claim for fraudulent inducement by a clear and specific disclaimer-of-reliance clause***." *Italian Cowboy Partners*, 341 S.W.3d 323, 331-32 (Tex. 2011) (emphasis added).

[286] *See infra* footnotes **301** – **309** (discussing waivers by words and conduct). *Triton Comm'l Props., Ltd. v. Norwest Bank Texas, N.A.*, 1 S.W.3d 814, 817-18 (Tex. App.–Corpus Christi 1999, pet. denied) (stating that whether couched in terms of "waiver" or "oral modification," implied representations to extend time for payment of option fee amounted to an oral alteration of the written deadline for payment and that it would not be practical to attempt to distinguish the concept of "waiver" from that of "modification."). Because waiver of the deadline for making payment by orally agreeing to late payment is indistinguishable from an oral agreement to modify the time for payment, the statute of frauds applies as it would in the case of any other oral modification.

[287] For purposes of awarding attorneys' fees, the term "***prevailing party***" means a party who successfully prosecutes an action ***or successfully defends against an action on the main issue***. *Emery Air Freight Corp. v. General Transp. Sys., Inc.*, 933 S.W.2d 312, 316 (Tex. App.—Houston [14th Dist.] 1996, no writ) disapproved of on other grounds by *Evanston Ins. Co. v. Atofina Petrochem., Inc.*, 256 S.W.3d 660 (Tex. 2008) ; *F.D.I.C. v. Graham*, 882 S.W.2d 890, 900 (Tex. App.—Houston [14th Dist.] 1994, no writ).

[288] ***General Rule: No Recovery of Attorneys' Fees***. In the absence of a contractual or statutory right, attorney's fees incurred in prosecuting a suit or defending against a wrong are not ordinarily recoverable. *Houghton v. Wholesale Elec. Supply*, 435 S.W.2d 216, 220 (Tex. Civ. App.—Waco 1968, writ ref'd n.r.e.). For example, attorneys' fees ordinarily are not recoverable by the tenant in a constructive eviction action because constructive eviction is a tort. *Huddleston v. Pace*, 790 S.W.2d 47, 51 (Tex. App.—San Antonio 1990, writ denied) (citing *Charalambous v. Jean LaFitte Corp.*, 652 S.W.2d 521, 526 (Tex. App.—El Paso 1983, writ ref d n.r.e.)). *But see Huddleston*, 790 S.W.2d at 52-55 (Chappa, J., dissenting). A number of statutes, however, allow recovery of attorneys' fees in landlord-tenant litigation.

(c) **Commissions**. Landlord and Tenant each agree to Defend and Indemnify the other against any Claim for any commission or brokerage fee connected with this Lease, its renewal, or any options granted in it arising from the indemnitor's acts or omissions.[289]

Trial of Eviction. Eviction cases are governed by special rules governing the award of attorneys' fees. A landlord may recover its attorneys' fees in a forcible detainer action if the lease permits recovery of attorneys' fees. TEX. PROP. CODE § 24.006(b). If a landlord does not have a contractual right to recover attorneys' fees, it must send its tenant a written notice demanding possession and notifying the tenant that, if the tenant does not vacate the premises before the 11th day after the date of receipt of the notice, and if the landlord files suit, the landlord may recover attorneys' fees. The demand must be sent by registered or certified mail, return receipt requested, at least 10 days before the date the suit is filed. TEX. PROP. CODE § 24.006(a). This statutory right to recover attorneys' fees has two negative aspects. First, the statute requires the landlord to give 10 days, as opposed to 3 days, notice before filing suit; second, it allows the tenant, if the tenant prevails, to recover reasonable attorneys' fees from the landlord. *See* TEX. PROP. CODE § 24.006(c). And, a prevailing tenant is not required to give notice in order to recover its attorneys' fees from the landlord. *MasterMark Homebuilders, Inc. v. Offenburger Constr., Inc*., 857 S.W.2d 765, 767 (Tex. App.—Houston [14th Dist.] 1993, no writ). The prevailing party also is entitled to recover all costs of court. TEX. PROP. CODE § 24.006(d).

Appeal of Eviction. The prevailing party in an appeal of an eviction case may only recover damages under Rule 752. TEX. R. CIV. P. 752 (stating that either party to an appeal may "plead, prove and recover his damages, if any, suffered for withholding or defending the premises during the pendency of the appeal."). These damages ordinarily include the reasonable rental value of the premises between the date of the judgment in justice court and of the disposition of the appeal, plus reasonable attorneys' fees and costs incurred in justice and county court. *See, e.g., Hart v. Keller Props.*, 567 S.W.2d 888, 889 (Tex. Civ. App.—Dallas 1978, no writ); *Stewart v. Breese*, 367 S.W.2d 72, 74 (Tex. Civ. App.—Dallas 1963, writ dism'd); *Snyder v. Tousinau*, 177 S.W.2d 799, 800 (Tex. Civ. App.—Galveston 1944, no writ); *see Koelzer v. Pizzirani*, 718 S.W.2d 420, 422 (Tex. App.—Fort Worth 1986, no writ) (applying same damage measure in forcible entry and detainer case).

Breach of Contract. In other types of lease litigation, the prevailing party in a breach-of-contract suit is entitled to recover reasonable attorneys' fees. *See* TEX. CIV. PRAC. & REM. CODE § 38.001.

Declaratory Judgment. The prevailing party in a declaratory-judgment action may recover reasonable attorneys' fees. *See* TEX. CIV. PRAC. & REM. CODE § 37.009. While attorneys' fees are normally recoverable under the Declaratory Judgments Act, when one seeks such a judgment by counterclaim, that party must also show that the counterclaim is not seeking resolution of disputes already pending before the court. *See John Chezik Buick Co. v. Friendly Chevrolet Co*., 749 S.W.2d 591, 594-95 (Tex. App.—Corpus Christi 1988, writ denied). Otherwise, a counterclaim presenting no new controversies provides a means to bring a suit "solely to pave an avenue to attorney's fees" and is improper. *See Narisi v. Legend Diversified Invs.*, 715 S.W.2d 49, 51-52 (Tex. App.—Dallas 1986, writ ref'd n.r.e.); *John Chezik Buick Co*., 749 S.W.2d at 595.

[289] ***Landlord Liability for Brokerage Commissions***. As a general rule, an assignee of a landlord is not liable to a real estate broker on the original landlord's promise to pay a commission in the lease, unless the assignee expressly and specifically assumes the obligation. *Regency Advantage Ltd. P'ship v. Bingo Idea-Watauga, Inc. 936 S.W.2d 275, 278 (Tex. 1996)*, 936 S.W.2d at 278; *see Lone Star Gas Co. v. Mexia Oil & Gas, Inc*., 833 S.W.2d 199, 201 (Tex. App.—Dallas 1992, no writ)(stating that courts "have found implied assumptions where (1) the benefit was so entwined with the burden that the assignee was estopped from denying assumption and (2) the assignee would otherwise be unjustly enriched" but holding that assignee did not impliedly assume assignor's indemnity obligation in the absence of express promissory words of assumption on the part of the assignee); *Hall v. Arnett*, 31 S.W.2d 506, 508 (Tex. Civ. App.—Amarillo 1929, writ dism'd); *Potts v. Burkett*, 278 S.W. 471, 473 (Tex. Civ. App.—Eastland 1926, no writ) (stating that "assignee of a contract is not bound for the performance of its obligations, unless they are expressly assumed by the assignee, but [assignee] may be held liable for the acts performed by [assignee] under such contract" and holding that assignee was not personally liable for assignor's breach of warranty). *See infra* p. 22-104, ¶ 41(l) and footnote 300 (discussing successor landlord's liability for continuing breach).

This rule operates in ways that may be contrary to contemporary commercial expectations with respect to brokerage commissions, unless the terms of the commission agreement itself, sale documents, or both properly address successor liability issues. On the other hand, the successor to the original landlord, who stands to benefit from the commissionable event (*e.g*., renewal or expansion of the lease), may benefit greatly from the renewal but have no obligation to pay the broker's commissions under the agreement between the original landlord and the broker. A landlord's promise to pay a lease commission does not bind a transferee of the property, or of a landlord's interest in the lease, even if the promise to pay the commission is in the lease. *Blasser v. Cass*, 314 S.W.2d 807, 808-09 (Tex. 1958) (reasoning that promise to pay commission does not run with land and that transferee of landlord's interest did not assume obligation to pay commission by accepting deed subject to existing leases); *Dauley v. First Nat'l Bank*, 565 S.W.2d 346, 348-49 (Tex. Civ. App.—Fort Worth

(d) **Construction**. Landlord and Tenant have participated in drafting this Lease, and they agree that this Lease will not be construed against either party as its drafter.[290] Each defined term includes any capitalized grammatical variants, and the use of bold type is sometimes used for the reader's convenience, but its use does not affect any term's meaning or relative importance. Unless the context otherwise requires, the singular includes the plural, and *vice versa*, and any gender references are interchangeable. Time is of the essence.[291]

(e) **Force Majeure**. Whenever this Lease sets a time period for a party to act, the party required to perform the act will not be liable to the other party, and the computation of the time period will

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1978, writ ref'd n.r.e.) (holding that broker did not have an equitable lien for commission payments and could not enforce landlord-mortgagor's promise to pay commission against mortgagee who purchased property at foreclosure). On the one hand, unless the brokerage agreement releases the original landlord upon a transfer, the original landlord, who signs a commission agreement promising to pay commissions upon renewals, expansions, or other events that occur the after original landlord no longer owns the building, may be liable to the broker for those commissions.

[290] ***Neutral Construction***. In at least one unpublished opinion, a Texas intermediate appellate court enforced a similar prohibition on construing a lease against either party. *Wilbur & Vill. Lane Ltd. v. Cinemark Corp*., 14-00-00760-CV, 2002 WL 1041083 (Tex. App.—Houston [14th Dist.] May 23, 2002, no pet.) (giving effect to lease provision that stated: "[i]n any such interpretation, construction or determination of the meaning of any provision of this Lease, no presumption whatsoever shall arise from the fact that the Lease was prepared by or on behalf of a particular party hereto.").

Construe Lease against Landlord. Absent a prohibition on doing so, "it is a generally accepted rule that a lease will be most strongly construed against the lessor." *Watley v. Vergott*, 561 S.W.2d 925, 926 (Tex. Civ. App.—Fort Worth 1978, no writ) (citing *Sirtex Oil Indus., Inc. v. Erigan*, 403 S.W.2d 784, 788 (Tex.1966)); *Golden Spread Oil v. American Petrofina Co*., 431 S.W.2d 50 (Tex. Civ. App. Amarillo 1968, writ ref'd n. r. e.). This rule "is particularly appropriate" when the original lessor drafts the lease. *Watley*, 561 S.W.2d at 926. But "this rule only applies after the document is found to be ambiguous." *AT & T Corp. v. Rylander*, 2 S.W.3d 546, 559 (Tex. App.—Austin 1999, pet. denied) (citing *GTE Mobilnet of S. Texas Ltd. P'ship v. Telecell Cellular, Inc*., 955 S.W.2d 286, 290 (Tex. App.—Houston [1st Dist.] 1997, pet. denied)).

Ambiguity. Whether a contract is ambiguous is a question of law for the court to decide. *R & P Enters. v. LaGuarta, Gavrel & Kirk, Inc*., 596 S.W.2d 517, 518 (Tex. 1980). A contract is not ambiguous if it can be given certain or definite legal meaning or interpretation. *Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd*., 940 S.W.2d 587, 589 (Tex. 1996); *Friendswood Dev. Co. v. McDade & Co*., 926 S.W.2d 280, 282 (Tex. 1996). Ambiguity does not arise simply because the parties advance conflicting interpretations of the contract; rather, for an ambiguity to exist, both interpretations must be reasonable. *Columbia Gas*, 940 S.W.2d at 589; *National Union Fire Ins. Co. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995). A contract is ambiguous only if: (1) it cannot be given a definite legal meaning, and (2) it is reasonably susceptible to more than one meaning. *Id*.

[291] ***Time is of the Essence***. As a general rule of contract law, time is not of the essence, and a date stated for performance, without more, does not make time of the essence. *Kennedy Ship & Repair, L.P. v. Pham*, 210 S.W.3d 11, 19 (Tex. App.—Houston [14th Dist.] 2006, no pet.). For timely performance to be a material term in a lease, the lease must state expressly that time is of the essence "***or*** there must be something in the nature or purpose of the contract and the circumstances surrounding it making it apparent that the parties intended that time be of the essence." *Breof BNK Texas, L.P. v. D.H. Hill Advisors, Inc*., 370 S.W.3d 58, 64 Tex. App.—Houston [14th Dist.] 2012, no pet.); *Deep Nines, Inc. v. McAfee, Inc*., 246 S.W.3d 842, 846 (Tex. App.—Dallas 2008, no pet.). Unless the contract expressly makes time of the essence, the issue is a fact question. 370 S.W.3d 64. When it is clear from the terms or the contract or the surrounding circumstances that the parties intend that time is of the essence, untimely performance is a material breach discharging the duties of the non-breaching party. *Mustang Pipeline Co. v. Driver Pipeline Co*., 134 S.W.3d 195, 196 (Tex.2004) (per curiam).

Option Contracts. The general rule does not apply to options. By its very nature, an option is time-sensitive. Even when an option does not expressly state that "time is of the essence," time is essential to the option, and the holder of the option must exercise the option within the specified time period. *Thermo Prods. Co. v. Chilton Ind. Sch. Dist*., 647 S.W.2d 726, 734 (Tex. App.-Waco 1983, writ ref'd n.r.e.); *Tabor v. Ragle*, 526 S.W.2d 670, 675 (Tex. Civ. App.-Fort Worth 1975, writ ref'd n.r.e.); *see also Johnson v. Portwood*, 34 S.W. 596, 598 (Tex. 1896) (stating time is of the essence for exercise of an option because an option is unilateral and for the benefit of the optionee); *Smith v. Hues*, 540 S.W.2d 485, 488 (Tex. Civ. App.—Houston [14th Dist.] 1976, writ ref'd n.r.e.). Thus, "any failure to exercise an option according to its terms, including untimely or defective acceptance, is simply ineffectual, and legally amounts to nothing more than a rejection." *Atterbury v. Brison*, 871 S.W.2d 824, 829 (Tex. App.—Texarkana 1994, writ denied) (Cornelius, J., concurring).

exclude, any delays due to strikes; riots; acts of God; shortages of labor or materials; war; governmental laws, regulations, or restrictions; or any other cause beyond that party's control.[292] But no such *force majeure* will excuse Tenant's obligations to timely pay Rent or any other sum of money to Landlord.

(f) **Joint And Several Liability**. Tenant and each Guarantor will be jointly and severally liable to Landlord for Tenant's obligations under this Lease.

(g) **No Merger**. If the same person or entity acquires any direct or indirect interest in this Lease or the leasehold and in the fee, the leasehold will not merge with the fee. And, neither Tenant's surrender of this Lease nor its mutual cancellation will constitute a merger.[293] But, upon any surrender or cancellation of this Lease, Landlord, in its sole discretion, may terminate or assume any then existing sub-tenancy.

(h) **Nondisclosure**. Tenant will not to disclose any terms of its Lease to other tenants in this Building or to the general public.

(i) **Recording**. Tenant will not record this Lease or any memorandum of this Lease.[294]

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[292] The theory of ***force majeure*** has existed for many years. Often likened to impossibility, it historically embodied the notion that parties could be relieved of performing their contractual duties when performance was prevented by causes beyond their control, such as an act of God. *See* 6A Corbin, CORBIN ON CONTRACTS § 1324 (1962). But much of its historic underpinnings have fallen by the wayside. *Force majeure* is now little more than a descriptive phrase without much inherent substance. Indeed, its scope and application, for the most part, depend upon the terms of the contract in which it appears. *Hydrocarbon Mgmnt., Inc. v. Tracker Exploration, Inc.*, 861 S.W.2d 427, 436 (Tex. App.—Amarillo 1993, no writ) (stating that "lease terms are controlling regarding *force majeure*, and common law rules merely fill in gaps left by the lease.") (italics in original). In other words, when the parties have themselves defined the contours of *force majeure* in their agreement, those contours dictate the application, effect, and scope of *force majeure*. *Texas City Ref, Inc. v. Conoco, Inc.*, 767 S.W.2d 183, 186 (Tex. App.—Houston [14th Dist.] 1989, writ denied).

Contractual Force Majeure. Some courts suggest that ***force majeure*** is now utterly dependent upon the terms of the contract. For instance, in *Perlman v. Pioneer Ltd. P'ship*, 918 F.2d 1244 (5th Cir. 1990), the court viewed the concept as "not a fixed rule of law that regulates the content of all *force majeure* clauses, but instead [as] a term that describes a particular type of event… which may excuse performance…." *Id.* at 1248 n.5. Moreover, merely labeling a condition or event "*force majeure*" does not automatically excuse performance upon the occurrence of the event. *Id.* Instead, the court must look to the language of the contract to determine whether the parties intended that the event excuse performance. *Id.*; *see PPG Indus., Inc. v. Shell Oil Co.*, 919 F.2d 17, 18 (5th Cir. 1990) (recognizing that reasonable control requirement, which was allegedly an element of historic doctrine of *force majeure*, applied because parties so stated in their contract not because common law dictated that result).

[293] ***Merger of Title***. The obligation to pay rent under a lease is discharged when lessee acquires title to the reversion because the merger of the leasehold with the reversion terminates the lease. *Hall v. Prof'l Leasing Assocs*., 550 S.W.2d 392, 394 (Tex. Civ. App. —Dallas 1977, no writ) (citing *Buell v. Simon Newman Co.*, 154 F.2d 35, 37-38 (9th Cir. 1946)).

[294] ***Actual possession*** ordinarily supplies sufficient notice to preserve the priority, and to give notice to the world, of the existence of most unrecorded leases. *Boyd v. United Bank, N.A.*, 794 S.W.2d 839, 841 (Tex. App.—El Paso 1990, writ denied); *see also Texas Life Ins. Co. v. Texas Bldg. Co.*, 307 S.W.2d 149, 152 (Tex. Civ. App.—Fort Worth 1957, no writ); *Williams v. Rabb*, 161 S.W.2d 121, 123 (Tex. Civ. App.—Texarkana 1942, writ ref'd).

> As a general rule, actual possession provides constructive knowledge of the rights of the party in possession of the real property. When another person possesses and occupies the realty, the mortgagee has notice of an equitable interest or an adverse claim in the property as much as if the contract on which it is based was recorded. Courts presume, as a matter of law, that if inquiry had been made, the possessor would have given the status of the title. Thus, one who accepts a mortgage may be charged with knowledge as to the possessor's interest and be held to have acquired a lien which is inferior to the possessor's interest or estate.… In order to constitute notice by possession, the possession must be of such a character as to make it the duty of one who contemplates securing a mortgage on the property to ask the possessor regarding the nature of the claim and to reveal, if inquiry is made, the possessor's interest in the realty.

(j) **Disclaimer of Representations and Warranties**. Tenant represents and warrants to Landlord that: (i) no Landlord Party made, ***and no Tenant Party relied on***, any representation, warranty, or promise, express or implied, with respect to this Lease, the Premises, or the Project, ***except*** for those specifically expressed in this Lease;[295] (ii) Tenant acquired no rights, easements, or licenses (by implication or otherwise), ***except*** for those specifically expressed in this Lease. **LANDLORD DISCLAIMS ALL IMPLIED WARRANTIES TO THE FULLEST EXTENT PERMITTED BY LAW, INCLUDING, WITHOUT LIMITATION, ANY IMPLIED WARRANTY OF SUITABILITY,[296]HABITABILITY, AND FITNESS FOR A PARTICULAR PURPOSE.**[297]

(k) **Severability**. If any term of this Lease is or becomes illegal, invalid, or unenforceable, the remaining terms of this Lease will ***not*** be affected, and the invalid, illegal, or unenforceable term will be reformed to give effect (to the fullest extent possible) to the parties' intentions in a manner that is legal, valid, and enforceable.[298]

Boyd, 794 S.W.2d at 841; *see also Carver v. Moore*, 288 S.W. 156, 158 (Tex. 1926) (stating that, "…in the absence of knowledge of any facts to the contrary, the purchaser is not bound to make inquiry beyond the recorded deed executed by the one in possession purporting to convey the land to the person from whom the purchaser is acquiring same."); *Collum v. Sanger Bros.*, 80 S.W. 459, 460 (Tex. 1904) (stating that,…it a safe and salutary rule to require of a prospective purchaser of land to ascertain whether any other be in occupancy of it; and if there be such possession, to go to the possessor and ascertain the nature and extent of his claim. Possession is evidence of title, and it seems to us that common prudence and common honesty demand this course. If so the possession should be notice to him, and if notice to a purchaser it is notice to a creditor."). Under these rules, a tenant, who has an unrecorded lease, but who is not actually occupying the premises, may be at some risk of losing the priority of its unrecorded lease. As a practical matter, however, it would be rare that a lender or buyer would not acquire actual knowledge of the existence of such a lease during the due diligence process.

[295] ***Disclaimer of Reliance***. This disclaimer has two parts. First, it disclaims the existence of any representations, warranties, or promises by any Landlord Party, other than those expressly made in the Lease. Second, the italicized, bolded, and underlined text adds an express disclaimer of reliance on any representation that tenant just represented was not made in the first place. The Texas Supreme Court has held that both a disclaimer of parol representations and a disclaimer of reliance on such representations is necessary to preclude claims for fraud and fraudulent inducement. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co.*, 341 S.W.3d 323, 332 (Tex. 2011) (holding that, in the absence of a clear disclaimer of reliance, a merger clause, together with the following language **was insufficient** to defeat tenant's fraudulent inducement claim: ***Tenant acknowledges that neither Landlord nor Landlord's agents, employees or contractors have made any representations or promises with respect to the Site, the Shopping Center or this Lease except as expressly set forth herein."***).

[296] "There is an ***implied warranty of suitability*** by the landlord in a commercial lease that the premises are suitable for their intended commercial purpose. This warranty means that at the inception of the lease there are no latent defects in the facilities that are vital to the use of the premises for their intended commercial purpose and that these essential facilities will remain in a suitable condition." *Davidow,* 747 S.W.2d at 377. Breach of the implied warranty of suitability is a complete defense to tenant's obligation to pay rent. *Neuro-Devopmental Assocs. of Houston v. Corporate Pines Rlty. Corp.*, 908 S.W.2d 26, 28 (Tex. App.—Houston [1st Dist.] 1995, writ denied).

[297] To be ***merchantable*** under the Texas UCC, goods must be "at least such as are fit for the ordinary purposes for which such goods are used." TEX. BUS. & COM. CODE § 2.314(b)(3) (Tex. UCC). A party claiming breach of this warranty must show that the goods were defective and not fit for the ordinary purposes for which the goods are used. *Plas-Tex, Inc. v. U.S. Steel Corp.*, 772 S.W.2d 442 (Tex. 1989). To the extent a landlord agrees to supply goods and services, along with space, requiring the tenant to waive this implied warranty may be prudent.

[298] "The ***doctrine of severability*** applies when the original consideration of the contract is legal and ***incidental*** promises within the contract are found to be illegal." *Rogers v. Wolfson*, 763 S.W.2d 922, 925 (Tex. App.—Dallas 1989, writ) (citing *Williams v. Williams*, 569 S.W.2d 867, 871 (Tex. 1978)) (emphasis added). "In such a case, the invalid provisions may be severed and the valid portion of the agreement upheld." *Rogers,* 763 S.W.2d at 925 (citing *Wicks v. Comves*, 221 S.W. 938, 939 (Tex. 1920); *C.C. Slaughter Cattle Co. v. Potter County*, 235 S.W. 295, 307 (Tex. Civ. App.— Amarillo 1921, writ dismissed), *aff'd*, 254 S.W. 775 (Tex. Comm'n App. 1923, judgment adopted); *cf. Smith v. Morton I.S.D.*, 85 S.W.2d 853, 858 (Tex. Civ. App.— Amarillo 1935, writ dism'd). In determining whether the invalid portions may be severed from the valid portions of a contract, the issue is whether the parties "would have entered into the agreement absent to the illegal parts." *Rogers,* 763 S.W.2d at 925.

(l) **Successors**. This Lease will apply to, inure to the benefit of, and bind Landlord and Tenant, and their respective heirs, successors-in-interest, legal representatives, and permitted assigns,[299] except as otherwise expressly provided in this Lease.

(m) **Waivers**.[300] Landlord will ***not*** be deemed to have Waived any right or Tenant's breach of any obligation under this Lease, unless Landlord delivers a signed writing, addressed to Tenant explicitly

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Severable v. Entire Contracts. The severability doctrine applies to severable but not entire contracts. When a lease contract is entire, a tenant cannot maintain an action to cancel the lease as to a part of the acreage conveyed. *See Burson v. Blackley*, 2 S.W. 668, 780 (Tex. 1886) ("[t]here can be no partial rescission of an entire contract"); *Nass v. Chadwick*, 7 S.W. 828 (Tex. 1888) ("affirmance or rescission must be as to all or none of" an entire contract); *Culbertson v. Blanchard*, 15 S.W. 700, 702 (Tex. 1891) (stating that party waived right to rescind entire contract when evidence showed that "had they tendered him conveyances to the whole land of the best approved form, accompanied by livery of seisin, broken earth and 'olive branches,' he would have refused to accept them"); *Wilkerson v. Bacon*, 79 S.W. 348 (Tex. Civ. App. 1904, no writ); *Moon v. Sherwood*, 180 S.W. 296, 299 (Tex. Civ. App. 1915, Amarillo, no writ). It is difficult to frame an abstract definition of either an entire or a severable contract. William Herbert Page, 4 PAGE ON THE LAW OF CONTRACTS 2084 (The W. H. Anderson Co. 1922). Whether a contract is entire or severable depends primarily upon the intention of the parties; if the subject matter is not divisible, and the consideration cannot be apportioned, the contract is entire. *Rogers,* 763 S.W.2d at 925. As a general rule, "[a] contract is entire when its terms, nature, and purpose contemplate that each and all of its parts, and the consideration are common each to the other and interdependent. On the other hand, as a general rule, a severable contract is one which, in its nature and purpose, is susceptible of division and apportionment." *Wellington R.R. Comm. v. Crawford*, 216 S.W. 151, 155 (Tex. Comm'n App. 1919) (citing 13 C.J. 561).

[299] ***Successor Liability for Continuing Breach***. "The transferee [of an interest in leased property] will not be liable for any breach of the promise which occurred before the transfer to him." *Regency Advantage Ltd. P'shp v. The Bingo Idea-Watauga, Inc.*, 936 S.W.2d 275, 277(Tex. 1996) (citing THE RESTATEMENT (SECOND) OF PROPERTY § 16.1(3) (1977)). As the Restatement explains:

> A transferee is liable on a promise that runs with the transferred interest only to the extent of a breach of the promise that occurs while the transferee is in privity of estate with the person entitled to enforce the promise. If the promise is capable of being broken only once and was broken before the transfer, the transferee does not incur any personal liability with respect to it. If the promise is capable of successive independent breaches, the breaches that occur before the transfer cannot subject the transferee to any personal liability.

Id. § 16.1 cmt. h. In other words, a transferee of a landlord's reversion is not liable for a breach of a landlord's covenant that occurred before the transfer. *See* 3 FRIEDMAN ON LEASES § 36.2 (3d ed. 1990). But, as comment h to section 16.1 of the Restatement further explains, in situations in which the original lessor has breached a lease before transferring the lease to its assignee, the other party to the lease may be entitled to terminate the lease for the past breaches and, if so, the transferee's position under the transfer may be affected accordingly. *See* THE RESTATEMENT (SECOND) OF PROPERTY § 16.1 cmt. h (1977); *Regency Advantage Ltd. P'ship*, 936 S.W.2d at 277-78 (holding that original landlord's duty to build out leased premises by a specified date before the original landlord's transfer of the lease to its assignee was a one-time, not a continuing, obligation). Stated another way, while original landlord's assignee will not be liable to tenant for original landlord's breach, the transfer will not affect any right tenant may have had to terminate or any defense against payment of rent. *Id* at 277.

SNDA. Many SNDA requirements in leases and in typical SNDA forms would require tenant to relinquish all offsets and defenses that arise from acts or omissions of landlord that occur, or in the case of a continuing breach, that begin before any foreclosure. *See* Holly E. Magliolo, *Texas Annotated Subordination, Non-Disturbance, and Attornment Agreement*, STATE BAR OF TEXAS: 24TH ANNUAL ADVANCED REAL ESTATE DRAFTING COURSE (March 7-8, 2013) (annotated SNDA form provides that "in no event shall the New Owner (successor landlord after foreclosure) be… subject to any offset, defense, claim or counterclaim which Tenant might be entitled to assert against any previous landlord (including Landlord)."). When a lease requires landlord to provide an allowance for, or to make, significant tenant improvements, it may be possible for tenant to preserve its offset rights and defenses in the event landlord's mortgagee forecloses before landlord has fully paid the allowance or completed the improvements. This requirement is eminently reasonable when landlord's lender must approve the lease or agrees to advance the funds, or allows landlord to use tenant improvement reserves held by lender to fund such improvements.

[300] ***Waiver*** is an intentional relinquishment or surrender of a right that, at the time, is known to the party. *Sun Exploration & Prod. Co. v. Benton*, 728 S.W.2d 35, 37 (Tex. 1987); *The Praetorians*, 66 S.W.2d at 689. Ordinarily, waiver is a question of fact for the trier of fact to determine. *Andrews v. Powell*, 242 S.W.2d 656, 662 (Tex. Civ. App.— Texarkana 1951,

relinquishing that right or breach,[301] and Landlord's Waiver of any right, or of Tenant's breach, on one or more occasions, will not be deemed a Waiver on any other occasion.[302] No custom or practice arising during the

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writ ref'd n.r.e.). But waiver must be clearly proven, and the proof must amount to more than a scintilla of evidence, surmise, or suspicion. *First State Bank v. Jones*, 183 S.W. 874, 877 (Tex. 1916).

[301] ***Waiver by Oral Agreement***. A lease for more than one year must satisfy the statute of frauds. But not all modifications of contracts subject to the statute of frauds must be in writing. *Vendig v. Traylor*, 604 S.W.2d 424, 427 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.). "[A]n oral modification of a written contract is enforceable under the Statute of Frauds only if the modification does not materially alter the obligations imposed by the underlying agreement. *Id*. Even if a lease prohibits oral waivers or modifications, a number of Texas cases hold that "[p]arties to a contract may waive the protection of a provision forbidding oral modifications." *Group Hosp. Servs., Inc. v. One & Two Brookriver Ctr.*, 704 S.W.2d 886, 890 (Tex. App.—Dallas 1986, no writ) (citing *Hyatt Cheek Bldrs.—Eng'rs Co. v. Board of Regents of the Univ. of Texas Sys.*, 607 S.W.2d 258, 265 (Tex. Civ. App.—Texarkana 1980, writ dism'd)); *Zwick v. Lodewijk Corp.*, 847 S.W.2d 316, 317 (Tex. App.—Texarkana 1993, writ denied) (finding that tenant raised fact issue on its waiver defense so as to preclude summary judgment despite lease provision stating "[t]his lease shall not be amended, changed, or extended except by written instrument signed by both parties herein"); *Regent Int'l Hotels, Ltd. v. Las Colinas Hotels Corp.*, 704 S.W.2d 101, 104 (Tex. App.—Dallas 1985, no writ) (finding, on appeal of summary judgment, that letters raised fact issue as to whether owner waived conditions on its right to enforce forfeiture clause, despite no-waiver clause stating that "[n]o condition agreement, term, or condition of this Agreement and no breach thereof shall be waived, altered or modified except by written instrument.").

[302] ***Waiver by Prior Conduct.*** In *Taherzadeh v. Clements*, the Fifth Circuit Court of Appeals considered whether landlord, by previously accepting late rent payments, waived its right to place the tenant in default for failing to pay rent timely. 781 F.2d 1093, 1098 (5th Cir. 1986). The lease clause prohibiting waiver by prior waiver or conduct read:

> One or more waivers of any covenant, term or condition of this lease by either party shall not be construed as a waiver of a subsequent breach of the same covenant, term or condition.

781 F.2d at 1098. According to the court of appeals, such a clause precludes the defense of waiver as a matter of law. *Id*. at 1098 (citing *Giller Indus., Inc. v. Hartley*, 644 S.W.2d 183, 184 (Tex. App.—Dallas 1982, no writ) (holding, as a matter of law, that a non-waiver clause, which read, "No waiver by the parties hereto of any default or breach of any term, condition or covenant of this lease shall be deemed to be a waiver of any subsequent default or breach of the same or any other term, condition, or covenant contained herein[,]" allowed the landlord to declare a lease in default for failure to timely pay rent, even though it had accepted late rent for the preceding six months).

Other Texas cases reject the view that no waiver clauses are enforceable as a matter of law. *See, e.g., Wendlandt v. Sommers Drug Stores Co.,* 551 S.W.2d 488, 490-91 (Tex. Civ. App.—Austin 1977, no writ) (holding that tenant did not breach covenant to pay rent timely in view of landlord's prior acceptance, without protest, of late rent payments). Under this view, a no waiver clause constitutes some evidence that a party does not intend to relinquish a known right, or establishes a presumption of non-waiver that the party seeking to prove waiver must overcome. *Id*. at 490 ("notice of default in payment of rent must convey a message that the notifier is initiating steps necessary to finally assert his legal rights that if default is not cured, he may take final action as provided in the contract").

Whatever the appellate decisions say, trial courts tend to ignore the literal terms of no waiver clauses when a landlord has ignored a pattern delinquencies and suddenly decides to reverse course and insist on the literal enforcement of the forfeiture provisions in a lease. Don't take no waiver clauses too literally. But don't dismiss them entirely. No waiver clauses help a landlord end lax enforcement patterns if landlord first gives tenant notice that it intends to end them and gives tenant a fair and reasonable opportunity to end its own lax performance before landlord declares a forfeiture.

