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# Law

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International Council of Shopping Centers
1221 Avenue of the Americas, New York, NY 10020-1099
Phone: +1 646 728 3800 | Fax: +1 732 694 1690 | E-mail: scls@icsc.org

# Can a Fee Simple Interest Be Subordinated?

Alexander Tselos

It may not be possible to subordinate a fee simple interest in real property as a matter of real estate legal principle; nevertheless, that principle has not prevented parties from using such language in legal documents to describe the legal relationship between a fee owner,[1] a tenant and a lender. A recent appellate case in Arizona, *Earle Investments v. Southern Desert Medical Center Partners*,[2] provides insight into this issue and the impact of drafting documents purporting to subordinate a fee interest.

**What Is a Subordination of the Fee?**

"Subordinating the fee"[3] is typically interpreted by legal commentators to mean that a fee owner has agreed, in connection with a lease transaction, to have the owner's fee interest in the property subject to a leasehold mortgage and have the property itself serve as additional collateral for the tenant's loan.[4] This arrangement provides the lender with a lien against both the owner's fee simple interest and the tenant's leasehold estate, so that in the event of a default under the loan, the lender may foreclose against both the fee title and the leasehold estate, in which case the lender becomes the fee owner of the property free and clear of the leasehold estate.[5] As discussed further below, the fundamental problem is that, conceptually, subordinating a fee interest is a "misnomer," has "no specific meaning," suffers from "gross uncertainty," and may end up achieving "nothing at all."[6]

**The Purpose of a Subordination of the Fee**

The demand for the fee owner's joinder in the mortgage arises from the "inherently riskier" nature of a leasehold mortgage (compared with a fee mortgage), including that a leasehold will always be (1) legally subordinate to the fee interest, possibly including claims against that interest such as a fee owner's mortgages and (2) subject to the terms of the lease creating such leasehold interest, including provisions that may allow for termination of the leasehold under a variety of circumstances.[7] One commentator has likened a leasehold mortgage to a "toy balloon....Prick it and it's gone."[8]

In fact, a fee owner's joinder is not necessary to eliminate these risks because other mechanisms are available to do so. These mechanisms include:

1. providing that all financing against the fee interest is subordinate to the lease;
2. protecting against forfeiture of the leasehold by providing the lender with notice of (and opportunity to cure) defaults and
3. if there is an automatic termination of the lease (e.g., in the event of a bankruptcy), a right to a new lease (a so-called "pickup" lease) on the same terms as the prior lease between landlord and tenant.

Still, the most effective way to reduce the risks associated with leasehold financing is to have the landlord execute the leasehold mortgage together with the tenant/mortgagor, and have the fee owner subject its fee interest to the mortgage. The lender's view is that if the owner subjects its fee to the mortgage financing, the quality of the leasehold estate becomes relatively unimportant, since the entire value of the real estate is available to satisfy the loan.[9]

**Benefits to a Fee Owner of a Subordination of the Fee**

Although a thorough analysis of the possible benefits to the fee owner of agreeing to join the mortgage are beyond the scope of this article, those benefits are sufficient to justify such a decision under some circumstances. The potential reasons include the desire to enable the tenant to obtain financing to develop the property—particularly if the financing will provide funds for the development of the subject property, enhance the value of the owner's adjacent property and offer the opportunity to participate in the project's profits.[10] If a fee owner is willing to subject its fee interest to the mortgage, there are a variety of measures the fee owner can take to protect itself and reduce the possibility of a loss of the property in connection with such an arrangement, including:

- placing a limit on the maximum amount of borrowing;
- requiring disbursal of all loan funds through an escrow account to assure that the funds are used to improve the value of the property, providing that responsibility for repayment of the loan is nonrecourse to the fee owner and requiring notice and opportunity to cure a default by tenant under the leasehold mortgage[11] and
- subordination of the fee to a leasehold mortgage as a concept.[12]

The confusion created by a purported subordination of an owner's fee simple interest is caused by the attempt to combine three different real estate law concepts: fee simple, subordination and mortgage. According to *Black's Law Dictionary*, "fee simple" is "the broadest property interest allowed by law," "subordination" is the "act or an instance of moving something (such as a right or claim) to a lower rank, class, or position" and a "mortgage" is a "conveyance of title to property that is given as security for the payment of a debt or the performance of a duty and that will become void upon payment or performance according to the stipulated terms." As discussed below, several courts dealing with subordination of fee cases have noted that conflating these different structures creates legal incongruities.[13]

As the court noted in *Travelers Ins. Co. v. Holiday Village Shopping Center Ltd. Partnership*,[14] a "subordination agreement only dictates the priorities between existing interests, for example lien holders—it does not mortgage an interest in the property." Similarly, as noted by the court in *Old Stone Capital Corp. v. John Hoene Implement Corp.*,[15] "by its very nature, the vehicle of subordination could not be used to grant [the lender] an interest in the fee," and thus, that subordination "could not, as a matter of law, grant any interest in the fee, upon which foreclosure could be had." As the *Travelers* court concluded, language providing for the subordination of a fee interest is "inherently and internally inconsistent," since it poses an unanswerable question: How do you cause an interest (fee simple) that is "absolute and without limitation, to be placed in a lower or secondary position?" It seems it could not be otherwise, since, as one scholar has noted, "a fee estate can hardly be subordinated to a lien on a subordinate estate arising out of the fee estate."[16]

Where the courts have determined that the subordination did not create a mortgage against the fee, there has been a variety of views about the nature of such subordination to the leasehold mortgage. In *Republic National Life Ins. v. Lorraine Realty Corp.*, the court determined that the fee owners only intended to subordinate their interest as "lessors" and not their fee interest, so the court fashioned a complex arrangement where the lender was relieved of paying rent (but not expenses such as real estate taxes) unless the rents obtained from the property exceeded the annual amortization of the loan. This arrangement continued until the lender recovered its loan or the expiration of original mortgage.[17] In another case, *Culberson Transportation Services, Inc., v. John Alden Life Insurance Co.*,[18] the court ruled that subordination only provided that the landlord's leasehold remedies were subordinated to the leasehold mortgage such that (1) the mortgagee could intervene in the event of a default by the tenant and the subsequent eviction process, (2) the mortgagee could step into the tenant's position under the lease and (3) conveyance of the foreclosed leasehold estate without any approval from the landlord was permitted, but nothing further. Essentially, the benefits of subordination afforded the lender were only those benefits that, as discussed above, could mitigate the risk of loss of the leasehold estate without a mortgage over the fee.[19]

**Case Summary**

In January 1974, a fee owner leased a portion of its land to Southern Desert Medical Center, Inc., "Phase II," for a 50-year term (the "Lease"). The Lease provided that the tenant could create a horizontal property regime for tenant's leasehold interest under Arizona law by creating "Units" that could then be conveyed together with a proportionate interest in the "Common Areas," thereby creating what the court referred to as a condominium. The Lease provided for the following provision in connection with the possibility that an owner of a Unit might want to post its interest as security for a loan:

> Lessor may, in its sole discretion, but it shall not be obligated to, subordinate its interest in portions of the real estate to the lien of a mortgage or Deed of Trust granted of [sic] the grantee of the leasehold estate in one or more Units under a Declaration of Horizontal Property Regime. In such event, however, the subordination shall be only as to the property upon which the leasehold estate is owned by such grantee, and appurtenant interest in the Common Areas.

At some point after the establishment of the condominium, two Units were conveyed by the tenant to Duane P. Alleman ("Alleman"), who secured financing for tenant improvements for the Units by granting deeds of trust to a lender (the "Lender"). In connection with such financing, the then-current fee owner of the property, Arizona Title Insurance and Trust Company, entered into two identical Subordination Agreements with the Lender. Thereafter, a series of transfers resulted in fee ownership of the property being transferred to another entity, Southern Desert Medical Center Partners (the "Fee Owner"). Subsequently, Alleman failed to make payments to the Lender and, after foreclosure of Alleman's interest by the Lender, the Units were ultimately transferred to Earle Investments, LLC, ("Earle") subject to the two identical Subordination Agreements. Earle ultimately filed a quiet title action, arguing that the Fee Owner's interest in the Units was extinguished by the foreclosure of the Lender's mortgage.

**Decision**

The court ruled that the Subordination Agreements effectively conveyed the Fee Owner's fee simple interest in the property and rejected the landlord's argument that there was merely a "subordination" of the leasehold estate to the mortgage.[20] The court rejected the Fee Owner's argument that the presence and use of the word "subordination" prevented the creation of a mortgage. Instead, the court accepted Earle's argument that the Fee Owner had mortgaged its fee interest as security for the debt. The court based its decision on the inclusion of conveyancing language in the subordination agreement providing that "for purpose of giving effect to this subordination, Owner...consent[s] to and join[s] in the Deed of Trust and hereby grant[s], transfer[s] and assign[s] to the Trustee of the Deed of Trust all right, title and interest of Owner...in and to the

Property, in trust pursuant to the Deed of Trust with the power of sale....” This allowed the court to avoid having to rely on “subordination” language to effectuate a “mortgage” that other courts have been reluctant to create in the absence of express language.[21]

**Conclusion**

The *Earle* case delineates, as outlined by prior courts and scholars, all of the uncertainties created by purporting to subordinate the fee owner’s interest to a mortgage. The *Earle* case affirms the view that use of the word “subordination” in efforts to subject a fee owner’s interest to a leasehold mortgage is problematic because it creates ambiguities as to the intentions of the parties. However, *Earle* also establishes that if the parties are clear that the fee owner is itself granting a mortgage, then, notwithstanding the use of problematic subordination language, the fee owner’s interest will be subject to the mortgage.

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**Alexander Tselos** is senior counsel in the law department of Target Brands, Inc., in Minneapolis, MN.
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[1] Throughout this article the terms “fee owner,” “owner” and “landlord” are used interchangeably to refer to the owner of fee simple absolute in the land. While it is possible that a “landlord” could have less than a fee simple interest (e.g., if the landlord is itself a tenant), this article contemplates no such permutations.

[2] 242 Ariz. 252, 394 P. 3d 1089 (Ariz. App. 2017).

[3] Oddly, since it seems to evoke the subordination of the ground lease, commentators refer to a lease that contains a right in favor of the tenant to “subordinate the fee” as a “subordinated ground lease.” See “Ground Leases: Basic Legal Issues,” Association of University Real Estate Officials, 22nd Annual Meeting, September 24, 2002, Florence P. Mayne, J.D., page 3.

