The Legal Issues & Ancillary Services of Self-Storage Facilities

Ever since the invention of the cardboard box, Self-Storage operators have looked for ways to increase their bottom line by producing ancillary income from their Self-Storage business. There have been some interesting developments in this area over the past few years, but appropriate caution must be taken before pursuing these opportunities. This article focuses on the legal issues of wine storage; free or reduced-fee lending of a truck at move-in; record storage; and office suites/conference rooms.

I. Wine Storage. There are three major categories of issues that the Self-Storage operator must be aware of involving wine storage business: (1) controlling the climate; (2) controlling the security; and (3) understanding and complying with laws involving alcohol in the state in which the facility is located.

First, many operators promise that they will maintain a certain temperature and humidity in the wine storage area. While operators may even redundant systems to maintain temperature and humidity, is the operator actually always able to offer this temperature and humidity control? For example, if there is a black-out, brown-out or some type of emergency, can the operator keep the temperature and humidity exactly as promised? If not, the operator must draft the Lease so that the wine storage area will maintained at a certain temperature and humidity with certain exceptions outside of the operator's control. You have probably seen those types of provisions in other contracts that allow for deviation from the contract in the event of an act of God, an emergency, act of war, shortage of supplies, strikes, etc. If you think there is any chance that your wine storage area can deviate from the prescribed temperature and humidity, make sure you have a provision in your lease that accounts for those types of situations. Further, make certain that you define a limit on the value of the wine being stored in your wine storage area. While there may be an amount of rent that makes it worth storing a single $50,000.00 bottle of wine, the amount of rent would be outrageous. A space that holds 100 cases of wine worth $30.00 a bottle results in a potential liability of $36,000.00. Wine storage operators should set some dollar limit on the value of wine being stored that is commensurate with the rent being charged so that in the event something happens to the wine (temperature fluctuation, humidity damage or theft) the operator knows the sum

total of the potential liability that they face as a result of the loss. I am not suggesting that the operator is always responsible for these losses, but there are times that the operator may be liable, and wine has a higher storage value than old mattresses. If someone is going to sue you, it is best to know how much liability you have with that customer based on the amount of rent you will be charging for the wine storage.

Second, make certain that you can live up to the security promises that you make. Often, Self-Storage operators who operate wine storage overstate the security of the area. Just because the room has a separate alarm or code for the door and all the individual bins are locked does not necessarily mean that no one can not get into that storage area and steal the wine. There are appropriate precautions to take. The operator should conduct a criminal and credit background check on any tenant who will be storing wine. While each individual bin may be locked, you are granting access to a common room where wine is stored. A smart thief would certainly not hesitate to rent a small space from you and have absolute access to the entire wine room, giving them the perfect opportunity to break into other units. Also, an individually-coded door is great, but is that door tied to an alarm system and does the alarm system alert the police if tripped? If not, you need to make certain that people understand that but tripping the alarm may not result in the police being summoned. Additionally, video cameras in the wine storage area if not real or recorded, need to be disclosed to the tenants. Otherwise, the tenant may rely on the fact that the operator is monitoring the video tape. I recommend that all video cameras in and around the wine storage room be real cameras that are taped and retained for a minimum of several weeks, if not longer, in order to be able to review any unauthorized activity in the wine storage room. Require high-security locks on the storage bins, thereby reducing the chance that another of your tenants may be "tempted" to get into someone else's wine storage bin. Finally, control your employees' access to the wine storage room. Any time wine turns up missing or damaged, the first allegation by the tenant tends to be that the theft or damage was an inside job. Have strict policies prohibiting the employees from entering the wine storage area unless they are either (a) showing the space to a prospective tenant; or (b) cleaning it. Further, in hot areas, the wine storage room can be the coolest room in the entire Self-Storage facility. Operators should prohibit employees from taking their breaks, especially smoke breaks, in the wine storage room.

Third, in certain states, the operator may be prohibited from allowing any consumption of the wine on the premises; this is state-sensitive. The operator must implement a rule that prohibits your tenants from consuming any wine on the premises. Several wine storage/marketing experts recommend that you hold functions, either for your existing tenants or to promote the facility, such as a wine tasting. Caution must be exercised in allowing any alcohol to be served on the premises unless you are certain that your state liquor laws permit the consumption of alcohol without a license and that you have general liability insurance that covers the serving of alcohol. Even if you are not serving alcohol yourself, if you are permitting the serving or consumption of alcohol on your premises, in some states this may lead to liability for any accident or damage that occurs as a result of the consumption of alcohol. I have seen cases where, as an example, art galleries offer free wine, but place a "tip jar" or "defray the cost jar" by the wine. This has been deemed by various state alcohol control agencies as the sale of alcohol without a license and has resulted in criminal charges against the gallery operators.

