“Compliance with Laws” Clauses in Leases:

What You See is Not Necessarily What You Get

Thomas H. Tanaka
Deputy General Counsel
Port of Seattle

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- How to draft a lease to allocate the cost of changes in regulations and laws.
- From the landlord/port perspective—how do you place as much of the risk on the tenant.

There are a number of clauses in leases that address this issue in different ways:

- Maintenance and Repair clauses
- Acceptance of Premises clauses (“as-is, where-is”)
- Indemnity clauses
- Environmental clause.

Focus today is on the clause obligating the tenant to comply with all laws and regulations during its tenancy.

- Why focus on this?

Often, there is a blind reliance that this gives the port/landlord some upper hand with the tenant in the event of some unforeseen change in laws or regulations

Examples:

- Changes related to safety (e.g., new safety railings, sprinkler systems)
- Environmental requirements—Asbestos
- Stormwater requirements

Purpose of the clause:

- Who bears the cost of making changes to the **premises** caused by regulatory changes during the lease term?
- From a landlord/port perspective, in most cases it should be the tenant.
- Not an issue of a change in the tenant's use during the term.

Example of a clause:

Lessee shall promptly and diligently observe and comply with all applicable laws, rules, regulations, standards, ordinances, permits and permit requirements, licenses and license requirements, franchises and franchise requirements, orders, decrees, policies, and other requirements of all federal, state, county, city, or other local jurisdiction governmental or public or quasi-public bodies, departments, agencies, bureaus, offices or subdivisions thereof, or other authority, which may be applicable to or have authority over the Premises or any improvements on the Premises, or over Lessee as they pertain to Lessee's operations on or about the Premises, or any activity conducted on or about the Premises, including, but not limited to, those of Lessor, and including, but not limited to, those pertaining to police, fire, safety, sanitation, environment, storm water, odor, dust and other emissions, noise, and track-out, all as currently in effect or as hereafter adopted, enacted, passed, directed, issued, or amended, and all obligations and conditions of all instruments of record at any time during the term of this Lease (collectively "Applicable Law"). Without limiting the foregoing, Lessee shall make any alterations or improvements to the Premises, whether or not they are structural in nature, required to comply with the requirements of this section. Lessee's obligations under this section include, but shall not be limited to, and Lessee shall observe and perform, all conditions and obligations as set forth in this Lease and in Exhibit ____. In addition to any other indemnity under this Lease, Lessee shall defend, indemnify, and hold Lessor harmless against all civil or criminal claims, costs (including but not limited to reasonable attorney fees), expenses, fees, fines, penalties, liabilities, losses, and damages that Lessor incurs by reason of any third party (including but not limited to any governmental agency) charge, claim, litigation, or enforcement action related to any actual or claimed violation by Lessee of any of the foregoing. Lessee's obligations under this section shall survive the expiration or other termination of this Lease.

- Does this clause work from a landlord's perspective?

- Answer: Maybe/Maybe not. It depends on the state.

- Surprisingly, there are a lot of reported cases on this issue in several states, but not much in the rest of the country where the applicability of this clause is raised.

- Will look at this in those states where it's been raised.

New York

Cases tend to be more tenant friendly—in other words, where there's a strong clause requiring tenant to do what's necessary to comply with laws and regulations, NY courts will not necessarily interpret it that way.

Herald Square Realty v. Saks & Co., 109 NE 545 (NY 1915).

Landlord constructed building for Saks department store on a long-term (20 years) lease. Lease required tenant to comply with all laws, etc. Some display windows extended out beyond the outer walls. Eight years after lease began, city law changed so that the windows had to be taken back, at a high cost.

Herald Square Realty v. Saks & Co.

Who bears the cost of the required alterations?

Court ruled it was the landlord because the change was structural in nature and not part of the tenant's obligations.

Bush Terminal Assoc. v. Federated Department Stores, 73 A.D. 2d 943 (NY App. Div.2d Dept. 1980)

EPA required new sewer lines to service the premises. The lease had a strong provision requiring the tenant to comply with all laws.