[4] See *A Guide to Ground Leases (With Forms and Checklists)* by Joshua Stein (2005), page 267; “Tenant’s Mortgage of Landlord’s Interest—Subordinating the Fee,” *Friedman on Leases*, 8:4 (page 8–23); “Canada: Financing Leasehold Interests: How To Manage The Risks,” January 17, 2007, by Harry G. Heching.

[5] Alternatively, the lender could choose to retain both the leasehold and fee estates as distinct estates in the absence of an automatic merger of estates. See Heching, supra, note 3.

[6] See *Friedman*, supra, note 3, pages 8–23; Stein, supra, note 3, page 267.

[7] See Heching, supra, note 3.

[8] See "Leasehold Mortgages: In General," *Friedman on Leases*, 7:8:1 (page 7–158).

[9] See "Financing Ground Leases in the Capital Markets" by Richard D. Jones and Karen Fiorentino (April 2000), page 1.

[10] See Mayne, supra, note 2, page 3.

[11] There is disagreement about how common it is for fee owners to agree to such subordination, with at least one commentator suggesting it is not "typical." See Mayne, supra, note 2, at 3. But at least one other source indicates that fee owners "customarily" agree to such provisions. See Madison & Dwyer, *The Law of Real Estate Financing* (2017), § 7:5 Advantage to developer who indicates that fee owners.

[12] Attempting to subordinate a fee mortgage to a leasehold mortgage also creates many similar concerns, and such efforts have been labeled as "conceptually repugnant." See *Friedman*, supra, note 7, page 7-162. To be clear, there is nothing problematic about a fee mortgagee subordinating its interest to a lease (which itself might be subject to a leasehold mortgage), just that a fee mortgage cannot, in and of itself, be subordinate to a leasehold mortgage because the "liens affect different estates." Nevertheless, some commentators seem to suggest doing so. See Heching, supra, note 3.

[13] Although it is beyond the scope of this article, a leasehold mortgagee must also be cognizant of the possibility that a fee owner may be considered a surety or guarantor for the leasehold loan, since the fee owner is offering its property as additional collateral to secure the debt of another, the tenant. See "Understanding the Basics of Ground Lease Financing" by Adam F. Zweifler in *Commercial Mortgage Insight*, November 2000. The result could be additional protections for the fee owner, including the possibility of a cancellation of the mortgage as to the fee owner's interest. See *Friedman*, supra, note 3, page 8-24. Another commentator has raised the possibility that if the fee owner is considered a surety, a later modification of the loan terms with the tenant might "unsubordinate" the landlord's interest. See *Real Estate Finance Law*, Sixth Edition, by Nelson (2014), page 308.

[14] 931 P.2d 1292 (Mont. 1996).

[15] 647 F. Supp. 916 (D. Idaho 1986).

[16] See Stein, supra, note 3, page 267.

[17] *Republic National Life Ins. v. Lorraine Realty Corp.*, 279 N.W.2d 349, 357 (Minn. 1979).

[18] *Culberson Transportation Services, Inc., v. John Alden Life Insurance Co.* (Ohio Court of Appeals) 1997 WL 358857.

[19] See "Lease Assignments and Sublease Agreements: Distinctions with a Difference" by Gregory Gosfield, presented on October 24, 2009, at ICSC 2009 US Shopping Center Law Conference, page 9.

[20] *Earle Investments, LLC, v. Southern Desert Medical Center Partners*, No. 1 CA-CV 15-0507 (Ariz.App., April 13, 2017). Since the horizontal property regime was only to last through the 50-year term of the lease, the fate of the property after such regime lapses is, in my view, somewhat unclear from the decision. However, my understanding of the court's decision is that Earle will end up with an undivided interest in the entirety of the land upon the expiration of such regime.

[21] See *Balch v. Leader Federal Bank for Sav.*, 315 Ark. 444, 868 S.W.2d 47 (1993), where the court's reluctance led to a different outcome.

# Does a “Groceries” Exclusive Include Alcoholic Beverages for Off-Site Consumption?

Eve A. Brackmann and Nairi Siddiqi

The cat-and-mouse game between landlord and tenant over enforcement of exclusive use clauses dates back almost prior to the ballpoint pen.[1] With the modern sea change in retail grocery sales—hot competition from online retailers, Amazon’s acquisition of Whole Foods, junior-box liquor retailers like BevMo popping up everywhere, etc.—the game has massively intensified.[2]

Naturally, questions arise today regarding the scope of the term “groceries” in decades-old exclusive use clauses. And a significant concern is whether the term “groceries” include alcoholic beverages sold for off-site consumption?

Interpretation of the scope of “groceries” in an exclusive use clause, when not otherwise expressly defined in the lease, varies widely among U.S. jurisdictions—particularly as to whether liquor qualifies. Certain lines of case law, examined here, have set important precedents and now provide helpful touchstones.

A diligent shopping center lease drafter should be aware and forewarned of these precedents, especially where the lease involves a grocery tenant that may intend to sell prepackaged liquor and other alcoholic beverages—immediately, or at some point. And anyone dealing with a dispute over enforcement of an exclusive use clause needs to know what, and how, the courts have decided.

**California**

California courts look to the intent of the parties. To date, California has published only one case directly on point, *Purity Stores, Limited, v. Linda Mar Shopping Center, Inc.*[3] The California Supreme Court has never considered the issue, however, and in the decades since *Purity*, California has provided no new guidance regarding whether “groceries” includes any type of alcoholic beverages sold for off-site consumption.

The California appellate court in *Purity* held that the term "groceries" in an exclusive use clause in a lease was sufficiently vague to allow introduction of parol evidence as to whether (at lease inception) the parties had intended the exclusive to include beer. The appellate court explained that "it cannot be said as a matter of law that the word 'groceries' does not include beer."[4]

More importantly for determining how California courts will decide in the future, the *Purity* court explained that parol evidence is necessary in determining whether "groceries," if not defined on the face of the lease, includes beer:

> No case holds, nor could any court properly hold, that the term either includes or excludes beer as a matter of law....We might even take judicial notice that many modern stores selling groceries, such as those of Purity, are no longer called grocery stores, but super markets, and that they have within them various departments or sections, some of which sell groceries and may even be expressly labeled as "grocery departments"....It follows that the court properly received parol evidence for the purpose of enabling it to arrive at a decision as to the parties' intent.[5]

Although California case law on the topic has not really developed since *Purity*, the case contains some key takeaways. At least in California: (1) the term "groceries" (if otherwise undefined in the lease) is sufficiently vague to require parol evidence as to whether the parties intended for it to include beer (and other alcoholic beverages); and (2) due to the changing nature of the industry, grocery stores have become "supermarkets" that sell a wide variety of non-food items. Further, under the rule that parol evidence is admissible to determine whether "groceries" includes alcoholic beverages, every case will have a unique outcome depending on the evidence of the parties' intentions at lease inception. The strongest parol evidence includes the parties' pre-dispute conduct (e.g., whether during the lease term an exclusive was enforced, whether liquor was sold from the date the store opened, etc.), plus what the dealmakers discussed and negotiated when drafting the lease. *Purity* has never been cited in California, although it has been cited in other jurisdictions.

The *Purity* opinion briefly cites a prior California case, *Hildebrand v. Stonecrest Corp.*,[6] for the rule that the parties' pre-controversy conduct is important and admissible parol evidence.[7] Besides *Purity*, *Hildebrand* is the only other California case to date that attempts to determine the scope of the term "groceries." The *Hildebrand* dispute involved retail sales of pharmaceutical-type items, however, rather than alcoholic beverages.

In *Hildebrand*, the appellate court affirmed the trial court's judgment enjoining the grocery tenant from selling "'O' type commodities,"[8] finding that such items did not qualify as "groceries" based on parol evidence of the parties' intentions as to the scope of that term. The court also noted: "It would

place a somewhat strained construction on the word 'groceries' to construe it to include the items in dispute."[9] Thus, it was *Hildebrand* that set the foundation in California for admission of parol evidence to define the scope of the term "groceries," and *Purity* followed.

**Florida**

Contrary to the California approach, Florida courts define the term "groceries" on its face and do not consider parol evidence as to the term's meaning in an exclusive use clause in a lease. The Winn-Dixie line out of Florida's state and federal courts spans a decade and provides important and oft-cited national precedent across the United States.

The seminal case of *Winn-Dixie Stores, Inc. v. 99 Cent Stuff–Trail Plaza, LLC* (*99 Cent*)[10] set the precedent in Florida for defining "groceries" broadly enough, on its face, to include some non-food grocery items. In reaching this conclusion, the *99 Cent* court looked to the dictionary definition of "groceries."[11] It noted: "Unless the document in question contains a glossary of terms requiring a different meaning...which is not the case here, to find the plain and ordinary meaning of words, one looks to the dictionary."[12]

Subsequently, the U.S. District Court of Appeal for the Southern District of Florida relied on *99 Cent* in determining that under Florida law (and Alabama and Georgia law, as well), the term "groceries" (otherwise undefined in the lease) does not include alcoholic beverages.[13] Notwithstanding the progress in federal decisions, the Florida state courts still have not directly decided whether alcoholic beverages qualify as "groceries."

**Other Notable Cases**

Some states agree with California's parol-evidence approach, while others parallel the Winn-Dixie line from Florida.

For instance, an Ohio court of appeal cited and rejected the analysis in *Purity*,[14] holding that it was improper for the trial court to consider parol evidence to interpret the scope of the term "groceries," particularly where the use clause also listed a variety of food types.[15] *Mark-It Place* has never been cited negatively on the issue, nor has it been cited at all in any subsequent grocery case. Thus, the last word from Ohio is that it disagrees with the California approach of considering parol evidence in order to interpret a grocery exclusive in the use clause of a grocery retail lease. Ohio has never considered the specific question, however, of whether the term "groceries," on its face, includes alcoholic beverages.

