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Special Real Estate Issue

Greetings, clients and friends. While the real estate market may seem dead in this downturn, the courts have been busy rendering decisions that could impact your business. Read on . . .

1. Square Footage and Audit Issues

A recent California case interpreted the standard American Industrial Real Estate Association's Industrial/Commercial Multi-Tenant Lease – Net on the issue of the tenant's overpayment of rent and CAM charges based on an inaccurate statement of square footage for the premises and shopping center. The court found the landlord guilty of misrepresentation and granted the tenant's request for an accounting. This decision essentially disregarded the fact that the square footage figure was expressed in the lease as an approximation, and the lease clearly stated that the rent and other payments based on the square footage figures could not be modified.

In *McClain v. Octagon Plaza*, the lease recited that the unit was "approximately 2,624 square feet" and the shopping center "approximately 11,835 square feet." Based on these figures, the rent was calculated at \$3,804 per month (based on \$1.45 per square foot) and the tenant's CAM percentage was calculated at 23% (although by my calculations this should have been 22%). Before signing the lease, the tenant asked to perform its own measurement but was discouraged from doing so by the landlord. The landlord also assured McClain that the figures were accurate. Based on those assurances, the tenant moved in without having the premises measured.

Eventually, the premises were measured, and it was discovered that they only contained 2,438 square feet. Moreover, the tenant alleged, based on the landlord's application for earthquake insurance, that the shopping center contained 12,800 square feet. These discrepancies would result in a \$590,000 overpayment of rent over the term of the lease, so the tenant sued the landlord.

Despite the lease language, the court found that the landlord's discouraging the tenant to measure the premises,

and assuring the tenant of the correctness of the stated measurements, amounted to fraud in the inducement, even though the tenant had signed the "standard" lease which contained wording acknowledging that the tenant had received a full opportunity to examine the unit.

The court also found that the tenant had a right to a "reasonably detailed statement" of information used to calculate CAM charges (although it denied any right to a full-blown audit in the absence of a lease provision expressly granting that right). The court ruled that the lease contained an implied covenant of good faith and fair dealing which imposed on the landlord a duty to share with the tenant, on request, such documentation as was necessary to verify that the expenses claimed were, in fact incurred and that the listed amounts were accurate.

2. Seller's Duty to Disclose

An appellate court recently ruled that a seller of real estate is required to disclose to a prospective buyer the existence of previous lawsuits alleging defects in a condominium. In *Calemine v. Samuelson*, the seller did not mention prior litigation over flooding problems and was later sued for the omission. The court ruled that the prior lawsuits might have materially affected the buyer's willingness to buy the condominium. Although the court found that the seller had adequately disclosed the existence and nature of the problem itself, i.e., flooding and water intrusion, the seller's failure to disclose the existence of lawsuits against the developer and, later, the company hired by the homeowners' association to remedy the problem, raised a triable issue of fact as to whether the existence of those lawsuits affected the desirability and value of the condominium. The lesson here: It is usually better to over-disclose than to under-disclose.



3. Construction Managers Not Required to Hold License

In *The Fifth Day, LLC v. Bolotin*, the court held that a landowner who had hired a project manager to develop twelve acres had to pay the construction manager despite the fact that the construction manager was not a licensed building contractor. In general, contracts entered into by unlicensed building contractors are considered illegal and cannot be enforced, even if good work was performed. In the *Fifth Day* case, however, the court ruled that a provider of "construction management services" in a "privately owned real estate development" is not required to be licensed pursuant to the State contractor's law, and therefore was entitled to payment from the property owner.

4. Lis Pendens Clarified

Clients often ask me if they can record a *lis pendens* when a dispute has arisen involving a piece of real property. Most of the time, the answer is "No." A *lis pendens* is a statutory right to record notice of a pending lawsuit against the affected property. Unless and until an actual lawsuit is commenced, a party has no right to record a *lis pendens* on another party's real estate. Two recent cases further clarify when a *lis pendens* is not available.

First, *Manhattan Loft, LLC v. Mercury Liquors, Inc.* held that a party cannot record a *lis pendens* if the dispute is being decided by binding arbitration. So, when considering whether you want to agree to binding arbitration in a contract, the unavailability of a *lis pendens* in the event a dispute arises should be factored into that decision. Second, *The Formula, Inc. v. Superior Court* held that a *lis pendens* cannot be recorded by out-of-state litigants, even if the dispute involves California real estate. In that case, a Florida purchaser of California condominiums brought suit in Florida for specific performance of a purchase contract. Meanwhile, the lender, who had foreclosed on the property, filed an action in California to quiet its title to the property and expunge the *lis pendens* that had been recorded by the prospective purchaser. The court found that providing clear title records in California was more important than protecting the out-of-state purchaser.

