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"But, Judge, Our Words Meant So Much More!" Another Example of the Perils of Strict Construction

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A recent opinion out of North Carolina is of particular interest to those of us who spend our days drafting leases for landlords and tenants. These documents are more often than not meant to exist for 30 years or more. As we draft leases, the intent of our client is fresh in our minds; however, we continue to learn from litigated cases that we can neither anticipate every scenario that may arise in the years to come nor predict how a judge may ultimately read and interpret the language we so carefully craft. The best we can do is stay up to date with opinions such as that of the North Carolina Court of Appeals and the case of *Charlotte Pavilion Road Retail Investment, L.L.C. and Wla Enterprises, Inc. vs. North Carolina CVS Pharmacy, LLC, Jeffrey Carpenter Investor Properties, LLC; Suburban Gardens Incorporated; and Sonny Boy Properties, LLC*, No. COA14-658 (Dec. 16, 2014). We can then incorporate the lessons learned from such results into our drafting.

The Case

The issue in *Charlotte Pavilion* involved a lease's exclusive use provision, which is common in retail leasing. The defendant, CVS Pharmacy, negotiated a standard drug store/pharmacy exclusive use provision into its lease for a 2-acre parcel of land with the landlord/owner of a larger, 15-acre commercial development. Naturally, the pharmacy's exclusive rights extended to the balance of the 15 acres, known as the Carpenter Tract. Specifically, the provision states: "During the term of the CVS lease, no owner of any portion of the Carpenter Tract shall allow its parcel to be leased or to be used for the purpose of a health and beauty aids store, a drug store, a vitamin store, and/or a pharmacy." This restrictive covenant was recorded in the public records as part of a sale of the CVS tract by the original owner.

Later, a third-party developer purchased the Carpenter Tract as well as an adjacent commercial parcel that was not part of the Carpenter Tract and that was not owned by a related party. As it happens, the developer intended to construct a Wal-Mart on the adjacent parcel with additional retail development on the Carpenter Tract and shared parking and access between the two. In fact, Wal-Mart customers were expected to park on the Carpenter Tract. As expected, Wal-Mart's business operations would include a pharmacy, the sale of vitamins, and the sale of health and beauty aids. When CVS objected, the developer filed suit for declaratory judgment and prevailed, the court stating that the developer's proposed use did not violate the covenant. CVS appealed.

Although the Wal-Mart itself was not intended to be located on the Carpenter Tract, CVS contended that the existence of a parking lot on the Carpenter Tract not only benefitted and served Wal-Mart and its customers, but also led to breach of the lease and the recorded restrictive covenant. CVS argued: The fact that a Wal-Mart cannot exist without the requisite parking lot leads to the conclusion that a parking lot on the Carpenter Tract that serves a prohibited use on another parcel is no different from the Wal-Mart store's being constructed on the Carpenter Tract. The intent of CVS at the time it entered into the lease was to prevent a competing use on the Carpenter Tract.

A Relevant Case

CVS pointed to a Texas case with similar facts, involving a grocery store with an exclusive grocery provision in its lease. The owner of an adjacent parcel intended to construct a grocery store and use the restricted parcel for parking and access to said store. *H.E. Butt Grocery Co. v. Justice,* 484 S.W.2d 628 (Tx.Civ.App.1972). The parcel was restricted "against the use of any portion thereof for the purpose of conducting thereon a foodstore *[sic]* or food department for the storage or sale for off-premises consumption of groceries, meats, produce, dairy products, frozen foods, or baking products." The Texas court took the same position with respect to restrictive covenants to which we have become accustomed—that is, to strictly construe such provisions and to resolve any ambiguity against favoring the restriction. In doing so, the court noted that operating the grocery store on the adjacent parcel will require a parking field, and that constructing the parking area on a restricted parcel is a violation of the covenant.

Using the Texas case as a precedent, CVS asked the North Carolina court to adopt the holding. The North Carolina court, however, saw a distinction in the provisions and upheld the lower court's ruling in favor of the developer. By applying the strict construction rule, the court determined that since the CVS provision noted that the parcel could not be used for a list of specific types of "stores," the prohibition was for buildings themselves and not appurtenant uses for such buildings. The court went on to say that if the intent of the parties had been to restrict such additional and incidental uses, the parties

could have, and should have, clearly said so. The court distinguished the Texas case from *Charlotte Pavilion* by noting that the grocery store provision acted to restrict the operation of a certain type of store on the parcel ("for the purpose of conducting thereon. . .,"); and because a parking lot is necessary for the operation of a grocery store, the restricted parcel could not be used for parking purposes.

A Distinction with a Difference

The distinction may strike us as subtle, but we must remember that the words we choose may ultimately be read by a judge or other arbiter who keeps the strict construction mantra on his or her desk as a daily reminder. We are well-served to keep that mantra in mind as we draft the intent of our clients into our documents and to then read the words as conservatively as a judge might read them.

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How to Ensure That Your Agreement Is Worth More than the Paper It Is Printed On: *Strategies for Dealing with the Fraud Exception to the Parol Evidence Rule*

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This article explores possible steps and actions that landlords, tenants and their attorneys can take to help ensure greater contract certainty in jurisdictions where fraud claims of one type or another are not barred by the parol evidence rule. In a majority of states, the parol evidence rule does not bar claims for fraudulent misrepresentations or promises at variance with the terms of a written contract. Such law creates a dilemma for parties involved in commercial lease and other retail transactions. Most such parties do not want their leases and other agreements to be impaired or voided, in whole or in part, due to actual or alleged representations or understandings not reflected therein.

Summary of Existing Law and Explanation of the Dilemma

To comprehend the subject dilemma more fully and better evaluate possible solutions, it is helpful to have a basic understanding of the parol evidence rule. It is also helpful to have a working understanding of the fraud exception to the parol evidence rule. The following summary is not an exhaustive analysis of the applicable law throughout the United States. It should, however, assist leasing representatives, brokers, attorneys and others involved in negotiating retail transactions to understand the potential problems that fraud claims (whether true or not) pose to parties who want to be able to rely on the express terms of their leases and other contracts. The summary also demonstrates why there is likely no universal solution to the problems that such fraud claims present nor is there one single way to prevent such fraud claims from occurring in the first place.

Parol Evidence Rule

In the absence of fraud or a mistake, it is a basic tenet of contract law that parties to a written agreement that is voluntarily executed and supported by consideration should be bound by it. To this end, the parol evidence rule is supposed to protect the integrity of written contracts by making their terms the exclusive evidence of the parties' agreement.[1] The rule provides that when parties enter an integrated written agreement, extrinsic evidence may not be relied upon to alter or add to the terms of the writing.[2] Parol or extrinsic evidence may consist of oral or written promises, representations or agreements made before or contemporaneously with the execution of the written contract under consideration, which promises, representations or agreements are not repeated or otherwise referenced in the contract.[3] In short, parol evidence is supposed to be inadmissible to show that parties meant something other than what they stated in their written contract.[4]

An agreement may be integrated either in whole or in part.[5] A fully integrated agreement is one that contains an integration clause. In substance, such clauses state that the contract is the final expression of the parties' agreement with respect to the subject matter thereof and all, or any, prior understandings, representations, agreements or communications pertaining to the subject matter of the agreement are not enforceable. A contract is deemed partially integrated with respect to terms that are expressly set forth therein.

The effectiveness of the parol evidence rule has, however, been undercut to a large degree by judicially or statutorily created exceptions to the rule. Such exceptions include the right to introduce extrinsic evidence to show that the contract in question was induced by fraud, mistake or undue duress. For those that value contract certainty, the fraud exception can be particularly troublesome in many jurisdictions due to its relatively expansive scope.

Majority Rule

In most states, including Arizona, Illinois, California and Oregon, evidence of fraud of any type is not precluded by the parol evidence rule.[6] In explaining the fraud exception as it exists in the majority of states (the "majority rule"), courts have stated that the parol evidence rule should not be used as a shield against fraudulent conduct.[7] Where the majority rule is followed, the parol evidence rule, as a doctrine of contract law, has no application to tort claims.[8] In such states, even claims for negligent misrepresentation are not precluded by an integrated contract.[9]

Where the majority rule has been adopted, the usefulness of contractual integration clauses is significantly reduced—i.e., except in rare circumstances such as whether a party's reliance on false representation is reasonable or justified is a question of fact.[10] Thus, where the majority rule prevails, parties being sued on fraud claims at variance with contractual provisions are unlikely to be able to resolve the action without a court or jury trial, absent a settlement or a decision by the plaintiff to dismiss the case.

Due to the California Supreme Court decision in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*,[11] California falls squarely within the states adhering to the majority rule. Its law on this issue can be summarized as

follows: A party claiming fraud in the inducement may introduce parol evidence in support of the party's claim, regardless of whether an integration clause exists and/or the parol evidence contradicts an explicit provision of the written contract or lease.[12] The exception applies, regardless of the sophistication of the parties to the transaction[13] and even if the alleged misrepresentation is contained in a letter of intent.[14] As a result, in lease transactions, allegations of extrinsic misrepresentations concerning the condition of the premises, the size of the premises, major tenant commitments to a project or shopping center, and the amount of common area maintenance (CAM) owed have been held not to be barred by the parol evidence rule.[15]

In California, to overcome the parol evidence rule, however, the party claiming fraud must plead and prove justifiable reliance.[16] Contractual language, including disclaimers concerning the lack of any reliance on extrinsic representations, is only a factor to be considered in determining whether justifiable reliance exists.[17] In *Riverisland,* the California Supreme Court also suggested that proof of fraudulent intent is necessary for the fraud exception to apply.[18] Nonetheless, to date, the lower courts of California have largely ignored this portion of the *Riverisland* opinion.

Some Variations on the Fraud Exception

In some states, the law occupies the middle ground, or something akin thereto, between the ability to use the parol evidence rule to bar most fraud claims and the rule being deemed inapplicable to such tort allegations. In Wyoming, for example, claims for negligent misrepresentation are barred by the parol evidence rule.[19] In New York State, a boilerplate or generic integration clause does not preclude evidence of fraud in the inducement. However, where a contract or lease contains an express disclaimer by a party as to particular representation, parol evidence at variance with the disclaimer is precluded. How specific a disclaimer must be to preclude contrary extrinsic evidence varies, based on factors such as the complexity of the transaction and the parties' sophistication.[20]

Pennsylvania permits the admission of parol evidence of prior or contemporaneous representations concerning a subject addressed in an integrated agreement to modify or avoid the terms of that agreement; however, that admission is permitted only where it is claimed that the parties agreed that those representations would be included in the agreement, but were omitted by fraud.[21] (Such fraud is commonly referred to as "fraud in the execution.") Pennsylvania does not permit evidence of a prior or contemporaneous representation where the party proffering the evidence claims that the representations were fraudulently made to induce said party to execute the written agreement, but offers no evidence that the representations were supposed to be included in the agreement itself. (This type of fraud is commonly known as "fraud in the inducement."[22])

New Jersey precludes the admission of parol evidence that directly contradicts a term of a written contract, regardless of whether the parol evidence consists of a promise or representation that was allegedly made to fraudulently induce execution of the contract.[23]

Possible Measures to Reduce and Protect Against Fraud Claims Being Successfully Asserted to Alter or Vary Contractual Terms

Whatever one thinks of the benefits or drawbacks of the parol evidence rule, it is clear that in most cases the fraud exception can be used to overcome integration clauses. This means that the parties to a contract or lease cannot rely exclusively on the terms thereof to protect their interests. As a result, those who want to be able to enforce their contracts and leases as written with some degree of relative certainty may opt to devote some critical thought as to how to increase the chances of such occurring. Below are some ideas and thoughts to consider if one wants to engage in such an endeavor:

1. *Understand What Law Applies in the Places Where You Are Doing Business.*
   While it is unlikely that there is any one silver bullet approach that can be used to prevent fraud claims based on parol evidence, some approaches will work better in certain jurisdictions. For example, in states like New York, spending time on crafting specific disclaimers makes a lot of sense. In jurisdictions such as California where the majority rule is followed in its unadulterated form, spending a significant amount of time on drafting specific disclaimers to preclude parol-based fraud claims is much less likely to yield beneficial results. In other words, before deciding what actions to take to try to obtain greater contractual certainty, it makes sense to first understand the scope of the fraud exception in the state or states where you are doing business.
2. *Limit Pre-Contract Communications.*
   Where the majority rule holds sway, the best way to avoid fraud claims at variance with the terms of a written contract or lease is to eliminate or restrict, whenever possible, pre-contract representations and factual statements concerning the contemplated transactions beyond the minimum deal points (such as, in a lease transaction, the location of the premises, the amount of base rent owed and the names of the parties). Communications of any type—including emails, broker brochures and other listing or advertising materials, and letters of intent—should be scrutinized to limit or omit extraneous information. In the case of a new retail project, a landlord, for instance, may want to avoid either directly, or through its agents or representatives, providing information that will not be part of the final lease agreement—such as CAM estimates, the name(s) of anticipated or potential anchor tenants, the ability of the tenant(s) to obtain any permits needed for it to operate, or the overall leasable square footage that will be contained in the project once completed. Similarly, a tenant in a retail project may want to avoid pre-contract representations concerning its plans to open for business, or when it expects to construct tenant improvements, unless the tenant will be required to so open or commence construction by a date, or dates certain, as part of its lease.