In contrast, the Arizona courts have directly addressed the issue of whether "groceries" includes beer and wine, and have found that it does.[16] In *Sevilla*, the appellant had operated a small grocery store since 1951.[17] During the course of the lease, rezoning rendered the store a "non-conforming use."[18] In 1966, the city denied the grocer's application to add beer and wine sales to the use permit on the basis that it would constitute the expansion of a nonconfirming use.[19]

This decision was overturned on appeal, based on a finding that "groceries" on its face does include alcoholic beverages, given the picture of today's modern grocery store. "The question before this Court is one of definition, namely, does the term 'grocery store' normally encompass an establishment which sells package beer and wine in addition to what we ordinarily believe to be groceries?"[20] In concluding that packaged beer and wine do constitute "groceries," the *Sevilla* Court did not consider the terms of the lease, but did provide strong discussion in favor of including beer and wine in the standard definition of what is sold by a grocer, including notes about modern-day market conditions and economic concerns:

In a day when drug stores sell bicycles, supermarkets provide banking services and service stations sell hunting licenses, the demands of competition would indicate that small businesses should not be burdened with narrow and restrictive views of what they may or may not sell.... The distinctions between greengrocer, butcher, baker and wine merchant are no longer respected, and it is the rare grocery store that does not sell fresh vegetables, meats, bakery goods and package beer and wine in addition to staples such as coffee, tea and flour.[21]

*Sevilla* has never been cited negatively in any jurisdiction and remains good law in Arizona.

**Conclusion**

In summary, the interpretation of the term "groceries," where not otherwise expressly defined, varies widely among jurisdictions. The most tenant-friendly jurisdiction appears to be Arizona, but this is the exception. Most jurisdictions range from either attempting to determine what the parties intended when drafting an ambiguous exclusive use clause to finding that the term "groceries" on its face does not include alcoholic beverages.

Accordingly, neither side should take any chances in drafting exclusive use clauses today, especially where the shopping center contains a grocery anchor. Tenant representatives drafting the lease should understand the client's business model and should pay particular attention to any potential future developments. Also, grocery tenants should understand and actively enforce their exclusive

use rights—an important lesson from *Purity*. Where a dispute arises, tenants also may benefit from highlighting other incidental uses of the proposed competing tenant that clearly interfere with the "grocery" exclusive in any jurisdiction today—e.g., sales of soft drinks, napkins, snacks, etc.

For landlords, the goal is to create a precise and threadlike exclusive-use provision. Also, the clause ideally includes carve-outs allowing other tenants to sell a percentage of the excluded products, e.g., on an "incidental" basis. In addition, landlords should carefully monitor tenants' actual uses in order to ensure compliance with permitted uses at the shopping center and to avoid disputes or even litigation with the grocery tenant.

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**Eve A. Brackmann** is a partner on the Litigation and Trial team of Stuart Kane LLP in Newport Beach, CA, practicing business litigation and counseling. She focuses on regular and complex commercial, environmental and real estate litigation and trials, with particular expertise in retail real estate matters. She can be reached at ebrackmann@stuartkane.com.

**Nairi Siddiqi** is a real estate associate in the Orange County, CA, office of Manatt, Phelps & Phillips, LLP. Her practice focuses on real estate transactions, including acquisitions and dispositions, development, joint ventures and secured loans. She was previously associated with Stuart Kane LLP in Newport Beach, CA. Ms. Siddiqi can be reached at nsiddiqi@manatt.com.

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[1] Feinberg and Meoli, "A Brief History of the Mall," *Advances in Consumer Research* (Vol. 18, 1991), pp. 426-27 (Shopping centers got their start in 1907 in a Baltimore neighborhood where a group of stores established off-street parking); https://en.wikipedia.org/wiki/Ballpoint_pen, and citations therein (the manufacture of economical, reliable ballpoint pens arose in the early 20th century).

[2] Notably, the title of *Progressive Grocer*'s 70th Annual Consumer Expenditures Study, released in 2017, reads: "Guarding the Perimeter: Grocery retailers must stay vigilant in their efforts to preserve market share as disruptors rule the day." *Progressive Grocer*, "Guarding the Perimeter: Grocery retailers must stay vigilant in their efforts to preserve market share as disruptors rule the day" (August 1, 2017), https://progressivegrocer.com/guarding-perimeter-pgs-2017-consumer-expenditure-study.

[3] 177 Cal.App.2d 568 (1960) (*Purity*).

[4] Ibid.

[5] *Purity*, 177 Cal.App.2d at 572-73.

[6] 174 Cal.App.2d 158 (1959) (*Hildebrand*).

[7] See *Purity* at 574.

[8] *Hildebrand*, 174 Cal.App.2d at 162 (defining "'O' Type commodities" as things normally sold over the counter in a pharmacy such as toothpaste, shaving supplies, shampoo, soap, deodorants, first aid supplies, etc.).

[9] *Hildebrand*, 174 Cal.App.2d at 168, citing *Webster's International Dictionary*, 2d ed., which "defines 'grocer' as 'a dealer in tea, sugar, spices, coffee, fruits, various other commodities, chiefly foodstuffs.'"

[10] 811 So.2d 719 (Fla.Dist.Ct.App. 2002) (*99 Cent*).

[11] *99 Cent*, 811 So.2d at 722.

[12] Id. at 722 (internal citations omitted).

[13] *Winn-Dixie v. Dolgencorp*, 746 F.3d 1008, 1015, 1017-1018 (2014).

[14] Notably, it is the only case so far to give *Purity* any negative treatment.

[15] *Mark-It Place Foods, Inc. v. New Plan Excel Realty Trust*, 156 Ohio App.3d 65 (Ohio Ct. App. 2004), 83-84, citing *American Heritage Dictionary* (2d Ed.1985) 577.

[16] *Sevilla v. Sweat*, 9 Ariz.App. 183 (Ariz. Ct. App. 1969) (*Sevilla*).

[17] *Sevilla*, at 184.

[18] Ibid.

[19] Ibid.

[20] Ibid at 186.

[21] Ibid at 186.

# Potential Pitfalls in a Lease Guaranty

Lisa Winnick

It is common in the commercial leasing industry to provide for a guaranty of a tenant's obligations under a lease. The guaranty is a contract just as the lease is a contract, and thus should be given proper attention and focus by the parties in order to accomplish their goals. The landlord's intent is to have the guarantor on the hook to answer for the tenant's default should such default occur. While it is the guarantor's intent to answer for the tenant's default, the guarantor seeks (or should seek) to limit its exposure such that defenses may be raised in the event that a claim is asserted by a landlord. Individuals, corporations, partnerships, trusts and banks may all enter into guaranty agreements. A guaranty can range from one sentence, such as, "The undersigned hereby guarantees the obligations of Tenant herein," to a multipage document. The common law of a jurisdiction will fill in the blanks within this vast range. A recent Supreme Court case in Utah illustrates this point.

**The Facts**

In *PC Riverview, LLC, v. Xiao-Yan Cao*, 2017 UT 52 (Utah Aug. 23, 2017), Cao personally guaranteed the performance of a tenant corporation under a lease with PC Riverview upon the assignment of the lease to the tenant corporation. The language of the guaranty included Cao's agreement to the "performance of all covenants, conditions and obligation and duties required of Tenant under said Lease." The lease itself had been amended prior to Cao's involvement to include the imposition of late fees and interest if rent was not paid on time. A few years later, the tenant corporation assigned the lease to Hong G. Lin, with the assignment document ratifying the terms of the lease and any of its amendments and/or extensions. As guarantors, both Cao and Lin executed an amendment to the lease providing for an extension of the term.

Lin fell behind on rent payments, which eventually led PC Riverview to file suit against Lin and Cao pursuant to the guaranty. As a result of a required mediation and without Cao's knowledge, PC Riverview and Lin agreed to a payment plan, which allowed Lin to remain in possession of the premises and pay its past due balance together with its regular monthly rent payments for the remainder of the term. Lin complied with the terms of the payment plan and cured the outstanding

balance; however, he vacated the premises with one month remaining in the lease term and did not pay the final month's rent. PC Riverview filed a new action against both Lin and Cao to recover the month of rent plus interest and attorney fees.

**The Trial Court's Decision**

Under the Restatement (Third) of Suretyship & Guaranties, the tenant/obligor has a duty to reimburse a guarantor if the landlord/obligee enforces its rights under a guaranty. If, during the life of the guaranty, the tenant/obligor acts in a manner that decreases its ability to reimburse the guarantor or increases the potential liability of the guarantor, a defense may be raised by the guarantor if a claim is asserted. Cao, having learned of the prior payment plan agreement, argued that the lease had been modified to such an extent that her guaranty was no longer effective. She argued that providing additional time to the tenant to repay its debt without her knowledge materially modified the terms of her underlying obligation, thus increasing her potential liability. The district court agreed, but on appeal, the court of appeals analyzed the matter differently.

**The Appellate Decision**

First, the court of appeals noted that the guaranty contract signed by Cao did not contain any provisions requiring prior notice to Cao of Lin's default or of modifications to the lease. Since the law of contracts governs guaranty agreements, the court concluded it cannot "draft better agreements for parties than those they draft for themselves." Second, the court determined that a mere extension of time within which to pay the stated rent in the lease did not increase Cao's obligations. She agreed to be responsible for "all obligations and duties" of the tenant, including rent in the amounts stated for the term of the lease as well as late fees and interest. The repayment agreement's obligations coincided with the lease term and thus did not extend payments beyond the expiration date of the lease.

The court referenced the Restatement, which states that "If the principal obligor and the obligee agree to a modification, *other than an extension of time*..., the secondary obligor is discharged from any unperformed duties..." (emphasis added) Restatement (Third) of Sur. And Guar. §41 (Am Law Inst. 1996). The court determined that since this was an extension of time within which past due payments could be made, and such time extension did not extend beyond the existing lease term, it was not a material modification and did not increase Cao's liability and risk in any way.

**Conclusion**

The *PC Riverview* case makes it clear that careful drafting is just as important with a guaranty document as with the lease. A guaranty should clearly provide for notice to the guarantor, especially in a situation where the guarantor's relationship with the primary obligor is somewhat removed, as Cao's was with the tenant. In addition, a guaranty may be a guaranty of payment of a debt or a guaranty of collection of a debt, and the document should specify the type.

A guaranty of payment of a debt is the type in the *PC Riverview* case and the type typically seen in commercial leases with national tenants. The guaranty of payment of a debt is an unconditional promise to satisfy the debt for the term of the agreement. A guaranty of collection of a debt is a conditional promise that applies only after reasonable efforts are made to collect the debt from the primary obligor/tenant.

