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Disclosure Duty

What information should landlords provide?

by Michael C. Patton

Do you have to tell your commercial tenant that its space is in a flood plain? The opinion of the U. S. District Court for the Middle District of Tennessee is that under Tennessee law, you do not. While this ruling was made under Tennessee law, the Court relied on general principles of law as articulated in decisions by courts in other states. As a result, the decision is good news for commercial landlords across the country.

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The Flood

On May 1, 2010, rain began to fall in the Nashville, Tenn., area. Before the rains stopped the next day, some areas of the Nashville basin had received more than 17 inches of water. On May 3, 2010, the Cumberland River ultimately crested at 51.86 feet in Nashville, almost 12 feet above flood stage, the highest recorded crest in 140 years.

The Federal Emergency Management Agency defines a flood as "a general and temporary condition where two or more acres of normally dry land or two or more properties are inundated by water or mudflow." The Army Corps of Engineers determined that the May 2010 flood in the Nashville area "was a 1,000-year flood — an event that could be expected to happen once in every 1,000 years on average."

The property damage from the May 2010 flood was extensive. According to Nashville's planning and codes department, private property damage exceeded $2 billion. In downtown Nashville, which is located high above the normal river level, the floodwater "inundated concert halls, honky-tonk bars and the city's arena and even left water hip-pad deep on LP Field, the home of the NFL's Tennessee Titans," according to the *New York Times*.

Once the floodwaters receded, the owners of the damaged property began to file claims under their insurance policies. Since many policies exclude damage from flooding, only those property owners with flood insurance had covered claims.

While the need for flood insurance may have been obvious to those occupying property near a river or stream such as the Cumberland, the May 2010 flood was a 1,000-year event. Many of the properties that were damaged were not obviously within the flood plain of the Cumberland River. Additionally, many occupants of those properties did not own the premises. Instead, they leased the properties. As such, they may never have considered the need for flood insurance.

The Case

One lessee that did not have flood insurance and claimed to have suffered more than $300,000 in damages contended that its landlord should have warned it that the leased premises were in a flood zone. In *Airpro Systems, Inc., f/k/a Airpro Systems, LLC v. Prologis North Carolina Limited Partnership*, the U. S. District Court for the Middle District of Tennessee rejected that contention in an opinion that was subsequently affirmed by the U. S. Court of Appeals for the Sixth Circuit.

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- an "integration clause that indicates no representations or promises, other than those contained within the [l]ease, have been made between the parties;"
- a clause disclaiming any warranty or representation as to the suitability of the premises for the tenant's business; and
- a clause requiring the tenant to maintain all risk property insurance.

In light of the *Airpro* decision, a landlord in Tennessee generally does not have to inform a commercial tenant that the leased property is prone to flooding. A landlord, however, has to answer truthfully questions about whether the property is in a flood plain.

The absence of a duty to disclose that a property is in a flood plain would also apply to other information that a prospective tenant could learn through the due diligence process. The prospective tenant has to ask about potential issues or exercise its own due diligence. The landlord only has to respond truthfully when specifically asked. (The one caveat to the Court's ruling is that it only applies to misrepresentation claims. Under Tennessee negligence law, the landlord has a duty to disclose to the tenant an unsafe or dangerous condition of which it is aware.)

Landlord Lessons

What are the lessons that a landlord should learn from the *Airpro* decision? The first is the importance of the three clauses which the Court cited in its opinion: the integration clause, the clause disclaiming any warranty of suitability and the clause as to maintaining all risk property insurance. This first lesson is now supported by a decision applying Tennessee law, but it is based on cases from other states. As a result, the utilization of these clauses would protect commercial landlords in other jurisdictions.

One potential addition to the insurance clause would be a specific reference to flood insurance. Most lenders require flood insurance for loans in which real property secures the indebtedness. There is no comparable requirement in a lease transaction, and many less sophisticated lessees may never consider the need for flood insurance.

The second lesson is always to answer any questions from a prospective tenant truthfully. That lesson is applicable in any state and in any context.

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