Courts in other jurisdictions are all over the map. *See, e.g., Dillingham Comm'l Co. v. Spears*, 641 P.2d 1, 7-8 (Alaska 1982) (landlord's long acquiescence constituted waiver of right to claim breach of lease for late rental payments, despite non-waiver clause in lease); *Entrepreneur, Ltd. v. Yasuna*, 498 A.2d 1151, 1163 (D.C. 1985) (non-waiver clause had no effect on determination of whether landlord was estopped from asserting breach); *Protean Invrs., Inc. v. Travel, Etc., Inc.*, 499 So.2d 49, 50 (Fla. Dist. Ct. App. 1986) (notwithstanding anti-waiver provision in lease, landlord was estopped to assert breach by late payment of rent where it had previously accepted all rental payments without protest and did not previously notify tenant of its breach); *M.J.G. Props., Inc. v. Hurley*, 27 Mass. App. Ct. 250, 537 N.E.2d 165, 166-67 n.4 (Mass. App. Ct. 1989) (landlord waived breach by subsequently accepting rental payments; non-waiver clause is merely a circumstance to be considered with other circumstances in determining waiver); *Frits v. Cloud Oak Flooring Co.*, 478 S.W.2d 8, 13-14 (Mo. Ct. App. 1972) (despite no-waiver clause, landlord waived right to evict tenant for late payment of rent after accepting ten prior late payments); *Summa Corp. v. Richardson*, 564 P.2d 181, 184-85 (Nev. 1977) (no-waiver clause in lease will not necessarily foreclose waiver defense); *Easterling v. Peterson*, 753 P.2d 902, 903 (N.M. 1988) (despite no-waiver clause in lease, fact issues

administration this Lease will Waive, or diminish, Landlord's right to insist upon strict performance of Tenant's obligations.[303] No restrictive endorsement or other statement on or accompanying any check or payment will be deemed an estoppel,[304] accord and satisfaction,[305] or novation,[306] and Landlord will be entitled to accept any such check or payment,[307] without prejudice, to Landlord's rights to recover the full amount due and to exercise its other remedies for a Default.[308]

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as to waiver defense precluded summary judgment); *Soltis v. Liles*, 551 P.2d 1297, 1300 (Or. 1976) (no-waiver clause in real estate contract was ineffective) *see also Cottonwood Plaza Assoc. v. Nordale*, 644 P.2d 1314, 1318-19 (Ariz. Ct. App. 1982) (no waiver of breach where lease provides that acceptance of late rents is not waiver of rights); *S.H.V.C., Inc. v. Roy*, 450 A.2d 351, 354-55 (Conn. 1982) (disallowing tenant's waiver defense based on no waiver clause when landlord's acceptance of late rent on prior occasions was only evidence of waiver). In such cases, courts tend to balance landlord's reliance on the no-waiver clause against tenant's justifiable reliance on landlord's previous acts of forbearance. *S.H.V.C., Inc.*, 450 A.2d at 353.

[303] *See supra* footnotes **300** – **302** (discussing waivers by words and conduct).

[304] ***Estoppel*** is a rule of equity applied to prevent a person from taking advantage of a condition or situation when, with the knowledge of the facts, he has so conducted himself to cause the other party to change his position for the worse and results in the former being prohibited from asserting an otherwise valid right. *The Praetorians*, 66 S.W.2d at 688–89. "Under Texas law, a landlord is estopped from collecting additional rentals after he has filed a sworn pleading terminating the lease." *Taherzadeh v. Clements*, 781 F.2d 1093, 1099 (5th Cir. 1986) (citing *Glasscock v. Console Drive Joint Venture*, 675 S.W.2d 590, 592-93 (Tex. Civ. App.-San Antonio 1984, no writ)).

[305] ***Accord and satisfaction*** is a type of contractual modification that rests upon a new contract, express or implied, in which the parties agree to the discharge of the existing obligation by means of a lesser payment tendered and accepted. *Jenkins v. Henry C. Beck Co.*, 449 S.W.2d 454, 455 (Tex.1969). Because a valid accord and satisfaction depends upon an agreement, it "only occurs when the parties mutually assent to it," and their intention is a controlling element. *McCarty v. Humphrey*, 261 S.W. 1015, 1016 (Tex. Comm'n App.1924, judgm't adopted); *Williams v. Colthurst*, 253 S.W.3d 353, 359 (Tex. App.—Eastland 2008, no pet.).

[306] ***Novation*** requires (1) a previous valid obligation; (2) the agreement of all parties to a new contract; (3) the extinguishment of the old contract; and (4) the validation of the new contract with further consideration. *McKinney v. Flato Bros., Inc.*, 397 S.W.2d 525, 529 (Tex. Civ. App.—Corpus Christi 1965, no writ). "[N]ovation of agreement need not be in writing or evidenced by express words, but may be inferred from the acts and conduct of the parties and other facts and circumstances." *Koelzer v. Pizzirani*, 718 S.W.2d 420, 422 (Tex. App.—Fort Worth 1986, no writ) (citing *Utay v. Urbish*, 433 S.W.2d 905, 909–10 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.)).

[307] ***Negotiating Rent Check.*** A landlord's acceptance of payment from a tenant of sums undoubtedly owed does not necessarily preclude landlord – by estoppel, accord and satisfaction, novation, or otherwise – from pursuing landlord's rights and remedies against tenant. Endorsing and accepting the proceeds of a check, even one with a restrictive endorsement, does not always prevent landlord from declaring a forfeiture of the lease. *George Linskie Co. v. Miller-Picking Corp.*, 463 S.W.2d 170, 172-73 (Tex.1971) (quoting *Jenkins v. Henry C. Beck Co.*, 449 S.W. 454 (Tex. 1970) for proposition that, as a general rule, for an accord and satisfaction to exist "[t]here must be an unmistakable communication to the creditor that tender of the lesser sum is upon the condition that acceptance will constitute satisfaction of the underlying obligation."). In *Koelzer,* landlord pursued a *de novo* appeal from justice court to county court; in the appeal, landlord sought judgment against its holdover tenant for possession and Rule 752 damages arising from tenant's wrongful holdover after the justice court awarded landlord judgment for possession. 718 S.W.2d at 422. The holdover tenant defended on the ground that its landlord had consented to tenant's holdover by accepting payment of holdover rent. In the absence of a *bona fide* dispute over the amount of rent owed, and in view of landlord's consistent and repeated demands for possession, the court of appeals held that landlord's acceptance of holdover rental did not preclude either landlord's entitlement to possession or right to recover damages. *Id.*; *see Curtiss Aero. & M. Corp. v. Haymakers Warehousing Corp.*, 264 S.W. 326, 328–29 (Tex. Civ. App.—Galveston 1924, writ dism'd) (holding that hold-over tenant is liable to its landlord for rental during hold-over tenancy and tenant's payment of holdover rent, in the absence of an agreement or other circumstances, does not preclude landlord's exercise of its rights and remedies); *compare Wilkes v. Mason*, 529 S.W.2d 255, 256-57 (Tex. Civ. App.–Amarillo 1975, no writ) (reversing summary judgment in favor of tenant on ground that material issue of fact existed as to whether landlord intended to accept tenant's payment in full satisfaction of amounts owed when landlord endorsed tenant's check tendered at tenant's initiative, which stated in "very small capital letters"; "THIS CHECK IS IN FULL SETTLEMENT AS SHOWN HERE ACCEPTANCE BY ENDORSEMENT CONSTITUTES RECEIPT IN FULL") *with Avent v. Stinnett*, 513 S.W.2d 89, 95 (Tex. Civ.

(i) **Tax Appraisals & Protests**. Tenant Waives its rights (if any) (A) to protest or appeal any appraisal, and (B) to receive notice of any appraisal.[309]

(ii) **Notices**. **TO THE FULLEST EXTENT PERMITTED BY LAW, TENANT WAIVES ALL NOTICES AND DEMANDS (INCLUDING, WITHOUT LIMITATION, NOTICE OF BREACH OR DEFAULT, NOTICE OF NONPAYMENT OR NONPERFORMANCE, DEMAND FOR PAYMENT OR PERFORMANCE, DEMAND FOR POSSESSION, NOTICE OF ANY CHANGE IN LOCKS OR ACCESS CONTROL DEVICES, REENTRY, OR REPOSSESSION, AND NOTICE TO VACATE),[310] EXCEPT FOR THOSE NOTICES AND DEMANDS EXPRESSLY REQUIRED IN THIS LEASE.**

App.—Amarillo 1974, no writ) (holding that check bearing same, but more prominently displayed typed notation as the court considered in *Wilkes*, constituted an accord and satisfaction when creditor asked for check and then voiced no objection to the amount).

[308] ***Waiver by Acceptance of Rent***. "[U]pon a theory that the occurrence of a cause of forfeiture gives the lessor an election to declare the lease at an end or to overlook the breach and allow the lease to remain in force, it is generally held that the acceptance of rent, which accrues after a breach of a covenant or condition of the lease, with knowledge of such breach, constitutes a waiver of the right to forfeit the lease on account of such breach." *C.G. Murphy Co.* v. Lack, 404 S.W.2d 853, 858 (Tex. Civ. App.—Corpus Christi; 1966, writ ref'd n.re.). This general rule is subject to numerous exceptions. *See* 2 FRIEDMAN ON LEASES, *Waiver by Landlord of Tenant Default* § 16.5. "The receipt of rent is not a waiver of a continuing breach of covenant, such as the breach of a covenant as to the use of the premises, a covenant to insure the premises, or a covenant to repair." *Tony v. McClelland*, 283 S.W. 679, 681(Tex. Civ. App. 1926, writ dismissed w.o.j.); *see also In re Wil-Low Cafeterias, Inc.*, 95 F.2d 306, 309 (2nd Cir. 1938) (holding that non-waiver clause stating "receipt of rent with knowledge of any breach, shall not be deemed to be a waiver as to any breach of any covenant or condition herein contained[,]" allowed landlord to accept rent, "notwithstanding knowledge of a breach of condition," without being deemed to waive its right to terminate for such breach).

[309] ***Waiver of Tax Protest Rights***. The Texas Tax Code entitles "[a] person leasing real property who is contractually obligated to reimburse the property owner for taxes imposed on the property…to protest before the appraisal review board a determination of the appraised value of the property if the property owner does not file a protest relating to the property. The protest provided by this subsection is limited to a single protest by either the property owner or the lessee." TEX. TAX CODE § 41.413(b) (Vernon 2013). Thus, when a lease requires tenant to pay directly, or to reimburse landlord for payment of, *ad valorem* taxes, the landlord, as "[t]he property owner,[,] shall timely send to the person leasing the property a copy of any notice of the property's reappraisal received by the property owner. Failure of the owner to send a copy of the notice to the person leasing the property does not affect the time within which the person leasing the property may protest the appraised value." TEX. TAX CODE § 41.413(b). A landlord in a multi-tenant project must procure waivers from each of its tenants to prevent chaos of multi-tenant attempted tax protests.

[310] ***Demand for Performance***. Texas law is arguably still unsettled on the issue of whether a landlord must demand payment or performance before demanding that a delinquent tenant vacate the premises. At common law, landlord could not terminate a written lease for tenant's breach, or exercise any right of re-entry, unless landlord first demanded performance. *McVea*, 587 S.W.2d at 531; *Sorrells*, 182 S.W.2d at 1011; *Gray v. Vogelsang*, 236 S.W. 122, 126 (Tex. Civ. App.—Galveston 1921, no writ). Several authorities seem to support this view, at least in eviction proceedings. In *Santos v. City of Eagle Pass*, the court of appeals assumed such a demand is required at common law but refused to require the landlord to make the common law demand for performance as a condition to obtaining a judgment for possession in a forcible detainer action, holding that resort to common law rules is unnecessary when a lease grants the landlord the right to re-enter the premises, to repossess them, and to terminate the tenant's right of possession. 727 S.W.2d 126, 127 (Tex. App.—San Antonio 1987, no writ). Other cases assume, without deciding, that a demand for performance is required as a predicate to a notice to vacate in forcible detainer cases. These cases, however, avoid directly ruling on the issue, finding instead that the tenant had waived any right to any notice or demand for performance it may have had at common law. *See, e.g.*, *Caro v. Housing Auth.*, 794 S.W.2d 901, 903–04 (Tex. App.—Austin 1990, writ denied) (holding that tenant may and did waive any common law demand requirement which would have otherwise been a precursor to filing forcible detainer action); *Gray*, 236 S.W. 127 (holding that contractual right to reenter upon default, without more, is not an effective waiver of any common law notice or demand requirements in action in ejectment, the common law analogue to statutory eviction). In the absence of any clear authority dispensing with the common law demand for performance, requiring tenant to waive specifically any such common law notice requirements would appear to be the safer course. *Cf. Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890, 893-94 (Tex. 1991) (holding that waivers of common law rights by maker of note must be specific).

(iii) DTPA.[311] **AFTER CONSULTING WITH AN ATTORNEY OF TENANT'S OWN SELECTION, TENANT VOLUNTARILY WAIVES ITS RIGHTS AGAINST LANDLORD PARTIES UNDER THE DECEPTIVE TRADE PRACTICES-CONSUMER PROTECTION ACT, SECTION 17.41 *et seq.*, TEXAS BUSINESS & COMMERCE CODE, A LAW THAT GIVES CONSUMERS SPECIAL RIGHTS AND PROTECTIONS. TENANT REPRESENTS AND WARRANTS THAT ITS ATTORNEY WAS NOT, DIRECTLY OR INDIRECTLY, IDENTIFIED, SUGGESTED, OR SELECTED BY ANY LANDLORD PARTY.**[312]

Eviction Proceedings: Notice to Vacate. A notice to vacate is considered a demand for possession for purposes of subsection (b) of section 24.002 of the Texas Property Code, *see* TEX. PROP. CODE § 24.005(h), but it seems unlikely that a notice to vacate, without more, constitutes a demand for performance, absent an accompanying demand for payment or a statement conditioning tenant's obligation to vacate on tenant's failure to pay or perform before the deadline to vacate stated in the notice. *See* TEX. PROP. CODE § 24.005(i).

Effect of Waiver of Notice. Such waivers also may eliminate the need to provide other statutory notices or shorten the prescribed notice periods. A landlord must give a person in possession of the premises under an oral or written lease at least three days written notice to vacate before filing a forcible detainer suit, unless (i) the parties have contracted for a shorter or longer notice period in a written lease or agreement; or (ii) the lease or other applicable law requires an opportunity to respond. *See* TEX. PROP. CODE § 24.005(a); *see also* TEX. PROP. CODE § 91.001(a) (termination of month-to-month tenancy by landlord or tenant). Section 24.005(f) also prescribes certain methods of delivery as a predicate to an eviction suit. TEX. PROP. CODE § 24.005(f) (requiring that notice to vacate must be given in person or by registered or certified mail, return receipt requested at the premises in question," by personal delivery to tenant, or by affixing the notice to the inside of the main entry door, or on the outside of the door, if entry is not possible). A landlord and tenant also may agree, in an instrument signed by both parties, to notice periods different from those specified in section 91.001 for terminating certain tenancies or to no notice periods at all. *See* TEX. PROP. CODE § 91.001(e).

Calculation of Statutory Notice Periods. In eviction proceedings, the applicable statutory notice period "is calculated from the date on which the notice is delivered." TEX. PROP. CODE § 24.005(g). Before taking any enforcement actions, check the contractual notice provisions to determine whether the lease establishes a different method to compute the effective date of notices or mandates different methods of giving notice.

[311] ***DTPA***. The Texas Deceptive Trade Practices Act (DTPA) allows a "consumer" to maintain a statutory action if: (1) a false, misleading, or deceptive act or practice listed in section 17.46 of the DTPA on which a consumer relies to its detriment; (2) a breach of an express or implied warranty; ***or*** (3) any unconscionable action or course of action is (4) a "a producing cause of damages." TEX. BUS. & COM. CODE §§ 17.46 (enumerating deceptive acts or practices prohibited) and § 17.50(a) (prescribing remedies for violations).

Consumer. As a general rule, a consumer is any "individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services…." TEX. BUS. & COM. CODE § 17.45(4); *Flenniken v. Longview Bank & Trust Co.,* 661 S.W.2d 705, 706 (Tex. 1983) (stating that "[s]ection 17.45(4), however, only describes the class of persons entitled to bring suit under section 17.50; it does not define the class of persons subject to liability under the DTPA."). Moreover, "'[g]oods' means tangible chattels *or real property* purchased *or leased* for use." TEX. BUS. & COM. CODE § 17.45(1) (emphasis added).

Excluded Claimants and Claims. Although the DTPA potentially applies to any lease of real property, its potential application to commercial lease transactions is limited in three ways. First, the DTPA excludes large business consumers from the definition of a consumer. "The term [consumer] does not include a business consumer that has assets of $25 million or more, or that is owned or controlled by a corporation or entity with assets of $25 million or more." TEX. BUS. & COM. CODE § 17.45(4) (emphasis added). Second, the DTPA exempts entirely any "cause of action arising from a transaction, a project, or a set of transactions relating to the same project, involving total consideration by the consumer of more than **$500,000.**" TEX. BUS. & COM. CODE § 17.49(g). Third, the DTPA conditionally exempts any "claim arising out of a written contract if: (1) the contract relates to a transaction, a project, or a set of transactions related to the same project involving total consideration by the consumer of more than **$100,000**; [and] (2) in negotiating the contract the consumer is represented by legal counsel who is not directly or indirectly identified, suggested, or selected by the defendant or an agent of the defendant and (3) the workout does not involve the consumer's residence." TEX. BUS. & COM. CODE § 17.49(f).

[312] ***DTPA Waivers***. Even if a leasing transaction is not otherwise exempt from the DTPA, a tenant may waive its rights and claims under the DTPA in accordance with section 17.42(a) ***if***:

(1) the waiver is in writing and is signed by the consumer;

(2) the consumer is not in a significantly disparate bargaining position; and

(iv) **Jury Trial**. **TENANT AND LANDLORD EACH KNOWINGLY, VOLUNTARILY, AND ON THE ADVICE OF COUNSEL: (A) AGREE NOT TO ELECT A JURY TRIAL IN ANY SUIT ARISING OUT OF, OR RELATING TO, THIS LEASE OR THE PROJECT; AND (B) WAIVE ANY PRESENT OR FUTURE RIGHT TO A JURY TRIAL.**[313]

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(3) the consumer is represented by legal counsel in seeking or acquiring the goods or services.

But a waiver that meets these three threshold requirements "is not effective if the consumer's legal counsel was directly or indirectly identified, suggested, or selected by a defendant or an agent of the defendant, DTPA § 17.42(b), or the waiver is not in the proper form. DTPA § 17.42(c). To satisfy the form requirements, the waiver also must be: (1) conspicuous and in bold-face type of at least **10 points i**n size; (2) identified by the heading "Waiver of Consumer Rights," or words of similar meaning; and (3) in substantially the following form:

> "I waive my rights under the Deceptive Trade Practices-Consumer Protection Act, Section 17.41 *et seq*., Business & Commerce Code, a law that gives consumers special rights and protections. After consultation with an attorney of my own selection, I voluntarily consent to this waiver."

DTPA § 17.42(c). The waiver required by Subsection (c) may be modified to waive only specified rights under this subchapter. DTPA § 17.42(d). Absent a valid waiver, the defenses available to DTPA claim arising from a transaction that is not exempt are quite limited. The common law defenses of estoppel, substantial completion, and ratification, among others, do not apply at all, and others, such as waiver, are severely restricted. *Haney v. Purcell Co., Inc.*, 770 S.W.2d 566, 567 (Tex. 1989) (holding that abandonment of cemetery did not preclude DTPA claim for failing to disclose that house was built on cemetery site); *Alvarado v. Bolton*, 749 S.W.2d 47, 48 (Tex. 1988) (holding common law doctrine of merger does not defeat DTPA cause of action for breach of express warranty made in earnest money contract when deed breached contractual warranty); *Ojeda deToca v. Wise*, 748 S.W.2d 449, 451 (Tex. 1988) (holding that constructive notice provided by recording statute is not defense to DTPA claim); *LSR Joint Venture # 2 v. Callewart*, 837 S.W.2d 693, 699 (Tex. App.—Dallas 1992, writ denied) (stating common law defenses of ratification and waiver did not apply to DTPA claims). The general prohibition of waivers of rights under the DTPA, however, does not preclude or invalidate waivers of implied warranties, such as the implied warranty of suitability.

[313] ***Waiver of Right to Jury Trial***. "The Texas Constitution guarantees the right to jury trial." *In re Key Equip. Fin. Inc.*, 371 S.W.3d 296, 301 (Tex. App.—Houston [1st Dist.] 2012) (orig. proceeding) (citing TEX. CONST. art. V, § 10). Even so, a knowing and voluntary jury trial waiver is enforceable in Texas. *In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 132-34 (Tex. 2004). To be enforceable, however, the waiver must be made knowingly, voluntarily, and intelligently "with sufficient awareness of the relevant circumstances and likely consequences." *Id.* at 132 (citing *Brady v. United States*, 397 U.S. 742, 748 (1970) and holding that tenant and guarantor knowingly and voluntarily waived right to trial by jury in "crystal clear" lease provision); *see also In re Bank of Am., N.A.*, 278 S.W.3d 342, 345 (Tex. 2009); *In re General Elec. Capital Corp.*, 203 S.W.3d 314, 316 (Tex. 2006) (per curiam). In *Prudential*, the Texas Supreme Court grounded its holding – that knowing and voluntary jury trial waivers are enforceable – on the "compelling public policy…to enforce legal agreements freely made." *In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 140. "Parties are free to agree to such remedies as they choose," and, as the supreme court noted, "they may have good reasons for agreeing to waive a jury trial. " *Id.*; *see also Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 95 (Tex.2011) (stating that "[a]s a fundamental matter, Texas law recognizes and protects a broad freedom of contract.").

Burden Shifting. An inconspicuous jury trial waiver is enforceable in theory ***if*** the party seeking to enforce the waiver proves the waiver is knowing and voluntary. *In re Bank of Am., N.A.*, 278 S.W.3d at 345; *In re General Elec. Capital Corp.*, 203 S.W.3d at 316; *In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 134. By contrast, a conspicuous jury waiver provision is itself "*prima facie* evidence of a knowing and voluntary waiver and shifts the burden to the [party] opposing [the waiver] to rebut it." *In re Bank of Am., N.A.*, 278 S.W.3d at 343 (quoting *In re General Elec. Capital Corp.*, 203 S.W.3d at 316); *see In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 134 fn.36 (assuming, but not deciding, that jury trial waiver must be conspicuous). Thus, absent an allegation of fraud, "a conspicuous waiver of trial by jury is presumed to be knowing and voluntary." *In re Bank of Am., N.A.*, 278 S.W.3d at 345; *In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 134 (citing *Estes v. Republic Nat'l Bank*, 462 S.W.2d 273, 276 (Tex.1970) and stating that presumption that conspicuous waiver is knowing an voluntary arises from "general rule [] that in the absence of a showing of fraud or imposition, a party's failure to read an instrument before signing it is not a ground for avoiding it.").

The ***test for conspicuousness*** is whether the waiver is "so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it." TEX. BUS. & COM. CODE § 1.201(10); *see In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 134. Under the Texas UCC:

42. **EXHIBITS AND RIDERS**. These Exhibits and Riders are part of this Lease:

	EXHIBITS		RIDERS
Exhibit A:	Premises	Rider 1:	Renewal Option
Exhibit B:	Legal Description of Land[314]	Rider 2:	Expansion Option
Exhibit C:	Rules and Regulations	Rider 3:	Right of First Refusal
Exhibit D:	Work Letter	Rider 4:	Form of SNDA
Exhibit E:	Commencement Letter		
Exhibit F:	Guaranty		
Exhibit G	Janitorial Specifications		

Appendices

Appendix I — **Pass Through Provisions**

- App. I-A — 8. Additional Rent
- App. I-B — 9. Operating Expense Definition
- App. I-C — 10. Taxes; Rent Taxes
- App. I-D — 11. Management Fee Calculation

"Conspicuous," with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language.

TEX. BUS. & COM. CODE § 1.201(10); *In re Prudential Ins. Co. of Am.*, 148 S.W.3d at 134 fn. 36 (stating that "[w]hether a term is 'conspicuous' or not is a decision for the court.'"). To determine whether the jury trial waiver in *Bank of Am.* was conspicuous, the supreme court considered a number of factors: the length of the addendum at issue ("only two pages long"); the number of provisions (20); the general typography ("each of the twenty provisions [was] set apart by one line and numbered individually"); the fact that of 20 provisions only 5 had "bolded introductory captions similar to the waiver provision in *Prudential*" and that the "Waiver of Trial By Jury" caption was one of the 5 with a bolded captions; and the fact that the caption was hand-underlined, as was the word "waiver" and the words "trial by jury" within the provision. *Id.* at 344. "This bolded, underlined, and captioned waiver provision is no less conspicuous than those contractual waivers that we upheld in both *Prudential* and *General Electric*," and, therefore, is sufficient to serve "as *prima facie* evidence that the representatives of [the party] knowingly and voluntarily waived their constitutional right to trial by jury." *Id.*

Fraudulent Inducement of Jury Waiver. Even a conspicuous jury trial waiver may be ineffective if the waiver is procured by fraud. But "general allegations of fraud [are] not sufficient to shift the burden of proof" from the party opposing waiver to the party seeking to enforce it. Otherwise, the "[t]he purpose of [jury waiver] provisions—to control resolution of future disputes—would be almost entirely defeated if the assertion of fraud common to such disputes were enough to bar enforcement." *In re Bank of Am., N.A.*, 278 S.W.3d at 344. An allegation of fraud, however, ***might be sufficient*** to shift the burden to the party seeking to enforce the waiver if fraud is alleged in the execution of the waiver provision itself. *Prudential*, 148 S.W.3d at 134 If a party could simply allege fraud on the entire transaction in order to nullify a jury—waiver provision, there would hardly ever be a circumstance when waiver provisions could ever be enforceable. *In re Bank of Am., N.A.*, 278 S.W.3d at 346.

Arbitration. Some leases commit certain issues or disputes to arbitration. Fair rental value renewal options often submit to arbitration the determination of the fair rental value during a renewal term. Texas courts routinely enforce agreements — *i.e.*, contracts — to arbitrate future disputes. *Massey v. Galvan*, 822 S.W.2d 309, 318-19 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (stating that "when a party agrees to have a dispute resolved through arbitration rather than a judicial proceeding, that party has waived its right to a jury trial."); *see Telum, Inc. v. E.F. Hutton*, 859 F.2d 835 (10th Cir. 1988), *cert. denied*, 490 U.S. 1021 (1989) (holding, based on analogy to rule in arbitration cases, that general allegations of fraud in the inducement of entire contract are not sufficient to invalidate arbitration provision).

[314] *See supra* p. 22-15, ¶ 1(o) for definition of ***Land*** and accompanying footnote 27 (discussing adequacy of legal description).

EXHIBITS		RIDERS
<u>**Appendix II**</u>	**Repair, Maintenance, Surrender & Casualty**	
• App. II-A	As Is Waiver (aka Italian Cowboy Rider)	
• App. II-B	Repair & Maintenance & Surrender Clauses	
<u>**Appendix III**</u>	**Monetary Remedies and Mitigation**	
<u>**Appendix IV**</u>	**List of 2013 ISO CGL Form Revisions**	
<u>**Appendix V**</u>	**Short Form Subordination of Landlord's Lien**	

Signatures on Next Page

Landlord and Tenant each executed multiple original counterparts of this Lease.

<u>LANDLORD</u>:
Notice Address:

____
____
____

Payment Address:

____
____
____

OVERLORD LEASING SYNDICATE, a Delaware limited partnership

By:______________________________________
Name:__________________________________
Title:___________________________________

Date:____________________________________

<u>TENANT</u>:
Notice Address before Occupancy:

____
____
____

Notice Address during Occupancy:

____
____
____

SERF PROTECTIVE SERVICES, a Texas corporation

By:______________________________________
Name:__________________________________
Title:___________________________________

Date:____________________________________

App. I-A: Sample Additional Rent Formula

- 95% Gross Up of Additional Rental
  - Operating Expenses (only variable costs grossed up)
  - Electrical Expenses (base building and vacancy electrical costs not grossed up)
  - Texas Margin Taxes (grossed up)
  - 3% Management Fee (grossed up)
- No Gross Up of other Real Estate Taxes

App. I-B: Sample Operating Expenses Definitions

App. I-C: Sample Definition of Real Estate Taxes (including Texas Margin Tax)

- Broad definition of Real Estate Taxes includes:
  - Taxes assessed by Federal, state, and local taxing authorities
  - Texas Margin Taxes (with gross-up)
- Express prohibition on Real Estate Tax gross up (other than Texas Margin Taxes)

App. I-D: Example of Management Fee Component Calculation

- 3% of Basic Rent, Operating Expenses, and Real Estate Taxes
- Computation method to avoid assessment of 3% management fee on management fee itself

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App. I-A: Sample Additional Rent Formula

8. Tenant's Additional Rental.

(a) Subject to the terms of this Section 8, from and after the Rental Commencement Date, Tenant shall pay to Landlord "Tenant's Forecast Additional Rental (as defined in subparagraph (b) below) and "Tenant's Additional Rental" (as defined in subparagraph (c) below). Payment of Tenant's Forecast Additional Rental shall be made as set forth in Section 5(a).

(b) "Tenant's Forecast Additional Rental" shall mean Landlord's reasonable estimate of Tenant's Additional Rental for the next occurring calendar year or portion thereof. If at any time it appears to Landlord, in its reasonable discretion, that Tenant's Additional Rental for the current calendar year will vary from Landlord's estimate by more than five percent (5%), Landlord shall have the right once each calendar year to revise, by notice to Tenant, its estimate for such year, and subsequent payments by Tenant for such year shall be based upon such revised estimate of Tenant's Additional Rental. Failure to make a revision contemplated by the immediately preceding sentence shall not prejudice Landlord's right to collect the full amount of Tenant's Additional Rental. At least thirty (30) days prior to the date on which the first payment of Additional Rental is due, and thereafter prior to the beginning of each calendar year during the Lease Term, including any extensions thereof, Landlord shall present to Tenant a statement of Tenant's Forecast Additional Rental for such calendar year; provided, however, that if such statement is not given prior to the beginning of any calendar year as aforesaid, Tenant shall continue to pay during the next ensuing calendar year on the basis of the amount of Tenant's Forecast Additional Rental payable during the calendar year just ended until the month after such statement is delivered to Tenant.

(c) For purposes of this Lease, "Tenant's Additional Rental" shall mean for each calendar year (or portion thereof) the sum of:

(i) the amount by which the Operating Expense and Real Estate Tax Amount (defined below) exceeds the sum of (A) the Operating Expense Stop plus (B) the Real Estate Tax Stop, multiplied by the number of square feet of Rentable Floor Area of Demised Premises. As used herein, "Operating Expense and Real Estate Tax Amount" shall mean an amount equal to (x) plus (y), where:

(x) equals the sum of (A) amount of Operating Expenses (as defined below) for such calendar year divided by the number of square feet of Rentable Floor Area of the Building; provided, however, if the costs Landlord incurs for components of Operating Expenses that vary directly with occupancy are lower than would be incurred if at least 95% of the Building were occupied or if Landlord does not furnish any particular item(s) of work or services (the cost of which would otherwise be included within Operating Expenses) to portions of the Building because (I) such portions are not occupied, (II) such item of work or services is not required or desired by the tenant of such portion, (III) such tenant is itself obtaining such item of work or services, or (IV) for

any other reason, then equitable, appropriate, and methodologically consistent adjustments shall be made to adjust such variable costs to be included in Operating Expenses for that calendar year and for the Base Year as though the Building were actually 95% occupied and as though Landlord had furnished such item of work or services to 95% of the Rentable Floor Area of the Building during each year in question and for the Base Year (but in no event shall Landlord collect and retain for Operating Expenses in excess of what Landlord expends or incurs for Operating Expenses), plus (B) the amount of Real Estate Taxes (without gross up) for such calendar year divided by the number of square feet of Rentable Floor Area of the Building; and

(y) equals a management fee contribution equal to three percent (3%) of the difference between Tenant's Base Rental and the sum of the Base Year amount for Operating Expenses (which includes Real Estate Taxes) (on a per square foot basis) plus three percent (3%) of the per square foot amount described in (x); except that, solely for the purpose of establishing the Base Year amount for Operating Expenses and for Real Estate Taxes, (y) will be equal to three percent (3%) of the difference between (i) Tenant's annual Base Rental Rate for the first Lease Year and (ii) three percent (3%) of Tenant's annual Base Rental Rate for the first Lease Year. An example of the calculation of the foregoing management fee is attached hereto as Exhibit "L"; plus

(ii) Tenant's Pro Rata Share of Electrical Expenses; provided however, if the Electrical Expenses actually incurred by Landlord are lower than the amount of expenses that would have been incurred had Landlord furnished full electrical services to 95% of all leasable space within the Building for the entire year in question (either because (A) portions of leasable space are not occupied, (B) any tenant is itself obtaining such service, or (C) for any other reason), then appropriate methodologically consistent adjustments shall be made to allocate 95% of the actual variable costs of supplying full electricity to the occupied space of tenants receiving full electrical service from Landlord among those tenants in the proportion that each tenant's use bears to the use of electricity by all such tenants receiving full electricity from Landlord taking into account the Rentable Floor Area, the number of days in occupancy if Landlord does not supply electricity to any such tenant for the entire calendar year, and the total electrical usage during the periods when such electrical service is provided.

(d) Within one hundred fifty (150) days after the end of the calendar year in which the Rental Commencement Date occurs and of each calendar year thereafter during the Lease Term, or as soon thereafter as practicable, Landlord shall provide Tenant a statement showing the Operating Expenses, Electrical Expenses and Real Estate Taxes for said calendar year, and a statement comparing Tenant's Forecast Additional Rental with Tenant's Additional Rental. In the event Tenant's Forecast Additional Rental exceeds Tenant's Additional Rental for said calendar year, Landlord shall credit such amount against Rent next due hereunder or, if the Lease Term has expired or is about to expire, refund such excess to Tenant if Tenant is not in default under this Lease (in the instance of a default such excess shall be held as additional security for Tenant's performance, may be applied by Landlord to cure any such default, and shall not be refunded until any such default is cured). If the Tenant's Additional Rental exceeds Tenant's Forecast Additional Rental for said calendar year, Tenant shall pay Landlord, within thirty (30) days of receipt of the statement, an amount equal to such difference. The provisions of this Lease concerning the payment and reconciliation of Tenant's Additional Rental shall survive the expiration or earlier termination of this Lease.