Bush Terminal Assoc. v. Federated Department Stores

Court ruled that this was the landlord's responsibility. The court ruled this requirement was not necessitated by the tenant's specific use, but would have been required for any tenant using the premises.

Mayfair Merchandise Co. v. Wayne, 415 F.2d 23 (2d Cir. 1969)

Issue was who bore cost of installing sprinkler system

Lease included this provision:
“[Lessee] shall also promptly comply with and execute all rules, orders and regulations of the New York Board of Fire Underwriters for the prevention of fires at the tenant's own cost and expense.”

The court ruled that the clause, as interpreted in New York, was intended to save the landlord from “correcting, preventing and abating nuisances or other similar grievances which might be created by the tenant during the tenancy.”
It did not mean the tenant had to bear the expense of paying for the required sprinklers.

Washington state

Washington courts look more to the intent of the parties when construing a compliance with laws clause.

In other words, did the parties intend to transfer the cost/burden of complying with all laws on the landlord or tenant?

Fisher Properties v. Arden-Mayfair, 106 Wn.2d 826 (1986)

Lease required tenant to observe and bear all expenses in complying with all laws, etc.

Court ruled this did not require the tenant to pay for repair costs for compliance if the governmental authorities never ordered the tenant to make the repairs.

Puget Sound Investment v. Wenck, 36b Wn.2d 817

Landlord sought recovery for a number of improvements the tenant should have done during its tenancy in order to comply with the law.

The court ruled the compliance with laws clause was only intended to make the tenant do work necessary to allow the tenant to use the premises for its business.

California

California has provided the clearest guide for interpreting this clause.

In two cases issued the same day in 1994, each reaching opposite results interpreting the same form in two different cases, the court laid out a 6-part test.

Hadian v. Schwartz, 884 P.2d 46 (Cal. 1994)

Following a safety inspection, the government order extensive earthquake retro-fitting for tenant's building. The Court ruled this was the landlord's obligation.

Brown v. Green, 884 P.2d 55 (Cal. 1994)

A government inspection revealed asbestos in tenant's building and abatement was ordered. The court ruled here that this was a tenant obligation.

Why the different results?

- Hadian, which favored the tenant, was a short term lease; Brown (favoring the landlord) was a longer term agreement.

- The cost of the repair was higher in relation to the remaining rent in Hadian than in Brown.

- The benefit to the landlord was greater in Hadian than in Brown (because of Hadian's shorter lease term and the size of the cost).

The Supreme Court created the following 6-part test for interpreting who had the repair obligations under a compliance with laws paragraph:

1. The relationship of the cost to the rent reserved.
2. The length of the term.
3. Comparison of the benefit of the repairs to the tenant vs. landlord.
4. Structural or non-structural repairs.
5. The degree of the interference to tenant while work in undertaken.
6. The degree to which the parties contemplated the particular law that created the situation.

Georgia

Sadler v. Winn Dixie Stores, 264 S.E.2d 291 (Ga. Ct. App. 1979)

Tenant held not liable for cost of sprinkler installation required by law that went into effect after lease began.

Note, however, that landlord under the lease did have this obligation.

Louisiana

Catalanotto v. TAC Amusement Co., 232 So.2d 843 (La. 1970)

Tenant operated a restaurant under lease that required tenant couldn't take actions that would cause insurance cancellation. The insurance company required installation of a new kind of fire system, which tenant refused to do and insurance was cancelled. Tenant prevailed when landlord sued for breach of lease because of the insurance cancellation.

Florida

Fairhaven Properties v. Tamberlane Condo Assn., 280 So.2d 65 (Fl. Dist. Ct. App 1973)

Tenant had 99 year lease for property containing a swimming pool. Tenant had all maintenance obligations, although lease was silent regarding compliance with laws. Four years after the lease began, a new municipal law required that fence be erected around the pool. The landlord was held to be obligated for the cost.

Questions?