Finally, all states prohibit the <u>sale</u> of alcohol without a license. Therefore, if for some reason a tenant defaults on their lease in the wine storage area, you must be cautious about selling the wine as if the operator were conducting a regular Self-Storage lien sale. There are some states that do not appear to have problems with the sale of wine in small quantities at a lien sale; there are other states that require a one-day temporary license that you would have to purchase each time you proposed to conduct a lien sale involving alcohol. There are other states that absolutely prohibit the sale of alcohol without a full-time license. Such a state would require the alcohol's disposal rather than sale.

II. Truck Rental or Lending. Many operators are offering a free or reduced-fee truck at move-in to their tenants. These operators believe a truck is a competitive advantage and has significantly increased their traffic. Actually, offering a truck at move-in is not something that legally should cause too much trouble. However, the operator needs to understand what the actual costs are, including insurance, of loaning a truck.

While the overall lease payment or purchase payment on the truck and the liability insurance payments may seem small compared to the traffic you may generate, there are other related

costs that you have to factor in to decide whether or not this is a venture that your facility can actually afford to support.

Generally, while state law provides that the liability for the operation of any vehicle follows the driver, not the owner, of the vehicle, there are legal concepts such as agency and negligent entrustment that a lawyer may raise in a lawsuit to try to include the Self-Storage owner, operator, manager, etc., in any lawsuit arising from a truck accident. The most important consideration is that you have the best possible insurance with the highest limits and fewest exclusions as possible to protect yourself and your business in the event someone raises a liability claim against the ownership or operators of the Self-Storage facility. Also, follow the rules set by your insurance provider, including confirming that the operator of the vehicle has a valid driver's license. The size of the truck that you may rent varies from state to state and, in all states, there is a certain size of truck that requires a commercial driver's license. Therefore, you need not look for a commercial driver's license, but make sure that the truck you have purchased or leased is legally operable by someone with a standard automobile license.

When shopping for insurance for the truck, you will need to ask all of the following questions at least: What type of documentation does the insurance company require you, the operator, to review and keep about the driver? Does the insurance company require a photocopy of a driver's license, motor vehicle background check, and/or a license check? These issues become extra-complicated when you are dealing with tenants who are coming to you from other states.

You also need to understand how the insurance deductible or deductibles apply. The deductible normally applies to the collision damage portion of the claim. Most insurance is set up similarly to that of insurance at a national car rental company where the owner of the vehicle has insurance to protect the rental company (in this case, the Self-Storage facility) from liability arising from the tenant's operation of the vehicle, including damage to other people's property and injury to others. There is a second component of the insurance that covers collision damage to the actual rented vehicle. Also similar to a national rental car agreement, the collision damage coverage is designed to be secondary to the tenant's normal automobile insurance, but unlike car rental at a car rental-type chain, it appears that approximately 90% of all personal auto insurance policies now written exclude collision and/or liability coverage when the insured rents or operates the truck.

Therefore, the insurance provided by the operator often becomes the primary collision insurance, even if the tenant has solid and valid automobile coverage for his or her own car.

What does this mean to you? There is a deductible that applies to these collision policies. You certainly should be aware of it, because at the end of the day, if your tenant causes collision damage to the truck, the first some-odd number of dollars in repairs must be paid by your tenant before the insurance would cover any portion of the claim. If the tenant is not solvent enough to pay for that damage or unwilling to pay for the damage, then that responsibility falls back on the operator up to the dollar limit of the deductible to pay for repairs to the truck.

The operator needs to make certain they have the best insurance possible with the least exclusions and highest possible limits. The operator then needs to analyze the cost of the truck, the insurance, and the possibility of out-of-pocket expenses from items such as the insurance collision deductibles, and determine if the truck loan/reduced fee program makes economic sense.