From a legal risk avoidance perspective, it also would appear to be a good idea for companies and organizations to limit the number of individuals who are permitted to engage in direct communications with the other side during contract or lease negotiations. Such individuals should fully understand the risks involved in making inaccurate statements as part of a lease or other contract negotiations. As other commentators have noted, absent a legal duty to do otherwise, a party to a contract or lease should also avoid making statements about the contents of the agreement, or the meaning of particular provisions therein, to the other party prior to the time that the agreement has been fully executed and delivered.[24]

3. *When Made, Factual Statements and Estimates Should Be Accurate in All Material Respects.*
While the above advice about minimizing or eliminating extraneous communications is sound, the realities of today's retail marketplace will require that potentially actionable representations and statements be made for many deals to get done. Recognizing that fact, great care should be given to making sure that such representations and statements are accurate in all material respects. If estimates are required, they should be made in good faith and the basis for the same explained. Such explanation should help make it more difficult for the other party to claim that they were misled by the prior estimate. Before the contemplated lease or contract is executed, prior communications, including the term sheet or letter of intent and e-mails, should be reviewed to confirm that any prior representations or factual statements contained therein are accurate. If not, the inaccuracies should be corrected and the correction acknowledged by the other party either as part of the written agreement or in a separate writing.

4. *Consider Including Due Diligence/Inspection Contingencies.*
Some fraud claims, such as those involving the condition of a premises, or the ability of the premises to be used for a specified purpose, may be eliminated or made more difficult to assert through the use of due diligence or inspection contingencies. Granting a party a right to terminate a transaction for any—or *no*—reason prior to the expiration of an inspection period may result in some upfront uncertainty and additional costs. Any such uncertainty and additional costs, however, will, in almost all instances, be far less than those arising out of a fraud action. Due diligence periods also allow for previously non-disclosed problems with a property to be discovered. Once discovered during a due diligence or inspection period, mutually acceptable business solutions addressing the problems can be reached before each side has become too invested in the deal.

5. *Include Robust Integration Clauses.*
In some jurisdictions, a good integration clause, including disclaimers stating that no party is relying on extrinsic representations or promises, can preclude fraud claims based on the parol evidence rule. In all jurisdictions, at a minimum, such clauses may help to show that the party asserting the fraud or misrepresentation in question did not reasonably or justifiably rely on the same in entering into the subject transaction. To bolster such reliance-based arguments, integration clauses should be made more conspicuous. To this end, integration clauses should be written in all caps, with boldface type and/or separately initialed. Ideally, the clauses would also be coupled with acknowledgments that each party has read the contract or lease in question and was given the opportunity to have it reviewed by counsel of said party's choosing.

6. *Execute Estoppel Certificates.*
Some practitioners have suggested, and certain institutional landowners are now requiring, at contract or lease execution, the execution of a separate declaration or estoppel certificate stating, among other things, that the executing party (i) is not relying on any promise or representation not contained within the contract; (ii) has read and understands the content of the contract or lease; and (iii) has had, or was given the opportunity to have, its counsel review the contract or lease.[25] As a general matter, courts have favorably viewed estoppel certificates and permitted parties involved in transactions to rely on the same so as to preclude claims contrary thereto.[26] As to whether a court would decide that such an estoppel certificate executed at the same time as the contract or lease in question overrides and precludes the application of the fraud exception is unclear, or at least the author is not aware of any reported cases so holding. One would expect that a party signing such an estoppel would argue that it cannot be estopped by an instrument obtained by fraud and that the estoppel certificate should not be viewed as being legally distinct from any contemporaneously executed contract or lease.[27]

It would seem, however, that the chances of using such estoppel certificates to defeat parol-based fraud claims would be significantly increased if (i) the delivery of estoppel certificate is made a post-execution event and (ii) the estoppel form in question includes a blank space and instructions similar to the following:

> If you are relying on any alleged representations and/or promises not contained in the written agreement as part of the reason for you deciding to sign the written agreement, please specify the exact representations and/or promises in question in the space provided below. If there are no such representations and/or promises, please specify "None."

If the delivery of the estoppel certificate is made a post-execution event, the party receiving the same should be granted the right to terminate the lease or contract in question if the estoppel is either not received or received in a form that is not acceptable to it. Under such circumstances, where no such extrinsic representation or promise is

included in the estoppel as signed and delivered, it would appear to be an uphill challenge for the party claiming fraud to assert that its reliance on the alleged fraud was reasonable.

While all of the above suggestions involve the implementation of additional processes and/or documentation, the time necessary for implementation of the same should, for the most part, be relatively limited. The suggestion to make diligent efforts to ensure that all pre-contract factual statements and/or representations are materially accurate is not only legally prudent, but also a good business practice. People want to engage in transactions with individuals and companies that they can trust. In any event, whatever the burdens imposed by implementing one or more of the suggestions, such implementation can be justified by current state of the law for those who want as much contract certainty as possible.

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[1] *Riverisland, infra*, 55 Cal.4th at 1171.
[2] *Riverisland, infra*, citing to *Casa Herrera, Inc. v. Beydown* 32 Cal.4th 336, 343 [9 Cal.Rpt.3rd 97]; *Snyder v. Lovercheck* 992 P.2d 1079, 1086 (Wyo. 1999) citing to *Union Pacific Resources Co. v. Texaco, Inc.* 882 P.2d 212, 220 (Wyo. 1994).
[3] *Lovercheck, supra*.
[4] For this reason, where a contract term is ambiguous, parol evidence may be used to help explain what the parties intended by its use. *See, e.g., Southern Pacific Transportation Co. v. Santa Fe Pacific Pipelines, Inc.*, 74 Cal.App.4th 1232, 1241 [88 Cal.Rpt. 304] (1999).
[5] Restatement 2nd Contracts, § 209(1).
[6] See *Riverisland Cold Storage Inc. et. al. v. Fresno-Madera Production Credit Assn.*, 55 Cal. 4th 1169, 155 Cal. Rpt.3d 93 (2013) citing to, among other cases, *Howell v. Oregonian Publishing Co.* 85 Ore. App 84 (1987); *Formento v. Encanto Business Park* 154 Ariz 495, 744 P.2D 22; (1987); *W.W. Vincent & Co. v. First Colony Life Ins. Co.*, 351 Ill. App. 3d 752 (2004) (integration clause does not bar a claim of fraud based on statement not contained in the contract).
[7] *Howell*, *supra*; *Riverisland*, *supra*.
[8] *W.W. Vincent & Co, supra,* n. 6.
[9] See, e.g., *Thrifty Payless, Inc., infra,* n. 15 at pp. 1241-1242 (Thrifty can sue for both intentional and negligent misrepresentation based upon Americana's grossly inaccurate pre-lease estimates); *Formento*, *supra,* n. 6 at p. 26 (parol evidence rule does not apply, because fraud is a recognized exception to the rule, and there is no difference in the result that obtains from either a fraudulent or a negligent misrepresentation); *Keller v. A.O. Smith Harvestore Products, Inc.* 819 P.2d 69, 72-73 (Colo. 1991).
[10] See, *e.g. Thrifty Payless, Inc., infra,* n. 15 at p. 1239.
[11] 55 Cal.4th 1169.
[12] See *Thrifty Payless, Inc., infra*, n. 15.
[13] See *Julius Castle Restaurants, Inc., infra,* n. 15
[14] See *Thrifty Payless, Inc., infra*, n. 15.
[15] *Thrifty Payless, Inc. v. The Americana at Brand, LLC* 218 Cal.App.4th 1230 [160 Cal.Rprtr. 3d 718] (2013) (parol evidence did not bar alleged false statement regarding amount of CAM owed contained in a letter of intent); *Hinesley v. Oakshade Town Center* 135 Cal.App.4th 289 [37 Cal.Rpt. 364] (2005) (false representation concerning that national tenants would be leasing space in a mall were not barred by a contractual disclaimer to the contrary); *McClain v. Octagon Plaza, LLC* 159 Cal.App.4th 784 [71 Cal.Rpt. 885) (2008) (stipulation in a contract that tenant had verified square footage of premises does not preclude fraud claim that the size of the premises was falsely represented both in the lease and prior to the signing thereof); *Julius Castle Restaurants, Inc. v. Payne* 216 Cal.App.4th 1423 [157 Cal.Rpt.3d 839] (2013) (parol evidence was admissible to show that lessor had represented that the premises were in good condition and that lessor would maintain the same despite the existence of an integration clause and "as-is" language in the lease).
[16] *Riverisland, supra,* n. 6 at p. 1183.
[17] *Hinesley, supra*, n. 15 at pp. 296-297.
[18] See *Riverisland, supra*, at p. 000 (stating that unkempt, but honest, promises or subsequent failure to perform a pre-contract promise are not sufficient to overcome the parol evidence rule).
[19] *Lovercheck, supra*. n. 2.
[20] *Rosenblum v. Glogoff* 96 A.D. 3d 514 (New York 2012); *Danamn Realty Corp. v. Harris* 5 N.Y.2d 517 (157 N.E.2d 597) (1959) (specific disclaimer precluded allegations that agreement was executed in reliance upon contrary, oral representations).
[21] *Sunquest Information Systems, Inc. v. Dean Witter Reynolds, Inc.* 40 F.Supp. 2d 644, (W.D. Pennsylvania) (applying Pennsylvania law).
[22] *Id*.
[23] See *Filmlife, Inc. v. Mal "Z" ena, Inc.*, 251 N.J. Super 570 (1991).
[24] Kredior & Piotti, *Mum's the Word: Why Saying Too Much May Invalidate a Contract,* California Litigation,Vol. 27. No. 2.

[25] *Id*.

[26] See, e.g., *Plaza Freeway Limited Partnership v. First Mountain Bank*, 81 Cal.App.4th 616 (96 Cal.Rprt. 2d 865 (2000) (tenant bank was estopped to assert that lease termination date was other than the date stated in the estoppel certificate and, as a result, the tenant could not exercise any option rights).

[27] See *Vai v. Bank of America Nat. Trust and Sav. Ass'n*, 56 Cal.2d 329 [15 Cal.Rpt. 71] (1961) (stipulation in a settlement agreement that it was not entered into in reliance on any promises or representations not contained therein did not preclude a party thereto from asserting that it was entered into by fraud).