(e) Provided Tenant is not in default under this Lease beyond applicable notice and cure periods, Landlord's books and records pertaining to Operating Expenses, Electrical Expenses, Real Estate Taxes and the calculation of Tenant's Additional Rental for any calendar year within the Lease Term may be audited by an authorized representative of Tenant at Tenant's expense, at any time within one hundred eighty (180) days after Tenant's receipt of the annual statement therefor; provided that Tenant shall give Landlord not less than thirty (30) days' prior written notice of any such audit. For purposes hereof, an authorized representative of Tenant shall mean a bona fide employee of Tenant, any accounting firm, attorney, real estate firm, any third party who has performed such an audit for any other tenant of the Building, or any other party reasonably approved in writing by Landlord. In no event shall an authorized representative of Tenant include the owner of any office building in the metropolitan Dallas, Texas area or any affiliate of such owner. Prior to the commencement of such audit, Tenant shall cause its authorized representative to agree in writing for the benefit of Landlord that such representative will keep the results of the audit confidential and that such representative will not disclose or divulge the results of such audit except to Tenant and Landlord and except in connection with any dispute between Landlord and Tenant relating to Operating Expenses, Electrical Expenses and/or Real Estate Taxes. Such audit shall be conducted during reasonable business hours at Landlord's office where Landlord's books and records are maintained. Tenant shall cause a written audit report to be prepared by its authorized representative following any such audit and shall provide Landlord with a copy of such report promptly after receipt thereof by Tenant. Notwithstanding anything to the contrary contained in the immediately preceding sentence, Tenant shall have no obligation to provide Landlord with a copy of such audit report unless Tenant, in its sole discretion, seeks a reduction or refund of such expenses based on Tenant's audit. If Landlord's calculation of Tenant's Additional Rental for the audited calendar year was incorrect, then Tenant shall be entitled to a prompt refund of any overpayment or Tenant shall promptly pay to Landlord the amount of any underpayment, as the case may be. In addition, if the audit reveals that Operating Expenses for the audited calendar year was overstated by more than three percent (3%), then Landlord shall also pay the reasonable out-of-pocket costs of Tenant's audit up to, but not in excess of, $5,000.00.

App. I-B: Operating Expenses Definitions

9. Operating Expenses.

(a) For the purposes of this Lease, "Operating Expenses" shall mean all reasonable and non-duplicative, direct expenses, costs and disbursements (but not specific costs billed or billable to specific tenants of the Building) of every kind and nature, computed on a commercially customary basis for real estate projects, incurred by Landlord in connection with the ownership, management (the costs of which that may be included in Operating Expenses shall be limited as provided in this Section 9), operation, repair, landscaping, and maintenance of the Project, including but not limited to, the following:

(i) wages, salaries and benefits of all on-site and off-site non-executive employees up to the level of regional property manager engaged either full or part-time (with such wages, salaries and other costs of part-time employees being allocated on an equitable basis based on time spent with respect to the Project) in the operation, management, maintenance or access control of the Project, including taxes, insurance and benefits relating to such employees, equitably allocated based upon the time such employees are engaged directly in providing such services;

(ii) the cost of all supplies, tools, equipment and materials used in the operation, management, maintenance and access control of the Project;

(iii) the cost of all utilities for the Project, including but not limited to the cost of gas, water, sewer services, communication services, lighting, heating, air conditioning and ventilating (excluding the cost of electricity used to supply such services, all Electrical Expenses, and the costs incurred to provide any of the foregoing services to any tenant during non-business hours;

(iv) the cost of all maintenance and service agreements for the Project and the equipment serving the Project, including but not limited to security service, garage operators, window cleaning, elevator maintenance, HVAC maintenance, janitorial service, waste disposal and recycling service, telecommunications services, interior and/or exterior landscaping maintenance and customary interior and/or exterior landscaping replacement;

(v) the cost of repairs and general maintenance of the Project;

(vi) annual amortization (together with reasonable financing charges, whether or not actually incurred, equal to nine percent (9%) per annum) of the reasonable cost of acquisition and/or installation of capital investment items and/or capital improvements made by Landlord (including security and energy management equipment), amortized on a straight line bases over their respective useful lives in accordance with generally accepted accounting principles consistently applied, which are installed for the purpose of reducing Operating Expenses (but only if Landlord was reasonable in determining that such capital investment item would reduce Operating Expenses), improve security services to the Building (so long as the items installed to improve security are consistent with the "First Class Standard" [as that term is defined in Paragraph (b) of Exhibit "E"]), or that are required to comply with governmental requirements not in effect as of the Effective Date;

(vii) the cost of insurance premiums for casualty, rental loss, and commercial general liability insurance carried by Landlord applicable to the Project and Landlord's personal property used in connection therewith;

(viii) the cost of trash and garbage removal, air quality audits, vermin extermination, and snow, ice and debris removal;

(ix) the cost of legal and accounting services incurred by Landlord in connection with the management, maintenance, operation and repair of the Project, excluding the owner's or Landlord's other accounting and legal services, such as partnership statements, financial statements and tax returns, and excluding services described in Section 9(b)(xiv) below;

(x) the reasonable cost of operating the management office within the Project (not to exceed 3,128 square feet in size) (but no costs for any portion of any leasing office and no capital costs incurred in the initial build out or furnishing of such management or leasing office shall be included as an Operating Expense under this provision), including the cost of office supplies, bulletins or newsletters distributed to tenants, postage, telephone expenses, maintenance and repair of office equipment, non-capital investment equipment, amortization (with reasonable financing charges) on a straight-line basis of the cost of capital investment equipment, and rent;

(xi) if a fitness center (not to exceed 5,000 square feet in size), conference center (not to exceed 3,000 square feet in size), or other amenity is available for use by tenants of the Building and is operating within the Building, the pro rata share applicable to the Building (and allocated on a per square foot basis among buildings which have tenants with the right to utilize the amenity in question) of the costs of operating (which shall include the cost of salaries and benefits for employees for and necessary for any such facility), managing, maintaining and repairing such amenity and the equipment and furnishings therein (but not for the initial capital costs of providing or equipping such facility, and only to the extent, if any, that such costs exceed any revenues, including but not limited to rent and fees paid by non-tenants, received from such facilities, including, without limitation, the cost of utilities, janitorial services, supplies, insurance, personal property taxes, and amortization (together with reasonable financing charges) on a straight-line basis of the cost of replacing worn out or obsolete equipment, furniture, or other applicable items, but excluding costs

of imputed or foregone rent on such space, upfitting the amenity space and the costs of purchasing the equipment and furniture initially installed in the amenity in question;

(xii) the pro rata share applicable to the Project of any other costs and expenses incurred by Landlord as "Owner" of the Project under and pursuant to any declaration of covenants and cross-easements, reciprocal easement agreements, ground leases (other than ground rent due thereunder), condominium association agreements or any other public or private arrangements or agreements, from time to time affecting the Project;

(xiii) amortization (together with reasonable financing charges, whether or not actually incurred) of the reasonable cost of acquisition and/or installation of capital investment items, amortized over their respective useful lives, which are installed for the purpose of maintaining the first-class nature of the Project (taking into account the age of the Project), including capital investment items which are replacements of items which are obsolete or cannot be repaired in an economically feasible manner, but excluding the cost of the Building Renovation Work (defined in Special Stipulation 8).

(xiv) the costs of implementing, operating, maintaining and complying with the Building's Asbestos Operations and Maintenance Plan and the Building's groundwater treatment and pumping system.

App. I-C: Real Estate Taxes (including Texas Margin Tax)

10. Taxes; Rent Taxes.

(a) The term "Real Estate Taxes" means real estate taxes, assessments and governmental charges, whether or not directly paid by Landlord, whether federal, state, county or municipal and whether they be by taxing districts or authorities presently taxing the Project or by other taxing authorities subsequently created, and any other real estate taxes and assessments attributable to the Project or its operation (and the reasonable costs of contesting any of the same), including community improvement district taxes and business license taxes and fees and any Real Estate Taxes payable by Landlord pursuant to V.T.C.A., Texas Tax Code, Chapter 171, Section 171.001, et seq. (the "Texas Margin Tax"), as such statute may be amended or recodified from time to time (but only to the extent such amendment or recodification does not alter the fundamental premise of the Texas Margin Tax as a tax created and imposed in lieu of ad valorem taxes or is otherwise a non-substantive amendment or recodification) allocable to the Project, excluding, however, taxes and assessments imposed on the personal property of the tenants of the Project, federal and state taxes on income, death taxes, franchise taxes imposed or measured on or by the net income, and any taxes (other than the Texas Margin Tax) imposed or measured on or by the net income of Landlord from the operation of the Project; and it is agreed that Tenant will be responsible for ad valorem taxes on its personal property and on the value of the leasehold improvements in the Demised Premises to the extent that the same exceed Building Standard allowances, if said taxes are based upon an assessment which includes the cost of such leasehold improvements in excess of Building Standard allowances (and if the taxing authorities do not separately assess Tenant's leasehold improvements, Landlord may make an appropriate allocation of the ad valorem taxes allocated to the Project to give effect to this sentence). Notwithstanding anything contained in this Lease to the contrary, Operating Expenses and Real Estate Taxes shall not include succession, gift or profit tax imposed upon Landlord or other taxes to the extent applicable to Landlord's general or net income, nor penalties imposed upon Landlord for Landlord's delinquent payment of any taxes, nor any special or benefit assessment, development tax or impact fee levied in connection with the initial construction or subsequent alteration, redevelopment, remodel or expansion of the Building and/or Project. If any taxes includable in Operating Expenses or Real Estate Taxes may be payable in installments, then Landlord shall be deemed to have elected to pay such taxes in installments over the longest reasonable period permitted by law, and in such case, Tenant shall only be obligated to reimburse Landlord for its share of each installment as it would otherwise be payable during the Term of this Lease. In the event Real Estate Taxes are not fully assessed for the entire Base Year, then the Real Estate Taxes for the Base Year shall be appropriately adjusted to an amount of "full assessment" (i.e., as if the Building were eighty-five percent [85%] occupied with tenant improvements constructed and with all tenants paying full market rent). The calculation of Tenant's Pro Rata Share of the Texas Margin Tax incurred by Landlord shall be calculated as follows: (a) the ratio of (1) Base Rental paid by Tenant to Landlord during the applicable calendar year, to (2) the total base rental received by Landlord from all tenants of the Project during such calendar year, multiplied by (b) the Texas Margin Tax liability that would be incurred by Landlord with respect to revenues earned during the calendar year if the Project was the sole operating asset owned by Landlord and Landlord was not part of a combined reporting group. During the Base Year, for purposes of calculating the Texas Margin Tax, such component of Real Estate Taxes shall be calculated as if Tenant was in fact paying full rent throughout the entire Base Year at the annual rate of $XX.xx per square foot of Rentable Floor Area so that the Base Year will be fully grossed up for this purpose.

(b) Tenant shall pay promptly when due all taxes directly or indirectly imposed or assessed upon Tenant's gross sales, business operations, machinery, equipment, trade fixtures and other personal property, whether such taxes are assessed against Tenant, Landlord or the Building. In the event that such taxes are imposed or assessed against Landlord or the Building, Landlord shall furnish Tenant with all applicable tax bills, public charges and other assessments or impositions and Tenant shall forthwith pay the same either directly to the taxing authority or, at Landlord's option, to Landlord. In addition, in the event there is imposed at any time a tax upon and/or measured by the rental payable by Tenant under this Lease, whether by way of a sales or use tax or otherwise, Tenant shall be responsible for the payment of such tax and shall pay the same on or prior to the due date thereof; provided, however, that the foregoing shall not include any inheritance, estate, succession, transfer, gift or income tax imposed on or payable by Landlord.

App. I-D:. Sample Management Fee Component Calculation

The following is an example to illustrate the calculation of the management fee component of Tenant's Additional Rental under Article 8(c) of this Lease for the 2015 calendar year based upon the terms of this Lease and certain assumptions made solely for purposes of this example.

Assume the Base Rental Rate for the Demised Premises for the 2015 Base Year is $21.50. Accordingly, the management fee component of the Base Rental Rate for the 2015 Base Year is $0.63, calculated as follows:

Base Rental Rate for first Lease Year	$21.50
3% of Base Rental Rate for first Lease Year	($ 0.65)
Difference	$20.85
Management fee contribution rate (3%)	.03
Management fee component for 2015 Base Year	$ 0.63

For purposes of this example, assume that the Operating Expenses for the 2015 Base Year, as adjusted pursuant to the Lease, are $8.50 per square foot and that, accordingly, the Operating Expense Amount for the 2015 Base Year is $9.13 per square foot ($8.50 plus $0.63). Also assume that the Operating Expenses for the 2016 calendar year, as adjusted pursuant to the Lease, are $8.80 per square foot (an increase in Operating Expenses of approximately 3.5% over the amount from the Base Year) and that the Tenant's Base Rental Rate for the Demised Premises for the 2016 calendar year (on an annual average basis) is $22.00 per square foot. Based upon such assumptions, the management fee contribution for the 2016 calendar year is calculated as follows:

Base Rental Rate for 2016 (averaged)	$22.00
Less Operating Expense Amount for Base Year	($9.13)
Plus Operating Expenses psf for 2016	$ 8.80 (A)
Total	$21.67
Management fee rate	3%
Management fee component for 2016 psf	$ 0.65 (B)
Operating Expense Amount for 2016	$9.45 (A+B)
Tenant's Additional Rental for 2016 psf	$0.32

I. LANDLORD'S REPAIR AND MAINTENANCE OBLIGATIONS

The common law and most commercial leases distinguish between a landlord's duty to repair common areas and other facilities over which the landlord retains possession or control, as opposed to the leased premises. Based largely on principles of control, a landlord – even when a lease is silent – has an implied contractual duty to its tenant, and a legal duty to third parties sounding in tort, to keep common areas and other facilities within the landlord's control in good repair and condition.[1] But, at common law, a landlord generally had no implied duty to the tenant (in contract or implied from the parties' relationship) or to third parties (in tort for premises liability) to keep the premises in good condition, absent either the express obligation to do so in the lease or the landlord's exercise of control of conditions within the premises.[2] The next section of the outline focuses on a landlord's obligation to its tenant—when the lease is silent—with respect to the maintenance and repair of the premises, common areas, and other facilities over which the landlord retains possession or control.

A. Traditional Rules.

1. ***Landlord Has Duty to Repair Common Areas***. At common law, a landlord has a duty to its tenant to maintain a common area or facility of which the landlord retains possession or control.[3] In the absence of an agreement to the contrary, a landlord is deemed to retain control of, and is thus responsible for repairs to, "every part of the building not included in the actual holding of any one tenant."[4] But under the traditional common law rule, this implied duty did not extend to latent defects in structural portions of a building possessed exclusively by a tenant.[5]

2. ***Landlord Has No Duty to Repair Premises.*** Under the traditional common law rule, a landlord was not required to make any repairs (including structural repairs) to the premises during the lease term, unless the lease expressly obligated the

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[1] *Brown v. Frontier Theatres, Inc.*, 369 S.W. 2d 299, 303 (Tex. 1963) (holding that when landlord retains possession or control of portion of leased premises, landlord is charged with duty of ordinary care in maintaining portion retained so as not to damage tenant); *Lang v. Henderson*, 215 S.W.2d 585, 588 (Tex. 1948) (stating that when landlord breaches duty to maintain common area or facility, landlord is liable to tenant who suffers injury due to defects in facilities over which landlord retains possession or control); *McCreless Props., Ltd. v. F. W. Woolworth Co.*, 533 S.W.2d 863, 866 (Tex. Civ. App. – San Antonio 1976, writ ref'd n.r.e.) (stating that when landlord retains possession or control of portion of leased premises, landlord, in absence of any agreement to contrary, has implied duty to tenant to maintain retained portion of premises "so as not to damage the tenant").

[2] *Johnson County Sheriff's Posse, Inc. v. Endsley*, 926 S.W.2d 284, 285 (Tex. 1996) (holding that landlord has no duty to tenant or its invitees for dangerous conditions in leased premises, unless landlord: (1) makes negligent repairs; (2) conceals defects in premises of which landlord is aware; or (3) retains control over that portion of premises where defect or unsafe condition causes injury); *Tillery v. Trans Texas Inv. Props.*, 2003 WL 1461476 (Tex. App. – Dallas 2003, pet. denied) (released for publication June 23, 2003) (assuming, without deciding, that – when applicable – implied warranty of suitability would create duty of landlord to third party injured as a result of latent defects in facilities essential to tenant's use of leased premises, but finding "nothing in the record . . . to establish that the condition of the sink made the premises unsuitable for its intended commercial purpose."); *see generally CMH Homes, Inc. v. Daenen*, 15 S.W.3d 97, 99 (Tex. 2000) (stating that 4 elements of injured invitee's premises liability claim are: (1) owner or occupier's actual or constructive knowledge of condition on premises; (2) existence of that condition poses unreasonable risk of harm; (3) owner or occupier fails to exercise reasonable care to reduce or eliminate that risk; and (4) owner's or occupier's failure to use reasonable care is proximate cause of invitee's injury); *Texas Co. v. Wheat*, 168 S.W.2d 632, 635 (Tex. 1943) (stating that, unless landlord has right to control, or undertakes right to control tenant or tenant's employees in details of performing covenant to keep premises clean, tenant's employees are not servants of landlord and, therefore, landlord is not liable to third party for premises liability claim arising from negligence of tenant's employees).

[3] *O'Connor v. Andrews*, 16 S.W. 628, 629 (Tex. 1891); *Lang*, 215 S.W.2d at 588 (stating landlord is liable to tenant who suffers injury due to defects in facilities over which landlord retains possession or control).

[4] *O'Connor*, 16 S.W. at 629 (stating that "[w]hen, however, a building consisting of a number of different apartments is divided among several tenants, each one of whom takes a distinct portion and none of them rent the entire building, the rule must then be applied so as to make each tenant responsible only for so much as his lease includes, leaving the landlord liable for every part of the building not included in the actual holding of any one tenant.")

[5] *American Exch. Nat'l Bank v. Swope & Mangold*, 101 S.W. 872, 873 (Tex. Civ. App. 1907, no writ) (stating that "[a]bsent a covenant, or evidence of concealment or misrepresentation, the landlord [is] not liable for a latent structural defect . . ." within premises that causes damage to tenant's property); *but cf. Dalkowitz Bros. v. Schreiner*, 110 S.W. 564 (Tex. Civ. App. 1908, no writ) (holding that, although a landlord had no express or implied duty to tenant to repair leaky roof, once landlord undertook a repair, landlord was required to use due care and was, therefore, liable for damage to tenant's property caused by leak in new roof).

landlord to do so. As the Texas Supreme Court put it nearly 70 years ago:

> The tendency of modern decisions is not to imply covenants which might and ought to have been expressed, if intended. A covenant is never implied that the [landlord] will make any repairs. The obligation to make repairs is a very important element of a lease contract. The parties were free to contract with respect to this obligation as they desired.[6]

Even when the parties to a lease did express their desire to require the landlord to make specified repairs, a landlord's failure to repair the premises ordinarily was not a defense to a tenant's obligation to pay rent,[7] unless the landlord's failure rose to the level of a constructive eviction.[8] This was so because "[a]ny obligation of the landlord to repair or maintain the premises would be independent of the tenant's obligation to pay rents."[9] The

[6] *Yarbrough v. Booher*, 174 S.W.2d 47, 49 (Tex. 1943); *see also Medlin v. Havener*, 98 S.W.2d 863, 864 (Tex. Civ. App. – Fort Worth 1936, no writ) (stating that "in the absence of a special contract to the contrary, and in the absence of fraud and deceit inducing the [tenant] to believe the landlord would make such repairs, the [landlord] is under no implied obligation to the [tenant] to keep the rented premises in a condition safe and suitable for the uses to be made of the demised premises by the [tenant]."). If a landlord makes repairs to the premises without the express obligation to do so, the fact that landlord made those repairs does not create an obligation. *Morton v. Burton-Lingo Co.*, 150 S.W.2d 239, 240 (1941); *Stacks v. Rushing*, 518 S.W.2d 611, 612-13 (Tex. Civ. App. – Dallas 1975, no writ)

[7] *Ravkind v. Jones Apothecary, Inc.*, 439 S.W.2d 470, 471-72 (Tex. Civ. App. – Houston [1st Dist.] 1969, writ ref'd n.r.e.) (holding that landlord's breach of covenant to repair – an independent covenant – did not excuse tenant from paying rent when tenant remained in premises after landlord's breach); *Edwards v. Ward Assocs., Inc.*, 367 S.W.2d 390, 393 (Tex. Civ. App. – Dallas 1963, writ ref'd n.r.e.) (holding that landlord's breach of covenant to repair did not excuse tenant from paying rent, even though tenant had vacated premises, when tenant failed to raise essential elements of claim for constructive eviction in jury charge); *Ammons v. Beaudry*, 337 S.W.2d 323, 324 (Tex. Civ. App. – Fort Worth 1960, writ ref'd) (holding that tenant could recoup any damages resulting from landlord's breach of its covenant to repair air conditioning units but that landlord's breach did not excuse tenant, who remained in premises, from paying rent).

[8] *Ingram v. Fred*, 210 S.W. 298, 300 (Tex. Civ. App. – Fort Worth 1918, writ ref'd) (stating that "even where the landlord is bound by custom or express contract to repair, and by his failure to do so the premises become uninhabitable, or unfit for the purposes for which they were leased, the tenant has no right to quit the premises or to refuse to pay rent according to his covenant, but his only remedy is by action for damages. Where, however, a landlord has covenanted or is under obligation to repair, and by reason of his failure to do so the premises have become untenantable, this may, it seems, according to the better rule in this country, constitute a constructive eviction justifying the tenant in abandoning the premises."); *see Cantile v. Vanity Fair Props.*, 505 S.W.2d 654, 657 (Tex. App. – San Antonio 1974, no writ) ("Because of historical reasons, the effect of the breach of his obligations by a party to a lease was determined by reference to the rules of real property relating to the eviction of, or the commission of waste by, the tenant. The application of these rules generally led to the conclusion that the obligations of lessor and lessee were "independent" in the sense that failure of one party to perform did not excuse performance by the other. 1 RESTATEMENT, *Contracts*, Section 290 (1932). However, under pressure of changing economic and social conditions, the courts, more and more, have shown a willingness to treat the obligations of the parties as mutually dependent. Some courts have achieved this transition within the apparent framework of property rules by resorting to fictions, such as the doctrine of constructive eviction. Other courts have reached the desired result simply and logically, as did the Court in *Ingram v. Fred*, 210 S.W. 298, 300 (Tex. Civ. App. – Fort Worth 1919, writ ref'd), by applying ordinary contract rules applicable to inter-dependent promises. *See generally* Hicks, *The Contractual Nature of Real Property Leases*, 24 BAYLOR L. REV. 445 (1972)"); *Silberstein v. Laibovitz*, 200 S.W.2d 647, 649 (Tex. Civ. App. – Austin 1947, no writ) (citing *Nabors v. Johnson*, 51 S.W.2d 1081, 1082 (Tex. Civ. App. – Waco 1932, no writ) for proposition that "[i]n order to constitute an eviction, it is not necessary that there be a manual or physical expulsion from the premises. If the landlord's conduct be such as to materially and permanently interfere with the beneficial use of the premises and the defendant leaves as a result thereof, then there is a constructive eviction."); *Downtown Realty, Inc. v. 509 Tremont Bldg., Inc.*, 748 S.W.2d 309, 311 (Tex. App. – Houston [14thlain Dist.] 1988, no writ) (stating that essential elements of constructive eviction are: (1) landlord must have a present intention, which may be proven by circumstantial evidence, that tenant shall no longer enjoy premises; (2) act or omission complained of must be material and permanent; (3) tenant must completely abandon premises within reasonable time after landlord's act; and (4) tenant must abandon premises as a direct consequence of complained of act or omission). *See generally Metroplex Glass Ctr. v. Vantage Props.*, 646 S.W.2d 263, 265 (Tex. App. – Dallas 1983, writ ref'd n.r.e.); *Michaux v. Koebig*, 555 S.W.2d 171, 177 (Tex. Civ. App. – Austin 1977, no writ); and *Stillman v. Youmans*, 266 S.W.2d 913, 916 (Tex. Civ. App. – Galveston 1954, no writ).

[9] *Edwards*, 367 S.W.2d at 393; *see generally Reavis v. Taylor*, 162 S.W.2d 1030, 1032-33 (Tex. Civ. App. – Eastland 1942, writ ref'd w.o.m.) (holding that landlord could not terminate lease when tenant failed to repair fences because covenant to repair ordinarily is not condition precedent to landlord's obligations to tenant, and, as a result, tenant's breach does not authorize landlord to terminate lease, unless lease expressly grants this remedy to landlord); *Foster v. L.M.S. Dev. Co.*, 346 S.W.2d 387, 394 (Tex. Civ. App. – Dallas 1961, writ ref'd n.r.e.) (holding that landlord could not terminate ground lease covering part of land upon which Mercantile Building in downtown Dallas was located after tenant failed to complete improvements within time required by lease because covenant to improve premises

traditional rules thus left a tenant with two options: (1) stay, pay and sue, or (2) leave and sue.

3. ***Tenant's Remedies***.

a. ***Stay, Pay, and Sue.*** In response to a landlord's breach of its express covenant to repair the premises, or breach of the landlord's express or implied covenant to repair the common areas, a tenant could remain in the premises, continue to pay rent, and sue on the lease for money damages or specific performance.[10] Generally, the measure of damages for landlord's breach of the covenant to repair is the difference between the rental rate set forth in the lease and the market value of the premises in their unrepaired state.[11] Tenant may also recover for loss of, or damages to, tenant's goods caused by landlord's failure to repair, and, if the parties intended, for lost profits.[12]

b. ***Leave and Sue.*** Or, a tenant could quit paying rent, quit the premises, and sue the landlord for constructive eviction, which claim, if established, would result in the termination of the landlord's right to as yet unaccrued rent and give rise to a claim for wrongful eviction.[13] If, however, the tenant guessed wrong (*i.e.*, the complained of disrepair did not constitute a constructive eviction), the tenant, by moving out and ceasing to pay rent, risked being held liable for any unpaid rent and other damages resulting from its own breach.

B. **Modern Exception: Landlord's Implied Warranty of Suitability.** The traditional rules governing a landlord's duty to its tenant to repair and maintain the premises partially gave way to the implied warranty of suitability in 1988. In *Davidow v. Inwood N. Prof'l Group-Phase I*,[14] the Texas Supreme Court held that there is an implied warranty of suitability that the premises in a commercial lease are suitable for their intended commercial purpose. "This warranty means that at the inception of the lease there are no latent defects in the facilities that are vital to the use of the premises for their intended commercial purpose and that these essential facilities will remain in a suitable condition. If, however, the parties to a lease expressly agree that the tenant will repair certain defects, then the provisions of the lease will control."[15]

1. ***Implied Warranty of Suitability Covers "Essential Facilities" Within Premises***. The implied warranty of suitability covers all latent defects in "essential facilities" within the leased premises.[16]

a. ***Physical Facilities in Premises***. Some courts hold the implied warranty of suitability only applies to physical conditions within the premises.[17]

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ordinarily is treated as an independent covenant, unless "the intention to create a conditional estate is clearly and unequivocally revealed by the language of the instrument.").

[10] *See, e.g.*, *Ammons*, 337 S.W.2d at 324 (holding that tenant could recoup any damages resulting from landlord's breach of its covenant to repair the air conditioning units but that landlord's breach did not excuse tenant, who remained in premises, from paying rent).

[11] *Birge v. Toppers Menswear, Inc.*, 473 S.W.2d 79, 84 (Tex. Civ. App. – Dallas 1971, writ ref'd n.r.e.); *Edwards v. Ward Associates*, Inc., 367 S.W.2d 390, 395 (Tex. Civ. App.- Dallas 1963, no writ); and *Langham's Estate v. Levy*, 198 S.W.2d 747, 756 (Tex. Civ. App. – Beaumont 1946, writ ref'd n.r.e.).

[12] *Birge*, 473 S.W.2d at 84; *Edwards*, 367 S.W.2d at 395.

[13] *Stillman*, 266 S.W.2d at 916 (stating that essential elements of constructive eviction are: (1) landlord must have present intention, which may be proven by circumstantial evidence, that tenant shall no longer enjoy premises; (2) act or omission complained of must be material and permanent; and (3) tenant must completely abandon premises within a reasonable time after, and as direct consequence of, complained of act or omission).

[14] 747 S.W.2d 373 (Tex. 1988).

[15] *Davidow*, 747 S.W.2d at 376.

[16] *Davidow*, 747 S.W.2d at 376-77; *see B & H Aircraft Sales v. Engine Components*, 933 S.W.2d 653, 656 (Tex. App. – San Antonio 1996, no writ) (affirming summary judgment for landlord and holding that tenant failed to raise material fact issues to establish that defects were latent as opposed to patent; that defects prevented commercial use for which premises were intended (*i.e.*, affidavit claimed defects prevented tenant from obtaining a certificate of occupancy but did not recite tenant had applied for, and had been denied, certificate of occupancy); or that acquisition of occupancy certificate was vital to use of premises); *Gober v. Wright*, 838 S.W.2d 794, 798 (Tex. App. – Houston [1st Dist] 1992, writ denied), *abrogated on other grounds*, *State Farm Fire & Cas. Co. v. Morua, 979 S.W.2d 616*; *Parts Indus. Corp. v. A.V.A Servs., Inc.*, 104 S.W.3d 671 (Tex. App. – Corpus Christi 2003, no pet.).

[17] *Coleman v. Rotana, Inc.*, 778 S.W.2d 867, 871 (Tex. App. – Dallas 1989, writ denied) (holding that implied warranty of suitability "covers latent defects in the nature of a physical or structural defect which the landlord has the duty to repair . . . [and that] 'facility' alleged to be defective must be within the leased premises.").

b. ***Exclusive Use of Premises***. In *Lee v. Perez*,[18] the court of appeals held that the landlord breached the implied warranty of suitability because the lease permitted the tenant to use the premises for a used car lot but a deed restriction prohibited use of the premises for any purpose other than residential use.[19]

c. ***Facilities Outside Premises.*** In *Coleman v. Rotana, Inc.*, the Dallas Court of Appeals held that inadequate parking caused by other tenants' use of their premises in violation of their respective leases is not the type of defect encompassed by the implied warranty of suitability, concluding that "this warranty only covers latent defects in the nature of a physical or structural defect which the landlord has the duty to repair."[20] The court of appeals also concluded that "not only must the defect alleged be within the scope of the warranty, the facility alleged to be defective must be within the leased premises."[21]

2. ***Negating Implied Warranty of Suitability.*** In *Davidow*, the Texas Supreme Court left the parties free to negate the implied warranty of suitability, stating that when "the parties to a lease expressly agree that the tenant will repair certain defects, then the provisions of the lease will control."[22] Until the Texas Supreme Court decided *Gym-N-I Playgrounds, Inc. v. Snider*,[23] the Texas courts of appeals were split on what the parties had to do to negate the implied warranty of suitability.[24]

a. ***"As Is" Clause and Express Disclaimer of Implied Warranties is Sufficient.*** The lease in *Gym-N-I* contained a conspicuous "as is" provision and explicitly disclaimed all implied warranties, including the implied warranty of suitability; however, the lease did not assign to the tenant responsibility for repairing the defective condition.[25] On these facts, the Texas Supreme Court held that "the implied warranty of suitability disclaimer expressly and effectively disclaimed that warranty, and the 'as is' clause negated the causation element of Gym-N-I's . . . claims against Snider."[26] The *Gym-N-I* Court noted that the factors set forth in *Prudential Ins. Co. of Am. v. Jefferson Assoc., Ltd.*[27] govern whether an "as is" clause is enforceable.[28] Thus, under the rule followed in *Gym-N-I*, a conspicuous "as is" clause and an express disclaimer of implied warranties is sufficient to negate the implied warranty of suitability, even though the lease does not assign to the tenant responsibility for repairing the essential facility. The *Gym-N-I* Court, however, did not address whether an "as is" clause standing alone is

[18] 120 S.W.3d 463 (Tex App. – Houston [14th Dist.] 2003, no pet.).

[19] 120 S.W.3d at 467-68 (citing *Davidow*, 747 S.W.2d at 377 and stating that, although "as is" clause "may indeed waive express or implied warranties," this as is clause – which "related to the physical condition of the property" – did not waive implied warranty of suitability as to use because deed restriction was not physical condition of premises); *but see Coleman*, 778 S.W.2d at 871 ("We do not hold that the implied warranty of suitability could never encompass adequate parking facilities. However, the acts and omissions of the landlord and the other tenants at the center, which allegedly resulted in the inadequacy of parking to serve the needs of a first-class restaurant of the size contemplated in appellants' lease, involved use of the parking area. [The tenant] specifically contracted for the nonexclusive use of that area. There can be no implied warranty as to a matter specifically covered by the written terms of the lease.").

[20] *Coleman*, 778 S.W.2d at 871.

[21] *Coleman*, 778 S.W.2d at 871.

[22] 747 S.W.2d at 377.

[23] 220 S.W. 2d 905 (2007).