Whether or not a guaranty is of a continuing nature is also dependent upon the language. This is where, as illustrated in the *PC Riverview* case, the guaranty should address modifications, amendments and extensions of the lease and whether or not the guarantor will be released upon those events occurring. A guaranty can even provide for a specific time frame during which the guaranty is effective and/or a capped dollar amount of exposure.

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**Lisa Winnick** is in-house counsel at Rite Aid Corporation in Camp Hill, PA, with primary focus on real estate transactions, such as leasing and development, as well as pharmacy acquisitions.

# Takings: Your Rights, Business Damages and Preventive Measures

Michael Geibelson, Michael R. Whitt and Michael A. Price

A discussion on government takings may not make for lively cocktail party banter, but the financial ramifications on shopping centers permeate all aspects of business operations, landlord-tenant relations and future development efforts. Any loss of parking, interruption in traffic flows or access, or other impacts may threaten the bottom line. To protect against government overreach, it is essential to have a working understanding of the government's burden in takings cases, methodologies for calculating damages and potential strategies for dealing with Uncle Sam's action.

**Takings: A Government's One-Two Combination Punch**

The Fifth Amendment's Takings Clause provides: "[N]or shall private property be taken for public use without just compensation." The origin of this constitutional right can be traced back to principles of the Magna Carta that colonists brought with them to the New World. Not surprisingly, early Americans balked at appropriations of their private property during the Revolutionary War, at the hands of both sides.[1] Centuries later, business and property owners continue to rely on the same fundamental constitutional rights demanded by our forefathers. At its core, the government's burden in exercising its eminent domain powers to take private property is a two-step process:

1. Establish a public use or purpose
2. Remit payment of just compensation to the property owner

Traditionally, the government has been required to demonstrate a public purpose or use for the subject property that dominates the private gain.[2] In 2005, the U.S. Supreme Court attempted to expand this "public use doctrine" in the case of *Kelo v. City of New London*. In *Kelo*, the court upheld the application of a Connecticut statute that allowed the government to take private property as part of an economic development project.[3] The court found that promoting economic development is a traditional and long-accepted governmental function and, thus, is a proper public purpose.[4] The fallout from *Kelo* was resounding and virtually unanimous when 43 states enacted legislation

that restricts a condemned parcel of property from being transferred from public to private entities. Still, in today's post-*Kelo* world, the line between public and private purposes remains muddied, and subject to dispute in condemnation proceedings.

The second element of a takings case requires the government to remit payment to the property owner in the form of just compensation. "Just compensation" under the Fifth Amendment is customarily measured by the market value of the property at the time of the taking.[5] This valuation turns on whether the government is effecting a "total taking" of the entire property, or a "partial taking" of only a portion of the subject property. In either type of taking, the permissible methodologies used to determine the fair market value will vary by state, but the three routine barometers are the comparable sales approach, income approach and cost approach.[6]

The comparable sales approach is by far the most widely used. It considers the highest price on the date of valuation that would be agreed to by a seller who is willing to sell but under no particular or urgent necessity for doing so, nor obliged to sell, and a buyer who is ready, willing and able to buy but under no particular necessity for doing so. Each party is dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.[7]

When no comparable sales are available for the subject property, however, the income approach or income capitalization approach analyzes the property's capacity to generate future benefits and capitalizes the income to indicate present value.[8] Finally, the property can be valued based on the owner's cost of construction or reproduction costs less depreciation.[9] Bear in mind, however, that all takings cases are unique, and the facts at issue will dictate the appropriate method by which the court will ultimately award just compensation to the property owner.

**Location, Location, Location**

During the early development and planning stages for shopping centers, the expense of due diligence and research can and will pay dividends when confronting partial takings claims in the future. In particular, standard practices should include sending public records requests to the state and local departments of transportation seeking any documents for roadways or drainage projects that may affect the property within five years. There is now a company that has an Internet-based search option for properties nationwide that will tell you if the property is slated to be affected by a government taking.[10] Additional due diligence should include consulting and reviewing government requirements, traffic studies, site access, negotiations for shared utilities, parking and common architectural plans. Through this process, shopping center owners can uncover whether the

department of transportation intends to widen contiguous roadways; whether drainage or runoff systems will need to be installed; or whether gas, electrical or telephone lines may need to be adjusted to enter the subject property.

Likewise, it is important during the early stages of development to maintain a pulse on public hearings and notices arising in the surrounding communities that may ultimately have some impact on development. By working closely with state and local officials, you can understand their methodologies related to future development and forge relationships that will promote transparency and access to information-sharing.

In addition, when reviewing subdivision controls and zoning ordinances, recognize that there are certain red flags that may increase the likelihood of encountering partial takings issues down the road. Avoid parcels that require severing environmentally sensitive areas or areas with partial property rights due to oil, gas and mineral deposits, as these may ultimately evolve into a takings claim in the future.[11] Upon selection of a parcel, ensure that the site plan for development delineates all structures, buildings and allocations for parking. If the development is to occur in stages, maintain consistency throughout the plans and identify the costs involved at each phase. And of utmost importance, always submit these site plans and associated financial allocations to the local government in order to put them on notice of your actions and financial undertakings.

In the context of partial takings that occur during the initial development stages of shopping centers, the condemning authority will want to pay as little compensation as possible and may likely challenge the owner's purported use and damages arising therefrom as "speculative." However, by detailing the affirmative steps undertaken to make future plans a reality, property owners can substantiate their damages claim.

**No One Has Ever Said, "This Shopping Center Has Too Many Good Parking Spaces"**

Have you ever heard anyone complain about a business having too many good parking spaces? Obviously, the answer is no. In fact, for shopping centers in which customers can visit multiple stores in one trip, there is a strategic advantage in the allocation of parking for both businesses and customers alike. When the government takes a portion of a parking lot, damages are calculated based not just on the number of parking spaces that are lost, but the quality of those spaces in proximity to the main entrance. In such instances, the initial amount offered by the condemning authority to settle a partial taking is by no means likely to reflect the inherent value of those parking spaces to the bottom line. It may be necessary to hire an engineer to prepare "before" and "after" parking plans to demonstrate the loss of parking and its impact on traffic flows. Also, by obtaining an accredited appraiser to review business records and interview business owners, an accurate

amount of damages can be properly quantified. Without question, convenience and customer perception increase the proper amount of just compensation guaranteed under the Fifth Amendment.

In takings cases, the loss of parking spaces is calculated as “severance damages.” Severance damages in most states are calculated by using the “before” and “after” test, which determines the reduction in the value of the remaining property after the partial taking has been effectuated.[12] In addition to the value of the parking spaces lost through the partial takings, the measure of severance damages may also take into consideration whether the remaining number of parking spaces renders the subject property nonconforming with local land development regulations or the applicable zoning code. While a nonconforming shopping center will not be subject to an immediate destruction of the property or cessation of business, the nonconforming nature of the property will reduce its overall market value. While many local governments have “savings clauses” that allow nonconformities created by government takings to be treated as legally nonconforming under the land development codes, this does not benefit the property owner in the long run. Specifically, if the property is ever damaged as a result of fire, windstorm, flood or other casualty and must be rebuilt, all nonconformities must be corrected and the property must be brought into code compliance at the property owner’s expense. “Legally nonconforming” under these types of savings clauses is not necessarily the same as “legal,” and the condemning authority may be required to pay for the nonconformities it has created. Furthermore, if the lease agreement provides that a certain number of parking spaces will be available to customers of a lessee’s business, a shopping center lessor may be in violation of its lease. Consequently, a lessee may be entitled to a reduction in rent or an early termination of the lease.[13]

In anticipation of such issues, all lease provisions addressing the occurrence of a partial or total taking should be unambiguous and consistent with the applicable state laws at the time of execution, renewal and extension. For leasehold interests valued on the basis of fair market rent, the failure to express criteria for the treatment of condemnation may be fatal to a lessor’s ability to defend against litigation by a lessee addressing rental rate or lease termination arguments. Additionally, the owner and tenants will want to cooperate as soon as notification of a proposed taking is received, and well in advance of the actual taking, in order to ensure that both parties receive the full amount of just compensation to which they may be entitled.

**Conclusion**

At one point or another, shopping center owners are likely to encounter a partial taking from their local condemning authority. Nevertheless, by staying up to date on state and local government events and maintaining accurate and current lease provisions with lessee businesses, shopping center owners can stay ahead of the curve and protect the value of their business and property.

**Michael Geibelson** is the managing partner of Robins Kaplan LLP's Los Angeles, CA, office, where he represents retailers in real estate, unfair competition and class action matters.

**Michael R. Whitt** is board certified in business litigation and practices from Robins Kaplan's Naples, FL, office; he has over 30 years of experience in eminent domain and other real estate and business litigation matters.

**Michael A. Price** formerly practiced from Robins Kaplan's office in Naples, FL.

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[1] See *Horne v. Dep't of Agric.*, 135 S. Ct. 2419 (2015).

[2] See *Demeter Land Co. v. Florida Public Service Co.*, 99 Fla. 954, 128 So. 402, 430 (1930) (quoting *Boyd v. C. L. Ritter Lumber Co.*, 89 S.E. 273, 279 (Va. 1916)).

[3] *Kelo v. City of New London*, 545 U.S. 469 (2005).

[4] Ibid at 484.

[5] See *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984).

[6] See Julius L. Sackman, *Nichols' The Law of Eminent Domain* § 12B.14 (rev. 3rd ed. 2001); The Florida Bar, *Florida Eminent Domain Practice and Procedure*, § 9.62 (9th ed. 2014); *Unified Sch. Dist. No. 365 v. Diebold* (In re Acquisition of Prop. by Eminent Domain), 299 Kan. 37, 48 (Kan. 2014) (internal citations omitted).

[7] *Central Valley Gas Storage, LLC, v. Southam*, 11 Cal. App. 5th 686, 691, 2017 Cal. App. LEXIS 431, *7, 2017 WL 2001667 (Cal. App. 3d Dist. Apr. 19, 2017).