Enforcement of Co-tenancy Remedies: A Review of *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*

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When negotiating retail leases, tenants with leverage often insist on "co-tenancy" provisions. Co-tenancy provisions serve to protect a tenant's expectation that when it opens its store, and/or during the term of its lease, certain key tenants will also be operating at the shopping center or the shopping center will have a sufficient level of occupancy. Retail landlords have come to consider these provisions a necessary evil to getting a lease with national retail tenants. When times are good and occupancy levels are high, landlords do not see these provisions as creating unacceptable risk. But when a downturn comes, these provisions can have a profound effect on the viability of a shopping center.

This was the situation the landlord faced in the case of *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*[1] To avoid the unfortunate consequences of the co-tenancy provision in its lease with Ross Dress for Less, the landlord sued Ross, claiming the opening co-tenancy provision in the lease was unenforceable because it was unconscionable and resulted in unreasonable penalties. The California Court of Appeal, Fifth Appellate District, upheld the co-tenancy provision, finding that under the particular circumstances, the provision was not unconscionable, but that the tenant's remedy of a total rent abatement was an unreasonable penalty and therefore unenforceable.

The Facts

Grand Prospect Partners, L.P. ("Grand Prospect"), the owner of the Porterville Marketplace shopping center, filed an action to challenge the enforceability of the co-tenancy provisions in its lease with Ross Dress For Less, Inc. ("Ross"). The co-tenancy provisions in the lease conditioned Ross's obligation to open its store and pay rent on Mervyn's (as one of two required co-tenants) operating a store in the shopping center on the commencement date of the lease. It also granted Ross the option to terminate its lease if Mervyn's ceased operations and was not replaced by an acceptable retailer within 12 months from the commencement date of the lease. The lease did not provide the landlord with the option to replace Mervyn's in order to satisfy the opening co-tenancy condition.

The opening co-tenancy condition was not satisfied because Mervyn's filed for bankruptcy and closed its store before the commencement date of the lease. As authorized by its lease, Ross took possession of the space, never opened for business, never paid rent and terminated the lease after the 12-month cure period had expired.

Grand Prospect argued that the co-tenancy provisions in the lease were unconscionable or, alternatively, were unreasonable penalties, and in either event unenforceable. The trial court agreed with both theories and found that Ross had breached the lease by failing to pay rent and by terminating the lease. It awarded the landlord over $3.7 million in damages, which included lost rent over the term of the lease. The court of appeal reversed the lower court's decision in part, holding that the co-tenancy provision was not unconscionable and that Ross did have the right to terminate the lease. But it affirmed the lower court's decision that the rent abatement provision allowing the tenant to occupy the space for 12 months without paying rent was an unreasonable penalty and therefore unenforceable.

The Doctrine of Unconscionability

The doctrine of unconscionability is used to challenge the enforcement of a contract or a clause in a contract that is so unfair at the time it was made, a court may refuse to enforce the contract or the unconscionable provision of the contract. Most jurisdictions, including California, require both procedural and substantive unconscionability.[2] California and some other jurisdictions use a sliding-scale approach whereby "[t]he more substantive unconscionability present, the less procedural unconscionability is required, and vice versa."[3] Some jurisdictions require only one form of unconscionability.[4]

Procedural unconscionability focuses on oppression arising from an inequality of bargaining power that results in no real negotiation and an absence of meaningful choice.[5] Substantive unconscionability focuses on the one-sidedness or overly harsh effect of the actual contract or the terms of the contract.[6]

Procedural unconscionability can take the form of a contract of adhesion, in which a standardized contract drafted by the party of superior bargaining strength is imposed on the other party without the opportunity to negotiate the terms.[7] In considering whether or not procedural unconscionability existed, the court in *Grand Prospect* first determined the lease was not a contract of adhesion, and the co-tenancy provision did not constitute a clause of adhesion under law. In reaching this conclusion, the court noted that the lease was not a standardized, pre-printed form, and that the landlord was given an opportunity to negotiate its terms. Indeed, the lease had been conformed to a lease that had been negotiated by Ross and the landlord for another of landlord's retail properties. So the landlord was not required to choose either to accept Ross's form lease as presented by Ross or to lose the deal.

Other factors that may establish procedural unconscionability include, but are not limited to, (1) the amount of time the party is given to consider the proposed contract; (2) the amount and type of pressure exerted on the party to sign the proposed contract; (3) the length of the proposed contract and the length and complexity of the challenged provision; (4) the education and experience of the party; and (5) whether the party's review of the proposed contract was aided by an attorney.[8]

Even though Ross insisted upon the co-tenancy provision, the court held that the co-tenancy provision was not unconscionable because Grand Prospect's principals were experienced owners and operators of shopping centers, with over 33 years of experience in real estate, including prior experience in negotiating leases with Ross. Indeed, a salient fact noted by the court was that the principals were so sophisticated and experienced with Ross, they did not use a lawyer to negotiate this Ross lease, which had been conformed to a prior lease they had entered into with Ross. Also relevant was that Ross had not imposed any deadlines during negotiations to pressure Grand Prospect to execute the lease, and there was no evidence that Grand Prospect was under any time or economic pressures that would cause Grand Prospect to accept onerous terms.

In addition, although Ross had more bargaining power than Grand Prospect, based on Ross's financial resources and the fact that Ross had many options for opening stores in other locations, the court found that genuine back-and-forth negotiations of the lease took place between the parties. Also important was that Grand Prospect had meaningful choices when it pursued Ross; Grand Prospect chose Ross, which would pay higher rent but required a co-tenancy provision, over other tenants who would have paid a lower rent either without a co-tenancy provision or with one more favorable to Grand Prospect. Because the court concluded that there was no procedural unconscionability (and, as noted above, under California law both aspects of unconscionability must be present for the court to make a finding of unconscionability), the court held the co-tenancy provision was not unconscionable.

Unreasonable Penalties

Rent Abatement

In addition to its claim that the co-tenancy provision was unconscionable, Grand Prospect claimed the rent abatement and termination remedies in the co-tenancy provision were both unenforceable as unreasonable penalties. Although finding no unconscionability, the *Grand Prospect* court did find the facts supported the conclusion that the rent abatement provision in the lease was an unreasonable penalty and thus unenforceable. In its analysis, the court first determined that conditions precedent in a contract can operate as a penalty.[9] "A condition in a contract providing for the payment of money not earned is just as much a penalty as though it had been stipulated to penalize the promisor, should he default in the performance of his promise."[10] The court distinguished other cases where a condition had not been found to be a penalty by noting that a "contract provision that provides a party with a true alternative performance . . . does not involve an unenforceable penalty."[11]

In the instant case, in determining the co-tenancy condition did operate as a penalty, the court found that Grand Prospect did not have an alternative performance if the condition in the opening co-tenancy provision regarding Mervyn's occupancy was not met. The court noted that in contrast to the operating co-tenancy condition in the lease, the opening co-tenancy condition gave the landlord no option to replace Mervyn's as a co-tenant. Further, Grand Prospect did not own the Mervyn's space and therefore did not have any opportunity to affect or control Mervyn's decision to cease its operations.

Having decided that the co-tenancy condition could be considered a penalty, the court then considered whether the rent abatement provision was an unenforceable penalty. Generally, a contractual provision is an unenforceable penalty "if the value of the money or property forfeited or transferred to the party protected by the provision bears no reasonable relationship to the range of harm anticipated to be caused to that party by the failure of the provision's requirements."[12] The court determined that the value of the money that was forfeited by the landlord under the Ross lease was the rent under the lease, which was approximately $39,500.00 per month.

The court then examined the record of the lower court for evidence of the harm Ross anticipated from the failure of the co-tenancy condition due to Mervyn's closure, but found none. Particularly compelling to the court was the testimony of Ross's executives that no study or analysis was done to determine the impact of Mervyn's closure on Ross's potential sales, and that after learning of Mervyn's closure, they still considered the shopping center to be a desirable location for a store. Indeed, one executive testified that he could not state whether the closure of Mervyn's stores in shopping centers where Ross had stores adversely affected Ross's sales.

Consequently, having found that Ross anticipated that no harm would arise from Mervyn's closure, the court concluded there was no reasonable relationship between the value of the property forfeited by Grand Prospect (the loss of Ross's rent for the full the term of the lease) and the anticipated harm to Ross. Thus, the court found that the rent abatement was an unenforceable penalty, and Ross was required to pay its rent under the lease.

Termination

As for Grand Prospect's claim that the tenant's termination remedy was an unreasonable penalty, the court reversed the lower court's holding that the termination provision was unenforceable. The court first looked to earlier case law to determine if it needed to apply strict scrutiny to the termination provision in this lease.[13] The court found that "[w]hen a commercial lease contains a clause terminating the lease upon the occurrence of contingencies that (1) are agreed upon by sophisticated parties and (2) have no relation to any act or default of the parties, no forfeiture results from the exercise of the termination clause."[14]

In the *Grand Prospect* case, the court concluded that Ross's right to terminate the lease was based on conditions that were agreed upon by sophisticated parties. It also determined that such conditions were not based on a default of the parties because, when the lease was made, neither Ross nor Grand Prospect could control whether Mervyn's continued to operate a store in the shopping center or whether that space would be occupied by the type of anchor tenant specified in the lease. Therefore, the termination provision did not create a forfeiture and could not be deemed to be an unenforceable penalty. Because the termination provision was upheld by the court, Ross was required to pay only approximately 12 months of unpaid rent ($627,100.00).

Practice Pointers

1. ***Provide for replacement of co-tenants.***
   A significant factor in the *Grand Prospect* court's decision was that the opening co-tenancy provision was virtually incurable because it did not provide the landlord with the opportunity to satisfy the opening co-tenancy condition with a substitute retailer. Whenever a tenant's co-tenancy remedies are conditioned upon specific, named co-tenants operating in the center, the landlord should insist on the right to replace that named co-tenant with another tenant. The clause could permit the landlord to replace the co-tenant with any other tenant that is similar in nature (e.g., similar in number or location of other stores, similar in customer demographics, similar in amount of space being leased) or include a longer list of possible other named tenants for the landlord to choose from to replace the co-tenant. The *Grand Prospect* case should also encourage tenants to agree to give their landlord a replacement right since, without it, the tenant's remedies might be deemed to be unenforceable penalties. Co-tenancy provisions should also provide a landlord with sufficient opportunity to cure before the tenant can exercise its remedies.
2. ***Provide for liquidated damages.***
   In light of the *Grand Prospect* case, it may be prudent for tenants to require landlords to agree in the lease that the rent abatement represents liquidated damages, not a penalty, and is a reasonable estimate of the amount of damages that may be incurred. However, given that some courts will look to substance over form, parties should also be prepared to justify the rent abatement amount in relation to the amount of damages that may be incurred.
3. ***Establish harm before exercising rent abatement remedies.***
   Although the dispute in the *Grand Prospect* case specifically involved co-tenancy provisions, the court's decision not to enforce the rent abatement could apply to rent abatement remedies in other lease provisions as well, such as late delivery of possession or a violation of an exclusive use. Before exercising a rent abatement remedy in a lease, tenants should internally document the harm they have suffered, or expect to suffer, that justifies the rent abatement. It is likely that the court in *Grand Prospect* believed that Ross was taking advantage of the terms of the lease by taking possession of the space without paying rent for it, although it had no expectation that it would be harmed by the failure of Mervyn's to operate in the center.