[24] Some courts held that neither an as is clause, nor a general waiver of implied warranties, would negate the implied warranty of suitability; only a provision requiring the tenant to repair a specific "essential facility" was sufficient to negate the landlord's obligations under the implied warranty of suitability with respect to that facility. *See, e.g.*, *Gober v. Wright*, 838 S.W.2d 794, 798 (Tex. App. – Houston [1st Dist] 1992, writ denied), *abrogated on other grounds, State Farm Fire & Cas. Co. v. Morua, 979 S.W.2d 616*; *Parts Indus. Corp. v. A.V.A. Servs., Inc.*, 104 S.W.3d 671 (Tex. App. – Corpus Christi 2003, no pet.) (citing *Gober* and holding that tenant, who had not expressly agreed to repair roof on commercial rental property, did not waive implied warranty of suitability with respect to roof). *Cf. Gym-N-I Playgrounds, Inc. v Snider*, 158 S.W.3d 78 (Tex. App. – Austin 2005, *aff'd*, 220 S.W.3d 905 (Tex. 2007) (holding that an "as-is clause negates the implied warranty of suitability"); *Lee v. Perez*, 120 S.W.3d 463, 467-68 (Tex. App.—Houston [14th Dist.] 2003) (suggesting that "as is" language might waive the implied warranty of suitability as to the physical condition of the property).

[25] *Gym-N-I*, 220 S.W. 2d 905.

[26] 220 S.W. 2d 905 at 908. The *Gym-N-I* Court further reasoned that public policy supports the conclusion that the parties may contractually waive the implied warranty of suitability because Texas strongly favors parties' freedom of contract. *Id.* at 912.

[27] 896 S.W.2d 156, 162 (1995) (listing factors to be considered in determining whether "as is" clause is enforceable).

[28] 220 S.W. 2d 905 at 912, n. 10.

sufficient to waive the implied warranty of suitability.[29] To waive the implied warranty of suitability, an "as is" clause and disclaimer of the implied warranty of suitability should at least (1) clearly state that the tenant is accepting the premises "as is"; (2) provide the tenant the right to inspect the property and include an acknowledgement in the lease stating that the tenant has actually inspected the premises; (3) include an acknowledgement that the tenant is relying solely on its inspection of the premises; (4) clearly and unequivocally disclaim reliance on any representation by landlord; (5) state that including the "as is" provision is a material part of the consideration for the lease; (6) expressly disclaim the implied warranty of suitability; and (7) acknowledge that the tenant is familiar with the real estate transactions of the type contemplated by the lease.[30] In light of the Texas Supreme Court's recent decision in *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*,[31] a mere acknowledgement that tenant is not relying on any representation of landlord is insufficient.[32] The tenant must express a clear and unequivocal intent to disclaim reliance on landlord's representations.[33] *See* **Appendix II-A** for a sample clause negating the implied warranty of suitability without requiring the landlord to assume responsibility for repairing all facilities within the premises.

(1) **As Is Clause in Single Tenant Facility.** Including an "as is" provision covering the building and land in the lease of a single tenant facility is reasonable because that tenant is likely in a position to conduct inspections of the entire property.

(2) **As Is Clause in Multi-Tenant Facility.** A broad "as is" provision—one covering areas outside the premises—can have unintended consequences in a multi-tenant facility. In *El Sabor de Mi Tierra, Inc. v. Atascocita/Boone JV,* the court concluded, after analyzing the lease language, that the "as is" provisions waived only those claims based on problems occurring within the premises.[34] Since tenant's claims related to plumbing problems originating outside the premises, the "as is" clauses did not defeat those claims.[35] An "as is" clause covering common areas within a multi-tenant facility may leave a tenant without an effective remedy.

(3) **As Is Clause May Not Negate Statutory Environmental Liability.** Despite the Texas Supreme Court's holding in *Gym-N-I*, an as is clause may not effectively negate certain statutory liabilities for environmental damages.[36] One of basic principles behind an "as is" clause is that it negates the causation element of many claims. An "as is" clause has limited value in the context of statutory environmental liability because many statutory environmental provisions impose liability without the need to establish causation.

(4) **Tenant Expressly Assumes Repair Obligation.** Even in the absence of an "as is" clause and express disclaimer of the implied warranty of suitability, if tenant expressly assumes obligations for repairs that landlord would have otherwise been obligated to make, the provisions of the lease control and tenant's claim for breach of the implied warranty of suitability fails. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, illustrates the proper

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[29] 220 S.W. 3d at 910, n. 7.

[30] Summary adapted from Newtown, Anne, "*As Is" Provisions in Commercial Leases*, STATE BAR OF TEXAS ADVANCED REAL ESTATE STRATEGIES (October 2, 2008).

[31] 341 S.W.3d 323 (2011).

[32] *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323 (2011) (finding that tenant's fraudulent inducement claim was not barred by tenant's agreement that landlord did not make any representations outside the lease).

[33] In *Italian Cowboy*, the Texas Supreme Court found that the parties' intended a standard merger clause, not a disclaimer of reliance on landlord's representations, when they included the following provisions:

14.18 Representations. Tenant acknowledges that neither Landlord nor Landlord's agents, employees or contractors have made any representations or promises with respect to the Site, the Shopping Center or this Lease except as expressly set forth herein.

14.21 Entire Agreement. This lease constitutes the entire agreement between the parties hereto with respect to the subject matter hereof, and no subsequent amendment or agreement shall be binding upon either party unless it is signed by each party.

[34] 2007 WL 2417921, at *12. (Tex. App. – Houston [14th Dist.] 2007).

[35] Id.

[36] *Bonnie Blue, Inc. v. Reichenstein*, 127 S.W.3d 366, 369 (Tex. App. – Dallas 2004, no pet.) (holding that as is clause in contract of sale of realty did not negate seller's liability to buyer under Texas Solid Waste Disposal Act).

analysis of the second method of negating the implied warranty of suitability.[37]

(5) ***Italian Cowboy.*** In *Italian Cowboy* the tenant sued landlord for breach of the implied warranty of suitability, claiming that the presence of sewer gas odor was a breach of the warranty. The landlord claimed that the express terms of the lease relieved landlord from liability for breach of the implied warranty of suitability. The Texas Supreme Court recognized that if the parties to a lease expressly agree the tenant will make certain repairs, then the provisions of the lease control, and next determined that the proper analysis requires a two part inquiry: (1) what is the defect, and (2) whether the lease allocated the responsibility to repair the defect to landlord or tenant. After noting that the tenant had accepted responsibility for certain repairs the landlord would have otherwise been obligated to make, that the grease interceptor and waste-water and sanitary sewer lines in the common area adjacent to the premises were the facilities producing the sewer gas odor, and that the repair required to cure the odor problem was an alteration of the sewer lines, the Court then reviewed the lease provisions to determine whether landlord or tenant was responsible for repairing the defective facility. The lease allocated similar repair responsibilities in different ways to both landlord and tenant but the Court found, based on landlord's obligation to repair the sewer lines, the common area, and structural components, and the fact that tenant was expressly precluded from making alterations to the utility lines or systems without landlord's consent, that the landlord was obligated to repair the condition causing the odor and the condition was, therefore, covered by the implied warranty.[38] *Italian Cowboy* further illustrates the importance of carefully defining each party's repair and maintenance obligations. The Court's decision regarding the implied warranty of suitability turned on which party was obligated to repair the facilities producing the sewer gas odor. If a landlord finds it necessary to rely on tenant's express assumption of certain repair obligations (perhaps because of a defective "as is" clause or disclaimer of the implied warranty of suitability), the landlord needs to be sure the descriptions of each party's repair obligations are clear.

[37] 341 S.W.3d 323 (2011) (analyzing whether the tenant expressly assumed the obligation to repair the defect causing a sewer gas odor, but ultimately finding tenant did not expressly assume the obligation).

[38] 341 S.W.3d 323 at 340-43.

b. ***Contractually Limiting Tenant's Remedies***. A landlord may be able to secure further protection against liability by expressly limiting the tenant's remedies for breach of the implied warranty of suitability rather than just attempting to negate the implied warranty completely.

(1) **No Cases Directly on Point.** No court has directly addressed whether, or to what extent, a landlord and tenant may limit by agreement a tenant's remedies under the implied warranty of suitability. But Texas courts have addressed the parties' ability to limit similar warranties implied in other contexts.

(2) **General Rules Limiting Remedies**. As a general rule, the parties to a contract are free to limit or modify the remedies for breach of their agreement, unless the contractual remedies fail in their essential purpose, are against public policy, or are illegal.[39] In *Barragan v. Munoz*, a case decided before *Davidow*, the El Paso Court of Appeals specifically stated that exculpatory provisions insulating a landlord from liability for defects in

[39] *See PPG Indus. v. JMB/Houston Ctrs.*, 146 S.W.3d 79, 101 (Tex. 2004) (noting that Texas UCC specifically allows parties to limit remedies for breach of warranty); *Sava Gumarska in Kemijska Industria D.D. v. Advanced Polymer Scis.*, 128 S.W.3d 304, 317 (Tex. App. – Dallas 2004, no pet.) (stating that parties are generally free to limit or modify remedies available for breach of their agreement and citing *Great Am. Ins. Co. v. N. Austin Mun. Util. Dist.*, 902 S.W.2d 488, 499 (Tex. App. – Austin 1993), *aff'd in part, rev'd in part on other grounds*, 908 S.W.2d 415 (Tex. 1995) for the proposition that, if parties agree to contractual remedy, that remedy will be enforced unless it is illegal or against public policy); *see also Employers Ins. v. Suwannee River Spa Lines*, 866 F.2d 752, 776 (5th Cir. 1989) (quoting *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435 (S.D.N.Y. 1976) for proposition that clauses restricting one party's remedies and limiting other party's liability, regardless of its negligence, are valid and enforceable); *Delhomme Indus., Inc. v. Houston Beechcraft, Inc.*, 735 F.2d 177, 184 (5th Cir. 1984) (stating that when limited remedy fails of its essential purpose in a contract for sale of goods, buyer is relegated to applicable UCC remedies); and *Johnson Serv. Co. v. Transamerica Ins. Co.*, 485 F.2d 164, 170 (5th Cir. 1973) (stating that when parties clearly limit their remedial rights, their agreement, if reasonable, is controlling and excludes other consequences).

leased premises are not contrary to public policy and are valid and enforceable.[40]

c. ***Tenant's Remedies for Breach***. In the absence of a proper waiver of the implied warranty of suitability or tenant's express assumption of a repair obligation otherwise covered by the implied warranty of suitability, the principles announced in *Davidow* and its progeny still apply. In addition to giving rise to a claim for damages, a landlord's breach of the implied warranty of suitability is a complete defense to a tenant's obligations under the lease.[41] Moreover, once a defense to payment of rent or a right to terminate the lease accrues, it ordinarily will survive the landlord's transfer of the lease to another party, absent an agreement – such as a subordination and non-disturbance agreement – to the contrary.[42]

II. TENANT'S REPAIR AND SURRENDER OBLIGATIONS

The next section of this outline reviews the scope of the tenant's obligations under the implied covenant against waste and the relationship between this implied covenant and any express clauses in the lease relating to the condition of the premises.

A. **Tenant's Implied Duty Not to Commit Waste**. Even in the absence of express repair and surrender covenants, a tenant has an implied obligation not to commit waste.[43] "Waste is an injury to the reversionary interest in land caused by the wrongful act of a tenant or other party rightfully in possession, and [it] is primarily distinguishable from trespass in that trespass is an injury to land caused by the act of one not rightfully in possession."[44] This implied covenant against waste arises from the landlord-tenant relationship, and unless superseded by an express covenant, obligates the tenant "to make such repairs as are necessary to preserve the property in the condition in which it was when rented, reasonable wear and tear excepted[.]"[45].

[40] 525 S.W.2d 559, 561 (Tex. Civ. App. – El Paso 1971, no writ) (holding that exculpatory provision in lease stating that "landlord shall not be liable to the tenant for damages to property from latent or patent defects in the building, nor for damages to other property occasioned by or from plumbing, gas, water, steam and other pipes or apparatus being out of repair . . ." was not contrary to public policy).

[41] *Neuro-Developmental Assocs. v. Corporate Pines Realty Corp.*, 908 S.W.2d 26, 28 (Tex. App. – Houston [1st Dist.] 1995, no writ) (stating that "breach of implied warranty of suitability alone, without a finding of producing cause of damages, is a complete defense to liability for past due rent"). *But see, McGraw v. Brown Realty Company*, 195 S.W.3d 271 (Tex. App.—Dallas 2006, no pet.) (although landlord's breach of the implied warranty of suitability is a complete defense to a tenant's non-payment of rent, the court stated that tenant's non-payment of rent was not excused; the lease unequivocally states tenant waived his right to terminate the lease because of the condition of the premises and, therefore, tenant contractually waived his remedy or defenses to the non-payment of rent based on the implied warranty of suitability).

[42] *Regency Advantage Ltd. P'ship v. Bingo Idea - Watauga, Inc.*, 936 S.W.2d 275, 277 (Tex. 1996) (citing RESTATEMENT (SECOND) OF PROPERTY§16.1(3) (1977) for proposition that "[t]he transferee [of an interest in leased property] will not be liable for any breach of the promise which occurred before the transfer to him . . ." and holding that even though tenant could not hold assignee of original landlord liable in damages for non-continuing breach of lease that occurred before landlord assigned lease to assignee, any defense to payment of rent or right to terminate lease survived assignment and could be asserted against assignee); *see also Lazell v. Stone*, 123 S.W.3d 6, 12 (Tex. App. – Houston [1st Dist.] 2003, pet. denied).

[43] *R.C. Bowen Estate v. Continental Trailways, Inc.*, 256 S.W.2d 71, 72 (Tex. 1953) (citing *Camden Trust Co. v. Handle*, 26 A.2d 865 (N.J. 1942)); *King's Court Racquetball v. Dawkins*, 62 S.W.3d 229, 233 (Tex. App. – Amarillo 2001, no pet.) (stating that covenant against waste is "the implicit duty of a tenant to exercise reasonable care to protect the leased premises from injury other than by ordinary wear and tear"); *In re D.H. Overmyer Co.*, 12 B.R. 777, 785-86 (Bankr. S.D.N.Y. 1981) (applying Texas law), *aff'd*, 30 B.R. 823 (S.D.N.Y. 1983) (stating that "[a] tenant, at common law, *in the absence of an express covenant or a statutory duty*, has the obligation to make leasehold repairs coextensive merely with the duty imposed upon him not to permit or commit waste. . . .") (emphasis added).

[44] *R.C. Bowen Estate*, 256 S.W.2d at 72; *King's Court Racquetball*, 62 S.W.3d at 232 (stating that "to constitute waste, the act allegedly causing it must be wrongful"); *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 753 (Tex. App. – El Paso 2000, no pet.) (stating that "[w]aste also includes injury resulting from a failure to exercise reasonable care in preserving the property"); *Erickson v. Rocco*, 433 S.W.2d 746 (Tex. Civ. App. – Houston [14th Dist.] 1968, writ ref'd n.r.e.).

[45] *R.C. Bowen Estate*, 256 S.W.2d at 72-73 (citing *Norman v. Stark Grain & Elevator Co.*, 237 S.W. 963, 965 (Tex. Civ. App. – Dallas 1922, writ ref'd); *Great A. & P. Tea Co. v. Athens Lodge No.* 165, 207 S.W. 2d 217 (Tex. Civ. App. – Fort Worth 1947, writ ref'd n.r.e.); *Texas Co. v. Gibson*, 88 S.W. 2d 757 (Tex. Civ. App. – Beaumont 1935), *rev'd on other grounds*, 116 S.W. 2d 686 (1938)). *See generally* C. R. McCorkle, Annotation, *Liability of Tenant for Damage to the Leased Property Due to His Acts or Neglect*, 10 A.L.R.2d 1012 (1950 & 2012) (covering cases in which landlord seeks to recover damages for specific injuries to property due to tenant's own acts or negligence as distinguished from cases in which tenant's liability is predicated upon breach of duty to keep property in repair or to return it in good condition); C. Jhong, *Measure of Damages in Landlord's Action for Waste Against Tenant*, 82

1. ***Breach Requires "Wrongful" Conduct***. Because waste requires that the tenant commit a wrongful act or fail to exercise ordinary care in preserving the property, waste does not include deterioration resulting from ordinary wear and tear, accident, or other causes that are not the fault of the tenant.[46]

a. ***Damage Caused by Tenant's Negligence Constitutes Waste***. A tenant is liable to its landlord for any damage to the premises, the common areas, or the landlord's other property caused by the tenant's negligence, unless the lease clearly provides otherwise.[47]

b. ***Unauthorized Alterations Constitute Waste***. Unauthorized alterations or changes in the premises constitute waste.[48]

c. *Alterations and Subletting*. A lease term permitting the tenant to assign or sublet the premises may create a limited exception to a general prohibition on altering the premises without the landlord's consent. In *Mayer v. Texas Tire & Rubber Co.*,[49] the landlord sued to enjoin its tenant from subdividing the space for a subtenant. The lease permitted the tenant to sublease all or a part of the premises without the landlord's consent. And while the lease required the tenant to make all repairs to the premises, it prohibited the tenant from altering the premises without the landlord's consent. The court of appeals affirmed the trial court's decision to dissolve a temporary restraining order, which had briefly prohibited the tenant from subdividing the premises for its subtenant. In support of its ruling, the court of appeals stated:

> We think the stipulation in the contract of lease between the plaintiff and the defendants, according to the defendants the right to sublet the premises in part or in whole, carried with it the right of the [tenant] to make, or permit the making of, such changes and additions in the building as were reasonably necessary to the use of the building by such tenants, provided such changes did not constitute a substantial change in the structural quality of the building, and where the additions could be removed at the expiration of the lease without injury to the building.[50]

2. ***Implied Covenant Against Waste Is Not General Repair Covenant***. The implied covenant against waste is not a promise "to repair generally, but to so use the property as to avoid the necessity for repairs, as far as possible…It has never been so construed as to make a tenant answerable for accidental damages, or to bind him to rebuild, if the buildings are burned down or otherwise destroyed by accident."[51] A tenant's only obligation under this implied covenant is to use the premises so as not to commit voluntary waste.

B. **Impact of Various Express Clauses on Implied Covenant against Waste**. Courts applying Texas law have looked to various lease terms in an effort to determine when a lease exculpates a tenant from liability for damage to the premises caused by the tenant's own negligence.

1. ***Landlord's Repair Covenant Does Not Excuse Tenant for Negligent Damage to Premises***. A covenant obligating the landlord to repair certain improvements (*e.g.*, the roof) may not relieve the tenant from the obligation to pay for damages to those improvements caused by the tenant's

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A.L.R.2d 1106 (1962 & 2012) (covering cases dealing with landlord's measure of damages resulting from tenant's violation implied duty to care for leased property as distinguished from cases concerned with damages resulting from violation of express covenant to keep property in repair, to use it for a certain specific purpose, or to return it in good condition).

[46] *R.C. Bowen Estate*, 256 S.W.2d at 72-73; *Norman*, 237 S.W. at 965 (holding that tenant was not liable to landlord for cost of rebuilding granary under express covenant obligating tenant "to take good care of the property and not suffer any waste" because jury found granary collapsed due to "act of god" rather than tenant's negligence); *Great A. & P. Tea Co. v. Athens Lodge No. 165*, 207 S.W. 2d 217 (Tex. Civ. App. – Fort Worth 1947, writ ref'd n.r.e.); Texas Co., 88 S.W. 2d at 757.

[47] Wichita City Lines, Inc. v. Puckett, 295 S.W.2d 894, 899 (Tex. 1956).

[48] *King's Court Racquetball*, 62 S.W.3d at 232 (holding tenant liable for waste and rejecting tenant's contention that demolishing improvements was not wrongful because lease extension permitted tenant to "alter, reconstruct, rebuild and modify the premises without restriction."); *Mayer v. Texas Tire & Rubber Co.*, 223 S.W. 874, 875 (Tex. Civ. App. – Fort Worth 1920, no writ).

[49] 223 S.W. 874 (Tex. Civ. App. – Fort Worth 1920, no writ).

[50] 223 S.W. at 875 (citing *Cawker v. Trimmel*, 143 N.W. 1046, 1047 (Wis. 1913) (stating that "[o]rdinarily the word 'alteration' as applied to a building means a substantial change therein[]") and *Kresge v. Maryland Cas. Co.*, 143 N.W. 668, 669 (Wis. 1913) (holding that policy covered damage to vestibule and doors constructed on a building, even though policy excluded "[a]dditions to or alterations in, or the construction of any building or structure, or elevator . . ." from coverage).

[51] *United States v. Bostwick*, 94 U.S. 53, 68 (1876).

negligence. In *Wichita City Lines*,[52] the tenant's negligence caused a fire that burned down the building. The tenant, citing the following repair clause in the lease, argued that it should not be compelled to pay for any resulting damage to the roof:

> [Tenant] shall take good care of the property and its fixtures and shall at its own expense and cost keep said premises, except the roof, in good repair.

The Texas Supreme Court rejected the tenant's argument, stating that "this Court will not in this case construe an exemption of the roof from the duty to keep in good repair as a license to the [tenant] to negligently destroy the roof with immunity."[53]

2. ***Property Insurance***. A lease provision that requires the landlord to procure property insurance covering the premises does not – standing alone – preclude the landlord's insurer from exercising its subrogation rights under the landlord's policy or exonerate the tenant from liability for its own negligence. But a landlord cannot require the tenant to carry and pay for property insurance on the landlord's property and still sue the tenant for damage covered by the tenant's property insurance.

a. ***Wichita Lines v. Puckett.*** *In Wichita City Lines*, the lease stated that "[Landlord] agrees to carry his own insurance against loss by fire, etc., on the entire building."[54] In support of its conclusion that this clause did not make the tenant a beneficiary of the landlord's policy, the Texas Supreme Court noted:

> The provision by its terms imposed no obligation on the [landlord] to take out any insurance to protect himself or the [tenant]. No amount of insurance is stipulated nor does one find any of the specific terms to be expected if the provision was designed to protect the [tenant]. Furthermore, the lease provided that in the event of fire that should the [landlord] deem the building unfit of occupancy, he could decide not to repair but to remodel or rebuild and terminate the lease. This seems inconsistent with any intention in the insurance provision to protect the interest of the [tenant].[55]

b. ***Publix Theatres Corp. v. Powell.*** In *Publix Theatres Corp. v. Powell*,[56] the tenant agreed to carry fire insurance on the leased building with a solvent insurance company with any loss payable to the landlord. The building burned, the landlord collected the insurance, and then the landlord then sued the tenant to collect again for the fire damage. The Supreme Court rejected the landlord's overreach, declaring "that to permit the landlord to keep the insurance money and also to collect from the [tenant] would be a double recovery not sanctioned by the law when the [tenant] had already provided for payment of the damages through the insurance he had contracted and paid for."[57]

3. ***Exculpation from Tenant's Own Negligence***. A lease term will not be construed to exonerate the landlord or tenant from liability for its own negligence unless the term is "clear and unambiguous," and even then, any term purporting to exculpate a party from its own negligence "will be strictly construed by the courts against such an intendment and not given such effect 'if any other meaning may reasonably be ascribed to the language employed.'"[58]

4. ***Indemnity for Damage to Landlord's Property***. Public policy does not restrict a landlord and tenant from agreeing that the tenant will be responsible for any damages to the landlord's property caused by the tenant or a cotenant.[59]

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[52] 295 S.W.2d 894 (Tex. 1956).

[53] *Wichita City Lines, Inc*, 295 S.W.2d at 899 (distinguishing *Orr v. Vandygriff*, 251 S.W. 2d 573 (Tex. Civ. App. – Waco 1952, no writ) on ground that tenant in *Orr* was not obligated to pay to repair damage caused by "purely accidental fire" and was not seeking to construe lease provision as exemption from tenant's own negligence).

[54] *Id*. at 898-99.

[55] *Id*. at 899.

[56] 71 S.W. 2d 237 (Tex. 1934).

[57] 71 S.W. 2d at 241-42.

[58] *Wichita City Lines*, 295 S.W.2d at 898 (stating that provision in lease requiring landlord to insure property at its own expense "certainly does not meet the requirements of such a strict rule of interpretation in order to exonerate the [tenant] of its negligence.").

[59] *Churchill Forge, Inc. v. Brown*, 61 S.W.3d 368, 370, 373 (Tex. 2001) (observing that "competent parties in Texas 'shall have the utmost liberty of contracting . . .'" and holding that "there is nothing extraordinary or unjust in requiring a tenant to

C. **Express Repair Covenants Supersede Implied Covenant Against Waste**. "Of course, the parties to a lease agreement may, by an express covenant therein, enlarge a tenant's obligation with respect to repairs, alterations, or improvements of the demised premises."[60] In *Martinez v. Thompson*, the tenant "obligated himself to bear all expenses of repairing or improving the property during his occupancy."[61] The Texas Supreme Court held that the tenant was bound by the express terms of his lease to repair damage to the building, even though the tenant would not have been required to make the same repairs by the implied covenant against waste. As the Texas Supreme Court explained:

> It may be conceded that, in the absence of the express contract to bear the expense of repairs, it would not have been the duty of defendant to make other repairs than such as were necessary to preserve the property in the condition in which it was when he rented it less such deterioration as time and ordinary use of it would work, or to bear the expenses of such repairs as might be made and not necessary to keep it in such condition, but his obligation does not rest alone on the obligation to repair which the law imposes on every tenant, but upon his express contract made with a knowledge of the condition of the house at the time he rented.[62]

The rule followed in *Martinez* is consistent with the general rule in Texas that "[t]here can be no implied covenant as to a matter specifically covered by the written terms of the contract."[63]

1. ***Express Repair and Maintenance Covenant in Single Tenant Building versus Multi-Tenant Building***. In a single tenant building the tenant is often responsible for all repair and maintenance obligations. This is reasonable since that tenant often maintains control over the entire property. In contrast, in multi-tenant buildings—such as shopping centers and office buildings—the repair and maintenance obligations are usually divided between landlord and tenant. In the latter case, clarity in drafting is important; express repair covenants must specify where one party's obligation ends and the other party's obligation ends.[64]

2. ***Tenant's Express Repair and Maintenance Covenant in Single Tenant Facility.*** The occupant of a single tenant office building often is responsible for maintaining the leased premises. This obligation may extend to expensive maintenance items such as the roof, HVAC systems, loading dock pavement, and structural components. A prudent tenant will inspect the leased premises prior to executing the lease to ensure that it is not assuming unforeseen repair costs.[65]

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reimburse the landlord for damages negligently caused by the tenant or one occupying the premises with the tenant's consent.").

[60] *In re D.H. Overmyer Co*., 12 B.R. 777, 785-86 (Bankr. S.D.N.Y. 1981) (applying Texas law), *aff'd,* 30 B.R. 823 (S.D.N.Y. 1983) (emphasis added); *Martinez v. Thompson*, 16 S.W. 334, 335 (Tex. 1891); *cf. McKenzie Equip. Co., Inc. v. Hess Oil & Chem. Corp*., 451 S.W.2d 230 (Tex. 1970) (Reavely, J.) (holding that bailee's covenant to accept "full responsibility and liability for any and all damages . . . due to . . . fire . . . or for any causes whatsoever other than ordinary wear and tear . . . enlarged the bailee's liability beyond that of the common law standard" for fire damage to an air compressor, even though damage resulted from unavoidable accident); *King's Court Racquetball*, 62 S.W.3d at 233 (stating that covenant against waste is "the implicit duty of a tenant to exercise reasonable care to protect the leased premises from injury other than by ordinary wear and tear").

[61] *Martinez*, 16 S.W. at 335 (emphasis in original).

[62] 16 S.W. at 335.

[63] *Exxon Corp. v. Atlantic Richfield Co*., 678 S.W.2d 944, 947 (Tex. 1984) (quoting *Freeport Sulphur Co. v. American Sulphur Royalty Co*., 6 S.W.2d 1039, 1042 (Tex. 1928); see Dewitt County Elec. Coop., Inc. v. Parks, 1 S.W.3d 96, 105 (Tex. 1999) (holding that when contract spells out parties' respective rights, contract and not common law negligence governs any dispute); *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 752-54 (Tex. App. -- El Paso 2000, no pet.) (holding that express covenant in contract requiring operator "to conduct all such operations in a good and workmanlike manner" precluded action for breach of implied covenant against waste); *Coleman*, 778 S.W.2d at 871 (citing *Exxon Corp*., 678 S.W.2d at 947 in support of its holding that express repair covenant supersedes implied warranty of suitability); Sunray DX Oil Co. v. Texaco, Inc., 417 S.W.2d 424, 429 (Tex. Civ. App. – El Paso 1967, writ ref'd n.r.e.).

[64] *See* Barton, Cary J., O*verview of Major Lease Types Including Related Bar Section Forms*, THE UNIVERSITY OF TEXAS SCHOOL OF LAW BERNARD O. DOW LEASING INSTITUTE (September 15-16, 2011).

[65] Alletag, Gary M., "Important Issues to Consider When Negotiating a Commercial Lease Agreement from the Tenant's Perspective." THE UNIVERSITY OF TEXAS SCHOOL OF LAW CORPORATE COUNSEL INSTITUTE (April 19, 2007).

III. PROPERTY CONDITION CLAUSES

The repair, surrender, and casualty clauses are the primary lease terms allocating the parties' respective obligations for the physical condition of the premises. Nevertheless, "in arriving at the true intention of the parties . . . with respect to the [tenant's] expressed covenant to maintain the leased premises in good repair and condition during the term of the lease, the courts should consider all of the material provisions contained in the contract relating to the subject of repairs, giving effect to the reasonable sense and meaning of the words employed therein."[66] Courts applying Texas law thus examine the repair clauses for the landlord and the tenant, the tenant's surrender covenant, the casualty clause, insurance provisions, terms requiring the tenant's compliance with applicable laws, recitations about the condition of the premises, and any other relevant terms of the lease to determine the scope of a party's responsibility to make or to pay for repairs. This section reviews some of the significant cases interpreting these interrelated clauses.

A. **Repair v. Surrender**. Most commercial leases require the tenant to make certain repairs during the term and to surrender the premises at the end of the term in a specified condition. Texas courts construe the entire lease to determine the meaning of express covenants "to repair" and "deliver up in good order and condition," and all of the covenants bearing upon the tenant's obligation in this respect are construed together so as to give reasonable meaning to each of them.[67] Even though the subject matter of these two covenants is essentially the same,[68] the time for the tenant's performance is not.

> The courts have uniformly observed a distinction between a covenant upon the part of a [tenant] to keep leased premises in repair, and a covenant to deliver up the premises at the expiration of the term in as good condition of repair as they were at the beginning of the term. A covenant to keep in repair requires the tenant to keep the premises in repair at all times during the term, and if he permits them to get out of repair at any time, the [landlord], upon that breach, may sue during the term as for injury to the reversion; whereas, on a covenant to leave the premises in as good condition as he found them, no action will lie against the [tenant] until the end of the term, for obvious reasons.[69]

These covenants also differ in the measure of a landlord's damages for breach, despite the fact that a covenant "to repair" or "to keep in repair" is ordinarily construed much the same as a covenant to deliver up the premises in good order and condition.[70]

1. ***Measure of Damages***. The measure of damages for a tenant's breach of the repair and surrender covenants depends on several factors, including the terms of the lease and, in the case of the repair covenant, whether suit is brought during or after the lease term.[71]

a. ***Suit Before End of Term***. When a landlord sues its tenant for injury to the premises before the lease term expires, the landlord's measure of damages depends on whether the landlord has made the repairs at the time of suit. If the repairs have not been made, the proper measure of damages is the

[66] *Orr v. Vandygriff*, 251 S.W.2d 573, 574 (Tex. Civ. App. – Waco 1952, no writ) (stating that "a lease contract, like other written agreements, should be given a reasonable construction that will carry out the intention of the parties as expressed by the language used in the contract.").

[67] *Howeth v. Anderson*, 25 Tex. 557 (1860); *see also King v. Richards-Cunningham Co.*, 28 P.2d 492 (Wyo. 1934); *Ginsburg v. Jacobson*, 176 N.E. 918 (Mass. 1931).

[68] *Freight Terminals, Inc. v. Ryder System, Inc.*, 326 F. Supp. 881, 889 (S D. Tex. 1971) (citing *Fisher v. Temco Aircraft Corp.*, 324 S.W. 2d 571, 575 (Tex. Civ. App. – Texarkana 1959, no writ) for proposition that "[t]he established rule is that these two covenants are essentially the same.").

[69] *City Hotel Co. v. Aumont Hotel Co.*, 107 S.W.2d 1094, 1095 (Tex. Civ. App. – San Antonio 1937, no writ) (citations omitted).

[70] *See Fisher*, 324 S.W.2d at 575 (citing *Shaffer v. George*, 64 Colo. 47, 171 P. 881, 882 (1917). *But See Tinsley v. Smith*, 101 N.Y.S. 382, 115 A.D. 708, 712 (N.Y. App. Div. 1906) (citing *Payne v. Haine*, 16 Mees & Welsb. 541 for proposition that covenant to ***keep*** in good repair obligates tenant to ***put*** the premises in good repair if they were not so at the commencement of the term and citing *White v. Albany Railway* (17 Hun. 98) for proposition that covenant to ***make*** necessary repairs only requires the tenant to make those repairs that the tenant might find necessary for its use of the premises and does not require the tenant to put the premises in better condition than they were at the commencement of the term).

[71] William H. Danne, Jr., Annotation, Measure and Elements of Damages for Lessee's Breach of Covenant as to Repairs, 45 A.L.R.5th 251, 253 (1997 & 2012).

injury to the market value of the reversion, not the cost of repairs.[72] If the landlord actually makes repairs during the term, Texas law permits the landlord to recover the reasonable cost of doing so.[73]

b. ***Suit After End of Term.*** As a general rule, a landlord is entitled to the reasonable cost of repairs as the proper measure of damages if the landlord waits to sue for breach of the repair covenant until after the term of the lease expires.[74]

c. ***Allowances Against Cost of Repair.*** In determining the reasonable cost of repair under a repair or surrender clause that excepts ordinary wear and tear, a tenant – depending on the terms of the covenant – may be entitled to a credit for the age and condition of the property before the commencement of the term and for any depreciation during the term due to ordinary wear and tear. In *Baroid Div., Nat'l Lead Co. v. Early*,[75] the court of appeals found that the trial court's computation of the landlord's damages properly applied the rule "that where a [tenant] covenanted to return property at the end of the lease in as good condition as when received, ordinary wear and tear excepted, the proper measure of damages was the reasonable cost of repairs necessary to place the building in such good condition."[76] In applying this rule, the trial court considered the fact that about 16 feet of the building, or approximately 1/4th of its length, was set aside for office purposes and that the only damage in that portion of the building was occasioned by customary wear and tear. The trial court deducted 1/4th of the cost of repairing the entire floor from the landlord's damage claim. The trial court then estimated that the floor, which had been in the building over a period of 11 or 12 years, had depreciated by approximately 30% before the lease term began. To determine the landlord's recoverable damages, the court reduced the total repair cost by 25% for ordinary wear and tear and by another 30% to account for depreciation that occurred before the lease began.