[8] *Columbia Gas Transmission, LLC, v. An Easement to Construct, Operate & Maintain a 20-Inch Gas Transmission Pipeline Across Props.*, 2017 U.S. Dist. LEXIS 56520, *6 (W.D. Pa. Apr. 13, 2017) (citing *United States v. 275.81 Acres of Land*, 2013 U.S. Dist. LEXIS 34416, *26, 90 Fed. R. Evid. Serv. (Callaghan) 1174, 2013 WL 989956 (W.D. Pa. Mar. 13, 2013)).

[9] *State Dep't of Highways v. Mahaffey*, 697 P.2d 773, 775, 1984 Colo. App. LEXIS 1384, *6 (Colo. Ct. App. Aug. 30, 1984); *Denver Urban Renewal Authority v. Berglund-Cherne Co.*, 193 Colo. 562, 568 P.2d 478 (Colo. 1977).

[10] Impact Check, LLC (Georgia); www.impactcheck.com.

[11] "APA Policy Guide on Takings," American Planning Association, April 11, 1995.

[12] See, e.g., *Utah Dep't of Transp. v. Jones*, 694 P.2d 1031, 1033 (Utah 1984); *Mulkey v. Division of Administration, State of Florida, Dep't. of Transportation*, 448 So.2d 1062 (Fla. 2d DCA 1984).

[13] *Yazoo Properties v. Katz & Besthoff No. 284*, 644 So. 2d 429, 1994 Miss. LEXIS 498 (Miss. Oct. 13, 1994).

# Creative Ways to Draft and Use ADR Clauses

Gary S. Saltzman and David K. Taylor

An unresolved business conflict will be resolved one way or another. Traditionally, the parties resort to filing a lawsuit. The use of alternative dispute resolution ("ADR"), such as nonbinding mediation and binding arbitration, has swept through the legal and business fields. Many state and federal courts mandate mediation prior to trial. These courts also favor arbitration and generally enforce arbitration clauses. Many businesses and organizations, including the federal government, pledge to use ADR to resolve disputes. Like any other method of dispute resolution, there are advantages and disadvantages to using ADR.

**Issues With Litigating Real Estate Disputes**

There are many problems associated with resolving real estate/landlord/tenant disputes using the conventional means of filing a lawsuit in the county where the property is located.

*Costs of Litigation*. Going to court is expensive and time-consuming. Settlement often takes place on the courthouse steps after the parties have incurred the majority of the costs of litigation. Under most state laws, unless there is an attorney fee provision in the contract, such expenses are not recoverable. A company may win the battle in court but lose the war when, after subtracting the fees and expenses spent on a litigated case, the bottom line is a "net zero" recovery. There are many horror stories where the attorney fees and expenses incurred by all sides to a dispute far exceed the amounts at stake.

A business must also consider—and managers and owners frequently do not consider—the substantial "soft costs" of litigation. This fact is also sometimes not fully understood by counsel. Time is money. In any lawsuit, management and other key employees must give—and spend—a considerable amount of time in the dispute in educating lawyers and being deposed, all of which disrupts normal business operations. The simple fact is that being accused of fraud or breaching a contract has a psychological impact on the company. One client said it best: "While only 1 percent of my deals have ended up in a lawsuit, that one deal cost me 75 percent of the profit I made on 90 percent of the successful deals, and lots of lost sleep."

*Publicity and Public Filings*. Litigation can damage reputations and help competitors. Court filings are public record, and one cannot "un-ring" a bell. While the filing of a lawsuit—even if frivolous—may make the front page of the newspaper, the dismissal of that claim a year later may not be reported. All filings in court, and transcripts of testimony at trial, are open to any competitor seeking a competitive edge or inside information. In a case involving a claim for lost profits, for instance, the business making the claim must open up its financial books and records in the discovery process. Protective orders offer ways to limit access to confidential information, but sometimes the information leaks out to the public.

*Time*. Depending on court dockets, some lawsuits take years to get to trial, and then, even after a trial, the party has an automatic right to appeal, which may take another two or three years. Federal courts must give deference to criminal trials. Consequently, any smart lawyer can make the other side wait a considerable amount of time before getting before a judge—which in some circumstances may be exactly what the client intended. There are many instances where an otherwise solvent defendant has been able to delay a final hearing, and by the time a judgment has been rendered, that company's assets are gone, or a bankruptcy has been filed.

*Unpredictable Results*. There is no way to predict what a judge or jury may do in a civil case—much less a complicated commercial real estate dispute. If the case involves complex facts or expert testimony, there is a potential for the jury, and even the judge, to get confused and render an unfair judgment. It is also difficult, in the short time of a trial, to educate the jury and judge about the particular subject matter of the dispute. Any time a business places a substantial legal dispute—especially where the outcome of the business may be at stake—in the hands of a judge or jury, it is gambling on the outcome.

**Mediation**

Mediation is the fastest-growing method of dispute resolution. In mediation, the parties hire a neutral third party (a mediator) to help them negotiate a face-to-face settlement. Mediation is confidential and not open to the public. Statistics show that 85 percent of all disputes submitted to mediation settle. Mediation can be set up in a matter of weeks and normally does not take more than one business day. Mediation can take place at any time, before or after a lawsuit has been filed, and there is no need to obtain court approval. The process also may or may not involve lawyers.

The role of the mediator is much different from that of an arbitrator or a judge. The mediator does not make or impose a decision. The sole purpose of mediation is to attempt to negotiate and get the parties to agree to a settlement voluntarily. Mediation is most effective when both parties have a

genuine interest in settlement and have a history of cooperating with one another—and when the disagreement has not escalated to the point of real animosity. Furthermore, the solutions sought in mediation can be business solutions and not strictly legal solutions.

**Binding Arbitration**

Binding arbitration is where the dispute is decided by an impartial (third) person or panel of three individuals chosen in advance by the parties. When parties agree to arbitrate a dispute, they forego enforcing their legal rights, choosing instead to rely upon the arbitrator's sense of fair play. The arbitrator(s) is usually someone with knowledge and expertise in the field being disputed. Legal considerations in arbitration will not be disregarded entirely, but the procedural and evidentiary rules specifically followed in the courts are not employed unless the parties agree otherwise. Accordingly, it is almost impossible to appeal an arbitration decision.

The decision to place an arbitration clause in a contract, or to agree to arbitrate a claim after a dispute has arisen, is a vital business decision. As stated above, many fields, such as construction and securities, have determined that binding arbitration is a better method of dispute resolution, and incorporate arbitration clauses in their "form" contracts (such as the AIA form documents for construction). It is important for businesses making this decision to fully understand the pros and cons of arbitration. Some considerations for binding arbitration are as follows:

*Predictability*. The most frequent complaint of litigation is that judges or juries do not understand complicated business disputes, which often leads to unpredictable and unsatisfactory results. There can never be any real answer to why a jury or judge ruled the way it did in a case. Arbitration employs a third-party neutral or neutrals who have extensive experience and knowledge in real estate. Arbitrators do not have to be lawyers. This characteristic of arbitration can eliminate the substantial problems and costs of educating a judge or jury in the nuances of a specified business field. Properly selected arbitrators are able to understand and focus on the most relevant issues in the dispute, and are not easily swayed by a lawyer's emotional arguments. Moreover, there is considerably less formality in an arbitration hearing. For instance, strict adherence to conventional rules of evidence and procedure are not followed. Instead, the focus is on the facts and testimony and not any archaic rule of evidence.

*Time*. Because there is no need to rely on a crowded court docket, even when millions of dollars are at stake, arbitrations can normally be set for hearing in a matter of months, not years. In addition, it is almost impossible to appeal an arbitration award, and so finality is the rule rather than the exception. The luxury of being able to schedule a hearing and have a dispute resolved quickly benefits all parties.

*Costs*. In most cases, the costs and expenses of arbitration are much less than litigation. Since litigation is most often criticized for the abuse of pretrial discovery (i.e., scores of unnecessary depositions), it is significant that, with a few exceptions, depositions are not allowed in arbitration. In most arbitrations, the absence of prehearing motions and depositions, as well as the finality of the decision, significantly reduces attorney fees and costs. The normal rule is that one day of arbitration equals two to three days in court, again saving money for both parties. Arbitration also avoids the prolonged personal involvement of crucial officers and employees of a company in depositions and discovery planning conferences, which takes away from the pursuit of other business.

*Privacy*. Unlike the public court system, arbitration is typically private and confidential. The proceedings are not subject to the requirement for openness and accessibility of proceedings of civil litigation. Arbitrators and mediators maintain the privacy of the hearings unless some law provides to the contrary.

Arbitration and mediation are not panaceas, and in some instances parties are better off in court. However, businesses should address with their lawyers whether or not they want to place ADR clauses into their contracts, and they should know about the availability of ADR in the event a legal claim arises. Finally, any lawyer advising a company should, as an ethical requirement, advise a client that there are, in fact, alternatives to litigation. If the dispute can be resolved through ADR, clients can be assured of proceedings that will, in most instances, be faster, more confidential, more predictable and less expensive than litigation.

**Drafting Nonstandard Arbitration Clauses**

ADR is purely a contractual matter. The parties are free to determine not only what controversies can be submitted to arbitration, but the procedures and guidelines for the arbitration. The drafting goal is to achieve clarity. In any "nonstandard" ADR provision, the last thing any drafter wants is to create a sea of "mini-litigation" over the provision itself or the scope of the particular matters the parties intended to arbitrate. While considering arbitration, it is essential to be generally familiar with the terms of the Federal Arbitration Act (FAA), 9 U.S.C. § 1-8, and any state version of the FAA.

**What Procedural Rules Should Apply?**

Most arbitration clauses incorporate by reference the rules and procedures of administrative agencies such as the American Arbitration Association (AAA). These groups offer ADR administrative services, including a roster of mediators/arbitrators and specific rules and procedures, although there can be considerable differences among agencies in their rules. The primary point is that an arbitration clause should never be agreed upon without reviewing the actual rules that will apply if a

dispute occurs. For example, after telling a client that an advantage of arbitration is the unavailability of discovery, especially depositions, it would be embarrassing to discover that the rules of the agency specifically allow full-scale discovery.

There is currently a tendency among some lawyers to agree to "private" arbitration, even if a clause references a certain agency, without going through such an agency. They argue that counsel should be able to agree on an arbitrator and even use the procedural rules of an agency. Thus, avoiding possible delay and the costs involved with an agency-administered hearing. However, agencies such as the AAA offer many services, not the least of which is the designation of a case manager for the dispute and a nationwide panel of trained arbitrators in the particular field that is involved.

