Commercial Property - USA

Tenant's fraud suit against landlord based on letter of intent to proceed

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Introduction

Applicable California law provides that an integrated written lease may not be varied by extrinsic evidence to alter or add to the terms of the writing.(1) An established exception to the rule allows a party to present extrinsic evidence to show that the lease was procured by fraud.(2) Landlords must be wary of assertions made in the course of pre-lease negotiations following the recent California Court of Appeal decision in *Thrifty Payless, Inc v The Americana at Brand, LLC.* The court held that letters of intent and estimates of certain charges provided by a property owner prior to lease execution may serve as the basis for allegations of fraud by the tenant.(3)

Letters of intent and lease

In *Thrifty*, the landlord and tenant entered into lease negotiations and exchanged draft letters of intent in 2004. The landlord provided the tenant with estimates of what the tenant would pay annually per square foot for common area maintenance fees, real property taxes and insurance (collectively, the 'triple-net charges'). The parties executed a written lease in 2005. Although the lease did not contain specific amount or percentage for the triple-net charges payable by the tenant, it did specify that the tenant would pay its *pro rata* share of the triple-net charges based on the square footage of the leased premises and the gross leasable area of the retail portion of the development. The lease also contained generally customary integration language (eg, "the lease represents the entire agreement of the parties notwithstanding prior negotiations or discussions").

Trial

In 2009 the landlord billed the tenant for triple-net charges in amount substantially higher than the estimates provided prior to execution of the lease (common area maintenance fees billed were 386% of the estimate, real property taxes billed were 233% of the estimate and insurance billed was 194% of the estimate). The tenant sued the landlord under various theories to recover money damages, as well as for reformation and/or rescission of the lease. The landlord moved to dismiss the complaint, on the basis that the allegations of the complaint did not support the relief requested, and the trial court granted the landlord's motion. On appeal, the appellate court reversed, effectively allowing the tenant's case against the landlord to proceed in the trial court.

Appeal

The appellate court reasoned that the tenant could proceed on the fraud and negligent misrepresentation claims, because extrinsic evidence (ie, the letter of intent and communications before lease execution) is admissible to establish fraud or negligent misrepresentation even when the lease has an integration clause. Similarly, the appellate court opined that the tenant's claims of innocent misrepresentation and mutual mistake were improperly dismissed, because the tenant had alleged specific facts to support pleading requirements in order to reform and rescind the lease based on a lack of mutual assent in the formation of the lease (ie, there was never any meeting of the minds between the landlord and the tenant). Finally, the appellate court opined that because the tenant alleged that the landlord had improperly exercised its discretion in allocating the triple-net charges between the retail and non-retail portions of the development, the tenant's claims for breach of contract and the implied covenant

of good faith and fair dealing should not have been dismissed.

Comment

The appellate court's ruling simply allows the case to proceed beyond the pleading stage, and possibly to trial, but is nonetheless troubling. The opinion suggests that despite an integration clause, extrinsic evidence and communications prior to execution of a lease may prevent a shopping centre landlord from securing early dismissals of tenant lawsuits. It is also disturbing that the appellate court concluded that "the huge disparity between the estimates and the ultimate costs supports an inference of misrepresentation", particularly when this case involved a new mixed-use development with no historical data available (for either party) regarding the magnitude of the triple-net charges. Indeed, under these circumstances, it is difficult to know what more the landlord could have done to emphasise that the amounts set forth in the letters of intent were only estimates, and that the lease terms would ultimately control. As more owners of shopping centres in California migrate to fixed common area maintenance fee leases, leasing personnel should exercise great care in all pre-lease communications relating to triple-net charges, and owners should consider revising the language of their leases to address significant variances in triple-net charges and limit tenants' rights appropriately.

For further information on this topic, please contact Brian D Huben or Janella T Gholian at Katten Muchin Rosenman LLP by telephone (+1 310 788 4400), fax (+1 310 788 4471) or email (brian.huben@kattenlaw.com or janella.gholian@kattenlaw.com).The Katten Muchin Rosenman website can be accessed at www.kattenlaw.com

Endnotes

(1) *Casa Herrera, Inc v Beydoun* (2004) 32 Cal.4th 336.

(2) *Riverisland Cold Storage, Inc v Fresno-Madera Production Credit Assn* (2013) 55 Cal.4th 1169.

(3) *Thrifty Payless, Inc v The Americana at Brand, LLC*, California Court of Appeal Case No B242573.

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