2. ***Good Repair Covenant Does Not Make Tenant Insurer of Property Condition.*** A covenant requiring the tenant to redeliver the leased premises to the landlord in a good state of repair upon the termination of the lease, standing alone, ordinarily does not require the tenant to restore or obligate the tenant to pay for restoring damage to the premises caused by a fire of unknown origin, Act of God, or other cause not the fault of the tenant. In the early case of *Howeth v. Anderson*,[77] the Texas Supreme Court held that a tenant's covenant to redeliver a steam sawmill at the expiration of the term of the lease in as good order as when it was received, excepting usual wear and tear and unavoidable accidents, did not render the tenant liable in damages for the accidental loss of the premises by fire. In the course of its opinion, the supreme court stated:

> Looking to the terms and subject matter of the contract, we do not think it reasonable or fair to conclude that the parties contemplated that the [tenant]s were to become insurers of the property against those casualties which ordinary prudence and foresight could not have guarded against; or that it was supposed or intended that they were to become liable to repair the loss in case of accidental destruction of the property by fire without negligence or fault on their part. . . It would have been a very extraordinary liability for the [tenant] to assume; and, if intended, it would doubtless have been clearly expressed in the lease.[78]

[72] *Fagan v. Whitcomb*, 14 S.W. 1018 (Tex. Civ. App. 1889, no writ); *Glickman v. DeBerry*, 11 S.W.2d 367 (Tex. Civ. App. – Austin 1928, no writ).

[73] *Pully v. Milberger*, 198 S.W.3d 418, 429 (Tex. App. – Dallas 2006) (to establish right to recover costs of repair, it is not necessary for Landlord to use the words "reasonable and necessary" when introducing evidence of the cost of repairs).

[74] *Siegler v. Robinson*, 600 S.W.2d 382, 386 (Tex. Civ. App. – Houston [1st Dist.] 1980, writ ref'd n.r.e.); *Dunlap v. Mars Plumbing Supply*, 504 S.W.2d 917, 918 (Tex. Civ. App. – San Antonio 1973, no writ); *Whitworth Estate v. Mangels of Texas, Inc.*, 363 S.W.2d 851 (Tex. Civ. App. – Waco 1962, no writ).

[75] 390 S.W.2d 866 (Tex. Civ. App. – Eastland 1965, no writ).

[76] *Id*. at 868 (citing *Whitworth Estate v. Mangels of Texas, Inc.*, 363 S.W.2d 851 (Tex. Civ. App. – Waco 1962, no writ)).

[77] 25 Tex. 557 (1860).

[78] 25 Tex. 557; *see also* *Orr v. Vandygriff*, 251 S.W.2d 573, 574 (Tex. Civ. App. – Waco 1952, no writ) (emphasis added) (holding that tenant's obligation to maintain premises during term "in good repair and condition" and to surrender them at end of term "in good tenantable repair in all respects" was not general covenant to repair accidental fire damage when related provisions excused tenant from obligation to make any "structural repairs to the roof or main walls of the building," to make any "alterations or improvements," or "to repair or replace" worn

If the parties desire to make the tenant responsible for restoring the premises after a casualty, the parties may do so, but the lease must contain additional language (*e.g.*, a casualty clause requiring the tenant to rebuild) that places these obligations on the tenant.[79]

3. ***Scope of Repairs Required***. A tenant's repair obligations ordinarily "will not be extended or enlarged beyond the plain meaning of language used in the covenants[,]" a rule consistent with the more general proposition that a lease should be construed "most strongly" against the landlord.[80] Thus, a covenant "to repair" or "to keep in repair" is ordinarily construed much the same as a covenant to deliver up the premises in good order and condition.[81] As a result, "all" does not always mean "all" in a lease clause requiring the tenant to make "all" necessary repairs and replacements during the term or to comply with "all" applicable laws.[82]

a. ***Structural Repairs***. A general covenant to repair ordinarily obligates the tenant to make ordinary repairs reasonably required to keep the premises in proper condition but does not require the tenant to make structural repairs.[83]

b. ***Asbestos.*** No Texas case apparently has decided the issue, but courts in other jurisdictions have held that a general repair covenant, even one that requires the tenant to make structural repairs, ordinarily does not require the tenant to abate asbestos generally or to abate asbestos that has deteriorated due to ordinary wear and tear.[84] But, the recent case of *Spodek v. U.S. Postal Services,* the district court found that landlord failure to abate asbestos in leased premises constituted a default under the lease and a constructive eviction.[85] However, the lease in *Spodek* obligated landlord to maintain the premises "in good repair and tenantable condition" and to put the premises in satisfactory condition if any part of the premises "becomes unfit for the purposes leased . . . as determined by the [tenant]."

c. ***Wiring***. In *Xiu Chen v. Rb & Rb Invs.*,[86] the landlord and tenant both became aware of defective wiring. That wiring caused a fire a few weeks after the parties became aware of the defect. Each party claimed the other party was liable for the fire damage because it was the other party's responsibility to fix the defective wiring. The maintenance and repair covenant in the lease recited:

> Landlord shall keep the foundation, the exterior walls… and the roof of the Leased Premises in good repair … Tenant shall… make all needed

out equipment and required landlord to make these kinds of repairs, replacements, alterations and improvements, if any, at the its own expense).

[79] *Miller, Billups & Co. v. Morris, Ragsdale & Simpson*, 55 Tex. 412, 420 (1881) (holding that surrender covenant requiring tenant to redeliver or restore premises in as good repair and condition at the termination of the lease as when received by tenant did not bind tenant to rebuild in case of casual destruction by fire or impose the burden of loss on the tenant and stating that "[i]t is not within the intendment and according to general understanding that such stipulation imposes on the tenant the responsibility of insurer. If that greater risk is assumed, it must be clearly and explicitly set forth in the contract.").

[80] *Fisher*, 324 S.W.2d at 575 (citing *Puget Invest. Co. v. Wenck*, 221 P.2d 459 (Wash. 1950)).

[81] *See Walling v. Christie & Hobby*, 54 S.W.2d 186 (Tex. Civ. App. – Galveston 1932, no writ); *Pickrell v. Buckler*, 293 S.W. 667 (Tex. Civ. App. – El Paso), *writ ref'd,* 116 Tex. 567, 296 S.W. 1062 (1927).

[82] See C. T. Drechsler, *Annotation, Who, as Between Landlord and Tenant, must Make, or Bear Expense Of, Alterations, Improvements, or Repairs Ordered by Public Authorities*, 22 A.L.R.3d 521 (1968 & 2012); Milton R. Friedman & Patrick A. Randolph, Jr., 2 FRIEDMAN ON LEASES, *Compliance with Laws* § 11.1 (5th Ed. 2004) (stating that covenants to keep in repair and to cause premises to comply with laws are separate covenants) [hereinafter FRIEDMAN ON LEASES].

[83] 1 FRIEDMAN ON LEASES, Tenant's Covenant to Repair: Scope § 10.6.1; *see also* G. Van Ingen, Annotation, E*xtent of Lessee's Obligation under Express Covenant as to Repairs*, 20 A.L.R.2d 1331 (1952 & 2012).

[84] *See Arnot Realty Corp. v. New York Tel. Co.*, 245 A.D.2d 780, 665 N.Y.S.2d 478 (N.Y. App. Div. 1998) (holding that tenant, who had duty to make all necessary structural repairs to leased premises, was not required to abate asbestos hazard on premises because asbestos hazard was not condition in need of repair); *Mittleman Props. v. Bank of California*, 886 P.2d 1061 (Ore. 1994) (stating that nothing in lease obligating tenant to keep premises in "good order and condition and to promptly make all necessary repairs" required tenant to remove asbestos that was not a current health hazard or in a state of disrepair).

[85] No. 3:07–CV–1888–BF, 2012 WL 3234427, (N.D. Tex. Aug. 9, 2012).

[86] 2003 WL 297674, *1-2 (Tex. App. – Houston [14th Dist.] 2003, no pet.).

repairs… except for repairs required to be made by Landlord under this section.

In support of its conclusion that this clause "unambiguously placed the duty to repair electrical wiring on [the tenant][,]" the court of appeals noted that the lease only required the landlord to repair "structural components of the premises," and it recited that the tenant had examined the premises and accepted them "AS IS." In addition, the tenant had presented no evidence that the defective wire was located in an "exterior" wall, which the landlord was obligated to maintain, as opposed to an "interior" wall, which the lease required the tenant to maintain.[87]

4. ***Timing Issues.*** Because the repair and surrender covenants are performable at different times, each must be considered separately in dealing with various issues that arise in the course of the tenant's occupancy.

a. ***Estoppels and Renewals***. Estoppel certificates and lease renewals often recite that neither party is then in breach of any covenant under the lease.[88] A landlord should be especially careful to consider the impact of such a recital on its ability to enforce a repair clause as to any condition in disrepair as of the effective date of the estoppel or renewal. A tenant should be aware that such a recital may not prevent the landlord from requiring a tenant to make repairs under the repair covenant at the end of the term. Because a tenant's performance is not due until the end of the term, a tenant cannot be in breach of its surrender obligation before the end of the term, even if the premises are in disrepair before the end of the term.

b. ***Assignments.*** Similarly, assignments often require the assignee to perform all obligations accruing under the lease after the effective date of the assignment. In *Tesoro Marine Servs. v. Bagby*,[89] the lease obligated the tenant to surrender the premises, including dock and roads,...in as good condition and state of repair, reasonable wear and tear excepted."[90] The parties could not agree whether "in as good condition and state of repair" referred to inception of the lease in 1969 or the date of the 1996 assignment and assumption. Based on the surrender clause, the court of appeals held that the assignee was responsible for restoring the premises to its condition in 1969. A tenant, as well as its assignee, should consider the extent of any repair and restoration obligations that may accrue under the surrender clause at the end of the lease.[91]

B. **Problematic Words and Phrases**. Many words and phrases commonly used in repair and surrender covenants are the source of several recurring problems. One major difficulty is that many words and phrases used in leases "with respect to the subject of repairs [are] uncertain in meaning by reason of such descriptive terms as 'workable condition,' 'good repair and condition,' 'tenantable repair,' and 'structural repairs.'"[92] Another difficulty is that in the attempt to ascertain the true intent of the parties, courts interpret these descriptive words and phrases differently depending on the circumstances. A tenant occupying a new building under a long term lease, for example, may be held to a higher standard under a "good repair" covenant than a tenant occupying an older building under a short term

[87] *See Baty v. ProTech Ins. Agency*, 63 S.W.3d 841, 854 (Tex. App. – Houston [14th Dist.] 2001, pet. denied) (applying maxim *expressio unius est exclusio alterius*); *Sun Operating L.P. v. Holt*, 984 S.W.2d 277, 292 (Tex. App. – Amarillo 1998, pet. denied).

[88] *But see, Airport Garage, LLC v. Dollar Rent A Car Systems, Inc.*, 245 S.W.3d 488 (Tex. App. – Houston [14th Dist.] 2007, pet. denied) (tenant not estopped from asserting claims against landlord arising out of defective expansion joints even though tenant signed estoppel certificate stating, among other things, that landlord was not in default under lease; at the time tenant signed the estoppel certificate it was dealing with landlord about defective expansion joints and landlord had not failed to make the repairs that were requested or required, therefore tenant's statement that there were no uncured defaults did not constitute a false representation or concealment of material fact).

[89] 2004 WL 2450872 (Tex. App. – San Antonio 2004, pet. denied).

[90] *Id.* at *2.

[91] *Gehan Props. II v. Performance Interconnect, Inc.*, 2002 WL 1136989, *2 (Tex. App. – Dallas 2002, n.p.h.) (holding that tenant's assignee was liable for costs of restoring property at end of lease term under surrender clause because assignee's duty to perform (*i.e.*, to restore premises to their condition before alterations) did not accrue until lease terminated).

[92] *Orr v. Vandygriff*, 251 S.W.2d 573, 574 (Tex. Civ. App. – Waco 1952, no writ) (emphasis added); 1 FRIEDMAN ON LEASES, *Negotiating and Drafting Repair Clauses – Business and Practical Aspects* § 10.8, at p.10-161 (including structural repairs, casualty (as an undefined term), elements, and Acts of God among words and phrases to be avoided in repair and surrender clauses).

lease, even though both leases use the same phrase to describe the tenant's repair obligation.

1. ***Condition As When Received***. One genre of repair and surrender clauses requires the tenant to keep the premises in the condition received and return the premises in the same condition as when received at the end of the term, except for ordinary wear and tear.[93] This type of clause is easy to draft but difficult to enforce. When a lease is being drafted, the parties and their counsel are familiar with the condition of the premises. Even if the same people are around at the end of the 25-year lease, they aren't likely to recall the age, wear, and other general conditions of the premises, much less the specific condition of each piece of equipment within the premises. It is far more likely that any records of, as well as witnesses familiar with, the condition of the property at lease inception won't be around when counsel for the fourth landlord is called upon to prove that the third assignee has not restored the premises to the same condition as when received 25 years earlier.

a. ***Documenting Property Condition***. When it is appropriate to use such a repair or surrender clause, it is necessary to document the condition of the premises at lease inception. In large industrial facilities, it may be prudent to refer to, or even to attach, expert reports documenting the age, type, and condition of key facilities.

b. ***Reciting Property Condition***. Often ignored as boilerplate, recitals or stipulations in a lease concerning the condition of the property at the inception of the lease can be decisive in establishing the condition of the premises at that time. One Texas court has held that a tenant, by acknowledging at the inception of the lease that the premises are in good condition, cannot defeat a landlord's claim that the tenant failed to repair or to surrender the premises in the required condition on the ground that its landlord cannot prove the condition of the premises at the inception of the lease.[94] Such an acknowledgment may preclude a tenant from attacking its landlord's proof of damages on the ground that the landlord has not adequately shown, by other direct or circumstantial evidence, the condition of the premises at the inception of the Lease.[95]

c. ***Proving Property Condition***. When "the costs of repairs are disputed, the reasonableness of the alleged costs of repair can be established by testimony from property owners, contractors, and others knowledgeable about the condition of the property in question before and after the alleged damage."[96] "It is not incumbent upon plaintiffs to prove their damages with mathematical exactness, but only to meet the test of reasonable certainty."[97]

(1) **Direct Evidence Not Required**. "When a landlord is seeking to recover damages for failure to keep or to surrender the premises in the condition in which the tenant received the premises, the landlord party is not required to present direct proof of the condition of the premises on the precise date of the inception of the lease."[98] Nor does Texas law "otherwise indicate that such a direct showing is a prerequisite for a claim for damages."[99] Instead, Texas law merely requires

[93] *See, e.g., Jacobi v. Timmers Chevrolet, Inc.*, 164 Ga. App. 198, 200 (Ga. Ct. App. 1982) (emphasis added) (citing *Spacemaker, Inc. v. Borochoff Props., Inc.*, 145 S.E.2d 740 (Ga. Ct. App. 1965)).

[94] *J. L. Whitworth Estate v. Mangels of Texas, Inc.*, 363 S.W.2d 851, 857 (Tex. Civ. App. – Waco 1962, no writ) ("Where lease provided that premises should be surrendered at its termination in same condition of repair as at the date of execution of lease, and provided that its signing by [tenant] should be conclusive evidence that [tenant] received premises in good order and repair, [tenant] could not complain of judgment awarding damages to [landlord] for surrendering premises in damaged condition in violation of lease on ground that there was no evidence as to state of repair at beginning of lease.").

[95] *J. L. Whitworth Estate*, 363 S.W.2d at 857.

[96] *See Gupta v. Manwani*, 2004 WL 2097514, *2 (Tex. App. – San Antonio 2004, no pet.) (unpublished).

[97] *Young v. DeGuerin*, 591 S.W.2d 296, 299-300 (Tex. Civ. App. – Houst. [1st Dist.] 1979, no writ) (citing *City of San Augustine v. Roy W. Green Co.*, 548 S.W.2d 467 (Tex. Civ. App. – Tyler 1977, writ ref'd n. r. e.)).

[98] *Gupta*, 2004 WL 2097514, *2 (stating rule in suit by landlord against tenant to recover cost of repairs to premises resulting from tenant's breach of surrender covenant and covenant to repair).

[99] *Gupta*, 2004 WL 2097514, at *2; *Moren v. Pruske*, 570 S.W.2d 442, 444 (Tex. Civ. App. – San Antonio 1978, writ ref'd n.r.e.) (citing *Pasadena State Bank v. Isaac*, 228 S.W.2d 127 (Tex. 1950)); *Weaver Constr. Co. v. Rapier*, 448 S.W.2d 702, 703 (Tex. Civ. App. – Dallas 1969, no writ) (stating that "if the injury is not permanent, but is temporary and the injuries are repairable so that the property can be restored to its former condition, the measure of damages is the reasonable cost of the repairs necessary to restore the property to its condition immediately prior to the injury plus the loss occasioned by being deprived of the use of the property."); *Planet Plows, Inc. v. Evans*, 600 S.W.2d 874, 876 (Tex. Civ. App. – Amarillo 1980, no writ) (stating that "the proper measure of

that the landlord establish a "reasonable basis for estimating the loss..."[100]

(2) **Circumstantial Evidence Is Admissible.** In *McCulloch v. Dobson*, the landlord sued the tenant for the cost of repairs after the tenant failed to return to the landlord at the end of the lease certain machinery on the leased premises in the same condition as received by the tenant at the inception of the lease, reasonable wear and tear excepted.[101] The landlord did not offer direct proof of the condition of the premises at the inception of the lease, and the tenant argued that the landlord did not proffer sufficient proof of the condition of the machinery. The court rejected the tenant's argument based on circumstantial evidence and expert testimony from which the condition of the equipment at the inception of the lease could be inferred:

> Some of these witnesses were experts and they all described the condition of the articles of machinery, the appearance of the factory, and other defects in such a way as to reflect light upon the condition of the same articles a few months or weeks before. Evidence as to the condition of machinery in a mill at a particular date is competent, ordinarily, to show what its condition was at a date shortly before. It is not necessary that the witnesses should have seen the machinery at or before the time when its condition is to be ascertained. The fact that they did not examine or see the machinery at the very day, nor till some days or even months subsequent to the time in question may affect the value, but not, ordinarily, the competency of the testimony. It is a common thing to prove the condition of machinery or appliances at the time of the occurrence involved in the litigation by facts showing the like condition of the same machinery or appliances at another time when the circumstances shown are such as to raise a fair inference that no change has taken place.[102]

Under Texas law,[103] and cases like *McCulloch*, which is in accord with the legal principles laid down in Texas, a landlord may satisfy its burden of proof as to the condition of the premises at the inception of the lease by direct or circumstantial evidence or by expert testimony.

2. ***Good Repair and Condition***. A second genre of repair and surrender covenants require the tenant to "keep the premises in good repair and condition, reasonable wear and tear excepted" and to surrender the premises in similar condition at the end of the term. These clauses are the express equivalent of the implied covenant against waste.[104] This means that a lease provision expressly obligating the tenant to surrender the property in good condition ordinarily does not require the tenant to replace stolen fixtures or to repair damage that occurs without fault on the part of the tenant.[105] But it also means that, absent a contrary provision, a tenant usually is responsible for rebuilding

damages for a temporary injury to real property is the amount necessary to place the owner of the property in the same position he occupied prior to the injury. In this connection, the amount necessary is not the reasonable cost of remedial repairs made by an ordinarily prudent owner, but is, under the pleadings here, the reasonable cost of the repairs necessary to restore the property to its condition immediately prior to the injury.").

[100] *Young v. DeGuerin*, 591 S.W.2d 296, 299-300 (Tex. Civ. App. – Houston [1st Dist.] 1979, writ) (citing *Hindman v. Texas Lime Co.*, 305 S.W.2d 947 (Tex. 1957) for proposition that "[i]f the evidence affords a reasonable basis for estimating the loss, then the appellees should not be denied recovery simply because the exact amount is incapable of ascertainment.").

[101] *McCulloch, v. Dobson*, 30 N.E. 641, 644-45 (N. Y. Sup. Ct.1891).

[102] *McCulloch*, 30 N.E. at 644-45.

[103] *Gupta*, 2004 WL 2097514, at *2; *Moren*, 570 S.W.2d at 444 (citing *Pasadena*, 228 S.W.2d 127); *Weaver*, 448 S.W.2d 702 (stating that "the proper measure of damages where the injury to realty is repairable is the reasonable cost of repairs necessary to restore the property to its prior condition"); *Planet Plows*, 600 S.W.2d at 876.

[104] *R.C. Bowen Estate*, 256 S.W.2d at 72 (stating that parties "incorporated . . .implied covenant against waste into the lease contract . . ." in covenant providing that "[Tenant] . . . will upon the completion of the term, . . . yield up the said leased premises and all additions made thereto, in good tenantable condition and repair, reasonable use and wear thereof and damages by fire or other cause beyond the control of [tenant] excepted."); *Norman*, 237 S.W. at 965 (holding that covenant "'that the [tenant] shall take good care of the property and its fixtures and suffer no waste,' in its legal effect, is not equivalent to a covenant 'to uphold and repair,' or 'to repair,' but only to a covenant 'to redeliver or restore to the [landlord], in the same plight and condition, usual wear and tear excepted,' or other words of like import.").

[105] *Cf. B & B Vending Co. v. Carpenter*, 472 S.W.2d 281, 283 (Tex. Civ. App. 1971) (finding that exception of "casualty" in surrender clause exculpated tenant from any liability for disappearance of air conditioner without proving fault on part of tenant).

damage caused by the tenant's negligence. By contrast, the Fifth Circuit Court of Appeals has stated that the phrase good order and condition in a 20-year lease for a new building "contemplates an objective standard by which to determine the necessity of repairs."[106] Under this standard, a tenant "must repair or replace property that a reasonably prudent owner would repair or replace[,]"[107]even if the need for repair arises as a result of normal wear and tear without fault or negligence on the tenant's part.

3. ***Satisfactory Condition.*** The obligation to surrender the premises "in a satisfactory condition" does "not clearly reflect" the extent of a party's obligation for the condition of the premises.[108]

4. ***Reasonable Wear and Tear Excepted.*** This phrase in repair and surrender clauses is as ubiquitous as it is problematic. When a lease excepts "reasonable wear and tear" from the tenant's obligations under the repair or the surrender clause but not both, the lease is ambiguous.[109] Reasonable wear and tear provisions sometimes leave a hole in the lease that creates problems when it comes time to fix a hole in the roof. If, for example, a tenant agrees to maintain the premises (including the roof) in the condition received, normal wear and tear excepted, and the roof begins to leak during the term as a result of normal wear and tear, the tenant may not have any contractual obligation to fix the roof, even though water penetration from the leak may be damaging the building. See **Appendix II-B** for a sample clause (from a landlord's perspective) to modify the wear and tear exception in an industrial facility—where repairs are a major issue.

a. ***Exception for Ordinary Wear and Tear in Repair Clause May Limit Tenant's Surrender Obligations.*** As a general rule, any qualification of the tenant's covenant to keep the premises in good repair and condition, such as the ordinary wear and tear exception, also qualifies the tenant's covenant to surrender the property in good repair at the end of the lease term, even if the qualification is not expressly repeated in the surrender covenant.[110] The converse is generally, but not always, true.[111]

b. ***Good Repair Clause May Limit Wear and Tear Exception in Surrender Clause.*** In *Nadler v. American Motor Sales Corp.*[112] the Fifth Circuit recognized that Texas courts have generally determined that the exception for reasonable wear and tear in the surrender covenant "significantly qualifies the [tenant]'s repair obligations."[113] Although the *Nadler* court did not follow the general rule, the court of appeals "emphasiz[ed] that our determination of the effect of the [reasonable wear and tear] exception applies only to the facts of this case."[114]

(1) **Contentions**. Toward the end of the lease term, the landlord claimed that the tenant was required to repair or replace the HVAC system. The tenant claimed that it had no obligation to repair or replace the HVAC system to the extent the deterioration was due to ordinary wear and tear.

(2) **Facts**. The tenant leased a brand-new building, with a state-of-the-art HVAC system, for a 20-year term. The repair covenant obligated the tenant to "take good care of the premises," but the repair covenant itself did not contain an exception for ordinary wear. The surrender covenant, however, required the tenant to surrender the premises in the "same condition as when received [i.e., new] except for reasonable use and natural wear."

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[106] *Nadler v. American Motor Sales Corp.*, 764 F.2d 409, 415 (5th Cir. 1985).

[107] *Nadler*, 764 F.2d at 416.

[108] *See Freight Terminals v. Ryder Sys.*, 326 F. Supp. 881, 889 (S.D. Tex.1971), *aff'd*, 461 F.2d 1046 (5th Cir. 1972).

[109] *See Freight Terminals*, 326 F. Supp. at 889 (noting, under Texas law, that "a limitation that applied to the 'repair' covenant would also apply to the 'return' covenant"); *Fisher*, 324 S.W.2d at 575 (holding that surrender covenant excepting "natural deterioration and damage by fire, tornado or other casualty . . . could only have been intended to modify, limit, and restrict the obligation of the 'keep in good repair' clause"); *cf. B & B Vending Co. v. Carpenter*, 472 S.W.2d 281, 283 (Tex. Civ. App. – Waco 1971, no writ) (finding that exception of "casualty" excluded responsibility for disappearance of air conditioner through no fault of [tenant]").

[110] *See Freight Terminals*, 326 F. Supp. at 889; *Fisher*, 324 S.W.2d at 575.

[111] *See Nadler*, 764 F.2d at 415 (acknowledging the general rule but declining to follow it); *Beverly Enters.-Texas, Inc. v. Morton*, 2005 WL 1277895 (Tex. App. – Amarillo 2005, pet. filed) (unpublished opinion).

[112] 764 F.2d 409 (5th Cir. 1985).

[113] *Nadler*, 764 F.2d at 415.

[114] *Id*. at 415-16.

(3) **Reasoning**. To reconcile the conflict between the repair and surrender covenants, the court of appeals refused to "rest our analysis upon scrutiny of the covenants alone, for the words they employ arguably support a finding that the surrender covenant exception significantly qualifies the [tenant]'s repair obligations." "Under the terms of the surrender covenant," the court of appeals observed, "if [the tenant] had delivered to the [landlord] at the end of the term a heap of stripped nuts and bolts, gnarled sheet metal, shorted-out motors, and blighted condensers, the [tenant] would have fully discharged its obligation – so long as reasonable use and natural wear brought about the system's demise." Instead reading literal terms of the surrender clause in isolation from the other terms of the lease, the court of appeals looked to the facts and circumstances surrounding the execution of the lease to determine the parties' intent. The language in the repair and surrender covenants, when considered in light of a long-term lease for a new building, gave rise to the inference that the parties intended the tenant to maintain the premises "as a reasonable and prudent owner would."

(4) **Holding**. The court of appeals held that such a lease obligates the tenant to repair or replace the HVAC system if it falls below "good order and condition," even if reasonable use and natural wear causes its decline. Because of factual disputes in the summary judgment record, however, the court of appeals remanded the case for the trier of fact to determine "whether the system remained in good order and condition" at the end of the term.[115] The Fifth Circuit's reasoning and holding is consistent with other Texas cases.[116]

C. Issues Incident to Landlord's and Tenant's Repair, Maintenance, and Surrender Obligations.

1. ***Pay v. Perform***. One of the principal tasks in drafting and negotiating a lease is to avoid conflicts among its various provisions. In too many leases, one provision purports to require one party to pay an expense while another purports to require the other party to pay the very same expense. The problem is all too common with respect to repair and surrender clauses and the related clauses that obligate one party or the other to pay for a particular repair.

a. ***Pay For Does Not Mean Fix***. "A covenant to pay for repairs is distinct from the covenant to make repairs, and such an agreement does not impose upon the landlord any active duty to repair."[117]

b. ***Fix Does Not Necessarily Mean Pay For***. A covenant obligating a landlord to make certain repairs does not necessarily mean the landlord ultimately will bear the cost of doing so. Repair covenants in many leases obligate the landlord to make certain repairs and either permit the landlord to charge the tenant directly or allow the landlord to recover a portion of such repair costs as operating costs.

(1) **Complying with Applicable Laws.** More than one lease purports in one paragraph to obligate the landlord, at its sole cost, to comply with all laws applicable to the building, but allows the landlord in another paragraph to recover the same

[115] *Id*. at 416.

[116] *See Clark & Johnson v. Hamilton*, 16 S.W.2d 833 (Tex. Civ. App. 1929, no writ). In *Clark*, the lease required the tenant to "take good care of the property and its fixtures, and suffer no waste; and . . , at [tenant's] expense and cost, keep said premises in good repair; keep the plumbing work, closets, pipes and fixtures belonging thereto in repair; and keep the water pipes and connections free from ice and other obstructions, to the satisfaction of the municipal and police authorities, during the hereby granted term of five (5) years and at the end or other expiration of the term shall deliver up the demised premises in good order and condition, natural wear and tear and damages by fire and the elements only excepted." The court submitted two damage questions to the jury. The first asked the jury to find the reasonable cost to make the repairs. The second asked the jury to determine whether the required repairs were needed as a result of natural wear and tear. The trial court disregarded the jury's answer to the second issue and entered judgment for the landlord based on the jury's finding as to the cost of repairs. The Texas Court of Appeals affirmed, reasoning that the exceptions for natural wear and tear qualified the covenant requiring the tenant to surrender the premises in good order and condition at the end of the term, but did not qualify the covenant to repair. "In other words, the [tenant] covenanted to make all needed repairs on the building and keep the same in good repair, and in such repaired condition to surrender in good order and condition, natural wear and tear and damage by fire and the elements alone excepted." Based on this reading of the lease, the court of appeals held "that under the terms of the lease contract the court properly treated as immaterial the finding that the repairs in question were necessitated by natural wear and tear or the elements."

[117] *National Living Ctrs., Inc. v. Cities Realty Corp*., 619 S.W.2d 422, 424 (Tex. App. – Texarkana1981, no writ).

compliance costs from the tenant as an operating cost.

(2) **ADA Compliance**. Many leases require the tenant to pay the costs of complying with the ADA within the premises and require the landlord to pay for the cost of complying with the ADA in common areas of the building. This cost allocation, however, can be inconsistent with an operating cost provision that allows the landlord to recover the capital and other costs of complying with applicable laws.

(3) **Environmental Contamination**. Many environmental clauses in leases are at least partially inconsistent with the operating cost provisions.

2. ***Inspection Clauses***. Inspection clauses are yet another "boilerplate" lease term worthy of more careful drafting attention. Without the express right to reenter to repair, inspect, and test facilities within the premises, a landlord may be unable to perform its own repair obligations or to police adequately the tenant's performance of its obligations.

a. ***Landlord Has No Common Law Right of Entry***. Absent a lease provision granting the landlord the right to reenter the premises, the tenant enjoys the exclusive right of possession, even as against its landlord.[118] This rule is so strong that "[i]n the absence of a provision so allowing in the contract of lease, and of a consent by the tenant, the landlord has no right of entry upon the leased premises even to make needed repairs."[119] If a landlord does intrude upon the tenant's exclusive possession of the premises, without the tenant's permission or in violation of the lease, the tenant may maintain an action for trespass against its own landlord and recover any damages resulting from that trespass.[120]

b. ***Timing of Inspections***. When a lease allows the landlord to inspect the premises but does not set the time within which the tenant is required to comply with a request for an inspection, the law implies a reasonable time to comply.[121] Without a time limit, the term is open to interpretation as to what is reasonable and, therefore, is ambiguous.[122]

c. ***Extent of Inspection***. A lease that allows a landlord to enter to "inspect" the premises may not allow destructive testing. *In J.H. Corp. v. Keating*,[123] the tenant opposed the landlord's request to enter the premises and take samples for environmental testing. The inspection clause provided:

> [Tenant] shall permit [Landlord] or [Landlord]'s agents, representatives, or employees to enter on the leased premises for the purpose of inspection, determining whether [Tenant] is in compliance with the lease, maintaining, repairing, or altering the premises, or showing the leased premises to prospective [tenants], purchasers, mortgagees, or beneficiaries under trust deeds.
>
> The lease did not define "inspection." The tenant argued that the landlord's right to enter and to conduct an "inspection" did not include the right to take samples for environmental testing. The landlord argued that the plain meaning of inspection in the lease allows environmental testing. The court found that the scope of inspection permitted by this lease was ambiguous, stating "'inspection' has no standard or ordinary meaning that includes testing of land and may be defined or interpreted differently depending on the factual circumstances of its application."

3. ***Fixtures***. "There has been much confusion in the decisions on the question of what are and what are not removable as fixtures."[124] At common law, "[a] fixture is broadly defined as something that is

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[118] *See Cleveland v. Milner*, 170 S.W.2d 472, 475 (Tex. 1943) (citing *Brown v. Johnson*, 12 S.W. 2d 543, 545 (Tex. 1929)).

[119] *Higby v. Kirksey*, 164 S.W. 315, 316 (Tex. Civ. App. — Fort Worth 1913, writ refused) (emphasis added).

[120] *See Alford v. Thomas*, 238 S.W. 270, 272 (Tex. Civ. App. – Fort Worth 1922, no writ); *Higby*, 164 S.W. at 316.

[121] *J.H. Corp. v. Keating*, 2000 WL 26748, *3 (Tex. App. – Dallas 2000, no pet.) (citing *Moore v. Dilworth*, 1 179 S.W.2d 940, 942 (Tex. 1944); *West Anderson Plaza v. Feyznia*, 876 S.W.2d 528, 534 (Tex. App. – Austin 1994, no writ) (op. on reh'g); *Pearcy v. Environmental Conservancy of Austin & Cent. Tex., Inc.*, 814 S.W.2d 243, 246 (Tex. App. – Austin 1991, writ denied).