**Scope of Issues to Be Arbitrated**

The parties may agree to arbitrate all disputes or only some disputes arising under a contract or relationship. For example, in the context of a lease, while a landlord may wish to arbitrate certain disputes, it probably wants the ability to file an eviction action. Parties may also limit arbitration to disputes over a certain dollar amount. Most standard arbitration clauses have been consistently held to be broad enough to encompass all disputes arising out of a contract, including tort claims and claims related to contract formation issues. Accordingly, if the parties wish to limit the types of disputes that will be decided by arbitration, the clause must be very specific because any doubt will be resolved in favor of arbitration. Failure to be specific when an attempt is made to limit the issues to be litigated simply invites litigation, especially for one party that may be desperately trying to delay some type of final decision.

**Location of the Hearing**

An ADR clause can provide for the location of the mediation or arbitration hearing. The FAA provides that "unless otherwise provided by the agreement," the arbitrators designate both the time and location of the hearing. Most agreements do not specify the location, but rely on the rules of the referenced agency. The choice of location can be a significant strategic advantage, especially if the parties are located in different states. An arbitration provision can state that the arbitration shall take place not at the site of the dispute, but at the home office of one party. In such circumstances, while the dispute or project may arise in another state, one party will be forced to arbitrate in the home state or city of the other party. The locale gives jurisdiction to that party's courts to enforce or rule upon the ADR clause.

**Selection and Qualifications of Arbitrators**

The FAA provides that if the agreement does not provide a method of appointment, or if the agreed-upon method fails, the court may, upon application, appoint an arbitrator. The method for appointment should be agreed upon in advance because it is difficult, if not impossible, to obtain agreement on such a fundamental issue after a dispute has arisen. The methods parties may use to select arbitrators are only limited by the parties' imagination. For instance, they may select in advance a single arbitrator by agreement. They may decide to allow each side to appoint an arbitrator, with the third arbitrator to be a neutral decision-maker selected by the other two arbitrators. By incorporating into the contract the rules of an administrating agency such as the AAA, the parties agree to have the entire selection process performed by that agency, which has a prequalified panel of potential arbitrators. Some parties agree in advance on arbitrator qualifications. The qualifications may be as simple as requiring a certain experience level or as complex as requiring a multiple panel with each arbitrator from a particular profession. In situations that may involve the interpretation of contracts, for instance, it is recommended that a retired judge or attorney be included on any panel. If the arbitration involves complex technical issues, one suggestion is to provide for selection of one attorney and two other arbitrators with the requisite technical expertise.

**Prehearing Discovery**

The most frequently cited difference between arbitration and litigation is that, absent some agreement to the contrary, the parties are not entitled to prehearing discovery, such as depositions and interrogatories. This rule is somewhat misleading because most state arbitration acts provide for "prehearing" discovery on specified grounds, with the arbitrator's consent. Of course, the parties may always agree to conduct full-scale discovery, using all of the pretrial tools associated with litigation. As a practicality, the parties informally agree to conduct limited pretrial discovery. However, some commentators and practitioners of ADR believe in preserving the right to conduct limited discovery. In some instances, especially if the stakes are very high, the parties may not want to go into a binding hearing with little substantive knowledge of the testimony of fact and expert witnesses. The clause can also provide for more limited discovery, such as the identification of expert witnesses and the agreement to allow experts to be deposed.

**Evidentiary Standards**

Most attorneys dealing with arbitration for the first time are shocked to learn that an arbitrator need not comply with the rules of evidence. However, it is inevitable that evidentiary disputes arise. One option is for the parties to provide expressly by agreement for the application at the hearing of the Federal Rules of Evidence. If such a clause is included, however, it is vital that one or more attorneys serve on the panel. Another disadvantage is that adherence to such rules takes away from the informality of the hearing itself, as well as substantially increases the costs of arbitration. In practice,

arbitrators usually agree to hear any and all evidence, because one of the few statutory grounds for vacating an arbitration award is that the arbitrator refused to hear evidence material to the controversy.

**Conclusion**

The bottom line is that ADR is not a panacea for all that ails the “regular” legal process when dealing with commercial disputes. However, ADR should always be considered when negotiating any contract, or even after a dispute has arisen. In the majority of instances, parties can get to a faster, more efficient and fair result by using some form of ADR.

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**Gary S. Saltzman**, B.C.S., is a shareholder in Gray Robinson, P.A., Orlando, FL.

**David K. Taylor** is a partner in Bradley Arant Boult Cummings, LLP, Nashville, TN.

# What to Do When a Tenant Does Not Want to Open or Operate Continuously

Daniel J. Villalpando

When negotiating shopping center leases, landlords sometimes come across tenants that have enough bargaining power simply to say "no" when they are told that they will be expected to open for business and operate continuously for the full length of the term. For these tenants, if they have, for example, overexpanded by signing too many leases and are unable to mobilize by the date rent is supposed to start, it may be sensible *not* to open for business (and pay the cost to hire staff and fully merchandise the store), despite the fact that the obligation to pay rent will commence. Those tenants will not want the fact that they failed to open by a certain date to be a default under their lease.

In addition, it may make economic sense for tenants whose sales are not meeting expectations to close for business and continue paying rent, rather than pay the additional costs associated with running the store (payroll, merchandise, advertising, etc.). Tenants that are not willing to agree to operate continuously sometimes argue to the landlord that their primary obligation should be to pay rent on a monthly basis and that closing shop should be immaterial to the landlord as long as the rent is paid. Apart from arguing that those tenants may generate foot traffic for other merchants and that a shopping center with a lot of empty spaces will likely be less attractive to shoppers than one that is fully leased, what should a landlord do to protect itself if an otherwise attractive tenant insists on not being required to open or operate, or, put another way, on the right to be able to go dark?

**Suggested Options**

*Delay the Application of Remedies for Failure to Open*. Many leases provide that the tenant is required to open and that rent will commence a certain number of days following the delivery of the premises to tenant. This option will give the tenant time to prepare the store for opening. If a tenant balks at the potential for a default if it is not open within, for example, 90 days following delivery of the premises, a landlord may agree to allow more time before a tenant is deemed to have breached its lease. Sometimes, an additional 30 or 60 days will give a tenant that is willing to open some

comfort that it will not be in default early in the term if it misses a required opening date. Of course, the landlord will want the rent to commence, notwithstanding the grace period for the tenant to open.

*Require the Tenant to Open at Least for One Day*. Although the tenant may not agree to operate continuously, it should agree to open for at least one day, fully fixturized, staffed and stocked with merchandise. This may not seem like much, but a tenant that is required to spend the time and money to get a store in a position to open and operate, even for one day, is probably less likely to close after opening its doors, at least for awhile.

*Make Sure the Tenant Is Required to Perform All of Its Other Obligations Under the Lease*. Even if it gives up on requiring the tenant to be open continuously, the landlord should make sure that the tenant is still obligated to perform its other obligations under the lease, regardless of whether or not the tenant's store is open for business. Paying rent (including operating costs, taxes and insurance) is an obvious requirement, but the tenant should also be obligated to perform its maintenance obligations under the lease. Though their premises may be closed, they should not look shoddy or run down from the exterior, which could potentially drive away customers from the remainder of the shopping center. Also, it makes sense to allow a tenant to go dark only if it is not then in default of its other obligations under the lease. The right to close should be viewed as a benefit to the tenant and should only be exercisable if the tenant is, for example, current on its rent.

*Give the Landlord the Right to Recapture the Premises*. One general rule that landlords should try to live by is that for a landlord, it is of utmost importance to "control the real estate." With that in mind, a savvy landlord will want to negotiate the right to recapture the premises (essentially, to terminate the lease with the tenant) if the tenant is closed for business for an extended period of time (i.e., 60 days or more). The landlord's recapture right should be ongoing, unless the tenant reopens for business. The landlord will most likely exercise its recapture right only if it has another viable tenant, or thinks it can quickly find one. The amount of time a tenant needs to be closed before the landlord can recapture is negotiable, but a basic recapture right should be a starting point in the negotiations. The right to recapture is also a viable option in the event that the tenant will not agree to open for business even for one day. At some point, it may make sense for the landlord to terminate a lease where the tenant has not opened, even if that tenant is paying rent. In that case, if the tenant has not opened for business for (for example) 180 days or more, the landlord may want the right to take back the space and work on a deal with a new tenant who will open and help generate the foot traffic in the shopping center.

If a landlord is able to get a recapture right following a tenant's opening for business, it may also want to negotiate for the reimbursement of certain costs if it elects to exercise its right to take back the tenant's space. For example, a landlord may spend a significant amount of money on leasing

commissions to secure the tenant and agree to provide the tenant with an improvement allowance so that the tenant is able to build out the space to its current specifications. If a tenant elects to go dark early in the term and, in turn, the landlord recaptures the premises, it is reasonable for the landlord to seek the unamortized value of the leasing commissions and improvement allowance from the tenant to attempt to make itself whole. The landlord will likely need to spend additional money on leasing commissions and tenant improvements in the course of negotiating a new lease for the premises vacated by the original tenant. In addition, if the tenant knows that it will be required to pay out of pocket if it elects to close its doors and the landlord recaptures the space, it may think twice before shutting down. While not intended to be punitive in nature, such a repayment obligation may be a deterrent to a tenant considering exercising its right to go dark.

*A Tenant's Right to Go Dark Should Not Affect the Economics of Your Deal*. A tenant's right to close for business may seem innocuous enough, but it could have far-reaching effects on other sections of the lease. For example, if the tenant has the right elsewhere in the lease to pay modified rent (e.g., 5 percent of its gross sales in lieu of contract rent) because of a landlord misstep due to a co-tenancy failure or failure to adequately maintain a critical component of the shopping center, the tenant's rent may go down to zero, because a closed space generates no gross sales. In this case, the landlord will want to come up with an alternative "modified rent" mechanism to make sure that the tenant is obligated to pay rent even if it is closed for business. This type of potential pitfall could have a dramatic impact on the landlord's bottom line and the landlord's leverage against a tenant who has gone dark, and thus should be carefully considered.

