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NET-working
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By Michael Tubridy

European Competition and Employment Legal Issues

As North American shopping center developers and retailers eye opportunities in Europe, they will want to consider how The Continent's economic integration will affect competition and employment law. Two Web sites discuss the regulatory challenges posed by this evolving state of affairs.

Competition law and practice took front and center in a Jan. 8, 2007, speech to the European-American Press Club by Neelie Kroes, the European Commissioner for Competition and the chief spokesperson for the European Union (EU). Her address was summarized by Joseph J. Dehner, a Cincinnati, Ohio-based attorney with Frost Brown Todd LLC, in a Jan. 10, 2007, article on that law firm's Web site: "Europe's Competition Program": (http://www.frostbrowntodd.com/news/publications/detail.aspx?pub=1485).

Kroes outlined three objectives of EU competition policy:

1) Attack state subsidies. Unlike the United States, where states use various incentives to lure businesses from competitors, the EU views state aid as unfair to taxpayers and to

Continued on Page 2

INSIDE:

RISKY BUSINESS: DO WAIVER AND INDEMNIFICATION PROVISIONS WORK?

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Liability and waiver are among the most hotly negotiated issues in retail leases. Landlords and tenants rely on the lease's risk allocation provisions in obtaining their insurance and evaluating their potential exposure. In some cases, the parties' agreement on these issues affects the rent amount, and agreement on these provisions can dictate whether a deal gets done. Although these provisions are highly important to the parties, they can be difficult to enforce. The validity of negotiated lease waivers and indemnifications varies widely from state to state. Worse, they are frequently inconsistent with the lease's insurance provisions, and this can make parts of the parties' agreements ineffective. It is important that both landlords and tenants understand the treatment of liability and indemnity provisions under the various state laws and the ways in which these provisions can be made more enforceable.

Lease liability risks arise in two main areas. The first is liability for physical damage to each party's property: damage to the leased premises (the landlord's property) or damage to the tenant's improvements or inventory (the tenant's property). The second is liability to third parties: personal injuries or damage to property belonging to others.

These liability risks are allocated in three types of lease provisions. The first are waivers in which the tenant generally waives certain rights against the landlord and in which the landlord may waive some claims against the tenant. The second are indemnity agreements in which one party agrees to pay the other party's liabilities and its defense costs arising from certain types of accidents or bad conduct. The third, and most important, are insurance provisions in which the parties agree to maintain insurance that covers these areas. Although these provisions typically protect the landlord, tenants with greater bargaining power often negotiate for reciprocal provisions in their favor.

The ways in which these risks will be allocated should depend on the type of lease; the parties' respective control of the leased premises; and, in the case of a shopping center, the jointly used areas that serve the premises. In a net ground lease of a shopping center out-parcel, for example, the landlord will give the tenant total control of and, consequently, responsibility for the leased property. The landlord will expect the tenant to protect the landlord for, and to maintain insurance covering, not only damage to the property, including improvements built by the landlord, but also for all injuries that occur on the property. Even in-line shopping center tenants routinely assume liability for, and agree to maintain insurance policies with respect to, all injuries that occur in the leased space—regardless of whether the damage or accident is caused by a defect in the landlord's property or a matter that may otherwise be attributable to the landlord. In these cases, the tenant is the party that is cleaning, maintaining and operating the space, and the landlord wishes the tenant to be completely responsible for and to insure against all accidents that occur in the space, without having to prove that the tenant caused the accident.

Although the tenant in a shopping center may agree to be responsible for what happens within its space, it may ask for an agreement by the landlord to be responsible for its own negligence, particularly its negligence in the jointly used areas of the shopping center. A large tenant may also be able to persuade a small landlord to waive claims against the tenant for, and to indemnify the tenant against, claims for damage to the landlord's building and for all liability arising from accidents in the parking or other

Continued on Page 6

Risky Business

Continued From Page 1

common areas, regardless of the cause. This tenant will point out that because the landlord has control of the building as a whole and operates the common areas, the landlord should also maintain the insurance covering the building and the accidents in the common areas, as well as accidents in the leased space that the landlord causes. However, as the bargaining power of a tenant decreases, so too does its ability to negotiate favorable indemnity provisions. For this reason, most leases of in-line shopping center space provide that the tenant waives all claims for damage to the tenant's property and agrees to indemnify the landlord for all third-party claims, even if the incident was caused by the landlord's negligence or its other acts. Moreover, these leases do not contain waivers and indemnification agreements on the part of the landlord. These provisions in which the landlord is relieved from liability from its own negligence or other acts are the most likely to be contrary to state law and to be found ineffective by the courts.