III. Vault and Record Storage. This is not Self-Storage. It is important that the operator draw the distinction between Self-Storage and some of these ancillary services that involve the use of some or all of your storage space. Almost every state that has a Self-Storage statute with a lien sale right defines Self-Storage as (paraphrasing) any property used for the renting or leasing of individual storage spaces where occupants customarily store and remove their own property on a self-service basis. This is not what occurs in record or vault storage. Often the operators are involved in pick-up and delivery of boxes, they offer shredding service, even document retrieval and scanning, but the customer rarely, if ever, is responsible for delivering their boxes to an individual locked storage space and picking them up with no control over the area exercised by the operator of the facility. Record storage creates a bailment and "Bailment" is normally a dirty word when discussing Self-Storage. Operators avoid bailments because they want the protections of the Self-Storage lien sale statutes in their state. The operator must understand that their Self-Storage statute is not applicable to a type of operation where you are picking up, delivering and/or controlling the area in which record are stored, i.e., a bailment.

What does this mean? When a bailment is created, there is a higher level of responsibility imputed to the operator for the care and custody of the stored item. Just as if you valet-parked your car at a local restaurant, you would not expect to hear from the valet, "I'll charge

you a fee, but you park and lock your own car". You are giving the car to the valet to drive and park somewhere in a lot and return the car to you in the same condition as it was in when you left it before your meal.

Therefore, the most important legal issue in record or vault storage is that you have reviewed your insurance with a licensed insurance agent before you become involved in this area of the business. A regular Self-Storage liability policy is neither written nor intended to be sufficient for this type of business. You will need a separate business insurance policy.

Caution also must be given to your individual state's statute. There are examples, such as Ohio, which define a Self-Storage facility as a facility used ***only*** for the storage of personal property in a self-service storage arrangement. If your statute implies that it applies to a facility that is only for the specific purpose of Self-Storage, I strongly recommend against offering other services, such as record or vault storage.

You must also learn if your state has additional requirements imposed on the operator as a warehouseman. There is no doubt that when you take records and hold them for someone, you are engaged in the warehousing of records. This may impose upon you under your state's warehouseman's statute additional insurance requirements, bonding requirements, or additional fire/life-safety requirements at the facility, and, if you are picking up and delivering the records, there may be vehicle licensing, driver's licensing and insurance requirements in your state for the ability to operate a delivery vehicle. If you are operating near a state line and may cross the state line, you may also have to register with the Interstate Commerce Commission for transportation of freight across state lines. This may also result in your having to apportion the vehicle licensing, between states. While all of these obstacles may certainly be overcome, proceed carefully if you are considering converting a small portion of your Self-Storage facility to record storage. The expenses could far outweigh the benefits.

IV. Conference Rooms or Business Centers. Many Self-Storage facilities are now offering to their tenants their ability to use a conference room or business center room as a benefit to their tenants. Aside from the concerns expressed above regarding the possibility of violating your Self-Storage statute by offering ancillary services, there are not too many other concerns about offering a business center or conference room. The biggest concern is from a public

liability standpoint. Generally, Self-Storage allows a tenant to have access to their property at certain hours on certain days and access their unit at their own peril. Hopefully all of your leases contain certain liability exclusions between the landlord and the tenant that protect the landlord from being sued for things that may happen to the tenant while the tenant is using their rented Self-Storage space. For example, many leases contain a release and hold harmless agreement releasing the landlord from liability for any personal injury that may occur on the premises as a result of the tenant using their rented Self-Storage space. The problem with a business or conference center is that the tenant may be inviting people onto your property who are not parties to your lease. That is, your lessee may be having a business meeting at your facility with ten people who have never set foot on your premises before and with whom you have no contractual limitation of liability. Of course, most businesses face that risk every day, as do Self-Storage operators when a prospective tenant comes to look at the facility. It is simply appropriate to remind operators to make certain that they have significant and sufficient premises liability insurance to cover the operator (and avoid loss of personal or company assets) in the event there is a catastrophe while ten people are conducting a business meeting in your conference or business center.

If you charge any sort of rental fee for the conference rooms, business center or if you charge for the use of equipment in that center, such as a per-page fax charge, you may, in certain states, be obligated to collect sales tax on those rental or usage fees. If you are not otherwise obligated to collect sales tax and are not set up to do it, getting yourself set up to collect sales tax for these potentially small fees may not be worth the additional revenue.

This article does not intend to recommend against any of the above-referenced ancillary services that the operator wants to provide to tenants. This article only serves as a warning to the operator that there are additional considerations that must be addressed, and the operator must have a plan for how they are going to handle any potential claims or issues arising out of these ancillary services, before the issue actually arises.