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[1] *Grand Prospect Partners, L.P. v. Ross Dress for Less, Inc.*, No. F067327, 2015 Cal. App. Lexis 19 (5th Dist. Jan. 12, 2015).
[2] See, e.g., *Strand v. U.S. Bank Nat. Ass'n ND*, 693 N.W.2d 918, 924 (N.D. 2005).
[3] *Wisconsin Auto Title Loans, Inc. v. Jones*, 714 N.W.2d 155, 165 (Wis. 2006).
[4] See, e.g., *Spann v. American Express Travel Related Services Co.*, 224 S.W.3d 698 (Tenn. Ct. App. 2006).
[5] *Grand Prospect*, 2015 Cal. App. Lexis at 24.
[6] *Id.* at 27.
[7] *Id.* at 29.
[8] *Id.* at 25.
[9] *Compare with Old Navy, LLC v. Center Developments Oreg., LLC*, 2012 U.S. Dist. Lexis 82579 (D. Or. 2012) (finding that a condition precedent was not a penalty).
[10] *Grand Prospect*, 2015 Cal. App. Lexis at 43.
[11] *Id.* at 45.
[12] *Id.* at 51.
[13] *C.M. Staub Shoe Co. v. Byrne,* 169 Cal. 122 (1915).
[14] *Grand Prospect*, 2015 Cal. App. Lexis at 62.

Evolution of Shopping Center Signage Creates New Legal Issues for Landlords and Tenants

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The ancient Greek philosopher Heraclitus (535 to 475 BC) said, "The only thing that is constant is change." With the advent of the Internet 20+ years ago, the pace of change has been greatly accelerated, and the impact has become more dramatic and far-reaching. National trends such as the evolution of technology, the REIT revolution, and consumer and industry responses to such trends have had profound effects on how real estate owners and their tenants do business today. And as the retail real estate business changes, so do the legal issues facing landlords and tenants. This article will examine some of the trends driving retail real estate today, their impact on retail signage, and legal issues that are emerging as signage morphs and changes.

National Trends Impacting Signage

It is suggested that the following four trends are among the major influences that affect retail signage today.

1. ***The Internet***

   The intersection of the Internet and the SmartPhone has placed the "world's largest store in every [consumer's] pocket." This gives each consumer unprecedented power to buy whatever and whenever s/he wants, at lower prices than ever before. SmartPhone penetration is now reported to be approximately 40%, and will grow to 60% in three years.[1] Amazon, probably the best-known online retailer, has been growing at the rate of approximately 17% per year.

   The result is that brick-and-mortar stores are becoming smaller, and perhaps fewer. Consider the following:

   - 4,500 brick-and-mortar stores closed in 2012.
   - New retail stores are generally 25% smaller, but retain 90% of in-store sales.[2]

   This is having a tremendous effect on retailers and their landlords, who are scrambling to fill excess space. The good news for shopping center owners and tenants is that engagement and interaction with social media reportedly increase consumer spending 20% to 40%. Omnichannel retail interfaces reportedly increase in-store sales in the neighborhood of 30%, and have become a major focus for most national chain stores.

   Just as NFL and NBA owners view themselves as being in the entertainment business rather than the "sports business," now property owners are seeking to bundle experiences for the consumer to enhance the "draw" of their projects, lure customers back to brick-and-mortar stores, and stay relevant. Tenant mix now contains 12% to 20% leisure, food and entertainment uses, which are combining dining, entertainment (whether it be movies, comedy clubs, billiards, bowling, etc.), socialization and shopping. The goal is to provide a complete family experience, with a higher spend per visit because people stay longer and spend more.

   There is also an emphasis on experiential retail that is interesting and unique. For instance, in order to drive traffic, shopping centers hold events such as in-store cooking demonstrations, wine tastings, rock climbing and curating a wardrobe using a "magic mirror" that employs computer technology to show customers how they look in the merchandise.

   Landlords desire to create an exciting, aesthetically pleasing and fun environment—a mini-Disney World—that can be easily accessed at the local level. The result is that customers enjoy a unique and memorable experience, and the shopping center stays relevant in the face of increased competition from the Internet. Amenities, lighting *and signage* are part of that experience.

2. ***Branding and Trade Dress***

   Years ago, signage was strictly limited to the occupant's trade name above the front door in a uniform format—in accordance with municipal codes and landlord sign criteria. Now, trade name, logo, color(s) and "trade dress" are key to a tenant's success. Branding appears not only on sign bulkheads, but also at myriad locations, including exterior awnings, on store display windows, blade signs and banners, which are used to dress up building facades and create interest.

3. *New Sign Technologies*
   Retailers are always looking for attractive and enticing signage. Newer energy efficiency codes now typically require LED (light-emitting diode) or fluorescent lighting, which use less energy and generally lasts longer than the older incandescent lighting. These technologies have improved, such that the colors they produce are more true and vibrant, and letters on signs can be thinner and more attractive.

   Many shopping centers are using digital video media boards in shopping centers, including "crawlers" and "Jumbotron" screens (discussed below), which fall within the category of "flashing, blinking or animated-type signage." For decades, digital video media boards were all but outlawed in the shopping center context.

   Many tenants' present and future plans include the incorporation of big-screen TVs and digital video media boards into their stores and/or in show windows. All of these devices require more electrical capacity. Also, since these devices generate heat, stores with these features are having to increase both their electrical and HVAC capacities.
4. *The REIT Revolution*
   Today, much of the retail landscape is dominated by publicly traded real estate investment trusts, which must please Wall Street analysts and shareholders by generating increased funds from operation each quarter. REITs are looking to generate "ancillary income" from every facet of their operation. One fruitful source is advertising revenue from signage on exterior pylons, on the exterior face of buildings and throughout enclosed malls. Such advertising can easily generate millions of dollars for the landlord, with a relatively modest investment of time and money (discussed below).

The Goal of Signage

The goals of retail signage are, simply put, to advertise the tenant's business, goods and services, and to attract customers who will make the cash registers ring. In the face of increased competition from online retailers, brick-and-mortar retailers are, more than ever, looking for signage that:

- Is inviting, vibrant and entertaining,
- Blends with the architecture and environment of the retail project,
- Is tasteful and proportioned to respect the architectural scale of the surrounding space,
- Provides immediate recognition of the tenant's business and premises,
- Is illuminated.

How do tenants get what they want, quickly, in the context of regulation by both landlords and municipalities? The focus here is not only on substance, but also timing, because the faster a store opens, the faster it generates revenue for the tenant—and for the landlord (as well as for the municipality, in the form of tax revenue)! Landlords and municipal code authorities have, and should have, the same goals as tenants:

- Attractive, inviting and entertaining signage,
- Streamlined approvals.

Regulation of Signage

Forward-thinking sign criteria set parameters, encourage innovation and will usually require submission of a color computer graphic or rendering of the entire elevation, along with sign drawings, for approval by the landlord and code authority. Parameters addressed by such criteria will typically include the type of signage (e.g., facade or storefront-mounted, canopy or awning, window graphics, blade signs, rooftop/parapet signs). Technical factors include the size, proportion, location, type of lettering, illumination, mounting, fabrication and materials, installation, operation and maintenance responsibilities, and limitations on signage in display windows. Fast and effective approvals require close cooperation between the landlord and tenant to achieve their shared goals.

Anchor tenants, which also have a legitimate concern about the appearance of signage in shopping centers that they occupy, have an appreciation of the retail landscape today, and are tending to be more flexible in what they will permit.

Municipal approvals are more difficult because municipalities strive for uniformity, not creativity. Furthermore, cash-strapped cities are short of staff, so approvals take longer; knowing this, tenants often negotiate to require their landlords to obtain their signage approval for them—based in part on the assumption that the landlord, as the local property owner, has a relationship with the code authority. Finally, most municipal sign codes have not been updated in decades, while the pace of change in a retailer's advertising and signage requirements moves at the speed of the Internet. But the financial realities that most local governments now face do not make overhauling their sign codes a priority.

Nevertheless, there seems to be a growing recognition that to be competitive, retailers have to upgrade their signage to be more attractive and inviting, and their retail signage must include tenant logos, colors and trade dress. The governmental emphasis on uniformity, and the desire to prevent garish signs that distract motorists and "clutter" the landscape,[3] is giving way to a recognition that the retail environment is changing, and that retailers and property owners need to stay competitive.

This situation was highlighted in a recent zoning battle in Paramus, New Jersey (generally regarded as "the retail capital of New Jersey"), between Paramus Park Mall, owned by General Growth Properties, and the Paramus Zoning Board of

Adjustments.[4] In this case, local retail vacancies were hovering above 10%, and the municipality was forced to recognize that "shifting shopper habits" were having a negative impact on the trade area. Consequently, the zoning board granted the mall owner variances that permit more signs per wall than normally permitted, and up to seven colors on a sign, rather than the four permitted by Paramus codes, to better accommodate retailers' trade dress.

Unfortunately, this increased flexibility is often seen only in connection with new projects that a municipality wants to do well and prosper, or with seriously troubled projects with high vacancy rates that are important to the municipality because of their size or location. Nevertheless, many financially strapped, enlightened, municipalities are backing off on tight signage requirements in the hope of raising tax revenue through increased sales.

There also seems to be a trend among city planners to try to eliminate pylon signs along roadways, which they view as producing a cluttered streetscape. Instead, planners prefer slightly larger and taller monument signs, and larger signs on buildings and storefronts as compensation for loss of the pylon advertising. In response to this trend, some big-box retailers add tower features to their stores, to which they add their logo and (in some cases) a sign bearing their trade name. This functions as a pylon, but is regulated as an "architectural feature" under many local codes.

With regard to new and redevelopment projects, forward-thinking developers are incorporating their signage criteria into their planned unit development approvals or zoning amendments to provide the speed and flexibility needed in today's retail world. For instance, codes in Columbus, Ohio[5] and Worthington, Ohio[6] have been modified to streamline approvals and allow the municipality to issue a sign permit within a few weeks. Without these changes, the process could take three months or more.

Digital Video Media Boards

The digital video media board (or Jumbotron) represents the intersection of new sign technology and property owners' quest for ancillary income. This device can deliver pictures, text and sound; is programmable; and can be changed in real time. Digital video media boards and crawlers are appearing on pylons, on monument signs, in malls, on kiosks, on parking structures and even in tenants' display windows. Digital video media may be the most controversial and problematic area in signage today because of the conflict between property owners' desire for revenue generation from these devices and the potential for disputes with anchors and other occupants over content. This type of sign can generate millions of dollars in revenue for the property owner/developer, and can be the deciding factor in whether a real estate project moves forward or not. For instance, store windows in Manhattan can be sublet for the purpose of locating a digital video media board for $1.2 million per year and up!

Large landlords are locking into national advertising contracts for digital video media boards that cover dozens of properties, and the landlords do not want any restrictions on content. Anchor tenants, on the other hand, are pushing back (primarily because they do not want competitors' advertising on these boards), and saying to landlords: "Here are our concerns—You figure it out."

When adding these boards to existing properties, there are a number of issues to consider, including municipal approvals and anchor approvals. Some municipalities prohibit digital media boards and crawlers, while others have not updated their codes in decades and impose no regulation whatsoever on these types of devices. Most older reciprocal easement agreements, on the other hand, were drafted before anyone ever thought of the Jumbotron. These agreements may prohibit flashing, rotating and animated signs or have blanket controls over "advertising medium," so the owner/developer will likely need multiple anchor approvals for one of these devices.

Keep in mind that some anchors may still be bound by Federal Trade Commission consent decrees that prohibit certain anti-competitive behavior. While these anchors do not want a competitor's ads on these devices, they may be prohibited from explicitly restricting them by their consent decrees. This can lead to gridlock—where all non-occupant advertising is prohibited. One area in which such gridlock can be broken, however, is by permitting advertising for businesses such as car dealerships that do not compete with the property's retail tenants.

