

Surrender Dorothy: Restoration Obligations In Office Leases



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Negotiating good surrender provisions might not take much heart, but it definitely takes some nerve and plenty of brains.

LET'S IMAGINE for a moment that Dorothy (of blue gingham dress and ruby slippers fame), as tenant, leases from the Wicked Witch of the West, as landlord, office space in a building located on the Yellow Brick Road near the Emerald City in the Land of Oz. The purpose of this article is to discuss Dorothy's restoration obligations upon the expiration or termination of the lease if the lease is silent with respect to restoration or surrender obligations; recommend restoration-related language to include in various provisions of the lease; and briefly examine certain situations in which special consideration should be given to restoration obligations in a lease.

NO LEASE PROVISION • If the Scarecrow, Dorothy's brainless friend, represented Dorothy in her lease negotiations with the Wicked Witch, he might have neglected to include a surrender or restoration provision in the lease. Does this mean that Dorothy is entitled to stay in the premises forever, because the lease does not explicitly require her to surrender the premises at the end of the term? No. Even in the absence of specific language in the lease, there is an implied covenant for a tenant to surrender its premises to the landlord upon the expiration or termination of its lease. *Friedman on Leases* (5th ed.), by

Milton R. Friedman and Patrick A. Randolph, Jr. (§18:1).

In what condition is Dorothy required to surrender the premises? In the context of surrender, the following general questions are important to both landlords and tenants:

- How does the condition of the premises upon surrender compare with its condition upon delivery of possession to tenant?
- Is tenant required to repair damage (including but not limited to casualty damage) to the premises caused by tenant?
- Is tenant required to remove its alterations to the premises? What about alterations that landlord made for the benefit of tenant?
- Is tenant required to remove its personal property from the premises?

Unless the parties have agreed otherwise, these questions will be answered as follows:

- Tenant must surrender the premises in substantially the same condition as tenant received the premises from landlord, normal wear and tear and damage by non-negligent fire excepted;
- Tenant is not liable for damage to the premises, except that tenant must repair damage caused by tenant's negligence (including damage caused by a fire that results from tenant's negligence), waste, or nuisance;
- Tenant is required to remove its alterations if tenant agreed to remove them at the time tenant made them or if tenant neglected to obtain landlord's approval of the alterations; and
- Tenant is obligated to remove its personal property and debris from the premises.

RESTORATION LANGUAGE TO INCLUDE IN THE LEASE • So let's give Scarecrow a brain. Thus equipped, Scarecrow will include—or know how to negotiate—the provisions discussed below.

Surrender Provision

Most leases (except those drafted and negotiated by scarecrows without brains) contain restoration language, either in a section of the lease entitled "Surrender" or, sometimes, in sections of the lease that address alterations or holdover.

Witch's Version

If the Wicked Witch conjures up the restoration language, the language may provide as follows:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in the same condition in which Landlord initially delivered possession of the Premises to Tenant.

This language requires Dorothy to:

- Remove all alterations she has made to the premises, including her initial improvements to the premises and alterations that she made during the term with landlord's consent; and
- Repair all damage to the premises, including reasonable wear and tear and damage by fire, regardless of whether Dorothy caused the fire.

Scarecrow's Version

In contrast, Dorothy's ideal surrender provision would read as follows:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in its 'as is, where is' condition.

Pursuant to this language, Dorothy is not required to remove any alterations, or repair any damage to the premises, even if she caused the damage.

Tin Man's Version

Obviously, both provisions are inequitable to the other party. Reasonable compromise language, as brokered through a big-hearted Tin Man, may provide as follows:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in good order and condition, excepting ordinary wear and tear and damage from fire, other casualty, condemnation and/or the acts or omissions of Landlord and its agents, employees, contractors, or representatives.