The foregoing addresses what a landlord should do if it has to grant a tenant the right either not to open or, once opened, to go dark in order to get a lease signed. Of course, the starting point for the landlord would be a requirement that the tenant open and operate continuously throughout the lease term (subject to industry standard closures for holidays, casualty, condemnation, etc.). However, if a tenant insists on the right either not to open or, once open, to close for business, the landlord should try to address as many of the foregoing issues as possible in the letter of intent stage (optimally), or in the lease itself.

**Conclusion**

This article discusses just a few basic points that arise in retail lease operating covenant negotiations. There are other nuances and complications that may arise in this context, and both landlords and tenants would be wise to contact experts in navigating these issues.

**Daniel J. Villalpando** is a partner in the Los Angeles, CA, office of Cox, Castle & Nicholson LLP. His practice focuses on retail development and commercial leasing. He specializes in the representation of commercial developers in connection with all aspects of shopping center development, including the acquisition and disposition of commercial real estate and the negotiation and drafting of development agreements, reciprocal easement agreements, declarations and major tenant leases.

# Maximizing Privilege in Canada

Martin Sheehan and Marcelo Ciecha

Together, solicitor-client privilege and litigation privilege can shield a vast array of documents and communications from outside access. However, it is not always clear whether privilege applies. And when it does, it is possible to waive the applicable privilege without even knowing it. Understanding the rules that govern the existence and waiver of these two types of privileges can help to ensure that they are used to their best and maximum effect in any legal matter arising in Canada.

**Solicitor-Client Privilege**

Although Canada contains both common law and civil law systems, the common law notion of attorney-client privilege is applied in both systems.[1] For decades now, solicitor-client privilege has been a principle of fundamental justice and a protected constitutional right[2] whose purpose it is to ensure that those seeking legal advice can do so in full confidence.[3]

In Quebec, Canada's only civil law province, the Quebec Charter and the Professional Code provide protection for communications between individuals and all professionals.[4] While the solicitor-client privilege is an offshoot of this more general protection, its protection is wider in scope and greater in intensity due to the nature of the lawyer's duty, the services they are called to render and the sensitivity of the information they handle.[5]

In the common law provinces, no similar protection exists for professional secrecy, such that lawyers and health care professionals, under certain circumstances,[6] are the only professions that benefit from privileged communications. The solicitor-client privilege is triggered where a communication is made:

1. in the context of a solicitor-client relationship,
2. in the course of a request for, or the provision of, legal advice and
3. where it is intended to remain confidential.

On the one hand, each individual communication must satisfy the three abovementioned criteria,[7] yet communications that do not specifically request or provide legal advice may nevertheless be considered privileged if they are part of a continuum of information that must be exchanged in order for legal advice to be sought or given.[8]

On the other hand, where the focus of the communication between a lawyer and a client is not the request for legal advice or its provision, such communication will not be protected. Indeed, it is not the fact that a person is party to the communication as a result of being legal counsel that gives rise to the privilege, but the context in which the communication occurs.[9] For example, solicitor-client privilege does not protect communications with legal counsel if they pertain exclusively to business matters.

Moreover, no action need be taken to create the privilege; it simply exists if the conditions for triggering it are met.[10] The privilege exists for the client's benefit, to protect his or her information, with the lawyer merely being its gatekeeper.[11]

**In-House Counsel**

The question of whether privilege applies is more complex when it comes to the work of in-house counsel, as opposed to private practitioners. Clients of in-house counsel have the same rights as those of private practitioners, and in-house counsel have the same obligations as private practitioners when it comes to protecting their client's information.[12] However, the subject matter of in-house counsel communications is more ambiguous than that of private practitioners because they frequently assist in many purely business matters.

The Supreme Court of Canada has stated that not everything done by in-house counsel is protected by solicitor-client privilege.[13] There is a presumption that over the course of a long and complex mandate between a lawyer and his or her client, all communications exchanged between the two are confidential in nature.[14] However, such a presumption could be rebutted by the party seeking access to such communications by demonstrating that the information sought is not covered by privilege or that the privilege should not apply under the given circumstances.[15]

In fact, any communications exchanged between lawyers and members of the organization in which they work regarding matters outside the solicitor-client relationship are not protected. Due to the nature of the work performed by in-house counsel, each claim of privilege must be analyzed separately, depending on the relationship between the solicitor and the client, the subject of the counsel sought and the circumstances surrounding the advice.[16]

For instance, the working papers and notes directly related to the request for legal advice or its provision are covered by solicitor-client privilege.[17] However, where a lawyer provides counsel on purely business matters, the communications exchanged in such a context are not protected by solicitor-client privilege.[18] Under those circumstances, an in-house counsel can justifiably be called upon to bear factual testimony.[19]

It is also noteworthy that the mere presence of a lawyer at a meeting will not result in rendering privileged the entirety of what is said during the meeting. Rather, privilege will attach only to those portions of board meeting minutes that record the lawyer's advice.[20] In addition, it has been held that categorically submitting copies of documents to a lawyer in order to shield the information contained in such copies is not an acceptable practice.[21]

In a recent administrative decision, a lawyer was hired by a municipality to be its clerk, manage the release of information to the public and ensure proper functioning of the municipality's office. He was not hired as a lawyer, but he did occasionally provide legal opinions. Plaintiffs sought access to all emails sent by the clerk internally with regard to their municipal taxation file. In this decision, the tribunal sifted through the emails in order to determine which contained legal opinions and which did not, the former being protected by solicitor-client privilege, while the latter were not.[22]

With regard to investigations, it should be noted that a fact-finding report and its supporting documentation will only be covered by solicitor-client privilege if it contains legal advice.[23] It is not because of the person's profession that their investigation and reporting of facts that could have been done by another person should be covered by solicitor-client privilege. On the other hand, a third-party report whose primary purpose was to assist in giving legal advice has been determined to be covered by solicitor-client privilege.[24]

**Litigation Privilege (Attorney Work Product)**

In addition to their inevitable overlap, the similarities between solicitor-client privilege and litigation privilege have resulted in some confusion. However, the Supreme Court of Canada clarified in 2006 that whereas solicitor-client privilege applies to a relationship, litigation privilege aims to protect the very process of adversarial litigation by creating a figurative protected area that will facilitate the investigation of the case for each side.[25] Moreover, litigation privilege is limited in time. When the litigation ends, so too will the privilege, while solicitor-client privilege has no temporal limitation. Lastly, the protection of litigation privilege covers all documentation related to pending or apprehended litigation, regardless of who created it, whom it is intended for or whether it is otherwise considered confidential.[26]

The Supreme Court indicated that to benefit from litigation privilege, a document must be created for "the dominant purpose of litigation."[27] But the existence of such purpose must be analyzed on a case-by-case basis.

In one case, a Quebec Court determined that notes taken by an employer while conducting an investigation prior to the dismissal of the person being interviewed was indeed covered by litigation privilege, even if there was no litigation at the time, due to the fact that litigation was feasible or foreseeable.[28]

In a recent real estate matter, a land developer was required to surrender to the City a part of the land on which its project was to be developed so that the City could build a park on it. The City, however, decided that the surrender of a retention pond did not count as land on which a park could be built. During preliminary examinations, a representative of the City referred to notes taken regarding the file from its start until the decision by the City to refuse to consider the lot containing the retention pond as suitable. As it was not demonstrated that such notes were taken at a time when the City could reasonably consider that litigation would ensue, the notes were considered not to be covered by privilege.[29]

This last case follows the principle that documents prepared by employees in the normal course of their duties do not satisfy the abovementioned dominant purpose criterion, since they had an independent usefulness before litigation commenced.[30]

Lastly, the Alberta Court of Appeal recently determined that where an employer has a statutory duty to conduct an investigation following a workplace accident, it cannot simply throw a blanket over all documents related to the investigation and claim privilege. Rather, the court approved the trial judge's use of a referee to determine the dominant purpose of each document in order to assess the claims of privilege.[31]

**Waiver**

Solicitor-client privilege and litigation privilege can be waived explicitly or implicitly. As an example of the latter, invoking only a part of a report that is otherwise covered by solicitor-client privilege may nevertheless result in a waiver. Such was the recent decision of an arbitrator in British Columbia, who found that an employer who retained the services of a lawyer to conduct a workplace investigation voluntarily waived the applicable privilege when it invoked the conclusions of the report in a related proceeding.

Both parties relied on a previous ruling by the current Chief Justice of the Supreme Court of Canada, who specified that while a waiver must be voluntary, it may also occur in the absence of an intention to do so, "where fairness and consistency so require."[32] On the basis of this logic, a party will be considered to have waived privilege where it justifies its position by pointing to legal advice it obtained or a report that supports its position. Indeed, it would not be fair for a party to make a claim based on certain information, while invoking privilege with regard to that same information.[33]

However, where an employer's representative makes a reference to the existence of notes taken while interviewing an employee who would later be dismissed, but does not actually look at the notes during his examination, the court determined that litigation privilege was not waived.[34]

The Supreme Court of Canada has also clarified that the mere presence of a third party does not entail a waiver of confidentiality when the clear intent was for confidentiality to be maintained by that third party.[35] For instance, the presence of translators who act as conduits of advice and instructions does not affect the privilege insofar as it already existed.[36]

In the context of in-house counsel, it has been determined that the communication of a document that is covered by solicitor-client privilege to another department within the same organization does not constitute a waiver.[37] Along similar lines, where a company's in-house counsel represents both the parent and a subsidiary on a matter of common interest, the corporate entities are considered to be in a joint client relationship with the legal department. Consequently, there is no waiver resulting from the sharing of information within the group. In addition, as the privilege exists for both clients, one cannot waive it for the other in a dispute with a third party. That being said, if litigation should ensue between the two entities, the privilege is waived.[38]

**Practical Conclusions**

In light of the applicable rules regarding privilege in Canada and how they apply to in-house counsel, it is important for in-house counsel of companies doing business in Canada to be aware of when solicitor-client privilege will apply and how documents are being prepared in the normal course of business as opposed to when litigation is anticipated.

Thus, any request for legal advice and the documentation sent in support of such a request should clearly identify its purpose and the fact that solicitor-client privilege is claimed.

Legal advice provided by in-house counsel should be communicated separately from any business advice or input on any other matter. As a corollary, counsel are encouraged to identify the capacity in which they are acting in their communications.

When any internal investigation is required, it should be stated that its purpose is to prepare for anticipated litigation. If outside counsel is used to conduct the investigation, the retainer letter should indicate the type of privilege being claimed pursuant to the investigator's mandate.