Remember, a *lis pendens* cannot be filed whenever you have a beef with a property owner; it is a very limited remedy that can be used only when you have filed a lawsuit in California involving California real estate.

5. Extension of Time to Close Escrow

The *Peak-Las Positas Partners v. Bollag* case is interesting because it may be the first published decision that required a seller to exercise "reasonable consent" in deciding whether to grant an extension of the closing date. In this case, the buyer, Peak-Las Positas Partners ("PLP"), was developing a ten-acre parcel near Santa Barbara. Part of their development included four and a half acres that PLP was buying from Bollag, the owner of a neighboring property. PLP needed to get approval from the county for a lot line adjustment. However, the county required that the project be annexed to the City of Santa Barbara as a condition of granting its approval. There were also several other site improvements included as conditions of approval, including a requirement that the project be redesigned as a planned residential development. In 2001, the buyer and seller executed an amendment to the purchase agreement extending the close of escrow for five years. PLP put an additional \$315,000 in escrow in exchange for the extension.

Five years later, PLP still had not obtained its approval. The City required more project changes. PLP had to prepare a comprehensive plan that included landscaping, open space areas, traffic mitigation, restoration of a creek, and landslide mitigation. After PLP spent almost \$5 million in project costs, the city council voted against the project in March of 2006. PLP's managing partner met with city officials and agreed to make more project changes for the lot line adjustment. PLP, however, needed more time to submit the changes to City and requested a two-year escrow extension. Bollag denied the request.

PLP then sued Bollag for specific performance of the contract. Five months later, the City of Santa Barbara finally approved the lot line adjustment. The court found that Bollag had unreasonably withheld his consent to the second requested extension of the closing date and therefore had breached the contract. Bollag was not only ordered to extend the closing until July, 2008, but was also ordered to pay PLP's attorneys fees and costs in the amount of \$530,000.

It is not clear whether the purchase agreement in this case contained the standard "Time is of the Essence" language and, if it did not, whether the inclusion of this language would have resulted in a different decision. Nonetheless, while this case probably does not require single-family residential home sellers to grant extensions of a fixed closing date, in the development context, it would be wise for sellers to be reasonable in deciding whether or not to grant closing date extensions, particularly where the buyer has invested a good deal of time and money in the project.

6. Interpretation of Option

Speaking of closing dates, in *Patel v. Liebermensch*, the California Supreme Court held that a real estate option contract was sufficiently certain to be specifically enforced in favor of the buyer, despite the fact that the length of the escrow period was not specified in the contract. In this case, tenants held an option, contained in their lease, to purchase the leased property. The tenants attempted to exercise the option, but the lease option terms did not specify a closing date. Initially, the landlord-seller and tenant-buyer engaged in some “back and forth” on the issue of the closing date, but the tenant eventually backed down and agreed to the landlord’s request that the closing period be 90 days, with a right to extend for an additional 30 days if necessary for the landlord to complete a 1031 exchange. However, even after giving in to the seller’s requested timeline, the landlord-seller disregarded the tenants’ submission of a signed purchase contract.

The tenant then brought suit seeking specific performance of the option, and the landlord claimed that the option was unenforceable because it omitted an essential term, i.e., the closing date. The trial court initially ruled in favor of the landlord, but the Court of Appeal reversed, holding that certain terms—like the manner and time of payment—can be inferred by reference to custom and reason if a purchase contract is silent on these points. Also, the Court found that the failure of an option provision to specify the length of the escrow period did not constitute uncertainty regarding an essential term, so as to preclude the option holder from specifically enforcing the contract.

Although this case seems to stand for the proposition that California courts do not like to invalidate contracts and will go out of their way to enforce what appears to be the contracting parties’ original intentions, it is always a safer bet to be as precise and definite as possible when it comes to essential terms. This is particularly critical in purchase options and lease renewal options, where the omission of a critical term can render the option unenforceable.

7. Liquidated Damages Upheld

In the recent case of *El Centro Mall, LLC v. Payless ShoeSource, Inc.*, the tenant, Payless ShoeSource, was subject to a continuous operation clause in its lease and faced a penalty of approximately \$330 a day for each day that the tenant did not open for business. Due to falling sales, Payless decided not to open but continue to pay rent until the end of the lease term. The landlord sued the tenant for about \$98,000 in liquidated damages for failure to operate. The tenant argued that the amount of liquidated damages was not a reasonable estimate of the landlord’s losses, but instead was mere “boilerplate” language, noting that smaller tenants

had similar provisions in their leases. The court found in favor of the landlord, based primarily upon testimony by the landlord’s expert witness who pointed out that when a store goes out of business in a shopping center, there is a loss of synergy, good will and patronage that is hard to quantify.



Feel free to contact me if you would like additional information about any of these cases.

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