This language allows Dorothy some flexibility with respect to the condition of the premises at the end of the term. She must surrender the premises to the Wicked Witch in good order and condition, but she is probably not required to repair normal floor scratches or carpet stains that occur during her tenancy (they will fall under the category of “ordinary wear and tear”), and she is not required to restore the premises in the event of a fire. On the other hand, the Wicked Witch is confident that she will not need to make significant repairs to make the premises attractive to the next potential tenant who falls out of the sky.

Does this language answer all of the questions set forth above with respect to alterations, damage, and personal property? No. Before finalizing the lease, Dorothy and the Wicked Witch should review the provisions of the lease that address alterations, casualty, maintenance, and personal property in order to ensure that there are no inconsistencies between those provisions and the surrender provision of the lease.

Alterations

Dorothy and the Wicked Witch need to consider two different categories of alterations in connection with Dorothy's surrender obligations at the

end of the lease term: initial improvements to the premises (whether completed by Dorothy or the Wicked Witch); and later alterations made to the premises.

Initial Improvements

Often, a lease contemplates that either the landlord or the tenant will perform certain improvements to the premises at the commencement of the term. Will those improvements need to be removed from the premises at the end of the term? This question is particularly important in the context of the “same condition” or “as is, where is” surrender language set forth above. If a tenant agrees to surrender the premises in the same condition in which tenant initially received them, and tenant performed significant improvements to the premises at the commencement of the term, then tenant should budget for the cost of removing those improvements at the end of the term. Conversely, if landlord performed significant tenant-specific improvements (e.g., installation of a kennel for Toto, a limited access area, or numerous partitions) before delivering possession of the premises to tenant, then landlord should be aware that the “same condition” language will mean that tenant will return the premises with those tenant-specific improvements in place. To avoid ambiguity, the lease should specifically address the disposition of the initial improvements upon surrender, either in the surrender provision itself or in the provision of the lease that describes the initial improvements:

Notwithstanding anything to the contrary contained in this Lease, upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, [Tenant shall not be required to remove from the Premises any of the Landlord's Work or the Tenant's Work] [Tenant shall be required to remove from the Premises all of the Landlord's Work and all of the

Tenant's Work and repair any damage to the Premises and to the Building caused by any such removal.]

Later Alterations

What about alterations that are made to the premises later in the lease term? As noted above, if the lease is silent with respect to alterations, then tenant is only required to remove alterations if the tenant made them without landlord's consent, or agreed to remove the alterations at the time tenant made them. To the extent that a lease includes language that addresses tenant's restoration obligations with respect to alterations, a landlord prefers language that gives it the greatest flexibility:

All alterations, additions, improvements, and partitions erected by Tenant (collectively, the 'Alterations') shall be and remain the property of Tenant during the Term of this Lease. Upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, the Alterations shall become the property of Landlord and title shall pass to Landlord under this Lease as by a bill of sale unless Landlord notifies Tenant in writing at such time that Tenant must remove the Alterations, in which case Tenant shall remove the Alterations and repair any damage to the Premises and to the Building caused by such removal.

Tenants rarely agree to such language. Rather, they modify the language as follows:

All alterations, additions, improvements, and partitions erected by Tenant (collectively, the "Alterations") shall be and remain the property of Tenant during the Term of this Lease. Upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, the Alterations shall become the property of Landlord and title shall pass to Landlord under this Lease as by a bill of sale unless Landlord notifies Tenant in writing at the such time that Landlord approves the Alterations that Tenant must remove the Alterations, in which case

Tenant shall remove the Alterations and repair any damage to the Premises and to the Building caused by such removal.

This language, as revised, allows tenants to determine before making any alterations whether they are willing to assume the cost of installing and—if required by landlord when landlord approves the alterations—removing the alterations at the end of the lease term. Careful drafters will add the following sentence to the surrender provision to eliminate any conflict between these two provisions:

Notwithstanding anything to the contrary contained herein, upon the expiration or earlier termination of the Term or upon the termination of Tenant's right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall not be required to remove any Alterations except as and to the extent provided in Section ____ [the alterations provision of the lease].