Some of the many other issues that arise in this context are:

- *Purpose*. What is the purpose of the digital media board? What will it be used for? To promote the center and its occupants? To advertise products and events at the center? Or to simply generate revenue for the landlord? Landlords argue that the revenue from these devices is theirs and theirs alone (generally, there is no dispute on this point), and is necessary to offset growing tenant subsidies and allowances necessary to attract high-quality tenants. Such reasoning is frequently unpersuasive to a tenant, particularly to an anchor store, with approval rights.
- *Economics*. A digital video media board can present significant installation and maintenance costs that must be defrayed through its use. Will landlords require an advertising minimum from certain tenants? Will free or discounted advertising be offered to tenants? Will there be tenant and non-tenant rates? Will certain tenants be offered a "most favored nations" rate?
- *Favoritism*. May these boards be used for advertising non-occupants' businesses? How about advertising the business of a tenant's competitor? The authors' informal surveys indicate that most industry professionals (representing landlords and tenants, including anchor tenants) consider advertising competitors' businesses to be objectionable, unfair and inappropriate.
- *Aesthetics*. Digital media boards produce glare, bright flashes and (sometimes) noise. Is the impact positive or negative?

- *Permitted Locations*. A digital video media board may be appropriate at one location, but it may constitute a traffic hazard in another area (see below).
- *Legal Liability*. These boards are programmable. What happens if a hacker gets into the system? What if a flashing screen causes a traffic accident, or triggers an adverse reaction by a disabled person? Who is liable? If screens show people, what about privacy issues? And how will all of this affect insurance rates?

Courts have not yet addressed many of these issues, and the legal landscape is still evolving. However, trends in related areas suggest that the impetus is on viewers to behave responsibly, and that sign proprietors owe them no legal duty. Courts have held, for example, that "the responsibility to lookout when driving is on the driver."[7]

In a case involving an injured party struck by a driver allegedly distracted by a Marlboro billboard, the court granted summary judgment in favor of the defendant property owner, sign owner and store lessee because "a rule which would uphold liability in the present case would be at odds with reasonable notions of individual responsibility."[8] While the court acknowledged that "the Marlboro sign did exactly what it was intended to do by Philip Morris, i.e., attract the attention of a passing motorist who might wish to purchase tobacco products," the court nevertheless found that the defendants owed no legal duty to passersby.[9]

Yet, these two cases held that liability for injuries attributed to commercial signage should be resolved by a jury.[10] At least one court has found that insurers are obligated to defend parties sued for signage-related personal injuries.[11]

Permitted and Prohibited Content

This is probably the greatest issue affecting signage (of any type) today. Developing guidelines in this area seem to include the following:

- Advertising of tenants' competitors should be prohibited.
- Advertising of non-occupants should be limited, unless the advertiser does not compete with tenants of the shopping center).
- Content must relate to the shopping center, its occupants and (perhaps) community activities.
- There must be a policy on access to the digital media board by community groups.[12]
- No political ads.
- No controversial issues.
- No intimate apparel/underwear ads (i.e., only "family-oriented' content).

Conclusion

Brick-and-mortar retail needs to attract more (and younger) shoppers to stay relevant. The flash and glitz of "Times Square" neon may be too much in most locations. Therefore, owners and occupants of retail projects, particularly anchor stores, need to work together to produce an exciting, esthetically pleasing and fun environment that is unique and memorable. At the same time, the architecture and environment of the project must blend with the advertising, be tasteful and proportioned in respect of the architectural scale of the surrounding space, and still meet the tenants' advertising requirements. With a thorough understanding of all parties' objectives (and objections) and a large dose of creativity, this effort need not be Mission Impossible!

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[1] *See* "How retailers can keep up with consumers" by Ian MacKenzie, Chris Meyer and Steve Noble, published by McKinsey & Company, October 2013, accessed July 8, 2014 at http://www.mckinsey.com/insights/consumer_and_retail/how_retailers_can_keep_up_with_consumers

[2] *Ibid*.

[3] Whether city planners' desire to protect the public from such unsightly clutter is rooted in aesthetics or concerns over public safety is unclear. There are some California cases that hold that "an occupier has no legal duty to provide a distraction barrier to prevent passing motorists from seeing or hearing what is occurring upon the land. [. . .] the occupier has no liability for injuries caused by the motorist who is not paying attention to where he or she is going. Rather, it is the motorist who has the duty to exercise reasonable care at all times, to be alert to potential dangers, and to not permit his or her attention to be so distracted by an interesting sight that such would interfere with the safe operation of a motor vehicle." *Lompoc Unified Sch. Dist. v. Superior Court*, 20 Cal. App. 4th 1688, 1694 (1993) (collecting cases). In light of these cases, it would seem that sign regulation based on concerns for public safety would be difficult to justify. Nevertheless, consider the following case discussing the constitutionality of restrictions on signage: "It cannot be disputed that signs are distracting. Their whole purpose is to call attention to themselves and to the extent that they are successful, a motorist's powers of observation are diverted from those things which he may injure or which may bring injury to him. A sign that is large enough to be seen at one glance may also be large enough to conceal a hazard. A small sign may get more than a glance just because it needs more attention to be understood. Usually, temporary signs rely on the impact of multiple exposures to convey their message, proliferating without seeming limit in the process. To suggest that one may simply turn away from the impact of temporary signs is to suggest that one may do that which the sign-placer has resolved one shall not do. Neither pedestrians nor drivers can turn away if there are three-four signs on every pole on both sides of the street. To argue that one need not look is to contend one should walk or drive carelessly. Furthermore, it cannot be disputed that temporary signs posted on traffic signs which either detract attention from them, or worse, conceal them, are hazardous both to drivers and pedestrians. Therefore, I find the ordinance promotes significant government interests which are causally related to achievement of stated goals." *Frumer v. Cheltenham Twp.*, 545 F. Supp. 1292, 1295 (E.D. Pa. 1982) *aff'd*, 709 F.2d 874 (3d Cir. 1983).

[4] *See* "Paramus Move to Ease Rules on Signs Aimed at Helping Hub Compete," by Joan Verdon, *The Record*, April 25, 2014, accessed on July 8, 2014 at: http://www.northjersey.com/news/paramus-move-to-ease-rules-on-signs-aimed-at-helping-retail-hub-complete

[5] *See* Columbus (Ohio) Code Chapters 3375 to 3383.

[6] *See* Worthington (Ohio) City Ordinances Chapter 1170.01 *et seq*.

[7] *DeFini v. Broadview Hts.*, 76 Ohio App. 3d 209, 216, 601(1991) (the city owed no duty to pedestrians who were killed when a motorist, distracted by a Christmas light display, struck them on a public road), and company employees "were not bound to anticipate that a passing motorist would negligently disregard his own safety because of their advertising acts, and that such motorist would violate traffic laws and cause injuries to third persons." (*Blakely v. Johnson*, 220 Ga. 572, 577, 140 S.E.2d 857, 860 (1965) (the driver was distracted by gas station employees attempting to attract attention to the station from potential customers.)

[8] *McCray v. Myers*, 614 So. 2d 587, 590 (Fla. Dist. Ct. App. 1993).

[9] *Id*.

[10] *See e.g., Chinnaraj v. Chehab*, No. A-2793-08T1, 2010 WL 3258135 (N.J. Super. Ct. App. Div. Aug. 13, 2010) (holding that "whether the visual clutter created by the assemblage of signs in the vicinity of the crosswalk posed a distraction to the driver or whether the signage obscured other signs giving notice of the crosswalk and contributed to the accident should be resolved by a jury."); *Colonial Stores, Inc. v. Owens*, 107 Ga. App. 436 (1963) (whether it was foreseeable and likely that someone might trip over signage and injure herself was a question for the jury).

[11] *Burdge v. Excelsior Ins. Co.*, 194 N.J. Super. 320 (App. Div. 1984) (insurance company required to defend party accused of negligently erecting a sign in a manner which "obstructed, distracted and impaired" driver's vision, causing collision).

Anti-Assignment Clause: *"So What?,"* Says the Third Circuit

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The commencement of a Chapter 11 bankruptcy case by a tenant will typically give rise to myriad issues and challenges for a commercial landlord, based upon various Bankruptcy Code provisions that may, and often will, change the parties' otherwise applicable rights and obligations pursuant to the terms of the lease and applicable non-bankruptcy law.

One such issue often faced by landlords is the post-petition enforceability of anti-assignment provisions that are commonly found within lease agreements. Recently, the Third Circuit weighed in on this issue by affirming an order from the Delaware Bankruptcy Court. This issue was resolved by reopening a Chapter 11 case of a reorganized debtor in order to permit the debtor's assignee to exercise a purchase option in a lease, notwithstanding the anti-assignment clauses contained therein.[1] In doing so, the Third Circuit reaffirmed the policy underlying anti-assignment provisions in connection with bankruptcy cases, and the extent of bankruptcy courts' jurisdiction after the closure of a case.

The I-4 Lease and Related Settlement Agreement

I-4 Land Holding Limited Co. ("I-4") owned certain property in Florida, which it leased to Lazy Days' R.V. Center, Inc. ("Lazy Days") pursuant to a written lease (the "Lease") entered into in July 1999. The lease provided Lazy Days with an option to purchase the real property in question, and otherwise prohibited its assignment or transfer without I-4's written consent, with certain exclusions. Beginning in 2008, Lazy Days failed to pay rent as it came due and informed I-4 of its intention to file for Chapter 11 and to assign the Lease to LDRV Holding Corp. ("LDRV").

Lazy Days and I-4 ultimately reached a settlement agreement in October 2009 (the "Settlement") pursuant to which: 1) I-4 consented to the proposed assignment; and 2) Lazy Days agreed that it would not "argue against the bankruptcy court abstaining from consideration of Lease interpretation issues . . . except to the extent necessary in connection with the assumption and assignment of the Lease as contemplated herein."[2] While the Settlement did not specifically address whether the purchase option would survive the assignment, the Settlement did provide that "there is no intent to, nor is the Lease modified in any respect and the Lease and all terms and conditions thereof remain in full force and effect."[3]

The Chapter 11 Case and the Bankruptcy Court's Decision

Lazy Days and LDRV (the "Reorganized Debtors") commenced their respective bankruptcy cases in November 2009. The bankruptcy court confirmed a plan of reorganization incorporating the Settlement in December 2009. The Chapter 11 case was ultimately closed in March 2010 and, thereafter, the Lease was assigned to LDRV in accordance with the terms of the Settlement.

In May 2011, LDRV attempted to exercise the purchase option contained in the Lease. When I-4 refused to honor the purchase option, LDRV and I-4 filed lawsuits in Florida state courts, requesting adjudication of their rights in connection with the Lease. Contemporaneously therewith, the Reorganized Debtors moved in the bankruptcy court to reopen the Chapter 11 cases, arguing that the anti-assignment provision of the Lease was unenforceable pursuant to § 365(f)(3) of the Bankruptcy Code, which provides in relevant part that an unexpired lease may not be terminated pursuant to an anti-assignment provision contained therein.[4]

Following opposition by I-4 and a contested hearing, the bankruptcy court held that: (1) the anti-assignment provision was unenforceable and (2) I-4's refusal to honor the purchase option violated the Settlement. As a result, the bankruptcy court ordered I-4 to honor the option. I-4 appealed to the federal district court, which then vacated the bankruptcy court's order, holding that the bankruptcy court's judgment was an advisory opinion directed at the Florida state courts in which the parties' litigation was pending.

The Third Circuit Appeal and Decision

On appeal, the Third Circuit reversed the decision of the district court and remanded the case to the bankruptcy court. The Third Circuit upheld the bankruptcy court's subject-matter jurisdiction to reopen the cases to address the dispute over the Settlement, which it confirmed as part of the Reorganized Debtors' plan of reorganization.