[122] See West Anderson Plaza, 876 S.W.2d at 534.

[123] 2000 WL 26748, *1.

[124] *Sanders v. Lefkovitz*, 292 S.W. 596, 598 (Tex. Civ. App. 1927, no writ). *See also C.W. 100 Louis Henna, Ltd. v. El Chico Restaurants of Texas, L.P.*, 295 S.W.3d 748 Tex. App. – Austin 2009, no pet.) (lease provided that upon termination the tenant owned trade fixtures, but landlord argued that tenant obligated to repair or replace vandalized and hail damaged HVAC units on top of restaurant; lease did not define trade fixtures but the court held that the HVAC units met the commonly understood definition of trade fixtures—those articles that may be annexed to the realty by the tenant to enable him to properly or efficiently carry on the trade, profession, or enterprise and which can be removed without material or permanent injury to the freehold.).

personal in nature but so annexed to realty as to become part of the realty."[125] "This, of course, does not mean that it must be impossible to remove the fixture..."[126]

a. ***Common Law Test***. Texas courts have used this 3 part test to determine whether a chattel has become an immovable fixture for over a century.

> (1) Has there been a real or constructive annexation of the property in question to the realty? (2) Was there a fitness or adaption of the article to the uses or purposes of the realty with which it is connected? (3) Was it the intention of the party making the annexation that the chattel should become a permanent accession to the freehold?[127]

"The third criteria, dealing with intention, is the preeminent factor whereas the first and second criteria are 'chiefly of value as evidence of this intention.'"[128] And the question of the parties's intention, as well as the general question of whether the property is a fixture, ordinarily is a question of fact.[129]

b. ***Tenant's Removal Right***. "The tenant may remove his fixtures at any time during his term, and after the term, while in possession of the demised premises, under some license or agreement, which creates what has been called an excrescence upon the term."[130] And "when the term depends upon some event uncertain as to the time of its happening, the tenant has a reasonable time after its determination to remove his fixtures."[131] But these general rules of law yield to any contrary terms in the lease.[132]

c. ***Terms Limiting a Tenant's Right to Remove Improvements Are Enforceable***. "The general rule that a tenant may remove improvements is subject not only to the law of fixtures concerning damage to the realty caused by removal, but is also subject to contracts to the contrary."[133] Thus, a provision in a lease stating that the "tenant shall have the right to remove said improvements, fixtures, furnishing, kiosk and other property erected or installed by him at the end of the lease term…provided that all amounts payable to landlord under the terms of this lease…have been paid[]" is enforceable.[134] "In this respect, the law of fixtures should not apply as long as conditions precedent to the right of removal have been complied with."[135]

d. ***Reasonable Time for Removal.*** Under Texas law, if the lease grants the tenant the right at the end of the lease to remove improvements that the tenant places upon the premises, the law allows the tenant a reasonable time after expiration of the lease to remove such improvements.[136] "What length of period constitutes a reasonable time is a question of fact or a mixed question of law and fact, to be determined according to the circumstances existing in the particular case."[137]

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[125] *Fenlon v. Jaffee*, 553 S.W.2d 422, 429 (Tex. Civ. App. – Tyler 1977, writ ref'd n.r.e.).

[126] *Id*. at 429.

[127] *O'Neil v. Quilter*, 234 S.W. 528, 529 (Tex. 1921) (citing *Hutchins v. Masterson*, 46 Tex. 551, 554 (1877)); *Ruby v. Cambridge Mut. Fire Ins. Co.*, 358 S.W.2d 943, 945 (Tex. Civ. App. – Dallas 1962, no writ).

[128] *Fenlon v. Jaffee*, 553 S.W.2d at 429 *Capitol Aggregates, Inc. v. Walker*, 448 S.W.2d 830, 834 (Tex. Civ. App. – Austin 1969, writ ref'd n.r.e.); *Millers Mutual Fire Ins. Co. v. Jackson*, 359 S.W.2d 510 (Tex. Civ. App. – Amarillo 1962, no writ).

[129] *Goodyear Serv. Stores v. Clegg*, 361 S.W.2d 445 (Tex. Civ. App. – San Antonio 1962, no writ); *Dallas Joint Stock Land Bank v. Lancaster*, 100 S.W.2d 1029, 1032 (Tex. Civ. App. – Waco 1936, writ dism'd).

[130] *Wright v. Macdonnell*, 30 S.W. 907, 909 (Tex. 1895).

[131] *Wright*, 30 S.W. at 909.

[132] *Id*. at 909 (stating that "[b]y agreement, fixtures "may become the property of the landlord, subject only to the lease; or they may be made personalty, and, as between the landlord and tenant, the absolute property of the latter. In case of a special agreement, the rights of the parties are to be determined by their intention as evidenced by the terms of the contract.").

[133] *Fenlon v. Jaffee*, 553 S.W.2d at 429 (citing *Eckstine v. Webb Walker Jewelry Co.*, 178 S.W.2d 532 (Tex. Civ. App. – Fort Worth 1944, writ ref'd) and affirming trial court's finding "that the intention of the parties as to the right of removal was subject to a condition precedent, that of payment of all rentals due.").

[134] *Fenlon*, 553 S.W.2d at 429 (stating that, even though "the law abhors forfeitures," evidence that tenant really did not want fixture, but wanted money instead, contributed to finding that tenant forfeited right to remove fixture).

[135] *Wright v. MacDonell*, 30 S.W. 907, 909 (Tex. 1895).

[136] *A. & M. Petroleum Co. v. Friar*, 152 S.W.2d 470, 471 (Tex. Civ. App. – El Paso 1941, no writ) (citing *Wright v. Macdonell*, 30 S.W. 907, 911 (Tex. 1895)); *Terry v. Crosswy*, 264 S.W. 718, 720 (Tex. Civ. App. 1924, no writ).

[137] *Fenlon v. Jaffee*, 553 S.W.2d 422, 429 (Tex. Civ. App. – Tyler 1977, writ ref'd n.r.e.); *Clark v. Clark*, 107 S.W.2d 421, 425 (Tex. Civ. App. – Texarkana 1937, no writ). But "[w]here there is a

e. ***Damages Incident to Removal of Fixtures.*** The traditional common law rule exculpates a tenant for non-negligent damage to the landlord's freehold incident to the tenant's removal of fixtures that the lease authorizes the tenant to remove. In *Gulf Oil Corp. v. Horton*,[138] the court of appeals, quoted the rules stated in several treatises:

> 'If there is a stipulation clearly giving to the tenant the right to remove annexations of a named character, the fact that the removal will result in injury to the leased premises, is immaterial. The language of the stipulation may, however, call for a different construction.'
>
> 'Where the tenant is given the right to make improvements and remove them during the term, the right to remove includes the right to do such damage to the freehold as such removal will naturally cause, and the tenant is liable only for such damages as are unnecessarily or wantonly caused by him.'
>
> 'Where authority is given a tenant to remove machinery he has put in it is implied that he may do such damage to the freehold in making the removal as in the exercise of ordinary care was necessary.'[139]

Because these rules run counter to contemporary commercial expectations, care should be taken to expressly define the extent of a tenant's responsibility to make ordinary repairs incident to the removal of its fixtures.

f. ***Remove and Repair Covenants***. Care should be taken to ensure that the repair clause is not overly broad. Typical lease forms require the tenant to "repair, at Tenant's sole cost, any and all damages caused by, or arising from, the removal of tenant's fixtures and trade fixtures."[140] This language, which requires a tenant to repair "all damages" caused by a specific act (removing fixtures and trade fixtures) could be construed to prevail over a general casualty clause that obligates the landlord to insure, repair, and pay for casualty damage. To avoid this potential ambiguity, specify whether the tenant's repair obligation does or does not extend to a fire or other casualty loss resulting from this specific act.

(1) **Problem**. Assume that the lease permits the tenant to remove its manufacturing equipment from the premises. In the ordinary course of removing the equipment, the tenant removes bolts from the concrete floor, leaving holes. The typical repair clause in the preceding paragraph would clearly obligate the tenant to pay for the cost of patching the holes in the concrete floor. But would such a repair clause – which literally purports to requires the tenant to repair all damage caused by removal of tenant's equipment – obligate the tenant to repair catastrophic fire damage to the building caused when the tenant's plumber starts a fire with his torch in the process of disconnecting the copper water pipes from the equipment? Or would a general casualty clause requiring the landlord to make and pay for damage caused by fire or other casualty control the outcome?

(2) **Renewals v. New Leases**. When a tenant's occupancy is extended, its right to remove fixtures at the end of the lease depends on whether the tenant's existing lease is being renewed or extended or a new lease is being created. "When a contract is entered into between the landlord and his tenant, which neither merely renews nor extends the former lease, but which creates a new lease, and in which the right to the fixtures annexed during the first lease is not reserved, the tenant loses his privilege of removal."[141]

D. **Abatement of Tenant's Rental Obligations**.

1. ***Landlord's and Tenant's Basic Concerns***.

a. ***Landlord's Concerns***. A landlord wants some or all of tenant's rental obligations to continue following a casualty or to obtain, or require its tenant to obtain, certain types of insurance coverage

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right of removal, if it is not exercised within a reasonable time, the right is forfeited." *Fenlon*, 553 S.W.2d at 429.

[138] 143 S.W.2d 132, 134 (Tex. Civ. App. – Amarillo 1940, no writ).

[139] 143 S.W.2d at 134.

[140] *See, e.g., Commack the Cook, LLC v. Eastburn*, 296 S.W.3d 884, 892-93 (Tex. App. – Texarkana 2009, pet. denied)(tenant subject to holdover provision of lease when tenant failed to remove improvements and restore premises because lease obligated tenant to "surrender the premises in good condition, remove all trade fixtures and alterations and improvements, restore the premises, and repair any damage to the property caused due to removal" and to leave the property "in 'broom-clean condition, and in the condition in which they existed as of the Lease Commencement Date.'").

[141] *Wright v. Macdonell*, 30 S.W. 907, 911 (Tex. 1895).

to compensate for the disruption of tenant's income stream and the rsulting disruption of landlord's rent stream.

b. ***Tenant's Concerns***. A tenant ordinarily will want rent to abate for as long as the premises are unusable for tenant's business purposes and for the period of time after restoration that it takes tenant to restore tenant finish out in the premises.

2. ***Drafting Considerations***.

a. ***Conditions to Rent Abatement – The Poison Casualty Pill***. Some leases purport to deny abatement of rent and hold the tenant liable for any casualty loss negligently caused by the tenant. To ensure that the tenant will not have to pay the landlord or its property insurer to rebuild the building when one of the tenant's employees leaves a coffee pot on and burns down the building, tenant's counsel must ensure that the landlord waives its claims against the tenant for such property damage, that the landlord's insurance carrier waives its subrogation rights, and that the tenant has not indemnified the landlord for such damages elsewhere in the lease. This no fault approach is reasonable if the tenant has paid for, or paid its proportionate share of, the landlord's property insurance policy.

b. ***Type of Rent Abated.*** If a landlord agrees to abate rent because the premises are damaged by a casualty, landlord and tenant will have to decide which type of rent abates.

(1) **Fixed Rent.** Despite the casualty, a landlord's obligations for its mortgage, taxes, insurance, and certain expenses continue. But a tenant will want its fixed rent to abate while tenant is unable to operate its business in the leased premises. Landlord may resist rent abatement on the grounds that the tenant can protect itself by obtaining Business Income and Additional Expenses insurance coverage; tenant will likely respond that landlord can protect itself by obtaining Business Income Rental Value insurance (and, in some cases, will argue that landlord already passes to tenant all or a portion of the cost of landlord's insurance premiums). Many retail leases obligate a tenant to pay taxes, insurance and other expenses as pass-throughs. Because these pass-throughs are not "rental income," a landlord cannot insure this loss with its Business Income Rental Value coverage. In these circumstances landlord and tenant may compromise—landlord agrees to abate fixed rent and obtains Business Income Rental Value insurance to cover that loss and tenant agrees to pay additional rent (*e.g.*, taxes, insurance, and other pass-throughs) and procures Business Income and Additional Expenses insurance to cover this loss. This compromise recognizes each party's ability to insure against these losses.

(2) **Percentage Rent**. In a retail lease landlord and tenant must also consider how the casualty affects percentage rent, if at all. This is another casualty issue that may implicate other lease provisions. A landlord will, of course, want to collect the percentage rent earned prior to the casualty. If the percentage rent terms obligate tenant to pay percentage rent on internet generated sales and a tenant's internet sales continue following the casualty, then landlord should continue to collect percentage rent. If percentage rent continues, a landlord will want to include a provision that proportionally reduces the breakpoint based on the reduced fixed rent following casualty.[142]

(3) **Pass-Throughs**. As noted in the discussion of fixed rent, landlord's obligation to pay taxes and insurance continue despite the casualty. If landlord and tenant use the compromise approach, the tenant will continue to pay the pass-throughs from the proceeds of its Business Income and Additional Expenses insurance.

(4) **Pre-Paid Rent**. When the lease is silent, a tenant is not entitled to a refund for prepaid rent following a casualty that results in termination of the lease.[143] If a landlord agrees to refund the prepaid rent, it should make the refund subject to landlord's right to offset against the prepaid rent any amount tenant owes landlord at the time the lease is terminated.

c. ***Amount of Rent Abated***. Once a landlord and tenant decide that rent will abate and identify the kind of rent that abates, the parties have to decide how much of the rent is abated.

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[142] For example, if annual fixed rent is $48,000 and the percentage rent is 6%, the breakpoint is $800,000. If the lease abates 50% of the fixed rent, then the new breakpoint should be $400,000.

[143] *Smith v. J. Weingarten, Inc.*, 120 S.W.2d 878 (Tex. Civ. App. – Beaumont 1938, *writ dism'd*)(in the absence of any provision of lease authorizing return of rent, tenant not entitled to return of prepaid rent upon total destruction of leased premises by fire).

(1) **Quantitative Approach.** A landlord prefers to reduce rent only to the extent the premises are unusable and not actually used. This is a purely numeric calculation—if the casualty damages 20% of the square footage of the premises, then rent is abated by 20%.

(2) **Fair and Reasonable Approach**. But from a tenant's perspective the quantitative approach does not take into account the quality of the portion of the premises destroyed. Instead, tenant will want rent abatement that is "fair and reasonable." For example, if only 25% of a restaurant is destroyed but the kitchen is the area destroyed, rent abatement of only 25% is inconsistent with the actual damage tenant suffers because of the casualty. This method of calculating the rent abatement may implicate the lease term defining tenant's permitted uses. Similarly, a fair and reasonable approach may take into account destruction of the common areas and other facilities that affect the traffic to tenant's premises.

d. ***Period of Time Rent Abated.*** Finally, landlord and tenant have to decide for how long the rent abatement will continue. If landlord has responsibility for and control over the restoration, it may agree to abate rent from the time of the casualty until the restoration is complete. However, if tenant has any control over the restoration, landlord is unlikely to permit rent abatement until the restoration is complete. On the other hand, tenant will want the rent to abate as long as the premises are unusable for tenant's business purposes, including a period of time for tenant to finish out the restored premises. A landlord is unlikely to allow the abatement to continue during this time if tenant has complete control over the finish out construction, but may agree to a specified period of time following completion of landlord's restoration work. If the tenant is responsible for restoring the premises, landlord will want to limit the period of rent abatement so that tenant does not have any incentive to prolong the restoration (though as a practical matter, a tenant without substitute space during the reconstruction phase will likely want to expedite this process so that it can resume its business operations).

Appendix II-A: Clause Negating Implied Warranty of Suitability
Appendix II-B: Clause Modifying Wear and Tear Exception
Appendix II-C: Casualty Clause
Appendix II-D: Office/Warehouse Lease Repair & Maintenance

Appendix II-A

Clause Negating Implied Warranty of Suitability

Article 15. Landlord Repairs

15.1(e) Waiver; Limitation of Remedies. Except for the specific, limited, express warranties in Sections ____ of this Lease, Landlord has not made, does not make, and expressly disclaims any representations, warranties, covenants, or guaranties, expressed or implied, or arising by operation of law or otherwise, as to the merchantability, suitability, habitability, quantity, quality, or environmental condition of the Premises or the Property or their suitability or fitness for any particular purpose or use.

(1) Tenant's Investigations. Tenant affirms that it has: (a) investigated and inspected the Premises, the Property, and any legal, contractual, or other restrictions on the use thereof to Tenant's satisfaction and is familiar and satisfied with the condition of the Premises and the Property; (b) made its own determination as to (i) the suitability, quantity, quality, and condition of the property, including the presence of any toxic or hazardous substances, materials, wastes, or other actual and potential environmental contaminates, and (ii) the Premises and Property's suitability and fitness for any particular purpose or use.

(2) AS IS. Tenant accepts the Premises and the Property "WITH ALL FAULTS" in its present "AS IS, WHERE IS" condition and state of compliance or non-compliance with applicable laws, use restrictions, and Tenant agrees and acknowledges that (a) Landlord would not have entered into this Lease without Tenant's acceptance, (b) the rental rate and other terms reflect the existing condition and use of the Premises and the Property, including the presence (if any) and potential presence of any environmental contamination, (c) Landlord has no liability or obligation to Tenant whatsoever to undertake any repair, alteration, remediation or other work of any kind with respect to any portion of the Premises or the Property, except as expressly provided in, and limited by, Sections ___ of this Lease, (d) Tenant is responsible for making all repairs and replacements of Tenant Repair Items, and (v) Tenant's use or intended use of the property may be impaired by known or unknown environmental conditions.

(3) Release. Except as expressly provided in subsection 15(e)(4), Tenant and its successors and assigns release and discharge Landlord and its agents, employees, representatives, lenders, and contractors (Landlord Parties) from any and all liability, obligations, and claims, known or unknown, affecting the value and use of the Premises or the Property, including, without limitation: (a) any claims or damages based, in whole or in part, upon the presence of toxic or hazardous substances, materials, or wastes, or other actual or potential environmental contaminates on, within, or under the surface of the Premises or the Property, (2) any action for contribution or indemnity, and (3) all responsibility, liability, obligations and claims that may arise under the Comprehensive Environmental Response, Compensation, and Liability Act, as amended 42 U.S.C. § 9601 et seq., or the Texas Solid Waste Disposal Act, as amended Texas Health and Safety Code § 361 et seq. Tenant and its successors and assigns further agree that if any remediation or other actions are required as a result of the environmental contamination of the Premises or the Property occurring after the Commencement Date, Tenant, and its successors and assigns shall be fully responsible to pay for and perform any remedial action necessary to restore the Premises and the Property to the condition it was in immediately before the contamination occurred, and Tenant will indemnify, defend, and hold Landlord harmless from any claims, loss, cost, or damage arising from, or relating to, any environmental condition or contamination occurring after the Commencement Date (including Landlord's passive negligence or failure to warn), but Tenant will have no obligation to indemnify Landlord for environmental contamination caused after the Commencement Date by Landlord's active negligence. This covenant shall bind Tenant, Tenant's successors, assigns and all other persons acquiring any interest in the Premises or the Property.

(4) Limitation on Tenant's Remedies. If any latent defect (including any environmental contamination present on or about the Premises or the Property as of the Commencement Date) in any facility essential to Tenant's Permitted Use of the Premises prevents or materially impairs Tenant's Permitted Use of, or access to, the Premises or the Property, Tenant must give Landlord immediate written notice of the alleged defect.

(A) Within ten (10) business days of delivery of Tenant's written notice to Landlord, Landlord, at its sole cost and not as an Operating Cost, will begin, and thereafter will diligently prosecute to completion, any repairs or other remedial action necessary to bring the portion of the Premises or the Property affected by post-Commencement Date contamination into compliance with then applicable laws.

(B) Tenant, as its sole and exclusive remedies for any latent defect that prevents or materially impairs Tenant's Permitted use of the Premises for more than ten (10) consecutive days, will be entitled to: (1) an equitable abatement of Base Rent and Operating Costs during and to the extent that Tenant's Permitted Use is prevented or materially impaired; and (2) if Tenant's Permitted Use is so prevented or materially impaired for more than ninety (90) consecutive days, Tenant will be entitled to terminate this Lease by delivering written notice to Landlord.

(C) In consideration for the limited abatement and termination rights granted to tenant under subsection 15.1(e)(4)(B), Tenant waives, releases, and relinquishes any and all claims against Landlord Parties for any offset, recoupment, loss, cost, damage, or expense suffered or incurred by Tenant (including, without limitation, incidental, consequential, and punitive damages, including, without limitation, lost profits and business interruption) arising from or relating to any latent, patent, or other condition or defect in the Premises or the Property existing as of the Commencement Date, except for claims arising from Landlord's gross negligence or willful and knowing concealment of any such condition or defect.

Appendix II-B

Clause Modifying Wear and Tear Exception

Article 16. Tenant Repairs

16.1 **Repairs During Term**. During the term, Tenant, at its sole cost, must keep the Tenant Repair Items in good order and repair.

(a) ***Tenant Repair Items*** include only Tenant's furniture, fixtures, and equipment in the Premises; Tenant's trade fixtures; Tenant's telecommunications and cabling; non-structural tenant improvements; electrical, plumbing, and mechanical systems in or exclusively serving the Premises. Tenant Repair Items also include any item otherwise defined as a Landlord Repair Item that is damaged by Tenant's failure to keep any Tenant Repair Item in good order and repair.

(b) *Landlord Repair Items* include, without limitation, the foundation, walls, roof, and all structural, building mechanical, plumbing, electrical, HVAC, other improvements, equipment, and other physical facilities in or serving the Building, excluding Tenant Repair items and similar items in the space leased by other tenants..

(c) ***Good order and repair*** means that the improvement, structure, equipment, or other item is (I) continuously and properly maintained in accordance with the manufacture's requirements or recommendations, or, in the absence of any such requirements or recommendations, best commercial maintenance practices appropriate to the item, and any additional requirements set forth in the Maintenance Schedule (Exhibit XX); (ii) promptly repaired or (if necessary) replaced to preserve intended function of the item, any system of which it is a part, and any other item or system the proper function of which depends on the proper function of the item in question. All such repairs and replacements must be performed in a good and workmanlike manner and in compliance with Applicable Laws using parts or equipment comparable quality and (when applicable) efficiency in the consumption of utilities.

(d) Tenant's obligation to keep Tenant Repair Items in good order and repair during the Term under this Article 16 includes the obligation to make any repairs and replacements that are required as a result of use (normal or

excessive), natural deterioration, breakage, failure, obsolescence, exposure to the elements, normal wear and tear, and any other cause, but Tenant's repair and restoration obligations exclude the repair or replacement of any damage, whether or not caused by Tenant, that results in, or is the result of, a Casualty Loss, which losses will be governed exclusively by Article 17, and any repair or restoration required as the result of a Condemnation, which losses will be governed exclusively by Article 18 of this Lease.

16.2 **Surrender at End of Term**. Except for any termination of this Lease by right granted under Article 17 upon a Casualty Loss or under Article 18 upon a Condemnation, Tenant must surrender the Tenant Repair Items to Landlord in good order and repair (as defined in Section 16.1(c)), except for any reasonable wear and tear between the last necessary repair, replacement, or restoration and the end of the Term. Reasonable wear and tear means any deterioration from normal use that does not prevent that does not prevent or materially impair the safe, efficient, normal, and effective use of the item for its intended commercial purpose.

Appendix II-C
Casualty

(a) **No Restoration**. If the Premises or the Building are damaged by fire or other casualty to the extent that (I) reconstruction cannot reasonably be completed within 90 days after the date of damage, as determined by Landlord, (ii) more than 50% of the rentable square feet of the Premises becomes untenantable due to casualty damage within the last 18 months of the Term, or (iii) the aggregate cost of reconstructing the Premises and the Building to their condition existing immediately prior to the date of damage exceeds the insurance proceeds made available for such purposes by Landlord's Mortgagee and Landlord elects not pay the difference, then either Landlord or Tenant may, by written notice given within 90 days of such damage, terminate this Lease, in which event Tenant shall be entitled to a fair diminution of Base Rent while and to the extent Tenant is unable to conduct its business in the Premises.

(b) **Restoration**. If this Lease is not so terminated, Landlord shall reconstruct the Premises and the Building to substantially the same condition as existed immediately prior to the date of damage, except that Landlord shall only be required to reconstruct the Building Standard leasehold improvements existing in the Premises on the date of damage ("Landlord's Contribution"). Tenant shall pay the difference between the total cost of reconstructing the Premises and Landlord's Contribution ("Tenant's Contribution"). Prior to Landlord's commencement of reconstruction, Tenant shall place Landlord's estimate of Tenant's Contribution in escrow with Landlord (or furnish Landlord with other commercially reasonable assurances of payment). Tenant shall be entitled to a fair diminution of Base Rent while and to the extent Tenant is unable to conduct its business in the Premises.

ARTICLE 17
DAMAGES BY CASUALTY

17.1 Notice from Tenant. Tenant must give immediate written notice to Landlord of any loss or damage to the Premises (the "Loss Notice").

17.2 Certain Rights Based Upon the Level of Damage. If the Premises are damaged or destroyed by fire or other peril insurable under standard "all risk" or "special form" or similar property insurance, Landlord agrees to deliver to Tenant, within 90 days after Tenant delivers to Landlord the Loss Notice, a realistic construction schedule, prepared by a reputable general contractor selected by Landlord, setting forth such general contractor's estimated time periods to substantially complete the repair and reconstruction that Landlord would be required to complete under this Article if neither Landlord or Tenant terminates this lease (the "Construction Schedule"). If the Construction Schedule indicates that such work will be completed after the expiration of the applicable time period set forth below (each of which is referred to as a "Reconstruction Period"), then either Landlord or Tenant may terminate this lease by written notice to the other at any time within 30 days after Landlord delivers the Construction Schedule to Tenant. If Landlord or Tenant terminates this lease as set forth above, then that termination will be effective on the date the termination notice is delivered to the other party. If Landlord or Tenant fails to terminate this lease in the manner set

forth above, then such party will be deemed to have waived the termination right set forth in this Section and if they both fail to do so, they both will be deemed to have waived the termination right set forth in this Section. The Reconstruction Periods are:

(A) For partial damage or destruction to the Premises, 120 days after the date upon which such work commences;

(B) For total destruction of the Premises where no other portion of the Project is damaged or destroyed, 180 days after the date upon which such work commences; and

(C) For total destruction of the Premises where any other portion of the Project is damaged or destroyed, one year after the date upon which such work commences.

17.3 Certain Rights Based Upon Available Insurance Proceeds. If the Premises are damaged or destroyed by fire or other peril that is not insurable under standard "all risk" or "special form" or similar property insurance, then Landlord may terminate this lease by written notice to Tenant. If the Premises are damaged or destroyed by fire or other peril, and neither Landlord nor Tenant is entitled to terminate this lease in accordance with any other Section of this lease or is entitled to terminate this lease but does not do so and the holder of any mortgage, deed of trust, or other lien senior to this lease elects under the terms of its security documents to apply all or any portion of the insurance proceeds to the reduction of Landlord's indebtedness, then Landlord may terminate this lease within 60 days after the lienholder notifies Landlord of its decision to apply the insurance proceeds to the debt. Any termination under this Section will be effective on the date such notice is delivered to Tenant. If Landlord fails to terminate this lease in the manner set forth above, then Landlord will be deemed to have waived its termination right under this Section.

17.4 Reconstruction Obligations. Landlord's obligation to rebuild and repair under this Article is limited to restoring the Landlord's Improvements. If Landlord fails to substantially complete its required repair and restoration within the applicable Reconstruction Period set forth in the Construction Schedule, then Tenant may, as its sole and exclusive remedy, terminate this lease by written notice to Landlord at any time after the end of the applicable Reconstruction Period but before the date of substantial completion of Landlord's required repair and restoration. If Tenant fails to terminate this lease in the manner set forth above, then Tenant will be deemed to have waived its termination right under this Section. Tenant agrees that promptly after substantial completion of the work Landlord is required to perform, Tenant must proceed with reasonable diligence and at Tenant's sole cost and expense to restore, repair, and replace the Tenant's Personal Property and the Tenant's Improvements.

17.5 Operation and Rent Abatement. Tenant agrees that during any period of reconstruction or repair of the Premises, it will continue the operation of its business within the Premises to the extent practicable. During the period from the occurrence of any damages to the Premises insurable under "all risk" or "special form" or similar property insurance until Landlord's required repairs are completed, the minimum guaranteed rent will be reduced to such extent as may be fair and reasonable under the circumstances, but there will be no abatement of the percentage rent and other charges provided for in this lease. Landlord and Tenant agree that it is fair that percentage rent not be abated because those sales have occurred even despite the damage and that other charges not be abated because Tenant can and is required to insure its obligations to pay those charges and Landlord cannot and is not required to insure its receipt of those payments.

ARTICLE 18
EMINENT DOMAIN

18.1 Termination Rights. If any portion of the Premises is taken for any public or quasi-public use under any governmental law, ordinance, or regulation or by right of eminent domain or by private purchase in lieu of the right of eminent domain (a "taking"), then Landlord or Tenant may terminate the lease by written notice to the other at any time within 30 days after the date physical possession is taken by the condemning authority.

18.2 Taking of the Common Area. If there is a taking of any part of the Common Area, this lease will not terminate, nor will the rent payable under this lease be reduced, except as set forth below in this Section. Either Landlord or Tenant may terminate this lease if the area of the Common Area remaining following such taking, plus any additional parking area provided by Landlord in reasonable proximity to the Project, is less than 70% of the area of the Common Area immediately prior to the taking. Any election to terminate this lease in accordance with this provision must be evidenced by written notice of termination delivered to the other party within 30 days after the date physical possession is taken by the applicable governmental authority.

18.3 Obligations if Lease not Terminated. If neither Landlord nor Tenant terminates this lease because of a taking, the minimum guaranteed rent (but not percentage rent) payable under the lease during the unexpired portion of this lease will be reduced in an amount that is fair and reasonable under the circumstances, effective on the date physical possession is taken by the condemning authority. Following such partial taking, Landlord must make all necessary repairs or alterations to the remaining Premises or, if an exhibit describing Landlord's Work is attached to this lease, all necessary repairs within the scope of Landlord's Work as described in such exhibit, as the case may be, required to make the remaining portions of the Premises an architectural whole.

18.4 Compensation. All compensation awarded for any taking (or the proceeds of private sale in lieu of a taking) of the Premises or Common Area is the property of Landlord and Tenant hereby assigns its interest in any such award to Landlord. However, Landlord has no interest in any award made to Tenant for Tenant's moving and relocation expenses or for the loss of Tenant's fixtures and Tenant's Personal Property if a separate award for such items is made to Tenant, as long as such separate award does not reduce the amount of the award that would otherwise be awarded to Landlord.

Appendix II-D
Office/Warehouse Lease

4. LANDLORD'S MAINTENANCE OBLIGATIONS

(a) This Lease is intended to be a net lease;[1] accordingly, Landlord's maintenance obligations are limited to the replacement of the Building roof[2] and maintenance of the foundation and structural members of the exterior walls (collectively, the "Building's Structure");[3] however, Landlord shall not be responsible (1) for any such work until Tenant delivers to Landlord written notice of the need therefor[4] or (2) for alterations to the Building's Structure required by Law because of Tenant's use of the Premises (which alterations shall be performed by Tenant).[5] The Building's Structure does not include skylights, windows, glass or plate glass, doors, special store fronts or office entries, all of which shall be maintained by Tenant. Landlord's liability for any defects, repairs, replacement or maintenance for which Landlord is responsible hereunder shall be limited to the cost of performing such work.[6]

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[1] What does this really mean?
[2] Some warehouse leases limit the landlord's obligation to maintain the roof on a warehouse to the structural supports and metal roof deck and require the tenant to maintain the other components of the roofing system. Drafting provisions that make these kinds of distinctions require some familiarity with the roofing system on a particular building and roofing system failures. If, for example, the tenant is responsible for maintaining the roofing membrane and the landlord is responsible for maintaining the metal roof deck, who is responsible for replacing the portion of the roof deck that rusts out as a result of the tenant's failure to maintain the roofing membrane properly?
[3] Who pays? Can the landlord pass through these repair costs to tenant?
[4] What is the landlord has actual knowledge of the "need therefor"?
[5] Who must make alterations to the Building's Structure required by Law (e.g., generally applicable ADA requirements) triggered by because of tenant's use of the premises as opposed to tenant's particular use of a the premises that triggers a special compliance requirement (e.g., additional fire suppression equipment required as a result of the nature of the material stored in the warehouse).
[6] Does this provision actually obligate the landlord to make the repairs? If so, when? And is the language sufficient to make recovery of the cost of performing this work tenant's sole and exclusive remedy?

(b) Additionally, Landlord shall, at Tenant's expense, maintain the parking areas, driveways, alleys and grounds surrounding the Premises in a clean and sanitary condition, consistent with the operation of a first-class office/warehouse building, including prompt maintenance, repairs and replacements of (1) any drill or spur tract servicing the Premises, (2) the exterior of the Building (including painting), (3) sprinkler systems and sewage lines,[7] and (4) any other items normally associated with the foregoing.[8] Tenant shall promptly notify Landlord of any work required to be performed under this Section 4. (b), and Landlord shall not be responsible for performing such work until Tenant delivers to Landlord such notice. All costs in performing the work described in this Section 4. (b) shall be included in Operating Expenses.