Casualty

What if Dorothy and the Wicked Witch have agreed that Dorothy will surrender the premises in "good" condition (without explicitly addressing casualty), and a few days before the end of the term, the Scarecrow catches fire and damages the premises? As noted above, if a lease is silent, a tenant is obligated to repair casualty damage only if caused by the tenant's negligence. Accordingly, if Dorothy negligently filled the premises with lit candles despite the fact that one of the occupants of the premises was highly flammable, then Dorothy would be obligated to repair the damage caused by the fire. If, on the other hand, the Wicked Witch threw one of her infamous fireballs at the Scarecrow, causing him to catch fire, then Dorothy would not be required to repair the damage.

When Is The Casualty Carveout Appropriate?

If Dorothy's surrender provision requires her to surrender the premises in good condition,

but specifically carves out casualty damage (see the “compromise” surrender language above), then Dorothy will not be required to repair such damage even if she caused it. This is an equitable result in which the Wicked Witch maintains casualty insurance with respect to the premises, since the Wicked Witch may make a claim under her casualty insurance policy, and theoretically, she will be made whole even if Dorothy caused the damage. If, however, the premises consist of an entire building, and Dorothy both insures the building and is obligated to restore any damage resulting from a casualty, then it is inappropriate to carve out casualty damage from Dorothy’s restoration obligations. Rather, the following sentence should be added to the surrender provision:

Notwithstanding anything to the contrary contained herein, in the event of a fire or other casualty caused by Tenant’s negligence, Tenant shall, at Tenant’s option, either (a) repair all damage caused by such casualty in accordance with Section ___ [the casualty provision] of this Lease, or (b) assign to Landlord the insurance proceeds payable to Tenant in connection with such casualty.

This language will ensure that the surrender provision does not diminish any of Dorothy’s repair obligations pursuant to the casualty provision of the lease.

Maintenance

The Wicked Witch and Dorothy should confirm that the surrender and maintenance provisions of the lease are consistent. Accordingly, if Dorothy is obligated to maintain the premises in good order, condition, and repair during the term, then the Wicked Witch should not agree to allow her to return the premises in their “as is, where is” condition at the end of the term. In such event, Dorothy may stop repairing the premises toward the end of the term, relying upon the “as is, where is” language to inoculate her against any claim that

she has breached the maintenance provision of the lease. Conversely, if Dorothy leases an entire office building and the lease provides that Dorothy will maintain the interior of the building while the Wicked Witch maintains the exterior of the building as well as the landscaping, parking areas, and driveways, then Dorothy should not agree to surrender the entire property in the “same” condition that she received it at the commencement of the term; such language would arguably require Dorothy to perform the Wicked Witch’s maintenance obligations to avoid a default under the surrender provision of the lease. The following language can be added to the surrender provision to clarify the relationship between the maintenance and the surrender provisions in the lease:

Notwithstanding anything to the contrary contained in this Lease, in no event shall the terms of this Section ___ be deemed to modify in any way either party’s obligations under Section ___ of this Lease [the maintenance provision].

Personal Property

The surrender provision should address the disposition of tenant’s trade fixtures, personal property, and equipment at the end of the term. Tenants will likely want the ability to remove any of such items at the end of the lease term (the tenant’s equipment lessor will most definitely want the tenant to have this right), and landlords will most certainly want the tenant to remove everything, so it is important to expressly address this responsibility. Equally important, from the Wicked Witch’s perspective, is to obligate the tenant to repair any damage caused by such removal, and perhaps to complete such repair in an expeditious and diligent manner. The following language can be added to the surrender provision:

Tenant shall remove Tenant’s furniture, equipment, machinery, safes, trade fixtures, and other items of movable personal property of every kind and description from the Premises, and

shall repair any damage to the Premises and to the Building caused by such removal. Such removal and restoration shall be performed before the end of the Term or Tenant's right of possession, whichever is earlier.