State Laws Dictate Enforceability

States differ widely in their treatment of lease clauses in which a tenant waives and agrees to indemnify the landlord for damages or injuries caused by the landlord. Most, if not all, states prohibit agreements in which one party assumes liability for the willful misconduct or gross negligence of another. This restriction on the parties' freedom of contract stems from the state's policy of deterring deliberate or reckless conduct that harms another.

More troubling are state statutes that invalidate provisions in which a party (usually the tenant) agrees to indemnify the other party (usually the landlord) for its ordinary negligence. Section 13-802(b) of the Georgia Code voids agreements in which a party obligated under a contract with respect to the construction, alteration, repair, or maintenance of a building agrees to indemnify another party for damage resulting from the "sole negligence" of the other party. Section 705/1 of the Illinois Landlord Tenant Act states that every agreement exempting the landlord from damages resulting from the "negligence" of the landlord or "in the operation or maintenance of the demised premises or the real property containing the demised premises" is void as against public policy. Fortunately, in 2005, the Illinois legislature amended this statute to exempt provisions in commercial leases releasing the landlord from liability for property damage. Chapter 186, § 15, of the Massachusetts General Laws states that a provision of a lease in which the tenant must indemnify or exonerate the landlord from liability "arising from any omission, fault, negligence or other misconduct of the lessor or landlord" on or about the leased premises or its common areas "shall be deemed to be against public policy." As a final example, § 5-321 of New York's General Obligations Laws voids agreements in a lease "exempting the lessor from liability for injuries to person or property" caused by "the negligence of the lessor" in the maintenance or operation of the premises.

What to Do?

How can a landlord or tenant that wishes to rely on the agreed provisions of its lease protect itself? In the case of property damage caused by the other party's ordinary negligence, courts have been particularly sympathetic and found waiver and indemnification provisions enforceable in commercial leases, even in some of the states with the harsh statutes described above. However, in reaching these decisions, courts generally rely on two factors: (1) the clarity of the language that sets out the parties' respective risk assumptions, and (2) the insurance that each party agrees to maintain.

First, the obligation on the part of the landlord or tenant to waive claims and indemnify the other party in all circumstances must be clear and unambiguous. The words of the lease must leave no doubt that the parties intended the waiver and indemnification provision to cover damage and claims caused by the negligence of the benefited party. In the case of damage to the tenant's property, the lease should state that the tenant is, in fact, agreeing to be responsible for all damage to and loss of its own property, regardless of whether the damage or loss is caused by the landlord's negligence or the negligence of others. When accidents on the leased premises are to be covered, the lease should state that the tenant waives all claims arising from and agrees to indemnify, defend and hold harmless the landlord from and against any property loss or damage or personal injury or death that occurs on the leased premises—even if it arises from the landlord's negligence. However, even clear language may not save a provision in which one party agrees to indemnify the other party for physical injuries caused by the indemnified party's own negligence.

Second, each party's express insurance responsibilities allocated in the lease must match its waiver and indemnification obligations. If parties of relatively equal bargaining position specify not only that the tenant is responsible for its own property, but also that the tenant agrees to maintain insurance on its own property for casualty and other loss or damage and waives its insurer's rights of subrogation against the landlord, then a court will have difficulty finding the landlord liable for accidental loss caused to the tenant's property, even if it is caused by the landlord's negligence. In a lease in which the premises are part of a shopping center building, this result may be bolstered by a reciprocal provision in which the landlord waives claims against the tenant for insurable damage to the landlord's building. A similar result should be reached if the tenant expressly assumes responsibility for accidents in the leased space and agrees to maintain liability insurance protecting both parties and covering all injuries and damage that occur in the leased space—even those caused by the landlord's negligence. However, courts have more trouble relieving a negligent party from liability for personal injuries. For this reason, a landlord should make the tenant's assumption of and agreement to insure for these risks clear in its lease, but it should not rely solely on the tenant or its insurance coverage, particularly for protection against claims for personal injury caused by the landlord's negligence.