5. TENANT'S MAINTENANCE AND REPAIR OBLIGATIONS

(a) Tenant shall maintain all parts of the Premises (except for maintenance work which Landlord is expressly responsible for under Section 4. (a)) in good condition and promptly make all necessary repairs and replacements to the Premises. Tenant shall repair and pay for any damage caused by a Tenant Party (defined below) or caused by Tenant's default hereunder.[9]

(b) Tenant shall maintain the hot water equipment and the heating, air conditioning, and ventilation equipment and system (the "HVAC System") in good repair and condition and in accordance with Law and with such equipment manufacturers' suggested operation/maintenance service program; such obligation shall include replacement of all equipment necessary to maintain such equipment and system in good working order.[10] Within ten days after the Commencement Date, Tenant shall enter into regularly scheduled preventive maintenance/service contracts for such equipment, each in compliance with Landlord's specifications and otherwise in form and substance and with a contractor reasonably acceptable to Landlord, and deliver copies thereof to Landlord. At least 14 days before the end of the Term, Tenant shall deliver to Landlord a certificate from an engineer reasonably acceptable to Landlord certifying that the hot water equipment and the HVAC System are then in good repair and working order.

10. CASUALTY DAMAGE.

(a) Tenant immediately shall give written notice to Landlord of any damage to the Premises or the Building. If the Premises or the Building are totally destroyed by an insured peril,[11] or so damaged by an insured peril that, in Landlord's estimation, rebuilding or repairs cannot be substantially completed within 180 days after the date of Landlord's actual knowledge of such damage,[12] then either Landlord or (if a Tenant Party did not cause such damage) [13]Tenant may terminate this Lease by delivering to the other written notice thereof within 30 days after such damage, in which case, the rent shall be abated during the unexpired portion of this Lease, effective upon the date such damage occurred. Time is of the essence with respect to the delivery of such notices.[14]

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[7] Is the tenant responsible for repairs to main trunk lines that may serve other tenants in a multi-tenant warehouse project or just branch lines that exclusively serve the premises?

[8] Anyone know what this phrase means?

[9] Is this provision consistent with the insurance, waiver of claims and subrogation, casualty loss, indemnity, and any rental abatement provisions in the lease?

[10] What happens if the system is not in good working order throughout the lease term and a compressor blows out 3 days before the end of the lease term? Does the tenant owe the landlord $20,000 for replacing the HVAC unit that was 5 years old when the lease commenced with a brand new unit?

[11] What if the party responsible for insuring the peril does not do so; is it an "insured" peril? What if rising water, which is not an insured peril under a special form policy, causes the damage?

[12] Has anyone asked whether the structure can be restored within 180 days if it takes 30 days for the insurer to adjust the loss, the architect takes 30 days to prepare plans that comply with current ordinances and laws, and the lender takes 90 days to decide whether to apply the insurance proceeds to the debt?

[13] Should the tenant be denied the right to terminate when it has paid its pro rata share of landlord's lost rent coverage and property insurance premiums?

[14] What happens if landlord decides to rebuild, provides the required notice, but does not complete the repairs within the 180 day repair period.

(b) Subject to Section 10(c), if this Lease is not terminated under Section 10. (a), then Landlord shall restore the Premises to substantially its previous condition, except that Landlord shall not be required to rebuild, repair or replace any part of the partitions, fixtures, additions and other improvements or personal property required to be covered by Tenant's insurance under Section 9. If the Premises are untenantable, in whole or in part, during the period beginning on the date such damage occurred and ending on the date of substantial completion of Landlord's repair or restoration work (the "Repair Period"), then the rent for such period shall be reduced to such extent as may be fair and reasonable under the circumstances and the Term shall be extended by the number of days in the Repair Period.

(c) If the Premises are destroyed or substantially damaged by any peril not covered by the insurance maintained by Landlord or any Landlord's Mortgagee (defined below) requires that insurance proceeds be applied to the indebtedness secured by its Mortgage (defined below) or to the Primary Lease (defined below) obligations, Landlord may terminate this Lease by delivering written notice of termination to Tenant within 30 days after such destruction or damage or such requirement is made known by any such Landlord's Mortgagee, as applicable, whereupon all rights and obligations hereunder shall cease and terminate, except for any liabilities of Tenant which accrued before this Lease is terminated.

A. FAILURE TO MITIGATE.

1. **Traditional Rule**. Under the traditional common law rule in Texas, a landlord had no duty to mitigate its damages by procuring a substitute tenant after the original tenant abandoned the premises.[1] Thus, a landlord was at liberty to (i) treat its tenant's conduct as a breach and hold the tenant liable for damages or (ii) disregard the breach and sue on the lease for rent accruing after the breach as the rent came due.[2] Many anticipatory breach cases recite the rule that a landlord has no duty to relet, but these same cases apply damage measures that incorporate a duty to mitigate once the landlord reentered the premises.[3] As the district court explained in *Williams v. Kaiser Aluminum & Chem. Sales, Inc.*:

> [E]ven without the contract provision [granting the landlord the right to re-enter and relet for the account of the tenant], the landlord would have had the right to relet the property and, not having agreed to surrender his rights under the lease contract, recover from the former [tenant] the amount of the agreed rent for the entire contractual period of the lease less the sum that he may realize from the reletting, after the use of reasonable diligence to obtain a [substitute] tenant.[4]

Under the rule stated in *Williams*, a landlord's recoverable damages were measured by the discounted present value of the difference between the rent the original tenant agreed to pay and either (i) the amount the landlord received from actually mitigating its damages (*i.e.*, the rent the original tenant contracted to pay less any rent received from, or promised by, a substitute tenant) or (ii) the amount the landlord would have received had it mitigated its damages (*i.e.*, the rent the original tenant contracted to pay less the fair market value of the premises for the remainder of the lease term).[5] Other Texas cases, while recognizing the general rule, imposed a duty to mitigate if the landlord reentered the premises and sued for damages resulting from an anticipatory breach.[6]

2. **Current Rule: Landlord Has Duty To Mitigate**. In 1997, the Texas Supreme Court and the Texas Legislature both recognized that a landlord now has a duty to mitigate its damages under Texas law. But the duty each recognized is not identical, and some of the differences are significant.

a. ***When Does Duty to Mitigate Arise*?** Under *Austin Hill Country Realty, Inc.*, a landlord "must have" a duty to mitigate when suing for anticipatory breach.[7] *Austin Hill Country Realty, Inc.* imposes the duty to mitigate when (i) a tenant abandons the

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[1] *RTC v. Cramer*, 6 F.3d 1102 (5th Cir. 1993) (stating that Texas intermediate appellate courts still adhered to rule that landlord had no common law duty to mitigate damages); *Williams v. Kaiser Aluminum & Chem. Sales, Inc.*, 396 F. Supp. 288, 292-93 (N.D. Tex. 1975) (citing *Evons v. Winkler*, 388 S.W.2d 265 (Tex. Civ. App.—Corpus Christi 1965, writ ref'd n.r.e.)); *Brown v. RepublicBank First Nat'l Midland*, 766 S.W.2d 203 (Tex. 1988) (five justices suggesting, in dicta, that Texas should abandon traditional rule that landlord does not have the duty to mitigate); *Marynick v. Bockelmann*, 733 S.W.2d 665 (Tex. App.—Dallas 1989), *rev'd sub nom. on other grounds*, *Bockelmann v. Marynick*, 788 S.W.2d 569 (Tex. 1990) (acknowledging supreme court's *dicta* in Brown but refusing to adopt rule requiring mitigation until supreme court expressly addressed issue); *Metroplex Glass Ctr., Inc. v. Vantage Props., Inc.*, 646 S.W.2d 263, 265 (Tex. App.—Dallas 1983, writ ref'd n.r.e.).

[2] *Stubbs v. Stuart*, 469 S.W.2d 311, 312 (Tex. Civ. App.—Houston [14th Dist.] 1971, no writ) (citing *Wukasch*, 247 S.W.2d at 597).

[3] *Brown*, 766 S.W.2d at 204 (Kilgarlin, J., concurring) (stating that landlord has duty to mitigate when it exercises contractual as opposed to common law remedies); *Williams*, 396 F. Supp. at 288.

[4] 396 F. Supp. 288, 292-93 (N.D. Tex. 1975); *see also Evons*, 388 S.W.2d at 269; *Stewart*, 106 S.W.2d at 1075 (stating that when landlord reenters after tenant abandons premises proper measure for damages is difference between the contract price for the lease term and such sums as the landlord may have received by way of rentals from a third party, *after the use of reasonable diligence to obtain a tenant at the best rental possible under circumstances of the case).*

[5] *In re Merry-Go-Round Enters.*, 241 B.R. 124, 135 (Bankr. D. Md., 1999) (stating, in a case applying Texas law, that Texas courts would limit future rent damages to the present value thereof under *Austin Hill Country Realty, Inc.*).

[6] *Employment Advisors, Inc. v. Sparks*, 364 S.W.2d 478, 480 (Tex. Civ. App. – Waco) (stating, in case in which landlord sued tenant for anticipatory repudiation of lease, that because landlord pursued a contractual remedy, landlord's damage recovery was "subject, of course, to the usual rules concerning mitigation."), *writ ref'd n.r.e. per curiam*, 368 S.W.2d 199, 200 (Tex. 1963) (declining, in *per curiam* opinion, to express opinion on appellate court's holding); *see also Evons*, 388 S.W.2d at 269.

[7] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299-300.

premises in violation of the lease, and (ii) the landlord either actually reenters the premises or has the right to do so without terminating the lease.[8] Under the mitigation statute, however, a landlord has the duty to mitigate its damages whenever the tenant abandons the premises in violation of the lease.[9] Neither *Austin Hill Country Realty, Inc.* nor the mitigation statute appear to alter the rule that a landlord does not have duty to mitigate before its tenant's breach.[10]

In cases in which the lease does not give the landlord the right to reenter the premises when its tenant defaults, the statute creates a dilemma for a landlord that *Austin Hill Country Realty, Inc.* anticipates but avoids. Because a landlord does not have a common law right to reenter the premises without risking termination of the lease, *Austin Hill Country Realty, Inc.* expressly exempts a landlord from the duty to mitigate if the lease does not give the landlord the right to reenter.[11] The mitigation statute does not explicitly recognize this exemption.[12] Unless such an exemption is implied, or the courts modify the existing rules for eviction and surrender, the mitigation statute places a landlord, who does not have an express right to reenter and relet, in a potentially untenable position. If, on the one hand, the landlord does not reenter and relet, its right to recover damages from the tenant could be compromised because the landlord has failed to mitigate its damages. If, on the other hand, the landlord reenters and relets, the landlord risks breaching the covenant of quiet enjoyment and thus forfeiting its right to recover any damages.

b. ***Can the Parties Waive the Duty to Mitigate*? *Leases Before-September 1, 1997, Yes:*** In *Austin Hill Country Realty, Inc.*, the supreme court stated that the duty to mitigate applies to all commercial leases, unless the landlord and the tenant contract otherwise.[13] *Austin Hill Country Realty, Inc.* applies to leases entered into before September 1, 1997. ***Leases After September 1, 1997, No:*** The mitigation statute declares void any lease provision purporting to waive a right or exempt a landlord from a liability under the statute,[14] but the statutory prohibition on such waivers only applies to leases entered into on or after September 1, 1997.[15]

c. ***Duty to Use Objectively Reasonable Efforts to Relet***. While the supreme court attempted to define the duty to mitigate, the legislature did not. In *Austin Hill Country Realty, Inc.*, the supreme court stated that a landlord has a duty to make "objectively reasonable" efforts to fill the premises.[16] This duty, however, is not absolute — a landlord is not required to fill the premises with any willing tenant. The substitute tenant, according to the court, must be "suitable."[17] The supreme court's explanation is only slightly more helpful than the legislature's silence.

d. ***Breach of Duty to Mitigate Gives Rise to Defense***. The supreme court also explained the effect of a landlord's breach of its duty to mitigate more clearly than did the legislature. The supreme court stated in *Austin Hill Country Realty, Inc.* that a landlord's breach of the duty to mitigate does not give rise to a cause of action against the landlord.[18]

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[8] *See id.* at 299.

[9] TEX. PROP. CODE § 91.006.

[10] *Cf. Vasquez v. Carmel Shopping Ctr. Co.*, 777 S.W.2d 532, 536 (Tex. App.—Corpus Christi 1989, writ denied) (holding that lease did not require landlord to accept assignment of lease to prospective buyer of tenant's business or to mitigate damages before tenant's breach).

[11] *Austin Hill Country, Inc.*, 948 S.W.2d at 299-300.

[12] The legislative bill analysis indicates that the Legislature merely intended to codify the Supreme Court's holding in the case. The 75th Legislature enacted Section 91.006 in Senate Bill 1678. The bill analysis for Senate Bill 1678 states that the bill combines four house bills, including House Bill 2291. *See* House Comm. on Bus. & Indus., Bill Analysis, Tex. S.B. 1678, 75th Leg., R.S. (1997) (available at http://www.legis.state.tx.us/tlodocs/75R/analysis/html/SB01678H.htm). The bill analysis for House Bill 2291 states that "[t]his bill would merely codify the Texas Supreme Court's ruling." House Comm. on Bus & Indus., Bill Analysis, Tex. H.B. 2291, 75th Leg., R.S. (1997) (available at http://www.legis.state.tx.us/tlodocs/75R/analysis/html/HB02291H.htm). *See Zaid v. Weingarten Realty Invs.*, 09-10-00225-CV, 2011 WL 3847379 (Tex. App.—Beaumont Aug. 31, 2011, no pet.).

[13] 948 S.W.2d 299; *Stucki*, 963 S.W.2d at 781 (holding that tenant must prove landlord failed to mitigate and how much landlord's damages were increased by such failure).

[14] TEX. PROP. CODE § 91.006(b).

[15] TEX. PROP. CODE § 91.006.

[16] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299.

[17] *See id.; Stucki*, 963 S.W.2d at 781(holding that tenant must prove landlord failed to mitigate and how much landlord's damages were increased by such failure).

[18] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299-300.

Instead, a landlord's failure to mitigate bars its recovery against a breaching tenant only to the extent that the landlord's damages reasonably could have been avoided, and when a landlord does mitigate, any damages the landlord actually avoids by reletting will reduce its recovery.[19]

e. ***Burden of Proof on Tenant***. Finally, the supreme court, but not the legislature, prescribed certain procedural rules for putting a landlord's duty to mitigate in issue.[20] If a tenant merely wishes to receive credits for any amounts generated by the landlord's efforts to mitigate, the tenant may file only a general denial. If, on the other hand, a tenant wishes to assert that its landlord breached its duty to mitigate, the tenant must plead failure to mitigate as an affirmative defense. The tenant bears the burden of proving the landlord's failure to mitigate and the amount of any credit to which the tenant is entitled.[21]

B. **LESSONS ON MITIGATION FROM OTHER JURISDICTIONS**.

Because the duty to mitigate is new to this jurisdiction, Texas courts may look to cases from other jurisdictions for guidance in determining whether a commercial landlord has fulfilled its duty to mitigate or surrendered the premises in its efforts to satisfy that duty.

1. **Surrender and Mitigation**. Some jurisdictions have recognized the need to reexamine the traditional rules of surrender when they adopt the duty to mitigate. The traditional rules of surrender — like the rule that a landlord has no duty to mitigate — are rooted in the real property doctrine that a lease is a conveyance of an interest in real property.[22] One rationale for requiring a commercial landlord to mitigate its damages is that a contemporary commercial lease is both a conveyance and a contract.[23] This rationale for mitigation also supports relaxing, if not entirely abandoning, the traditional rules of surrender.[24] Because a landlord must, in a physical sense, accept the tenant's surrender of the premises in order to relet them, it is inappropriate to adhere to the real property doctrine of acceptance of surrender in a jurisdiction that has adopted a duty to mitigate — *i.e.*, a jurisdiction that treats a tenant's abandonment of the premises as a breach of contract rather than a conveyance.[25]

Under this contract law rationale, a tenant, by abandoning the premises, forfeits its estate in real property, but remains liable for damages arising from its breach of contract.[26] One consequence of adopting the contract law rationale underlying this rule is that the traditional view that a landlord may renter on the tenant's behalf to mitigate its damages

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[19] *See id.*

[20] *See id.*

[21] *See id.* "[W]hen a tenant proves the landlord's failure to mitigate, but the tenant does not prove the amount of damages that could have been avoided, the tenant is not entitled to any reduction in damages. Even a landlord who makes no effort to mitigate is entitled to damages for a reasonable amount of time needed to find a new tenant and the expenses involved in reasonable mitigation efforts." *Mob 90 of Texas, L.P. v. Nejemie Alter, M.D., P.A.*, 13-08-173-CV, 2009 WL 1026603 (Tex. App.—Corpus Christi Apr. 16, 2009, no pet.) (citations omitted); *Compare Hygeia Dairy Co. v. Gonzalez,* 994 S.W.2d 220, 225-26 (Tex. App.—San Antonio 1999, no pet.) (stating, in negligence case, that requirement that tortfeaser must prove "'not only the lack of diligence, but also the amount by which the damages were increased by such failure[,]'"…"simply means that there must be some evidence in the record from which the jury can make a reasoned calculation about losses from failure to mitigate.") *with Hygeia Dairy Co.*, 994 S.W.2d at 226-27 (Hardberger, J., dissenting) (citing *Austin Hill County* and stating that "[t]o be entitled to such an instruction [on mitigation], however, Hygeia was required to prove the amount by which Gonzalez's damages were increased by his alleged failure to mitigate.").

[22] *Schneiker v. Gordon*, 732 P.2d 603, 606-07 (Colo. 1987); *see generally* Hicks, *The Contractual Nature of Real Property Leases,* 24 BAYLOR L. REV. 443, 446-51(1972) (documenting that law treated real property lease primarily as a contract until16th century before law consistently began treating lease essentially as a conveyance).

[23] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299-300; *Schneiker*, 732 P.2d at 606-12 (discussing, in detail, implications for doctrine of surrender of treating lease as both conveyance and contract).

[24] *United States Nat'l Bank of Oregon v. Homeland, Inc.*, 631 P.2d 761, 765 n. 5 (Or. 1981); *Schneiker*, 732 P.2d at 606-12 (holding that, even though reletting for longer term than abandoning tenant's lease would have constituted acceptance of surrender under traditional real property rules, landlord was entitled to recover damages under contract principles).

[25] *Homeland, Inc.*, 631 P.2d at 765 n. 5; *Schneiker*, 732 P.2d at 606-12.

[26] *Homeland, Inc.*, 631 P.2d at 765.

or on its own behalf to effect a surrender makes little sense.[27] Because the tenant forfeits its estate by abandoning the premises, maintaining the fiction that the landlord is acting as the tenant's agent (*i.e.*, the agent for the owner of the premises) is inconsistent with the rationale for requiring the landlord to mitigate its damages.[28]

2. **Reasonable Efforts To Relet**. Once the duty to mitigate arises under *Austin Hill Country Realty, Inc.*, a landlord must make "objectively reasonable" efforts to fill the premises.[29] Other jurisdictions use similar tests, requiring a landlord to exercise "due diligence," "reasonable diligence," "ordinary diligence," or the like.[30] Regardless of these differences in phrasing, the essence of a landlord's duty to mitigate in these jurisdictions is to act as a reasonable person would under the same or similar circumstances.[31] Determining whether the landlord has done so is normally, but not always, a question of fact.[32]

a. ***Duration of Duty to Mitigate***. Once a landlord's duty to mitigate arises, it continues so long as the original lease continues.[33]

b. ***Failure to Relet Not Determinative***. In cases in which the landlord does not relet the premises, most courts focus on the landlord's efforts, not the lack of results, in determining whether the landlord satisfied its obligation to mitigate.[34]

c. ***Effect of Failing to Mitigate***. A landlord's failure to take reasonable steps to mitigate its damages does not totally bar recovery; it only bars recovery of those damages that could have been avoided by reasonable efforts.[35] This view is consistent with the new Texas rule.[36]

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[27] *Wilson v. Ruhl*, 356 A.2d 544, 547 (Md. 1976) (summarizing traditional rule); *Homeland, Inc.*, 631 P.2d at 765 n. 5 (criticizing traditional rule); *Schneiker*, 732 P.2d at 606-12 (holding that, even though reletting for longer term than abandoning tenant's lease would have constituted acceptance of surrender under traditional real property rules, landlord was entitled to recover damages under contract principles).

[28] *Homeland, Inc.*, 631 P.2d at 765 n. 5 (criticizing traditional rule); *Schneiker*, 732 P.2d at 606-12 (criticizing traditional rule). For illustrations of facts creating tension between duty to mitigate and traditional surrender rules, *see generally Richard v. Broussard*, 495 So. 2d 1291, 1295 & fn. 6 (La. 1986) (holding that in absence of provision permitting landlord, after a tenant's default, to reenter and occupy premises for its own purposes, landlord risks accepting surrender by reentering and using the property to operate its own business); *Kimber v. Towne Hills Dev. Co.*, 274 S.E.2d 620 , 622 (Ga. Ct. App. 1980) (holding that merely entering premises to protect the property after tenant abandons them does not amount to landlord accepting surrender); *Hurwitz v. Kohm*, 594 S.W.2d 643 (Mo. Ct. App. 1980) (holding that landlord's demand that tenant return keys and remove equipment from premises was neutral on issue of whether landlord intended to relet for its own account or as agent for tenant).

[29] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299.

[30] *See* Annotation, *Landlord's Duty, on Tenant's Failure to Occupy, or Abandonment of, Premises, to Mitigate Damages by Accepting or Procuring Another Tenant*, 75 A.L.R.5th 1 (2004).

[31] *See, Easterling v. Halter Marine, Inc.*, 470 So. 2d 221, 223 (La. Ct. App.), cert. denied, 472 So. 2d 920 (La. 1985) (stating that it is unreasonable to require landlord to relet for less than market rent and holding that landlord fulfilled duty to mitigate by offering to relet premises for market rent, which was more than rent in defaulting tenant's lease).

[32] The reasonableness of the landlord's efforts to avoid damages is an issue for the fact finder. *White v. Harrison*, 390 S.W.3d 666, 675 (Tex. App.—Dallas 2012, no pet.); *Hunsucker v. Omega Indus.*, 659 S.W.2d 692, 698 (Tex. App.-Dallas 1983, no writ) ("issues such as reasonableness and foreseeability are inherently issues for a jury"). This rule is consistent with the rule followed in other jurisdictions under which the tenant bears the burden of proof to demonstrate that the landlord has failed to mitigate damages and the amount by which the landlord could have reduced his damages. *American Nat'l Bank & Trust Co. v. Hoyne Indus., Inc.*, 738 F. Supp. 297 (N.D. Ill 1990) (applying Illinois law) (stating that whether landlord made reasonable effort to mitigate damages under lease that was silent on mitigation was a question of fact); *Wilson v. Ruhl*, 356 A.2d 544, 547 (Md. 1976) (citing *Hirsch v. Merchants Nat'l Bank & Trust Co.*, 336 N.E. 2d 833 (Ind. App. 1975)); *but see Wingate v. Gin*, 714 P.2d 459, 461-62 (Ariz. Ct. App. 1986) (holding that trial court should have granted landlord's summary judgment under rule judging reasonableness of landlord's efforts to relet under totality of circumstances).

[33] *Millison v. Clarke*, 413 A.2d 198, 207 (Md. 1980).

[34] *Shank-Jewella v. Diamond Gallery*, 535 So. 2d 1207, 1212-13 (La. Ct. App. 1988) (holding that landlord did not breach duty to mitigate by leasing other vacant space in shopping when evidence showed that abandoning tenant's premises were not suitable to tenants who leased other vacant space).

[35] *S.N. Mart, Ltd. v. Maurices, Inc.*, 451 N.W.2d 259, 263 (Neb. 1990) (holding that landlord's failure to mitigate did

3. **Factors Considered In Determining Reasonableness**. To assess whether a landlord has diligently sought the relet the premises, courts in other jurisdictions routinely consider these factors:

a. ***Hiring a Broker***. Courts view favorably promptly hiring a real estate broker to market the premises after the tenant abandons them.[37] But hiring a broker is not always essential.[38] Even so, it is highly recommended. One court has even suggested that hiring a broker is all that is required to satisfy the duty to mitigate.[39]

b. ***Advertising in Publications***. Courts also consider advertising in publications as evidence of a landlord's diligence.[40]

c. ***Placing For Rent Sign in Premises***. This is one factor often cited in evaluating a landlord's diligence, but it is rarely controlling.[41]

d. ***Materially Altering Premises***. Because most courts do not require a landlord to substantially alter its obligations under the abandoning tenant's lease in order to mitigate its damages, a landlord should not have to substantially alter the abandoned premises to accommodate a different use.[42] But a landlord may make cosmetic renovations — without acquiescing to its tenant's abandonment (*i.e.*, accepting surrender)

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not bar its claim for percentage rent); *see also Kamada v. RX Group, Ltd.*, 639 S.W.2d 146, 149 (Mo. Ct. App. 1982) (stating that abandoning tenant must show its landlord would have found a substitute tenant if it had taken some specific and reasonable action).

[36] *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299-300 (stating that landlord's failure to mitigate bars its recovery against breaching tenant only to extent that landlord's damages reasonably could have been avoided, and when landlord does mitigate, any damages landlord actually avoids by reletting will reduce its recovery).

[37] *See, e.g., Wingate v. Gin*, 714 P.2d 459, 461-62 (Ariz. Ct. App. 1986) (holding that landlord made reasonable efforts to relet premises when landlord urged realtor to diligently seek substitute tenant); *Rokalor, Inc. v. Connecticut Eating Enters., Inc.*, 558 A.2d 265, 269 (Conn. App. Ct. 1989) (holding that landlord failed to use reasonable diligence to relet premises by hiring broker 4 months after tenant's default and by reducing rent even though value of property had increased); *Wilson v. Ruhl*, 356 A.2d 544, 547 (Md. 1976) (stating that statute imposing duty to use reasonable diligence to locate substitute tenant "surely…requires no more than that the landlord seek out a reputable real estate broker and list the property for rent with that broker.").

[38] *See, e.g., Kamada v. RX Group, Ltd.*, 639 S.W.2d 146, 149 (Mo. Ct. App. 1982) (stating that there is no case law establishing that a landlord breaches its duty to mitigate unless it hires real estate agent and holding that landlord used reasonable diligence to relet premises in medical building by advertising space in medical magazine and by putting up large for rent sign in building, even though landlord did not consult or engage real estate broker).

[39] *Wilson*, 356 A.2d 544 at 547 (stating that statute imposing duty to use reasonable diligence to locate substitute tenant "surely…requires no more than that the landlord seek out a reputable real estate broker and list the property for rent with that broker.").

[40] *See, e.g., Kimber v. Towne Hills Dev. Co.,* 274 S.E.2d 620, 621-22 (Ga. Ct. App. 1980) (holding that landlord used reasonable efforts to mitigate damages by entering into and repairing premises within 1 month after tenant vacated them, advertising premises in newspaper, and reletting premises to substitute tenant within 6 weeks); *Kamada*, 639 S.W.2d at 148-49 (finding that landlord used reasonable diligence to relet premises in medical building by advertising space in medical magazine and by putting up large for rent sign in building, even though landlord did not consult or engage real estate broker).

[41] *Compare Wingate v. Gin*, 714 P.2d 459, 461-62 (Ariz. Ct. App. 1986) (holding that landlord was entitled to summary judgment on issue of whether landlord made reasonable efforts to relet premises when tenant's evidence showed landlord did not put for rent sign in premises, but landlord's evidence showed landlord urged realtor to diligently seek substitute tenant, and agent contacted numerous prospects, advertised premises in local paper, included premises in all general mailings about vacancies in landlord's shopping center, showed premises to various prospects, sent brochures to all businesses listed in local yellow pages that were in same business as delinquent tenant, and asked fair market value for premises) *with Vawter v. McKissik*, 159 N.W.2d 538 (Iowa) (holding that only placing for rent sign in premises is not enough) and *Fanarjian v. Moskowitz*, 568 A.2d 94 (N.J. Super. 1989) (holding that evidence was insufficient to show landlord used reasonable diligence to relet when landlord did not supply electricity to premises, landlord only put up one for lease sign, and landlord proved it submitted advertisements but did not prove that journals actually published those ads).

[42] *Foggia v. Dix*, 509 P.2d 412 (Or. 1973) (holding that duty to mitigate did not require landlord to rent premises designed for dental clinic for a different use or for less than their fair market value).

— in an effort to secure another tenant and recover the costs of those renovations.[43] The courts may draw a line limiting the amount of improvement a landlord can complete without acquiescing in its tenant's abandonment.[44]

e. ***Repossessing Tenant's Personal Property***. A landlord may reenter the premises, take possession of a defaulting tenant's personal property, and hold that property until the landlord negotiates a new lease with a substitute tenant.[45] Such conduct evidences a landlord's intent to hold its tenant liable for any rental deficiency and is this consistent with the effort to mitigate damages.[46]

f. ***Offering Premises for Sale or Rent***. A landlord may satisfy its duty to mitigate by offering the premises for sale or rent, but it may breach its duty to mitigate by offering the premises for sale.[47] Offering the property for sale may be justified, however, for a very long term lease.

g. ***Substitute Tenant's Financial Capacity***. As a general rule, a landlord does not breach its duty to mitigate by refusing to relet to a party incapable of paying rent.[48]

h. ***Substitute Tenant Tendered by Original Tenant***. A landlord's failure to contact a prospective substitute tenant tendered by the abandoning tenant may contribute to a finding that it did not use reasonable diligence to relet premises.[49] Also, refusing to consent to an assignment for purely arbitrary reasons may contribute to a finding that the landlord failed to use reasonable diligence to avoid its losses.[50]

i. ***Accepting Subtenants of Abandoning Tenant***. A landlord may satisfy its duty to mitigate by entering into subleases with new and renewing subtenants of the abandoning tenant, and, a landlord who does so, may have no duty to replace the abandoning tenant with a new prime tenant.[51]

j. ***Renegotiating with Original Tenant***. A landlord is not under a duty to renegotiate a lease with its former tenant to mitigate damages.[52]

k. ***Permitting Occupancy by Third Party***. Allowing a third party to use premises vacated by a delinquent tenant may constitute surrender. But, at least one court has held that a landlord did not breach its duty to mitigate by allowing a charitable organization (council for retarded citizens) to use the premises rent free because the tenant failed to show the landlord refused rent or that the charitable

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[43] *International Comm'n on English in the Liturgy v. Schwartz*, 573 A.2d 1303, 1306 (D.C. 1990).

[44] *Schwartz*, 573 A.2d at 1306 n.2 (stating that such a line might be drawn beyond normal refurbishing to make premises attractive to substitute tenant but short of substantial improvements significantly increasing value of premises).

[45] *Hurwitz v. Kohm*, 594 S.W.2d 643, 646-47 (Mo. Ct. App. 1980) (holding that principles of constructive eviction do not apply when landlord repossesses premises and tenant's equipment after tenant's default and stating that maintaining attachment of delinquent tenant's equipment while attempting to relet premises evidenced landlord's intent to hold tenant liable for any loss caused by tenant's default).

[46] *Hurwitz*, 594 S.W.2d at 646-47.

[47] *Wilson*, 356 A.2d at 544 (holding that landlord under statutory duty to mitigate could not recover rent during period she offered premises for sale, but could recover rent during later periods when she offered premises for sale or lease and then offered premises for lease until reletting premises to another tenant).

[48] *Zanfino v. Moretti*, 86 Pittsb. Leg. J. 605 (Pa. 1938); *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299 (stating that substitute tenant must be "suitable").

[49] *S.N. Mart, Ltd. v. Maurices, Inc.*, 451 N.W.2d 259, 262 (Neb. 1990) (holding that landlord failed to use reasonable diligence to relet when landlord did not contact prospective substitute tenant tendered by original tenant; landlord did not have representative in city; and landlord made no other effort to relet); *Cameron v. Calhoun-Smith Dist. Co.*, 442 S.W.2d 815, 816-17 (Tex. Civ. App.— Austin 1969, no writ) (holding that tenant did not show, as a matter of law, landlord breached express covenant to credit proceeds from landlord's reasonable efforts to relet against any rental deficiency, even though tenant testified landlord was uncooperative and refused to lease premises to any of 10 prospects tenant tendered to landlord).

[50] *Bert Bidwell Inv. Corp. v. LaSalle & Schiffer*, P.C., 797 P.2d 811 (Colo. Ct. App. 1990) (holding that landlord failed to mitigate by unreasonably refusing to consent to assignment of lease solely because landlord personally disliked proposed assignee).

[51] *Vareka Invs., N.V. v. American Inv. Props., Inc.*, 724 F.2d 907, *cert. denied*, 105 S. Ct. 107 (1984).

[52] *Zanker Dev. Co. v. Cogito Systems, Inc.*, 215 Cal. App. 3rd 1377, 264 Cal. Rptr. 76, 80 (6th Dist. 1989) (quoting *Stanley Manly Boys' Clothes v. Hickey*, 259 S.W. 160, 162 (Tex. 1924) ("[w]e doubt if any man should be required to contract a second time with one who has without cause breached a prior contract with him….").

organization's occupancy prevented the landlord from reletting the premises.[53]

4. **Terms of Substitute Lease**. The following cases present some of the frequently recurring issues raised when a landlord procures, or simply seeks to procure, a substitute tenant on terms that differ from those in the abandoning tenant's lease. Some of these cases also point to important instances in which the duty to mitigate may be incompatible with the traditional rules of surrender.

a. ***Duration of Substitute Lease***. Under traditional surrender rules, a landlord risked accepting its tenant's surrender of the lease — and thus forfeiting any right to recover rent or damages— by reletting or attempting to relet for a longer term than the term remaining on the abandoning tenant's lease.[54] Most states adopting the duty to mitigate have rejected such a rule, believing it to be incompatible with a landlord's duty to mitigate.[55] As one court noted, reletting or attempting to relet for a longer or shorter term should not, of itself, bar the landlord's claim for damages as a matter of law, for to insist that the landlord relet only for the unexpired term of the lease might well inhibit its marketability, particularly when a short term remained on the original lease.[56]

b. ***Higher Rent Rate***. Other jurisdictions are split on whether a landlord may relet, or seek to relet, the premises for more than the abandoning tenant's rent without breaching the duty to mitigate.