The Wicked Witch would likely add the following language to this provision:

If Tenant does not remove such items, Tenant shall be conclusively presumed to have conveyed the same to Landlord without further payment or credit by Landlord to Tenant; or at Landlord's sole option, such items shall be deemed abandoned, in which event Landlord may (i) remove the same or any part in any manner that Landlord shall choose, repairing any damage to the Premises caused by such removal, and (ii) store, destroy, or otherwise dispose of the same without incurring liability to Tenant or any other person. In the event Landlord incurs any storage or other costs by reason of Tenant's failure to remove any property that Tenant is obligated to remove under this Section, Tenant upon demand shall pay to Landlord the amount of costs so incurred.

Dorothy may agree to this language provided she is given perhaps 20 days after lease termination or expiration to retrieve these items before ownership would transfer to landlord or be deemed abandoned.

WE'RE NOT IN KANSAS ANYMORE: SPECIAL RESTORATION CONSIDERATIONS

- Restoration obligations will vary from building to building and lease to lease, but a couple of issues to consider include cable removal and the effect of assignments and subleases on restoration obligations.

Cable Removal

Cable removal has recently become a fairly important area for landlords to address in the surrender provision, both because removing cable (T1 lines, for example) can be costly and because cabling increases the risk of fire because such cabling

runs through the risers and plenums of a building. In order to reduce the risk of fire, the National Electric Code (ANSI NFPA 70), or NCA, which is published by the National Fire Protection Association, requires that abandoned cable (which is defined as "installed cable that is not terminated at both ends at a connector or other equipment and not identified for future use") be removed from a building. Although the NEC is merely a standard prepared by the National Fire Protection Association for the safe installation of wiring and equipment, many jurisdictions have adopted the NEC for use in their own codes. Given the financial and casualty risks associated with cabling, a lease should include specific language that addresses responsibility for removal. Suggested language is set forth below. (Special thanks to James A. Francque, a Member of Jones Day, for permitting us to use his language.)

Without limiting in any way Tenant's obligations as otherwise may be set forth in this Lease to do any and all other removal and restoration work, and subject to the following rights of Landlord, Tenant shall, before the expiration of the Term, and at Tenant's sole expense, remove from the Premises all wires, cabling and other conduits installed by Tenant, its contractors, and agents and by Landlord and its contractors and agents as part of any work performed in connection with Tenant's lease of the Premises (including but not limited to the initial tenant improvement work, and whether or not such wires, cabling and conduits are visible), together with all equipment ancillary thereto (collectively, the "Cabling"). Tenant shall, unless otherwise elected by Landlord as described below, remove all of the Cabling in the Premises and outside the Premises, including but not limited to the Cabling above the ceiling and below the floor and in the Building risers and communication closets. In connection with such removal, Tenant shall perform, at its expense, all repairs and/or maintenance required to restore the Premises to its condition before the installation of such Cabling. Tenant shall notify Landlord in writing no sooner than ninety (90) days and no later than ten (10) days before Tenant commences the

removal of such Cabling, which notice must contain the date Tenant intends to commence such removal. Landlord shall have the right to approve, which approval shall not be unreasonably withheld, the methodology proposed by Tenant in connection with the removal of any Cabling. Notwithstanding the foregoing, upon Landlord's written direction, Tenant shall not remove all or any portion of the Cabling designated by Landlord in a written notice to Tenant to remain in place, in which case all such Cabling designated by Landlord shall become the property of Landlord upon the expiration or earlier termination of the Term.

Note that a tenant may refuse to remove cabling at the end of the term if the tenant will also remove cabling from the building at the commencement of the term in connection with its initial tenant improvements. In negotiating a cable removal provision, landlords and tenants should try to avoid being required to remove cabling from the building twice.

