

Avoiding Commercial Lease Disputes – Clearly Reflecting the Intent of the Parties is Key!

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A commercial lease symbolizes a consensual relationship between parties that can be enduring and rewarding, or short-sighted and emotionally and financially taxing.

Entering into a clearly drafted lease agreement at the outset of the relationship helps to set expectations, which minimizes the possibility of disputes over how the lease

should be interpreted.

However, not all commercial leases are clearly drafted, and disputes often arise between the parties over such issues as:

- How the property can be used,
- Who has responsibility for maintaining the property,
- Effect of short term non-payments of rent caused by factors beyond the control of the tenant or just sheer forgetfulness, and
- Who gets what when the lease terminates.

Disputes can also arise over the interpretation of provisions in commercial leases which deal with insurance coverage and liability of the parties. Commercial leases typically include provisions which require one or both of the parties to have and maintain property and liability insurance policies with specific amounts of coverage. These clauses also may include provisions which address the responsibility of the parties for damages or personal injuries.

Insurance and liability clauses are very important, and clearly drafting such clauses when the lease is created can minimize disputes between the parties regarding their obligations and liabilities under the terms of the lease. Understanding how North Carolina Courts interpret such clauses may help the parties draft clear and unambiguous provisions which will set appropriate expectations and minimize the risk of future disputes between the parties.

The North Carolina Supreme Court recently published an opinion which addresses this issue and provides guidance on how the North Carolina courts should interpret insurance and liability provisions in commercial leases. On December 7, 2018, the North Carolina Supreme Court reversed a decision of a divided panel of the North Carolina Court of Appeals in the case of [Morrell v. Hardin Creek, Inc.](#) The issue decided by the Court

was whether the insurance and liability provisions of a commercial lease operated as a complete bar to the tenant's claims for damage against the landlord and other defendants. In a split decision, the Court determined that the clear and unambiguous language of the subject lease indicated that the parties intended to discharge each other from all claims and liabilities resulting from hazards covered by insurance.

In Morrell, the tenant was in the business of manufacturing and distributing specialty pasta. The tenant entered into a commercial lease for a building located in Boone, North Carolina. During the term of the lease, an inspection of the premises found that modifications needed to be made to the building in order for the building to comply with state regulations regarding the production of food.

The lease contained a provision which allowed the tenant to alter or remodel the premises. That provision also included language which stated that the parties agreed to discharge each other from *all claims and liabilities arising from or caused by any hazard covered by insurance regardless of the cause of the damage or loss*. The landlord agreed to make the modifications in exchange for an extension in the term of the lease. The project was completed but later discovered to be in violation of certain building code provisions related to fire sprinkler systems.

The violations were discovered when the sprinkler pipes burst and flooded the premises. The flooding destroyed the tenant's inventory and specialty equipment. The tenant sued the landlord for negligence and other claims relating to the damages. The landlord moved for summary judgment and asserted that the damages discharge clause in the provision of the lease which allowed the remodeling barred all of the tenant's claims against the landlord.

The trial court agreed with the landlord and dismissed the complaint with prejudice. On appeal, a divided panel of the North Carolina Court of Appeals reversed the decision and held that the provision of the lease was ambiguous in that it did not clearly reflect the intention of the parties to bar negligence claims. The landlord filed an appeal to North Carolina Supreme Court based on the dissent in the Court of Appeals and for discretionary review of additional issues, which the Court allowed.

In its analysis of the case, the North Carolina Supreme Court discusses well-established principles of North Carolina law regarding the interpretation of contracts and, more specifically, provisions in contracts which exempt parties from liability – so-called "exculpatory" clauses. The Court cites to prior decisions which held that the intent of the parties is the deciding factor in contract interpretation cases.

Also, the Court states that contract provisions which exempt individuals from liability for their own negligence are not favored in the law. As a result, such provisions will not be construed to exempt a party from liability for its own negligence or the negligence of those acting for that party in the absence of explicit language clearly showing that this is the intent of the parties.

So, when a provision that exempts a party from liability for its own negligence is well drafted, and the intention of the parties is clearly and unambiguously shown, the provision exempting the party from liability will be upheld.

With regard to the exculpatory language of the lease in question in Morrell, the tenant acknowledged the broad and expansive nature of the language while also arguing that the breadth of the clause did not satisfy the general rule that such clauses must contain explicit language which clearly shows the intent of the parties to exclude liability. The Court was not persuaded and stated,

[Tenant's] chameleonic construction of this contractual language is unworkable. Given the 'broad and expansive' nature of the phrase 'all claims and liabilities . . . regardless of the cause of damage or loss,' it is a challenging exercise to conjure up language in an exculpatory clause that

would meet [tenant's'] implied standard for unambiguity regarding waiver of negligence-based claims other than to require such a waiver to explicitly mention the term 'negligence.'

The parties had agreed that the hazard of flooding which caused the tenant's damages was covered by insurance. For this reason, the Court found that the exculpatory language of the lease barred the tenant from bringing an action against the landlord for *all claims and liabilities* caused thereby, including business losses.

The tenant also argued that the exculpatory provision was limited by language contained in another provision of the lease which required the tenant to maintain insurance and to indemnify the landlord. The Court stated that, in effect, the tenant was asking the Court to add limiting language to the exculpatory clause based on inferences made from the separate insurance clause. The Court rejected the argument and stated,

This Court cannot creatively interpret the parties' actual lease agreement in the manner urged by [tenant], and must instead enforce the parties' intent as evidenced by the clear and explicit language of the lease.

The Court was very clear that North Carolina Courts must enforce contracts as written and may not, under the pretext of construing an ambiguous term, rewrite the contract for the parties.

The bottom line is that disputes over the interpretation of provisions in commercial leases can potentially be avoided if issues like the one describe in [Morrell](#) are thoroughly addressed and the intention of the parties is explicitly and unambiguously stated in the lease.

As always, those who need assistance with drafting commercial leases, or with a dispute over the interpretation of the terms of a commercial lease, should consult an attorney who is experienced in the area of drafting commercial leases or litigating commercial disputes.

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