Finally, the parties should set out in the lease the factual circumstances that make their allocations of responsibility for negligence reasonable. The language of a net lease, for example, should state that the tenant will have sole control of the leased property; will perform all maintenance, repairs and replacements; and will pay for all insurance. If the lease is not a net lease, but the parties nevertheless intend that the tenant pay for the insurance on its own property, control its own operations, and provide its own repairs and janito-

rial services, then the lease should detail the tenant's assumption of these responsibilities so that a court can see that the tenant's release of the landlord from liability for accidents on the property and damage to the tenant's property are an intrinsic and important part of the parties' overall agreement. Of course, if the landlord is providing maintenance, repairs or other services, then the landlord will be under greater risk of having its waiver and indemnity provisions invalidated if its negligence has caused the loss or injury, particularly in a state in which the legislature and courts have taken a harsh position on a party receiving the benefit of waiver and indemnification for its own negligence.

Conclusion

Clearly, landlords and tenants will and should continue to allocate contractually the risks of damage to each other's property and third-party liability. However, they should keep in mind that, in some states, these allocations may not be effective if the damage or liability is caused by the misconduct or negligence of the party protected by the lease provisions. They also should draft the lease in a way that explains to any court that the waiver and indemnification provisions represent a mutually agreed-upon division of responsibilities; that this division of responsibility is consistent with each party's control rights and its maintenance-and-repair obligations; and, most important, that the party that has assumed specified liabilities also has agreed to maintain the insurance that covers these risks. ■

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Legislative Update

Continued From Page 8

awards more than 20% of the amount the condemnor offered to the property owner prior to the start of a proceeding. (2) H.B. 1409 requires condemners to disclose all appraisals relating to the property, allows juries to consider the expected value of a property that will be used to generate revenue, and requires condemnors to pay the property owners attorney fees and expert witness fees if the court awards a higher amount of damages than was originally offered. (3) H.B. 2006 requires an entity, prior to exercising the power of eminent domain, to make a bona fide good-faith effort to acquire the property by voluntary purchase, and allows special commissioners in a condemnation proceeding to consider the value of the property to be condemned, including any evidence that a property owner would consider in a negotiated transaction.

Virginia Gov. Tim Kaine (D) made substantial changes to the transportation funding bill, H.B. 3202, which was passed by the General Assembly in early March. The amendments address three issues, ensuring that: (1) the regional plans in Northern Virginia and the Hampton Roads area are workable and acceptable to local elected officials; (2) rural areas get a fair share of transportation dollars; and (3) core services are protected and the debt contained in the package is supported in a fiscally responsible manner. Additionally, the amendments expand the scope and application of transportation impact fees for by-right commercial and residential development in communities with growing populations, which will encompass about 75 communities across the state. The bill will now be returned to the General Assembly, which may accept or reject Gov. Kaine's revisions. Should the Assembly refuse to accept or make further changes, the bill will go to the Governor for his signature or veto.

CASE BRIEFS

REDUCTION IN PERCENTAGE RENT

A tenant is not entitled to a reduction in percentage rent where a Second Amendment to a lease executed after the original lease removes that reduction in favor of a flat rate, and where the Second Amendment clearly states that any conflicts between the original lease and the Second Amendment would be resolved in favor of the Second Amendment. *Regal Cinemas, Inc. v. AVG Medina, LLC*, No. 05-4592, United States Court of Appeals for the Sixth Circuit,Oct. 12, 2006.

In 1997, the plaintiff and the defendant's predecessor entered into a 20-year lease agreement for operation of a movie theater. Under the terms of the original lease, the plaintiff paid a minimum rent and percentage rent that was based upon revenue. In 2001, the plaintiff commenced a Chapter 11 bankruptcy, and the parties agreed to modify the lease. The parties then executed a Second Amendment to the Shopping Center Lease. The Second Amendment, *inter alia*, modified the minimum rent requirement and the percentage rent requirement in favor of a flat rate. The Second Amendment further stated that if there were any conflicts between the Second Amendment and the original lease, the terms of the Amendment would control. After execution of the Second Amendment, the plaintiff proceeded to pay the reduced flat rate rent. Thereafter, the plaintiff believed that it had overpaid rent for 2002, 2003 and 2004, and commenced an action against the defendant, seeking reimbursement of the overpaid rent. The defendant moved for summary judgment, claiming that the terms of the Second Amendment were clear on their face and did not contain a provision for a reduction of the film rental costs from the calculation of gross ticket sales, as did the original lease. The court granted the defendant's motion for summary judgment. It held that the Second Amendment clearly and unambiguously eliminated the section of the original lease that permitted a reduction for film rental costs, and that the parties clearly intended for the Second Amendment to take precedence over the original lease.