For similar reasons, the Third Circuit held that the bankruptcy court was not required to abstain under 28 U.S.C. § 1334 (2). Moreover, the Third Circuit found the provision in the lease providing that the Reorganized Debtors would not argue against abstention to be unavailing, as the provision provided an exception for matters asserted "in connection with the assumption and assignment of the Lease[,]"[5] and the instant dispute concerned the assignment.

The Third Circuit concluded that

> [e]ven assuming arguendo that the parties may waive the protections of § 365(f)(3), neither of these provisions unambiguously eliminates the purchase option, as both could be read to mean that LDRV steps into Lazy Days['] shoes and acquires all the rights and obligations that Lazy Days had, notwithstanding any anti-assignment provisions.[6]

Moreover, the Third Circuit noted that the principle of § 365(f)(3) "is that anti-assignment clauses are unenforceable in bankruptcy." Accordingly, the Third Circuit found that the Settlement did not waive the anti-assignment protections of § 365(f)(3).

Practical Considerations

By reversing the decision of the district court, the Third Circuit reaffirmed the significance of bankruptcy jurisdiction after closure of a bankruptcy case. Indeed, notwithstanding that state court litigation had been commenced to determine the parties' respective rights under the Lease, the bankruptcy court was permitted to intervene, essentially to interpret and enforce the confirmation order it previously approved which incorporated the Settlement.

Practically speaking, the *Lazy Days'* decision re-emphasizes the use of bankruptcy as a strategic tool and stresses the importance of the fundamentals associated with anti-assignment provisions in leases adjudicated under the Bankruptcy Code. Landlords should be mindful, however, that, depending upon the particular facts and circumstances, pre- and post-petition steps can and should be taken in order to minimize risk and mitigate damage:

(1) Pre-petition enforcement of any and all available state law rights and remedies, such as preemptive termination or eviction for nonpayment;
(2) Including a liquidated damages clause in a lease agreement, which may help to quantify damages in the event of a lease rejection;
(3) Collection of any and all necessary cure payments;
(4) Challenging the assumption of a lease; and
(5) The filing of a proof of claim in a bankruptcy case.

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[1] *In re Lazy Days' RV Center Inc.*, No. 12-4047, — F3d. —, No. 12-4047 (3d Cir. July 30, 2013).
[2] *Id.* at * 1.
[3] *Id.*
[4] 11 U.S.C. § 365(f)(3).
[5] *Id.* at *5
[6] *Id*.

Cases

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ASSIGNMENT AND CONTINUING LEASE OBLIGATIONS

The United States District Court for the Eastern District of Louisiana found that disputed issues of material fact existed as to whether Best Buy breached the lease by failing to provide notice of the ultimate assignment of the lease, failing to use reasonable efforts to find a subtenant or assignee to cont inue to operate the leased premises, purportedly selling the building as part of the assignment, and failing to provide notice for insurance requirements. *Bayou Liberty Property, LLC v. Best Buy Stores, LP,* Civil Action No. 14-1112, 2014 WL 6774197 (E.D. La. Dec. 2, 2014).

Best Buy Stores, LP, and its parent company, Best Buy Co. (collectively, "Best Buy") and its landlord, Bayou Liberty Property, LLC ("Bayou"), were parties to a breach of contract action arising out of a ground lease for real property located in Louisiana. At issue, Best Buy had a right to assign its lease, but only with prior notice to the landlord; the assignee agreed in writing to be bound by the terms of the lease; and Best Buy agreed to remain liable for full performance of all the terms, covenants and conditions of the lease. Best Buy did assign its leasehold interest to Slidell Development Company ("SDC") under an assignment agreement ("SDC Agreement"), and then SDC assigned the interest to Levis Partners, LLC ("Levis"). Bayou filed suit against Best Buy for declaratory judgment and breach of contract for (1) failing to provide Bayou with prior written notice of the assignment of the lease; (2) failing to have the assignee execute a specific assumption of the entire lease; (3) failing to use reasonable efforts to find a subtenant or assignee to continue to operate the leased premises; (4) purportedly selling the building when Best Buy had no legal interest in immovable property belonging to Bayou; and (5) failing to maintain insurance coverage. Bayou also sought money damages, including for lost rental opportunities, in the amount of $1,549,602.

Best Buy filed a counterclaim for declaratory relief, breach of contract and deceptive practices for failing to provide Best Buy with a timely estoppel certificate. Best Buy also filed a third-party complaint against Levis for declaratory judgment and breach of contract, claiming that Levis was in breach of the assignment from SDC and, therefore, the cause of any purported breach by Best Buy. Levis counterclaimed, seeking a declaration that Best Buy had breached its obligations and return of $1,654,000 paid into escrow.

Based on the language of the SDC Agreement, the district court granted summary judgment for Best Buy on the issue of notice of the SDC assignment, finding that the language in the SDC Agreement was an agreement to assign at a future date and not a present assignment of the lease. Assignment to SDC did occur at a later date, and prior written notice of the assignment was given before the transfer date. Even though the assignment to SDC was proper, the district court found that, based on the assignment, there were disputed issues of material fact as to whether (1) there was a sale of the building under the SDC Agreement in contravention to the terms of the Lease; (2) Best Buy adhered to the insurance notification provisions; and (3) because the assignment did not require SDC or Levis to operate the premises, Best Buy used "reasonable efforts" under the lease to find a subtenant or assignee to operate the leased premises. As to the ultimate assignment to Levis, although there was notice when the assignment to SDC occurred, the district court found that there was no prior notice of the Levis assignment required under the lease.

As to Best Buy's claims against Bayou for failing to provide a timely estoppel certificate, the district court refused to enter summary judgment without Best Buy also establishing that Bayou's breach resulted in damages. The district court granted Levis' summary judgment for all claims asserted by Best Buy and release of the escrowed funds paid by Levis.

OWNER LIABILITY FOR INJURY

The Superior Court of Pennsylvania overruled the trial court regarding the owner's potential for injury at the shopping center caused by a sidewalk defect, finding that the sidewalk defect was not trivial. *Reinoso v. Heritage Warminster SPE LLC*, No, 3714 EDA 2012, 2015 WL 161934 (Pa. Super. Jan. 14, 2015).

As a result of a fall outside a Kohl's, located in a shopping center, Guadalupe and Edmundo Reinoso sued Heritage Warminster SPE LLC ("Heritage")—the owner of the center—for failing to maintain the defective sidewalk outside of Kohl's department store. The plaintiff's engineer/architect expert measured the site and found 5/8 of an inch height differential in the section of the sidewalk where the fall occurred. The trial court granted Heritage's summary judgment motion, agreeing that the sidewalk defect was *de minimis*, stating: "The landowner is not required to maintain the sidewalk to perfection, but only to the extent that unreasonably unsafe conditions are removed."

The plaintiffs appealed and, at first, a divided panel affirmed the trial court's grant of summary judgment. The case proceeded before the full appellate court *en banc*. First, the court recognized that Heritage owed a duty to the plaintiffs as business invitees. Second, the court disagreed with the court's finding that the sidewalk defect was trivial. The court did agree with the trial court that there was no issue of material fact regarding the height difference between the sections of the

sidewalk. The trial court, however, did not consider additional facts, including that the defect in the sidewalk was "seriously in excess of ¼ inch standard for a tripping danger and constituted a walkway safety hazard." The surrounding circumstances included: (1) the height differential between the sidewalk panels; (2) the heightened duty to an individual as an invitee; (3) expert testimony indicating that the height differential exceeds safety standards; and (4) testimony from the owner of the company charged with maintenance of the sidewalk that he considered the defect to be a tripping hazard and had reported it to the landowner.

There is a dissenting opinion, wherein the judge decided that he did not believe the trial court committed an error in granting summary judgment, by determining the 5/8-inch misalignment between sidewalk sections was, as a matter of law, a trivial defect.

SHOPPING CENTER DEVELOPMENT—DAMAGES FOR INJUNCTION

A landlord was entitled to terminate its lease with the tenant of an undeveloped shopping center, but was not entitled to liability on a bond once the injunction was dissolved for lost development opportunities. *Thrifty Payless, Inc. v. Mariners Mile Gateway*, LLC, 2015 WL 140029 (Cal. App. Jan. 12, 2015) (discussing *Thrifty Payless, Inc. v. Mariners Mile Gateway, LLC*, 185 Cal. App. 4th 1050 (2010)).

This case started almost eight years ago when the tenant, Thrifty Payless, Inc. ("Thrifty"), doing business as Rite Aid, brought an action for anticipatory breach of the lease against its landlord, Mariners Mile Gateway, LLC ("Mariners"), because of problems that arose with the development of the shopping center. Thrifty obtained a preliminary injunction, preventing Mariners from (1) leasing all or part of the leased property to any entity other than Rite Aid during the course of the litigation, or (2) developing, improving, altering or constructing the leased property in any way inconsistent or not in accordance with the lease. As a result of the injunction, Rite Aid was required to post a $5 million bond. The shopping center was never built; Mariners exercised the cancellation provision and notified Rite Aid it was terminating the lease. The trial court, as later affirmed by the court of appeal, found that the landlord validly exercised its termination right, which allowed it to terminate for any reason.

As a result of the decision, the court dissolved the injunction in 2008. In September 2011, Mariners attempted to collect on the full $5 million bond, arguing that if the injunction had not been in place, it would have begun developing a smaller version of the shopping center and would have obtained financing. The trial court denied Mariners' request to collect on the bond, finding: (1) Mariners failed to prove that the injunction barred it from proceeding with planning and other pre-development steps for the shopping center; (2) the injunction was not so restrictive because it only prevented Mariners from developing the property previously leased to Rite Aid in a manner inconsistent with the lease between Mariners and Rite Aid; (3) the new site plans were not inconsistent with the lease because they did not change the size or location of the leased property, but rather only made design changes, including eliminating a traffic signal and underground parking, and reducing the overall size of the shopping center; and (4) the evidence demonstrated that Mariners did not submit site plans or obtain financing for reasons unrelated to the injunction. As part of the claim for damages resulting from the injunction, Mariners claimed that it lost profits; however, the trial court found that the claim was speculative and could not be the basis for collecting on the bond.

Based on the language in the injunction and Mariners' conduct after the injunction was issued, the court of appeal affirmed, stating: "[W]e reject Mariners' claim it was prevented from taking any steps whatsoever to proceed with a new development plan. All it was enjoined from was altering the approximately 13,000 square foot premises leased to Rite Aid." The court of appeal also affirmed that the trial court had substantial evidence to establish that the injunction did not prevent Mariners from obtaining leases, financing or entitlements; Mariners did try to obtain other leases, and external market factors caused Mariners not to obtain entitlements or financing. As to lost profits, because the injunction was not the proximate cause of any damages, the court of appeal did not address Mariners' claim. Finally, Mariners argued—for the first time—that it was entitled to interest and carrying costs while the injunction was in effect. The court denied that claim for the same reason—i.e., the injunction did not prohibit Mariners from proceeding with the development of the shopping center.

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Parking Woes: The Supreme Court of Canada Sides With the Municipality

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The Supreme Court of Canada recently decided that the owner of a business operating in violation of a municipal by-law cannot invoke the doctrine of promissory estoppel as a defense in a penal proceeding. The Court ruled this way, despite the fact that the municipality of Québec (the "City") had, throughout its dealings with the business in question, led the business owner to believe that the nonconforming use was permitted.[1]

Facts and Judicial History

In 1998, Les Immeubles Jacques Robitaille Inc. (the "Owner") purchased a property on which a commercial parking lot had been operating since 1995. According to a zoning by-law in force since 1979,[2] the operation of a commercial parking lot on that property is prohibited, as it constitutes a non-conforming use. Despite the existence of the by-law, the Owner operated the commercial parking lot without issue until 2008, when the Owner received a statement of offence for permitting or tolerating a nonconforming use of the property.