(i) One View — Seeking Fair Market Rent OK. Some jurisdictions hold that reletting, or attempting to relet, at a rental rate higher than that in an abandoning tenant's lease does not bar, as a matter of law, a landlord's claim for damages.[57] In these jurisdictions, the duty to mitigate does not require a landlord to relet the premises for less than their then fair market rental value, even though any increase in rent may theoretically limit the premises' marketability.[58] And, even in jurisdictions recognizing a duty to mitigate, courts will give effect to lease provisions permitting a landlord to relet at the current commercial rate or at not less than the then current market rate.[59]

(ii) Another View — Seeking Higher Rent Inconsistent with Reletting as Agent for Tenant. Other jurisdictions hold that a commercial landlord may breach its duty to mitigate by seeking to relet the premises for significantly more than the rent stipulated in the defaulting tenant's lease, at least when seeking higher rent inhibits or delays reletting.[60] Most of these cases reason that the

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[53] *Radio Distrib. Co. v. National Bank & Trust Co.*, 489 N.E.2d 642, 649 (Ind. Ct. App. 1986).

[54] *Millison*, 413 A.2d at 202-06; *Homeland, Inc.*, 631 P.2d at 766 n. 9.

[55] *Homeland, Inc.*, 631 P.2d at 766.

[56] *Homeland, Inc.*, 631 P.2d at 766 (rejecting cases that hold reletting for a longer term interferes with tenant's estate in land and thus releases tenant from any liability on its lease).

[57] *Homeland, Inc.*, 631 P.2d at 765 (holding that landlord satisfied duty to mitigate by showing premises to interested persons, offering premises on same terms and conditions as other premises in building, and offering premises at rental terms competitive with other premises in city).

[58] *Homeland, Inc.*, 631 P.2d at 765; *see also American Nat'l Bank & Trust Co. v. Hoyne Industries, Inc.*, 738 F. Supp. 297 (N.D. Ill 1990) (applying Illinois law) (holding that landlord does not breach its duty to mitigate by offering to relet premises for more than delinquent tenant's rent so long as rental rate sought does not exceed then current market rate for premises); *Wingate*, 714 P.2d at 461-62 (holding that landlord was entitled to summary judgment on issue of whether landlord made reasonable efforts to relet premises, even though landlord offered to relet premises for their fair market value); *International Comm'n on English in the Liturgy v. Schwartz*, 573 A.2d 1303, 1306 (D.C. 1990) (holding that landlord fulfilled duty to mitigate, even though landlord made cosmetic renovations and sought higher rent); *Easterling v. Halter Marine, Inc.*, 470 So. 2d 221, 223 (La. Ct. App. 1985), *cert. denied*, 472 So. 2d 920 (La. 1985) (holding that landlord fulfilled duty to mitigate by offering to relet premises for market rent, which was more than rent in defaulting tenant's lease).

[59] *Del E. Webb Realty & Mgmt. v. Wessbecker*, 628 P.2d 114, 115-16 (Colo. Ct. App. 1980) (holding that landlord did not breach duty to mitigate by offering to relet space at market rates of $11 to $12 per square foot instead of $8 per square foot rate in delinquent tenant's lease).

[60] *See, e.g., Consolidated Sun Ray, Inc. v. Opperstein*, 335 F.2d 801, 811 (8th Cir. 1964) (stating that when landlord acts as agent for tenant, landlord cannot, in good faith, demand rental in excess of what tenant owed and that such demand raises inference that landlord has resumed possession in its own right and not as agent for tenant); *Williams v. Kaiser Aluminum & Chem. Sales, Inc.*, 396 F. Supp. 288, 295 n.11 (N.D. Tex. 1975) (when there is a great disparity between market rate and rate in abandoning tenant's lease, reasonable diligence by landlord acting as tenant's agent

landlord, by attempting to relet for more that the rent in the abandoning tenant's lease, is acting on its own behalf and not as the faithful agent of the defaulting tenant.[61]

c. ***Rent Rate Decrease***. A landlord does not necessarily breach its duty to mitigate by reletting the premises to a substitute tenant for less rent than the rent under the abandoning tenant's lease.[62]

d. ***Free Rent and Other Concessions***. Some courts allow a landlord to recover unpaid rent from a delinquent tenant during a brief rent-free period in a substitute tenant's lease.[63] Others do not.

5. **Contractually Defining Duty To Mitigate**. Many states imposing a duty to mitigate on commercial landlords also allow commercial landlords and tenants to contractually define the landlord's duty.[64] One response to *Austin Hill Country Realty, Inc.* is to define contractually the scope of any duty to mitigate in the lease. A mitigation clause should cover, among other things: (i) when the landlord's duty begins (*e.g.,* after the tenant formally relinquishes any claim to possession); (ii) whether the landlord has the option to let other available space before becoming obligated to relet the premises of the defaulting tenant; (iii) the creditworthiness of the substitute tenant; (iv) whether the landlord has an obligation to relet the premises on less favorable terms than comparable space in the landlord's property or in comparable properties; (v) the formulas for determining the application of proceeds to the costs of reletting, the rental deficiency, and other such accounting issues; (vi) whether the landlord must relet at less than the then fair market value, which may affect tenant mix; (vii) whether the landlord may relet for more than the rent stipulated in the abandoning tenant's lease; and (viii) whether the landlord must advance

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includes efforts to lease premises at or near rate in abandoning tenant's lease); *MBC, Inc. v. Space Ctr. of Minnesota*, 532 N.E.2d 255, 562-63 (Ill. App. Ct 1988) (holding, over dissent, that landlord failed to exercise reasonable diligence to mitigate its damages by offering to re-rent premises for higher rent than rent stipulated in delinquent tenant's lease); *Mar-Son, Inc. v. Terwalho Enters., Inc*., 259 N.W.2d 289, 292 (N.D. 1977) (stating that, if seeking higher rent inhibits re-rental of premises, it is not done in good faith and that landlord did not make good faith attempt to mitigate damages by, among other things, offering to relet premises for 50% more than defaulting tenant's rent); *see generally Hurwitz v. Kohm*, 594 S.W.2d 643, 646 (Mo. Ct. App. 1980) (stating that when landlord reenters after tenant abandons premises, a rebuttable presumption arises that landlord repossessed for tenant's benefit).

[61] *See supra* notes citing case relying on unfaithful agent rationale.

[62] *Middagh v. Stanal Sound, Ltd.*, 382 N.W.2d 303, 309 (Neb. 1986) (holding that landlord's efforts to relet were not unreasonable as a matter of law when landlord, after advertising and listing premises, relet premises to only party expressing an interest in leasing them for less than rent stipulated in original lease but more than rent for which premises had been listed); *but see Rokalor, Inc. v. Connecticut Eating Enters., Inc.*, 558 A.2d 265 (Conn. Ct. App.1989) (holding that landlord failed to use reasonable diligence to relet premises by hiring broker 4 months after tenant's default and by reducing rent even though value of property had increased).

[63] *Millison*, 413 A.2d at 207-08 (holding that if tenant shows landlord could have obtained rent, through exercise of reasonable diligence, during free-rent period given to substitute tenant (as part of substitute tenant's rent or otherwise), delinquent tenant would be entitled to credit for difference between its rent and amount of rent landlord should have obtained in rent free period through exercise of due diligence); *Radio Distributing v. National Bank & Trust Co.*, 489 N.E.2d 642, 649 (Ind. Ct. App. 1986) (holding that landlord did not breach duty to mitigate by allowing charitable organization to use premises rent-free to keep premises insured while landlord attempted to relet premises in the absence of evidence that landlord refused to accept rent or that charity's occupancy prevented landlord from reletting premises).

[64] *Compare American Nat'l Bank & Trust Co. v. Hoyne Indus., Inc.*, 738 F. Supp. 297, 301-02 (N.D. Ill. 1990) (enforcing lease providing that landlord could offer to relet premises for more than defaulting tenant's rent without breaching duty to mitigate so long as rate did not exceed fair market rent because Illinois' law allows parties, dealing at arms' length, to shape contract as they please by excluding or restricting remedies for economic losses) *with Stewart v. Basey*, 245 S.W.2d 484, 486 (Tex. 1952) (stating that agreement, made in advance of breach fixing damages therefor, is not enforceable as a contract and does not affect the damages recoverable for breach, unless the amount so fixed is a reasonable forecast of just compensation for the harm that is caused by the breach, and the harm caused by the breach is one that is incapable or very difficult of accurate estimation); *see also Pague v. Petroleum Prods., Inc.*, 461 P.2d 317, 320 (Wash. 1970) (holding that general liquidated damage clause providing that landlord may terminate lease and recover liquidated damages does not preclude landlord from bringing claim for rent).

payment for any tenant improvements required by a substitute tenant, lease commissions, or other costs associated with reletting.

6. **Computing Damages And Mitigation Credits**. When a landlord exercising objectively reasonable efforts seeks to relet the premises to a substitute tenant, the abandoning tenant, as a general rule, is liable to the landlord for:

- All unpaid rent and other sums due under the lease before the commencement of the substitute tenant's lease;[65] ***plus***
- the difference between the rent due under the abandoning tenant's lease and the rent received during the same period under the substitute tenant's lease, discounted to present value;[66] ***plus***
- any reasonable costs of reletting or attempting to relet, even if the landlord's reasonable efforts do not succeed in procuring a substitute tenant.[67]

Other legal and factual issues may complicate the application of this general rule, and other damage measures may need to be used to compensate landlord for its tenant's breach.[68]

a. ***Apportionment of Rent***. Courts in other jurisdictions are split on whether a landlord, who relets for more than the abandoning tenant's rent, must credit the excess rents from reletting in one period against a rental deficiency in another period or against the landlord's other damages. Some courts require such credits.[69] An older Texas case does not.[70]

b. ***Procedural Conditions to Payment of Additional Rent Are Excused***. As a general rule, one party's total breach of contract relieves the other party of its obligation for further performance.[71] Even though the non-breaching party's obligations may cease, the contract survives for purposes of measuring damages.[72] Under these rules of contract law, the landlord may recover damages after its tenant abandons the premises and ceases to pay rent, and the tenant's breach also will excuse the landlord from complying with certain contractual prerequisites — such as presenting a bill — to the landlord's right to recover taxes, expenses, and other damages.[73]

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[65] *Kulm v. Coast-to Coast Stores*, 432 P.2d 1006 (Or. 1967) (stating that if, after making reasonable efforts, landlord is unable to relet the premises, landlord is entitled to receive entire amount of rent for period during which premises could not be rented); *Schneiker*, 732 P. 2d at 607 (holding that if landlord makes reasonable efforts to relet, but its efforts are unsuccessful, landlord is entitled to amount equal to full rent reserved in lease, plus any other consequential damages).

[66] *Schneiker*, 732 P. 2d at 607 (holding that if landlord procures substitute tenant through its reasonable efforts to relet, landlord is entitled to recover difference between the rent reserved in lease and proceeds from reletting, plus any other consequential damages).

[67] *Richard v. Broussard*, 482 So. 2d 729 (La. Ct. App.), *aff'd*, 495 So. 2d 1291 (La. 1985) (holding that landlord could recover advertising costs incurred to procure substitute tenant even though landlord's reasonable efforts did not succeed); *Middagh*, 382 N.W.2d at 309 (holding that landlord is entitled to recover reasonable costs of reletting).

[68] "If the landlord re-lets the premises for only a portion of the unexpired term, . . . then the measure of damages has two components: (1) the measure of damages for the period of re-letting is the contractual rent provided in the original lease less the amount realized from the re-letting, and (2) the measure of damages for that portion or period of the lease term as to which there has been no re-letting is the difference between the present value of the rent contracted for in the lease and the reasonable cash market value of the lease for its unexpired term. *GKG.Net, Inc. v. Mitchell Rudder Props.*, L.P., 330 S.W.3d 426, 430 (Tex. App.—Houston [14th Dist.] 2010, no pet.) (citing 25 Richard A. Lord, WILLISTON ON CONTRACTS § 66:87 (4th ed. 2007)); see also *Randall's Food & Drugs, L.P. v. Patton*, 01-06-00821-CV, 2008 WL 3876149 (Tex. App.—Houston [1st Dist.] (Aug. 21, 2008, no pet.) (landlord's damages are equal to present value of future rentals under the unexpired term of the lease, reduced by either the reasonable value of re-renting the leased premises or the rent paid by any new tenant).

[69] *See, e.g., Dalamagas v. Fazzina*, 414 A. 2d 494, 495 (Conn Super. Ct. 1979) (reasoning that, if excess rents received in one period are not credited to deficiency in another, landlord will be in better position than it would have been in had breach not occurred, thus contravening principle that damages for breach of contract should put innocent party in same position as it would have been had contract been performed); *Wanderer v. Plainfield Carton Corp.*, 531 N.E.2d 630 (Ill. App. Ct. 1976) (holding that excess rent must be credited against other damages, including reletting costs).

[70] *Maida v. Main Bldg. of Houston*, 473 S.W.2d 648, 652-63 (Tex. Civ. App.—Houston [14th Dist.] 1971, no writ) (awarding landlord unpaid rents to date of trial, less the proceeds of reletting through the date of trial, plus renovation costs associated with reletting).

[71] *Rokolor, Inc.*, 558 A.2d at 269.

[72] *See id.* at 270.

[73] *See id.* at 270.

7. **Recovering Difference Between Contract Rent And Fair Market Rental Value**. This measure of damages for anticipatory breach should survive the adoption of the duty to mitigate. In *Harrison Riverside Ltd. P'ship v. Eagle Affiliates, Inc.*,[74] the tenant appealed a summary judgment awarding the landlord the difference between the fair market value of the premises during the period before the landlord relet the premises, even though there was a fact issue as to whether the landlord had made reasonable efforts to mitigate its damages.[75] This result may at first seem confusing, but it is probably correct.

The facts in *Harrison* were fairly straight forward. The landlord leased a 49,500 square foot warehouse to the tenant for a 5 year term beginning September 1, 1992, and ending August 31, 1997, at the rate of $4.85 per square foot. The tenant vacated the premises and stopped paying rent in July, 1994. But the substitute tenant did not take possession and begin paying its rent of $2.15 per square foot until August 1, 1996. That rent increased to $3.00 per square foot on September 1, 1997, just after the scheduled term of the original tenant's lease expired.[76]

The tenant sought reversal of the trial court's partial summary judgment, arguing that: (1) the landlord failed to make reasonable efforts to mitigate its damages after May 1, 1995; (2) its failure to do so terminated the lease as of that date and completely excused the tenant's obligation to pay rent or damages for the remainder of the lease term; and (3) the landlord failed to prove the substitute tenant was paying market rent.[77] The landlord countered that it was entitled to recover the difference between the rent in the original tenant's lease and the market value of the premises, even without proof of any reasonable mitigation efforts.[78]

The superior court rejected the tenant's first two contentions, reasoning that, even if the landlord did not act reasonably to mitigate its damages, the landlord was entitled to recover damages in a declining market measured by the difference between the abandoning tenant's rent and the market rent.[79] The superior court thus affirmed the trail court's partial summary judgment and awarded the landlord the difference between the abandoning tenant's rent ($4.85 psf) and the tenant's expert's opinion of the premises' fair market value ($3.00 psf) during the period — before the landlord relet the premises — in which a there was a fact issue as to the reasonableness of the landlord's mitigation efforts.[80] Much as Texas' courts have for years, the superior court treated the difference between the abandoning tenant's rent and the fair market value of the premises as a proxy for actually undertaking reasonable efforts to mitigate.

8. **Lost Volume Landlord**. When a landlord has other vacant property that is equally suitable to a substitute tenant, the traditional measures of damages may not put the landlord in the same position as it would have been in had the original tenant performed its lease. In this circumstance, a landlord is in a position similar to that of a lost volume seller.[81]

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[74] 770 A.2d 490 (N.J. Super. App. Div. 1998).

[75] 770 A.2d at 492.

[76] 770 A.2d at 491.

[77] 770 A.2d at 491.

[78] 770 A.2d at 492.

[79] 770 A.2d at 492 (stating that "[e]ven if [landlord] did not act reasonably, it would nevertheless be entitled to recovery of the difference between the net square footage rate under the lease and the fair market value in a declining market."). The superior court also cited these cased to support this holding: *Kuhn v. Spatial Design, Inc.*, 585 A.2d 967 (N.J. Super. App. Div.1991) (adopting sections 2.706 and 2.708 of UCC on seller's damages for sales of goods to determine seller's damages for breach of contract to buy real estate); *Brill v. Guardian Life Ins. Co. of Am.*, 666 A.2d 146 (N.J. 1995); *Carisi v. Wax*, 192 536, 542, 471 A.2d 439 (N.J. Super. Dist. Ct. 1983) (stating that when commercial lease does not excuse duty to mitigate the "landlord's recovery against tenant for unpaid rent has been diminished by the sum which landlord would have received had he mitigated damages."); *Austin Hill Country Realty, Inc.*, 948 S.W.2d at 299 (stating that "landlord's failure to use reasonable efforts to mitigate damages bars landlord's recovery against the breaching tenant only to the extent that damages reasonably could have been avoided."); *Ingraham v. Trowbridge Builders*, 687 A.2d 785 (N.J. Super. App. Div.1997) (duty to mitigate relates to "'[t]he amount of loss that…could reasonably have been avoided,'" quoting RESTATEMENT (SECOND) OF CONTRACTS, § 350, comment b (1981).

[80] 770 A.2d 492.

[81] *Cf. Hawkland*, 3 UNIFORM COMMERCIAL CODE SERIES § 2.708, at pp. 470-497 (Callaghan 1994) (discussing seller's

Illustration. The landlord built a new warehouse with two identical spaces, leased one space to a tenant for 5 years at $10,000 per year, and continued its efforts to find a second tenant for the vacant space. After the first year, the tenant vacated its space and stopped paying rent, triggering the landlord's duty to mitigate. Through its objectively reasonable efforts over the next year, the landlord procured another tenant for a three year term.

a. ***Traditional Conveyance Rationale and Analysis***. Because a lease was treated as a conveyance of a unique parcel of real property, the fact that the landlord had other property was simply irrelevant to the damages analysis. The landlord could recover rent (**Option 1**) or damages measured by the difference between the rent reserved in the lease and either the proceeds from reletting or the fair rental value of the premises (**Option 2** or **Option 3**). The following two examples assume the landlord made reasonable efforts to relet both spaces before and after the original tenant abandoned its space.

(i) Putting New Tenant in the Other Vacant Space. If the landlord put its new tenant in the other space, the landlord could recover: (**Option 1**) the unpaid rent ($40,000) for years 2 through 5 as it came due; or (**Option 2**) damages measured by the discounted present value of the rent for years 2 through 5, less the premises' fair rental value. The other damage measure — (**Option 3**) the discounted present value of the rent for years 2 through 5, less the proceeds from reletting, plus any reasonable reletting costs — would be irrelevant because the landlord did not relet, and had no obligation to relet, the original tenant's space. Assuming that the landlord elected to take its recovery under Option 1, and that it leased the other space to the new tenant for $10,000 per year, the landlord's revenue from the original tenant would be $50,000 and the revenue from the new tenant would be $30,000, for a total of $80,000, which is the same position the landlord would have been in had the original tenant performed its lease, except for reletting costs.

(ii) Putting Substitute Tenant in Original Tenant's Vacant Space. If the landlord put its new tenant in the original tenant's space, however, its recoverable damages would be dramatically reduced. The landlord could only recover: (1) the rent ($10,000) for year 2 as it came due; and (2) the discounted present value of the rent for years 3 through 5, less the proceeds from reletting, plus any reasonable reletting costs; or (3) the discounted present value of the rent for years 2 through 5, less the proceeds from reletting , plus any reasonable reletting costs. Assuming that the landlord elected to take its recovery under **Option 1**, and that it leased the original tenant's space to the new tenant for $10,000 per year, the landlord's revenue from the original tenant would be $20,000 and the revenue from the new tenant would be $30,000, for a total of $50,000. A duty to mitigate that would require the landlord to put the new tenant in the original tenant's space would not put the landlord in the same position it would have been in had the original tenant performed.

(iii) Contract Rationale and Analysis. If, instead of a being treated as a conveyance, a lease is treated as contract for purposes of computing damages after a tenant abandons the premises, the measures of damages — including the interpretation of the landlord's duty to mitigate them — should take into account circumstances in which the tenant's abandonment leaves the landlord in the position of a lost volume seller. Otherwise, the traditional damage measures will not always make the landlord whole.

C. SURRENDER BY OPERATION OF LAW.

Surrender is "the yielding up by the tenant of the leasehold estate to the landlord so that the leasehold estate comes to an end by the ***mutual agreement*** of the landlord and tenant.... For a surrender to occur, the landlord and tenant must have a meeting of the minds and must mutually agree that there be a surrender of the lease...."[82] Although a tenant

damages generally and damages for lost volume seller); UCC CASE DIG. ¶¶ 2.708 (Callaghan 1994 & Supp. 1997) (discussing seller's damages generally and damages for lost volume seller).

[82] *Arrington v. Loveless*, 486 S.W.2d 604, 606-07 (Tex. Civ. App.—Fort Worth 1972, no writ) (holding that landlord's cooperation with tenant to locate substitute tenant did not effect surrender); *see also Evans Young Wyatt, Inc. v. Hood & Hall Co.,* 517 S.W.2d 313, 315 (Tex. Civ. App.—1974, writ ref'd n.r.e.) (stating that "[f]or the lease to have terminated

usually must show that its landlord accepted the surrender with the intention to release the tenant from further liability under the lease,[83] some Texas courts have applied this doctrine on equitable grounds:

[T]here is said to be a surrender by operation of law whenever the parties have so acted that it would be inequitable for either to assert the continued existence of the lease. Therefore, if, upon an abandonment of the premises by the tenant in possession and a default in the rental obligation, the landlord re-enters and relets for *his own benefit*, the tenant's obligations will be considered terminated by operation of law.[84]

Texas courts have long placed the burden on the tenant to plead and prove express surrender or surrender in fact.[85]

1. **Surrender When Landlord Acts As Unfaithful Agent**. Many commercial leases contain a remedy provision that allows the landlord, after the tenant's default, to reenter and relet the premises "as agent of the tenant."[86] If a landlord reenters the premises and purports to relet the premises as the "tenant's agent," but the landlord instead enters into a new lease for its own benefit, the courts have treated the landlord's self-interested conduct as an acceptance of the original tenant's surrender of the premises, which terminates the lease.[87] Texas courts have found that a landlord acted for its own benefit, rather than its former tenant's benefit, in a number of different ways.

a. ***Terms of Lease with Substitute Tenant***. One court found that a landlord surrendered its lease by including a termination option in the lease with the substitute tenant. In *Flack v. Sarnosa Oil Corp.*,[88] a divided court of civil appeals held that the landlord, by reletting premises under a new lease that allowed the landlord to terminate the new lease after 90 days' notice in the event of either the sale or demolition of the premises, accepted the surrender of the premises because the 90 day cancellation clause was included for the landlord's benefit rather than for the benefit of the original tenant. The dissenting judge argued persuasively that, although the landlord's exercise of the termination option might have constituted an acceptance of surrender, the mere presence of the cancellation clause in the new lease, standing alone, should have been insufficient to cause a surrender.[89]

b. ***Landlord's Use of Premises Was for Landlord's Benefit***. Another court found that a landlord surrendered the lease by operating its tenant's business in the premises. In *Patterson v. McGee*,[90] a state agency prohibited using the property as a nursing home unless certain repairs were made. Shortly thereafter, the landlord demanded that the tenant vacate the premises, and the tenant complied. The landlord then held itself out as operator of the nursing home. The court of civil appeals found that this evidence supported the trial court's findings of a constructive eviction and a surrender by operation of law.

c. ***Landlord's Use of Premises to Expedite Reletting Was for Tenant's Benefit***. Yet, another court found

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as a matter of law upon surrender and acceptance of the premises there must have been an agreement to such effect by the parties.").

[83] *Arrington*, 486 S.W.2d at 606-07.

[84] *Dean v. Lacey*, 437 S.W.2d 433, 438 (Tex. Civ. App.—Beaumont 1969, no writ) (emphasis in original and noting that landlord physically occupied premises "without taking [unnamed] precautions to avoid a termination of the lease as to all parties…").

[85] *Harry Hines Med. Ctr., Ltd. v. Wilson*, 656 S.W.2d 598, 601 (Tex. App.—Dallas 1983, no writ); *Arrington*, 486 S.W.2d at 606-07 (stating burden of both pleading and of proving surrender by a preponderance of the evidence is on tenant who is attempting to avoid rent payments); *Crawford v. Haywood*, 392 S.W.2d 387 (Tex. Civ. App.—Corpus Christi 1965, no writ) (stating that tenant's declaration of its intent to vacate and not to pay further rent does not terminate landlord's rights under lease).

[86] *See, e.g, Flack v. Sarnosa Oil Corp.*, 293 S.W.2d 658 (Tex. Civ. App.—San Antonio 1956, no writ).

[87] *Flack*, 293 S.W.2d at 658 (explaining that "we must either presume that if [the landlord] was attempting to act as the agent of [the tenant] that it was an unfaithful agent, acting for its self-interest, or that in executing the [new lease], it was acting as principal....If [the landlord] acted as principal in executing in the [new] lease, such action constitutes an acceptance of [the tenant's] offer to surrender the leased premises and [the landlord] cannot recover for the full term of the lease.")

[88] 293 S.W.2d 658 (Tex. Civ. App.—San Antonio 1956, no writ).

[89] *Flack*, 293 S.W.2d at 690 (Nowell, J., dissenting).

[90] 350 S.W.2d 241 (Tex. Civ. App.—Eastland 1961, no writ).

that a landlord did not surrender its lease by allowing nearby hospital personnel to occupy a portion of the premises while it attempted to relet them. The landlord did so in an attempt to expedite completion of the hospital so that a substitute tenant could be found to relet the tenant's office suite. After the hospital was completed, the landlord relet the premises. Based on these facts, the court of appeals concluded:

> We have found no Texas case which finds surrender by operation of law where the landlord evidences an intent to relet or sell the premises after the tenant has left, even if such intent is communicated to the tenant. If a landlord re-enters and relets the abandoned premises for his own benefit, a tenant's obligations would cease. However, the evidence here shows that [the landlord's] conduct in allowing occupation of the premises after [the tenant's] departure was done in an attempt to mitigate the damages from non-payment of rent…. The conduct of [the landlord], in continuing to demand rental payments after [the tenant's] departure, clearly indicates that it did not accept any offer of surrender. The burden was on [the tenant] to plead and prove that a surrender occurred.[91]

2. **Surrender Is Complete Defense**. Surrender is a defense to a suit to recover rent that otherwise would have accrued after the surrender occurred.[92] But a tenant cannot recover any rent it prepaid before a surrender by operation of law.[93]

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[91] *Harry Hines Med. Ctr., Ltd.*, 656 S.W.2d at 601 (reversing trial court's judgment, which had excused tenant from its obligations under lease on ground that landlord had accepted surrender and constructively evicted tenant); *see generally Landlord's Permitting Third Party to Occupy Premises Rent-free as Acceptance of Tenant's Surrender of Premises*, 18 A.L.R.5th 437 (1994).

[92] *Meineke Disc. Muffler Shops, Inc. v. Coldwell Banker Prop. Mgmt. Co.*, 635 S.W.2d 135 (Tex. Civ. App.—Houston [1st Dist.] 1982, writ ref'd n.r.e.).

[93] *Dearborn Stove Co. v. Caples*, 236 S.W.2d 486 (Tex. 1951) (holding that tenant, who prepaid all rent when he executed his lease, and who vacated premises before end of lease term could not recover "unearned" rents because rent is not "apportionable.")

Effective April 2103, ISO revised its commercial general liability forms. –This list selects forms that may be useful to landlord or tenant in connection with commercial office lease. **Bold** type indicates a new form.

Commercial General Liability Coverage Form (Occurrence)	CG 00 01 04 13
Commercial General Liability Coverage Form (Claims Made)	CG 00 02 04 13
Owners And Contractors Protective Liability Coverage Form Coverage For Operations Of Designated Contractor	CG 00 09 04 13
Products/Completed Operations Liability Coverage Form (Occurrence)	CG 00 37 04 13
Products/Completed Operations Liability Coverage Form (Claims Made)	CG 00 38 04 13
Pollution Liability Coverage Form Designated Sites	CG 00 39 04 13
Pollution Liability Limited Coverage Form Designated Sites	CG 00 40 04 13
Electronic Data Liability	CG 04 37 04 13
Primary And Non-Contributory — Other Insurance Endorsement	**CG 20 01 04 13**
Additional Insured Controlling Interest	CG 20 05 04 13
Additional Insured Engineers Architects Or Surveyors	CG 20 07 04 13
Additional Insured User Of Golfmobiles	CG 20 08 04 13
Additional Insured Owners, Lessees Or Contractors Scheduled Person Or Organization	CG 20 10 04 13
Additional Insured Managers Or Lessors Of Premises	CG 20 11 04 13
Additional Insured Mortgagee, Assignee Or Receiver	CG 20 18 04 13
Additional Insured Designated Person Or Organization	CG 20 26 04 13
Additional Insured Co-Owner Of Insured Premises	CG 20 27 04 13
Additional Insured Lessor Of Leased Equipment	***CG 20 28 04 13***
Additional Insured Engineers, Architects Or Surveyors	CG 20 31 04 13
Additional Insured Owners, Lessees Or Contractors — Automatic Status When Required In Construction Agreement With You	CG 20 33 04 13
Additional Insured Lessor Of Leased Equipment Automatic Status When Required In Lease Agreement With You	***CG 20 34 04 13***
Additional Insured — Grantor Of Licenses — Automatic Status When Required By Licensor	CG 20 35 04 13
Exclusion — Designated Professional Services	CG 21 16 04 13
Real Estate Property Managed	CG 22 70 04 13
Professional Liability Exclusion — Health Or Exercise Clubs Or Commercially Operated Health Or Exercise Facilities	G 22 76 04 13
Exclusion — Contractors — Professional Liability	22 79 04 13
Limited Exclusion — Contractors — Professional Liability	22 80 04 13
Professional Liability Exclusion — Spas Or Personal Enhancement Facilities	CG22 90 04 13
Exclusion — Telecommunication Equipment Or Service Providers Errors And Omissions	CG22 91 04 13
Limited Exclusion — Personal And Advertising Injury — Lawyers	CG22 96 04 13
Exclusion — Real Estate Agents Or Brokers Errors Or Omissions	CG23 01 04 13
Amendment Of Personal And Advertising Injury Definition	CG24 13 04 13
Amendment Of Insured Contract Definition	CG24 26 04 13
Designated Location(S) Aggregate Limit	**CG25 14 04 13**
Pesticide Or Herbicide Applicator — Limited Pollution Coverage	CG28 12 04 13

Source: Article: ISO Form Changes Commercial General Liability | Insurance Thought Leadership

SUBORDINATION OF LANDLORD'S LIEN

This Subordination of Landlord's Lien ("Agreement") is executed effective the _________ day of _______________, 20__, by and between Landlord (as defined below) and Secured Party (as defined below).

DEFINITIONS:

Landlord: ____

Landlord's address:____

Secured Party:____

Secured Party's address::____

Tenant::____

Tenant's address:____

Tenant's trade name: ____

"Lease": Project Lease by and between Landlord and Tenant, as amended.

"Premises": Suite ______ in _______________________ Project (hereinafter referred to as the "Project") in the City of _____________________, ____________________ County, Texas.

"Secured Indebtedness": $________________ due from Tenant to Secured Party.

"Secured Property": All items described on Schedule 1, but excluding all items described on Schedule 2.

"Security Agreement": Instrument executed by Tenant pledging the Secured Property to Secured Party to secure the Secured Indebtedness and for no other purpose.

AGREEMENTS:

1. Landlord subordinates Landlord's lien on the Secured Property to the lien of the Secured Party, but only to the extent of the Secured Indebtedness. Landlord does not subordinate its lien on the items described on Schedule 2. Landlord's subordination will not be deemed applicable to, and will terminate upon, any refinancing or extension of the Secured Indebtedness or additional financing without Landlord's prior written consent. This subordination does not apply to any judgment lien to which Landlord may become entitled.

2. While the Lease is in effect or while any person or entity is in occupancy of the Premises, Landlord will not give Secured Party access to the Premises. However, if the Lease is terminated and no person or entity is occupying the Premises, Landlord will grant Secured Party access to the Premises in order to remove the Secured Property. Landlord may condition its obligation to grant Secured Party access upon Secured Party delivering to Landlord written consent by Tenant to Landlord granting Secured Party access to the Premises and to Secured Party's removal of the Secured Property from the Premises. Secured Party may not enter the Premises for any other purpose. Specifically, but not in limitation, Secured Party may not enter the Premises to operate within the Premises, Secured Party may not assign the Lease or allow any other person or entity

to operate within the Premises, and Secured Party may not conduct an auction or any other sale within the Premises.

3. Secured Party must remove the Secured Property within 10 days after Landlord delivers notice to Secured Party demanding that removal. Failure to remove the Secured Property within that 10-day period will terminate this subordination and give Landlord the right to remove the Secured Property and dispose of it as Landlord wishes without being obligated in any way to account to Secured Party or to Tenant.

4. Before Secured Party will be entitled to enter the Premises, Secured Party must deposit with Landlord an amount equal to Landlord's estimate of the cost to repair any damage to the Premises arising from the removal of the Secured Property, although that deposit will only be an estimate and Secured Party will be liable for all repairs resulting from that removal.

5. This Subordination of Landlord's Lien is not valid unless signed by both Landlord and Secured Party within 30 days of each other.

6. Wherever any notice is required or permitted under this Agreement, such notice must be in writing. Any notice required or permitted to be delivered under this Agreement will be deemed to be delivered when actually received by the designated addressee or, if earlier and regardless of whether actually received or not, when deposited in the United States mail, postage prepaid, certified mail, return receipt requested, or when sent by messenger or private overnight courier (but not facsimile), addressed to the applicable party at such party's address as set forth above or such other address as such party has previously specified by written notice.

LANDLORD

By:_______________________________________
Name______________________________________
Title:_____________________________________
Date of Signature:__________________________

SECURED PARTY

By:_______________________________________
Name______________________________________
Title:_____________________________________
Date of Signature:__________________________

NOT VALID UNLESS SCHEDULES 1 & 2 ARE ATTACHED.