Assignment And Subletting

When a tenant is not released from liability under a lease when it assigns the lease and/or subleases the space, the tenant must keep in mind that when the term expires or the lease otherwise terminates, the tenant, and not the assignee or subtenant (or perhaps in addition to the assignee or subtenant), will be on the hook for any obligations to restore the premises unless the parties agree otherwise. Any assignment or sublease should, for example, contain a provision that expressly makes it the assignee's or subtenant's obligation to surrender the premises in the precise condition that the tenant is obligated to surrender it at the end of the lease term pursuant to the tenant's lease. Without such precautionary measures, the tenant will be ultimately responsible for the restoration, which could be extensive, and may also be unknown to the tenant until the lease term expires.

One of our clients used an extremely open floor plan, with no cubicles or walls other than support

columns, and relied on the positioning of the desks to create a flow within the space. It was important to this client to design a space based upon feng shui principles, which resulted in space that most landlords would favor at the end of the term, since it would be much closer to a "vanilla box" than your average office space. Our client's surrender provision, which was satisfactory to our client when the lease commenced, required our client to surrender the space in this "vanilla box" condition. When the start-up/tech bubble burst, our client found itself in the position of having to sublease a large portion of its space. The subtenant, a law firm that already occupied space within our client's building, used a much more traditional office design, with walls, secretary stations, interior cubicles, and internal hallways. Accordingly, its build-out was going to be quite extensive. It was extremely important when we negotiated the sublease to address in express terms what the subtenant would be responsible for removing at the end of the sublease term. Our position was that the subtenant should be responsible for complete restoration with removal of all improvements made by the subtenant. Our client's surrender provision, through a long and hard-fought battle with the subtenant, looked very similar to the ideal landlord provision noted above. Anything less would have been burdensome for our client, both in terms of work and expense.

Sarbanes-Oxley

The reporting requirements of the Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stat 745, can have an impact on how public companies negotiate the surrender provision in their leases. Such companies are required to certify on an annual basis to the Securities and Exchange Commission as to any material issues, which could include contingent liabilities such as costly restoration obligations at the end of a lease term. In light of these contingencies, public company tenants may be wise to endeavor

to minimize their restoration obligations at the end of their lease terms.

CONCLUSION • Just as the Wicked Witch tries to steer clear of water, landlords and tenants try to avoid agreeing to significant restoration obligations in leases. In order to limit their obligations, landlords and tenants should draft and negotiate with care the lease provisions that address the following matters, and be aware of how such provisions interrelate: surrender, alterations, casualty, maintenance and personal property. In addition, to the extent that there is cabling in the premises and the building, landlords and tenants should consider includ-

ing language in the lease that specifically addresses removal of the cabling. Finally, the Sarbanes-Oxley Act should make public company tenants wary of agreeing to significant restoration obligations in a lease, and all tenants should require assignees and subtenants to surrender the space in the condition required by the original lease. If the parties have considered the relevant issues and agreed upon a fair resolution, then Dorothy will know exactly what is required of her when the Wicked Witch skywrites “Surrender Dorothy,” and Dorothy can return to Kansas confident that she has surrendered the premises in the condition required by the lease.

PRACTICE CHECKLIST FOR

Surrender Dorothy: Restoration Obligations In Commercial Leases

- For a surrender provision that favors the landlord, consider:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant’s right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in the same condition in which Landlord initially delivered possession of the Premises to Tenant.

- For a surrender provision that favors the tenant, consider:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant’s right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in its ‘as is, where is’ condition.

- As a compromise provision, consider:

Upon the expiration or earlier termination of the Term or upon the termination of Tenant’s right of possession, whether by lapse of time or at the option of Landlord or Tenant as provided in this Lease, Tenant shall immediately surrender the Premises to Landlord in good order and condition, excepting ordinary wear and tear and damage from fire, other casualty, condemnation and/or the acts or omissions of Landlord and its agents, employees, contractors, or representatives.