The Owner was taken aback by this charge. After all, since the business's inception, the City had conducted itself in a way that led the Owner to believe that the nonconforming use was permitted. Examples of this conduct include:

- In 2001, the City compensated the Owner for having to relocate certain parking spaces due to major construction on a highway near the property.
- In 2002, the City purchased a portion of the Owner's property. In addition to providing for the "preservation of the vendor's present rights," the deed of sale also provided for the construction of stairs and a new vehicle entrance at the City's expense.
- The City collected taxes on the Owner's property at a nonresidential rate.
- The City installed signs on the public road to advertise that parking was available on the Owner's property.

In municipal court, the Owner pleaded not guilty, claiming it had an acquired right to use the property as a commercial parking lot. To plead acquired rights successfully, the Owner had to establish that the property was primarily used as a parking lot prior to the adoption of the zoning by-law in 1979. The Owner's sole proof in support of this plea was a witness's oral testimony, which the trial judge rejected as hearsay. Furthermore, the witness's testimony indicated that parking was merely an accessory use of the property, not its primary function. Accordingly, the Owner was convicted and fined $200.

Appealing its conviction before the superior court, the Owner once again unsuccessfully pleaded acquired rights. Additionally, the Owner raised the doctrine of estoppel, citing the above-listed acts by the City in support of its argument. The superior court chose to overturn the trial judge's decision and acquit the Owner.

The court of appeal restored the conviction, finding that the superior court had erred in law and should have maintained the Owner's conviction, as there was no sufficient basis to claim acquired rights.

The Decision of the Supreme Court of Canada

The Supreme Court of Canada began by addressing estoppel in a public law context, stating that in order to be pleaded successfully, there must be proof of a clear and unambiguous promise made to a citizen by a public authority in order to induce the citizen to perform certain acts.[3] In addition, the citizen must have relied on the promise and acted on it by changing his or her conduct.[4]

However, even if these conditions are met, the Court points out that public law estoppel must yield to an overriding public interest and may not be invoked to prevent the application of an express legislative provision.[5] The Court notes that zoning by-laws are adopted in the public interest, ensuring the harmonious development of a zone to the mutual benefit of all property owners within its boundaries.[6]

Applying these findings to the case at bar, the Court found that the doctrine of estoppel was of no use to the Owner due to the public interest factor as well as the unambiguous wording of the legal provision.

Regarding the actions of the City that misled the Owner, the Court clarified that while the adoption of a by-law is a discretionary act by the City, the enforcement of a by-law is not.[7] A municipality cannot deviate from its zoning by-laws or

authorize such a deviation unless the legislation expressly authorizes it to do so.[8] The Court pointed out that if the the actions or tolerance of the City caused injury to the Owner, the Owner could bring an action in damages.[9]

The Owner raised a second argument, alleging that the duality of recourses available to the City, civil and penal, is a source of injustice. The Court rejected this argument, stating that the penal and civil remedies available to municipalities are clearly defined and serve separate purposes: Penal proceedings serve as a deterrent by punishing past conduct whereas civil proceedings are used to prevent such conduct from continuing in the future.

Conclusion

Owners and purchasers of residential or commercial property must be thorough when performing due diligence. Rather than rely on the actions or apparent tolerance of a municipality, it is preferable to refer directly to the applicable municipal zoning laws when verifying whether the intended use of the property will be acceptable.

Additionally, owners and purchasers of properties being used in contravention of municipal by-laws on the basis of an acquired right to do so must be able to provide clear proof of such a right. Accordingly, a deed of sale should make explicit reference to the right, and any documentation or other evidence proving the right's existence should be conserved with care.

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[1] *Immeubles Jacques Robitaille Inc. c. Québec (Ville)*, 2014 SCC 34.
[2] *Réglement de l'arrondissement de la Cité sur le zonage et l'urbanisme*, City of Québec by-law VQZ-3, ss. 40, 83 and 359.
[3] *Immeubles Jacques Robitaille Inc. c. Québec (Ville)*, supra note 1, ¶ 19.
[4] *Ibid*.
[5] *Id.*, ¶ 20.
[6] *Id.*, ¶ 23.
[7] *Id.*, ¶ 24.
[8] *Id.*, ¶ 27, 29.
[9] *Id.*, ¶ 38.

What Are Your Intentions? Letters of Intent in Real Estate Transactions

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Despite the use of words and phrases emphasizing that a Letter of Intent ("LOI") is non-binding, there are legal AND strategic consequences to consider when preparing an LOI. Understanding them is essential, to skillfully engage in the purchase and sale of commercial real estate.

The process of negotiating an LOI in any commercial transaction is sometimes compared to nailing jelly to a wall—for buyers and sellers, as well as landlords and tenants. Even for astute parties, this is tricky business.

Quick Offer

An interested purchaser may choose to present a vendor with an LOI to test whether the vendor is amenable to the deal the purchaser has in mind. Prior to knowing the vendor's position, a prospective purchaser may want to avoid the costs associated with a detailed agreement of purchase and sale. An LOI provides an inexpensive way to explore whether the parties are a likely match for a successful transaction.

Capturing Attention

There may be adverse consequences if a party substantially deviates from the terms of the LOI. This risk should be weighed against the advantages of postponing the preparation and execution of a definitive agreement of purchase and sale. Where many parties are vying for a vendor's attention, an attractive LOI can make one purchaser stand out in the crowd. Knowing that its LOI is non-binding, an attention-seeking purchaser may be tempted to include terms that are more generous to the vendor than the terms to which the prospective purchaser will eventually commit. However, this approach can have detrimental consequences.

An intrigued vendor will be acutely attuned to the LOI. If it subsequently comes to light that the purchaser is not committed to a deal on the terms of its LOI, but merely engaged in the process to pique the vendor's interest, the purchaser's credibility will suffer. The parties may anticipate slight deviations from the terms of the LOI, but substantial departure on important terms will be met with resistance and mistrust. Therefore, a prospective purchaser should be sure that it is willing to proceed on the terms and conditions of the LOI. Significant deviations are likely to strain the relationship and sour the negotiating process; they may even kill the deal.

Enforceability Concerns

An LOI expresses the basic terms of a potential contract. It indicates the parties' mutual intention to form a binding agreement of purchase and sale on terms that incorporate those of the LOI. The LOI is, essentially, an agreement to agree. Canadian courts have consistently held that an agreement to agree is no agreement at all.

An important exception to the general unenforceability of an LOI is that it may be found to be enforceable as a result of the parties' actions. In the case of *Wallace v. Allen* (2009), the Ontario Court of Appeal held that the parties' actions following the signing of an LOI for the sale of a business clearly demonstrated their expectation that they would be legally bound by the LOI. The vendor had not only announced his retirement and the planned sale of his business on multiple occasions, but had also introduced the purchaser as the new owner of the business. The purchaser immediately began working at the business on a full-time basis and had transferred the purchase funds into his solicitor's account on the day of closing. The LOI provided that "this letter of intent must be reduced into a binding agreement of purchase and sale within the next 40 days." The court interpreted this provision, in light of the parties' conduct, as plain evidence that the parties intended to be bound by the terms of the LOI, rather than a separate agreement incorporating the terms of the LOI.

In many cases, an LOI, while largely unenforceable, nevertheless includes some enforceable provisions. For example, an LOI may contain a provision obligating the parties to keep all aspects of their negotiation confidential. Another example is what is sometimes referred to as a "no shopping" or "exclusivity" provision. This term prohibits the vendor from negotiating with any other party for a prescribed period of time, with the result being that the vendor has agreed to temporarily take its property off the market notwithstanding the absence of a legally binding commitment on the part of the purchaser.

When Should an LOI Be Used?

An LOI provides a quick and inexpensive way to elicit a vendor's attention. But both parties should consider whether an LOI is the best vehicle to accomplish their objectives. Proceeding with an LOI can have significant strategic and legal implications on the subsequent negotiation, so the parties must carefully consider the details included in the LOI. Inclusion of terms in the LOI that are later retracted may extinguish the possibility of a deal; omitting essential terms that are later insisted on can have the same effect.

On the other hand, if the LOI is highly detailed, it may be preferable to simply approach the vendor with a binding agreement of purchase and sale. Where a great amount of time and expense is incurred to carefully consider and negotiate the details of the transaction, a non-binding LOI may simply add an unnecessary (and expensive) step to the process.

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Honesty Is the. . . LAW!

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In a unanimous seven-judge decision issued on November 13, 2014, the Supreme Court of Canada (SCC) established a new general principle of law that requires parties to perform their contractual obligations honestly.

Until this decision, the duty of good faith in the performance of contractual obligations had been generally established in the common law; but the duty might have been perceived as being of limited application. It was mainly implicated where a contracting party was granted a power of discretion or in certain relationships where a power imbalance existed between parties (e.g., employer-employee) or where it seemed equitable to ensure that contracting parties did not act in a manner that defeated the objectives of their agreement.

In the landmark ruling, the SCC emphatically stated: "parties [to a contract] must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of a contract." The SCC's ruling reiterated the principle of good faith in contractual relationships and extended it to include a duty of honest performance.

Facts of the Case

Bhasin v. Hrynew 2014 SCC 71 involved a dispute among three parties - two retailers and a wholesaler. Two of the parties colluded to deprive the third of the benefit of a contract and, in doing so, lied to achieve their purpose.

The sanctioned activity consisted of a series of deceptions by a wholesaler of educational savings plans, who attempted to mislead one of its retailers (Retailer 1) for the purpose of accessing the retailer's confidential client records and capturing its lucrative client base for the benefit of a second retailer (Retailer 2).

Retailer 1's refusal to go along with the wholesaler's demands culminated in the wholesaler exercising its right not to renew Retailer 1's contract. Retailer 1 initiated court proceedings claiming damages stemming from the wholesaler's preference for Retailer 2. Retailer 1 alleged a lack of good faith in the performance of the earlier contract and an unlawful conspiracy, as between the wholesaler and Retailer 2, to oust Retailer 1. The case found its way to the highest court in Canada.

The Supreme Court of Canada

The SCC noted that prior case law pertaining to a good-faith duty in contracts was plagued with inconsistencies. It introduced two incremental steps intended to bring certainty and coherence to contract law:

(a) *Good Faith as a General Organizing Principle*—The first step is an acknowledgment of a general organizing principle of good faith that applies to all contracts in Canada. The principle functions as a minimum standard of behaviour. It requires that contracting parties have "appropriate regard" for each other's legitimate interests by not undermining those interests in bad faith.

(b) *The Duty of Honest Contractual Performance*—In the second step, the SCC imposed a common-law duty of honesty in contractual performance. The duty does **not** seek to impose a positive duty of disclosure or loyalty; neither party is expected to forego any advantages flowing from the contract. However, the duty requires that parties to a contract **must not lie or knowingly mislead** their contractual counterparts.

Implications

The *Civil Code* of Quebec imposes a broad duty of good faith extending to the formation, performance and termination of a contract. It is a unique legal structure in Canada.

No common-law jurisdiction in Canada demands that pre-contractual negotiations be conducted in good faith, although based on the common law that had previously been pronounced in the realm of good faith, there is at minimum, an expectation that duties are to be performed reasonably and not capriciously or arbitrarily. The United States Uniform Commercial Code (UCC) also imposes an obligation of good faith in the performance and enforcement of contracts (but not in their formation).

With this new SCC ruling, the rest of Canada is effectively catching up to the experience in Quebec and the United States. While this new development does not preclude parties (outside of Quebec) from seeking the best possible deal for themselves in negotiations, parties bound to a Canadian contractual relationship must honour duties of good faith and honesty.

What we take from this case is that contracting parties cannot knowingly make false statements to each other to undermine the goals of a contract. For example, if a tenant requested information from its landlord regarding current market rates in connection with an extension or renewal right under its lease, the landlord would likely be safe in refusing to disclose confidential information, but not in inflating rental information to mislead its tenant.

Another example of when the duty of honesty might be triggered in the commercial leasing context would be where a lease requires a landlord to obtain its tenant's consent to alter the site plan of a project (such as by constructing new premises or modifying common areas). If the tenant were to withhold its consent for a collateral purpose unrelated to legitimate concerns about the proposed modifications, it should be prepared to justify its stance.

The Future

The judiciary has never looked favourably on lies and deceit. In that respect, the landmark decision in *Bhasin v. Hrynew* is not to be heralded for establishing a novel principle. However, the case establishes certainty in commercial relations.

Traditionally, courts have strained to curb bad behaviour by contracting parties, deploying doctrines of unconscionability and relying on a smattering of case law about good faith. Now there is clarity: contracting parties can be expected to face the consequences of exercising their rights dishonestly or in bad faith.

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An Update on a "Distressing" Canadian Remedy

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Introduction

American tenants are often surprised to learn that the ancient, common law remedy of distress is insidiously alive and well in many Canadian provinces. Distress is the landlord's right to seize and sell a tenant's goods to satisfy rent arrears. While the distress remedy is banned in many jurisdictions in the United States, it is regarded by many as a draconian, anachronistic remedy that should be abolished.

Law reform commissions in Ontario, Manitoba and British Columbia have recommended major changes to distress legislation. In 1993, the Civil Code of Quebec was amended to eliminate the remedy of seizure before judgment. (Quebec's version of the distress remedy is seizure before judgment.)

In April 2014, the British common law distress remedy was replaced by a statutory regime, which imposes significant limitations on the landlord's right to distrain. The distress remedy has also been abolished in certain jurisdictions in Australia and Northern Ireland.

For many Canadian landlords, however, distress is considered a highly effective means of recovering unpaid rent. If exercised properly, the distress remedy provides landlords with an efficient, cost-effective alternative to forfeiture or litigation proceedings.

Distress

The Remedy

The landlord's remedy of distress (or "distraint") is a self-help right that arises only when rent is in arrears.[1] This remedy consists of a right to seize the tenant's goods and chattels (personal property) and to sell them to satisfy the unpaid rent.

The remedy of distress is available only while the lease is ongoing and arrears of rent are outstanding. At the time of the distress, there must be a fixed and certain amount of rent owing under the lease, and the tenant must be in legal possession of the premises. It cannot be emphasized enough that the remedy of distress is not available following termination of the lease.

Distrainable vs. Non-Distrainable Property

A landlord may distrain only against certain assets of the tenant. For example, a landlord has no right to distrain over fixtures, whether characterized as immovable fixtures or trade fixtures.[2] Similarly, goods of a stranger (i.e., goods that do not belong to the tenant), wild animals, perishable goods, money (unless placed in a sealed bag or drawer), leased goods and consignment goods are all exempt from distress. If a landlord distrains against goods and chattels that are exempt from seizure, the distress will be rendered illegal; the landlord will be liable to the tenant for any damages the tenant incurs.

Procedural Requirements

Canadian courts have established a number of procedural requirements for effecting a proper distress. These requirements include:

- Distress must be levied during daylight hours.[3]
- Only the landlord or the landlord's designated agent (such as a bailiff) may distrain against the tenant's goods.[4]
- The landlord or landlord's agent must gain access to the premises through the "ordinary and natural" means of entrance, without the use of force[5] (subject to certain judicial and statutory exceptions). And
- Only goods found on the tenant's premises may be distrained[6] (subject to the landlord's right to follow goods that have been fraudulently removed from the premises).

Codification of the Common Law

In some Canadian provinces, the common law distress remedy has been codified by statute. For example, in Ontario, the *Commercial Tenancies Act*[7] modifies, supplements and in some cases restricts the common law distress remedy.

Pursuant to § 43 of the Act, distress must be reasonable. As to what makes a distress reasonable or not, consider that the Canadian courts have held for distress to be "reasonable"— i.e., the landlord must not seize and sell more goods than are reasonably necessary to satisfy the rent arrears.[8] To ensure compliance with this reasonableness requirement, many commercial landlords retain a reputable bailiff to carry out the distress proceedings, including a full appraisal of the tenant's goods by two independent appraisers.

The Act also prohibits illegal, irregular or excessive distress. If a landlord seizes goods of a tenant where the landlord had no right to distrain (e.g., in cases where there is no fixed and certain amount of rent owing), the distress will be deemed illegal. An illegal distress is considered void *ab initio* (wrongful from the beginning), and the landlord may be liable to the tenant in trespass if the distress is deemed illegal.

Conversely, irregular distress occurs where a landlord lawfully distrains against a tenant's goods, but subsequently violates the procedural requirements for distress pursuant to the Act, or as established by the courts. A distress has been found to be irregular where (1) the landlord fails to take an inventory of the distrained goods, (2) the distrained goods are not appraised and sold within a reasonable time, (3) the landlord sells the distrained goods without giving the tenant five days to replevy its goods, and (4) the landlord fails to provide proper notice of the distress. An irregular distress will give the tenant a cause of action for damages, but will not render the distress void *ab initio*.

If the landlord fails to effect a distress in accordance with the Act, the tenant may be entitled to certain remedies, including an action for damages (for trespass or conversion); injunctive relief; and, in some (rarer) cases, an order that the lease has been terminated.

As evidenced above, the distress remedy is fraught with significant procedural pitfalls imposed by statute and common law. However, if exercised properly, distress can be an inexpensive, effective means of recovering rent arrears and ensuring that tenants pay rent in a timely manner when it is due.

Termination vs. Distress

If a tenant fails to pay rent when due (and after expiry of any applicable notice and cure periods contained in the lease), the landlord must decide whether to terminate the lease and sue for the unpaid and future rent or to continue the tenancy and distrain on the tenant's goods.

Most commercial leases contain a clause stating that (1) the landlord's remedies under the lease are cumulative and (2) no remedy is exclusive or dependent on any other remedy. Since termination and distress are both powerful self-help remedies, why not use both?

If the landlord elects to terminate the lease and take possession of the premises (known as the landlord's right of forfeiture), it may sue the tenant for unpaid rent as well as lost future rent over the balance of the term. But, if the landlord elects to distrain and sell the tenant's goods to satisfy the rent arrears, it must preserve the lease, as the distress remedy is available only while the lease remains alive and arrears of rent are outstanding. In practice, some landlords elect to exercise the distress remedy first; if there are rent arrears still outstanding after selling the tenant's goods, the landlord will terminate the lease on the basis of the balance of rent owing. However, according to a recent decision of the British Columbia Court of Appeal, which will be examined below, it appears that this practice is not acceptable.

Canadian courts have consistently held that distress and termination are mutually exclusive remedies that cannot be exercised concurrently. In other words, a landlord cannot distrain *and* terminate the lease at the same time. Nor can a landlord terminate the lease and *then* distrain, as distress is available only while the lease is alive.

In *Delane Industry Co. Ltd. v. PCI Properties Corp.*,[9] the British Columbia Court of Appeal recently addressed the question of whether a landlord could distrain first and then terminate the lease after the distress is completed.

The *Delane* Case

In *Delane*, the tenant stopped paying rent due to a dispute with its landlord. The landlord commenced distress proceedings and sold the tenant's goods. The sale proceeds were not sufficient to satisfy the rent arrears, so the landlord terminated the lease for non-payment of rent immediately after the sale, relying on a notice of default that was delivered to the tenant during the distress proceedings.

The tenant brought an action against the landlord for, among other things, a declaration that the landlord illegally terminated the lease. At trial, the Supreme Court of British Columbia held that the notice of default delivered during the distress proceedings was not effective for terminating the lease. The court noted that since termination is fundamentally inconsistent with distress, the two remedies could not be exercised concurrently. The court also held that the "cumulative remedies" clause in the lease could not be extended to permit concurrent remedies that are, by definition, mutually exclusive. The court found that in order to terminate the lease, the landlord was required to provide the tenant with a fresh notice of default and an opportunity to cure after the distress was completed. In reaching its decision, the court implied that, had the landlord issued the new notice of default, it would have been entitled to terminate the lease based on the rent arrears that accrued before and during the distress.

The landlord appealed to the British Columbia Court of Appeal, which upheld the trial court's decision, but found that the trial judge erred in suggesting that the landlord could terminate the lease based on the rent arrears that accrued before and during the distress. The court of appeal concluded that, having elected to distrain for the rent arrears, the landlord permanently and irrevocably waived its right to terminate the lease for those particular rent arrears. The court of appeal noted that in order to terminate the lease, a fresh default, unrelated to the breach that led to the distress, would be necessary (i.e., to effectively terminate the lease, the landlord must wait for the next instalment of rent to go unpaid; issue a new notice of default for the arrears; and if the new arrears go unpaid, terminate on the basis of such arrears).

In reaching its decision, the court of appeal relied on the 1985 Alberta Court of Queen's Bench decision *A & M Enterprises Ltd. v. B.J. Millwork Ltd.*[10] In that case, the court noted that "distress is an unequivocal election to continue the landlord and tenant relationship and any subsequent forfeiture for the same breach is illegal."

Although the British Columbia Court of Appeal noted that some lower level decisions appeared to conclude that distress proceedings merely "suspended" the landlord's right to terminate until the distress was fully completed. This court ruled that this is an incorrect statement of law and contrary to the principles of contract interpretation.

In sum, an election between two mutually exclusive remedies is irrevocable; and, once the election is made, the remaining remedy is unavailable. Moreover, a "cumulative remedies" clause in a lease will not alter this outcome.

As a result, the landlord in *Delane* was entitled to sue for the arrears accruing before and during the distress, but it lost its right to terminate the lease for those arrears when it elected to distrain.

Bad News for Canadian Landlords

The *Delane* case is problematic for many Canadian landlords (and lawyers) who have, for years, assumed that if distress proceedings did not yield sufficient proceeds to cover a tenant's outstanding rent arrears, the landlord could simply terminate the lease and sue for the arrears, as well as lost future rent. The British Columbia Court of Appeal has made it clear that, for any given rent default, the landlord cannot pursue both distress and termination. The landlord must decide which path to take. Once the landlord chooses its path, there is no turning back.

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[1] *Commercial Credit Corp. Ltd. v. Harry D. Shields Ltd.* (1991), 29 O.R. (2d) 106 (H.C.J.), aff'd 32 O.R. (2d) 703 (C.A.).
[2] *859587 Ontario Ltd. v. Starmark Property Management Ltd.* (1980), 40 O.R. (3d) 481 (C.A.). 1998 7138 (ON CA)
[3] *Shaw v. Goodberry [1936] 4 D.L.R. 198 (Ont.H.C.J.).*
[4] *Symonds v. Kurtz* (1889), 61 L.T. 559.
[5] "Distress in Ontario" (1999), *Canadian Encyclopedic Digest* (August 1999, Release — 3) at p. 51; C.A.W. Bentley, M.J. Butkus and J. McNair, *Williams and Rhodes' Canadian Law of Landlord and Tenant*, 6th ed. (Toronto: Carswell, 1988) at pp. 8-59 to 8-61.
[6] *Peacey v. Ovas* (1876), 26 U.C.C.P. 464 (C.A.).
[7] R.S.O. 1990, c. L.7 (the "Act").
[8] *Rawlins v. Monsour* (1978), 88 D.L.R. (3d) (Ont. C.A.).
[9] 2014 BCCA 285 ("*Delane*").
[10] (1985) 61 A.R. 283.