During meetings, in-house counsel should consider creating separate documents for legal issues, limiting attendance to individuals whose presence is necessary and being aware of the attendance of third parties when discussing legal issues.

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**Martin Sheehan** is a senior partner in the litigation group of Fasken Martineau Dumoulin LLP in Montreal, Canada.

**Marcelo Ciecha** is an associate in the litigation group of Fasken Martineau Dumoulin LLP in Montreal, Canada.

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[1] Lyette Doré, "Le secret professionnel de l'avocat interne : regards croisés Europe-Canada-Québec," in *La Revue du Barreau*, tome 70, 2011, p. 405.

[2] Sections 7 and 8 of the *Canadian Charter of Rights and Freedoms*, *The Constitution Act*, 1982, Schedule B to the *Canada Act 1982* (UK), 1982, c 11 and article 9 of the *Quebec Charter of Human Rights and Freedoms*, *CQLR c C-12, Solosky v. The Queen*, [1980] 1 S.C.R. 821, *Canada (Attorney General) v. Federation of Law Societies of Canada*, [2015] 1 S.C.R. 401, *Maranda v. Richer*, [2003] 1 S.C.R. 456, para. 57.

[3] *Blank v. Canada* [2006] 2 S.C.R. 319, at para. 26.

[4] Article 9 of the *Quebec Charter of Human Rights and Freedoms*, CQLR c C-12, article 60.4 of the *Professional Code*, CQLR c C-26.

[5] *Foster Wheeler Power Co. v. Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.*, [2004] 1 S.C.R. 456.

[6] *M. (A.) v. Ryan,* [1997] 1 SCR 157.

[7] *Solosky v. The Queen*, [1980] 1 S.C.R. 821, p. 837.

[8] *Balabel v. Air India*, [1988] 2 All E.R. 246 (C.A.), R. c. Tate, 2016 QCCS 5046.

[9] *Maranda v. Richer*, [2003] 1 S.C.R. 456, para. 42.

[10] *Lavallee, Rackel & Heintz v. Canada (Attorney General)*; *White, Ottenheimer & Baker v. Canada (Attorney General); R. v. Fink,* [2002] 3 SCR 209, para. 39.

[11] *Lavallee, Rackel & Heintz v. Canada (Attorney General)*; *White, Ottenheimer & Baker v. Canada (Attorney General); R. v. Fink,* [2002] 3 SCR 209, para. 24.

[12] *IBM Canada Ltd. v. Xerox of Canada Ltd.,* [1978] 1 F.C. 513 at para. 9.

[13] *R. v. Campbell,* [1999] 1 SCR 565.

[14] *Foster Wheeler Power Co. v. Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.*, [2004] 1 S.C.R. 456, at para. 42.

[15] *Foster Wheeler Power Co. v. Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.,* [2004] 1 S.C.R. 456, at para. 42.

[16] *Pritchard v. Ontario (Human Rights Commission),* [2004] 1 S.C.R. 809, para. 20.

[17] *Susan Hosiery Ltd. v. Canada*, [1969] 2 Ex. C.R. 27.

[18] *R. v. Campbell*, [1999] 1 S.C.R. 565 at para. 50.

[19] Robinson c. Weinberg, 2005 CanLII 35800 (QC CS) para. 29.

[20] *Nova Scotia Power Corp. v. Surveyer, Nenniger & Chenevert Inc.* (1986), 74 N.S.R. (2d) 327 (N.S. T.D.) aff's (1987) 78 N.S.R. (2d) 217 (C.A.).

[21] *Guelph (City) v. Super Blue Box Recycling Corp.*, [2004] OJ No 4468 (QL), at para. 120.

[22] A.D. c. Joliette, 2015 QCCAI 106.

[23] Howard c. London (City), 2015 ONSC 156, at para. 69-70.

[24] *McCarthy Tétrault v. Ontario*, (1992), 95 D.L.R. (4th) 94 (Ont. P. Div.), *General Accident Assurance Co. v. Chrusz,* [1999] 45 O.R. (3d) 321 (C.A.), *Hydro-One Network Services Inc. v. Ontario* (Ministry of Labour) (2002) O.J. No. 4370.

[25] "Claiming Privilege in the Discovery Process," in *Special Lectures of the Law Society of Upper Canada* (1984), 163, at pp. 164-65, as quoted in *Blank v. Canada (Minister of Justice)*, [2006] 2 S.C.R. 319, at para. 28.

[26] *Lizotte v. Aviva Insurance Company of Canada*, [2016] 2 SCR 521, at para. 22; *Blank v. Canada* (Minister of Justice), [2006] 2 S.C.R. 319, at para. 8, 34, 35, 37, 38.

[27] *Blank v. Canada* (Minister of Justice), [2006] 2 S.C.R. 319, at para. 59.

[28] Amato c. Bofiq inc., 2017 QCCQ 4226, at para. 31.

[29] *Immobilier Veridis I inc. c. Laval (Ville de)*, 2016 QCCS 57.

[30] *Société coopérative agricole de St-Damase c. Coopérative fédérée de Québec*, 2007 QCCS 317, at para. 16–17.

[31] *Alberta v. Suncor Inc.*, 2017 ABCA 221, at para. 53.

[32] *S. & K. Processors Ltd. v. Campbell Avenues Herring Producers Ltd.*, [1983] 4 WWR 762 (BCSC), at para. 6.

[33] *R. v. Campbell*, [1999] 1 S.C.R. 565 at para. 69; Mahmud Jamal, "The Supreme Court of Canada on solicitor-client privilege : what every practitioner needs to know," *LegalTree*, February 28, 2007.

[34] *Amato c. Bofiq inc.*, 2017 QCCQ 4226.

[35] *Foster Wheeler Power Co. v. Société intermunicipale de gestion et d'élimination des déchets (SIGED) inc.*, [2004] 1 S.C.R. 456, at para. 49.

[36] *Susan Hosiery Ltd. v. Canada,* [1969] 2 Ex. C.R. 27.

[37] *Halifax Shipyard v. Minister of Public Works and Government Services* [1996] F.C.J. No. 677; *International Minerals & Chemical Corp. (Canada) v. Commonwealth Insurance Co.* [1990] S.J. 615; 89 Sask R. 1 (Sask. Q.B.); *Global Cash Access (Canada) Inc. v. The Queen*, 2010 TCC 493; *Imperial Tobacco Canada Limited v. The Queen*, 2013 TCC 144.

[38] *Archean energy Ltd. v. Canada* (Minister of National Revenue) (1997), 202, A.R. 198 (Q.B), *Fraser Milner Casgrain LLP c. Canada (Minister of National revenue)*, 2002 BCSC 1344, *Imperial Tobacco Canada Limited v. The Queen*, 2013 TCC 144.

## Professional Licensing, Lenders, Percentage Rent, Premise Liability

George J. Kroculick and Heather R. Rosser

**Landlord and Tenant**

**The Court of Appeal of Florida upheld a trial court's ruling that a prior suit for unpaid rents against a tenant in breach did not preclude a subsequent suit against the same tenant for rents that had not yet accrued at the time the judgment was issued in the prior case. *JPay, Inc., v. 10800 Biscayne Holdings, LLC,* 2017 Fla. App. LEXIS 8961, 42 Fla. L. Weekly D 1418 (Fla. Dist. Ct. App. June 21, 2017).**

10800 Biscayne Holdings ("Biscayne") leased commercial space to JPay, Inc. ("JPay") beginning in August 2007 for a term set to run until September 2015. Prior to the scheduled expiration of the lease, JPay failed to pay rent and then vacated the commercial space in February 2013. When JPay vacated the commercial space, Biscayne did not terminate the lease; instead, it held JPay in breach and re-let the space to a new tenant. Biscayne then sued JPay for overdue and unpaid rent from the time JPay vacated the space through January 2014.

In that suit, JPay unsuccessfully argued that Biscayne had terminated the lease and retaken the commercial space for its own use. Biscayne argued instead that it retook possession of the space for the account of JPay—not for its own account—and was therefore entitled to the difference between the rental amount in JPay's lease and the amount recovered through re-letting the space. The court agreed with Biscayne and, in February 2014, ordered JPay to pay the outstanding rental amount, which it did.

Subsequently, in October 2014, Biscayne sought to recover from JPay the rent that went unpaid following the court order of February 2014. Biscayne attempted to do this by filing a renewed motion for partial summary judgment, rather than by filing a new complaint. In response, JPay argued that the court lacked jurisdiction to hear the matter now brought by Biscayne, because the February 2014 order was a final one. The court agreed with JPay and struck the renewed motion for partial summary judgment. Biscayne filed a new complaint pursuing damages for the unpaid rent resulting from JPay's breach of the lease post-February 2014. JPay responded by asserting that res judicata barred this new action because the court's order in the prior case was a final judgment, thus

precluding any subsequent litigation on the same matter of unpaid rents in breach of the lease. JPay also argued that in the prior case, Biscayne had pursued accelerated lease payments, preventing Biscayne from now seeking any further unpaid rent.

The Third District Court of Appeal of Florida was not persuaded by JPay's arguments. It held that res judicata did not bar the present action brought by Biscayne because it was seeking rental payments for wholly separate monthly periods from those it had previously sought, and was awarded, in the prior litigation. For res judicata to apply, the parties to both actions must be the same, the purpose for suing must be the same, and there must have been a final judgment on the merits in the first case. While the parties in the current suit matched those in the prior litigation, the purpose for the suit was completely new. In the current suit, Biscayne was pursuing rent owed for months that had not yet passed at the time of the February 2014 order. Because the rental payments now sought had not yet accrued at the time of the final judgment in the prior litigation, Biscayne was suing for something different—namely, for a different set of monthly rents. The court thus held that res judicata did not apply and that Biscayne could rightfully bring its suit against JPay for further unpaid rents.

Regarding JPay's claim that Biscayne had sought the acceleration of rental payments in the prior litigation, the court also disagreed. To seek accelerated rent payments, a party must evince an intent to terminate the lease and retake possession of the property for itself. JPay argued that, in fact, this is what Biscayne did. The court rejected this argument, determining that Biscayne had retaken possession of the commercial space and re-let it on JPay's behalf—not for itself—with the purpose of maintaining the lease rather than terminating it. Moreover, the court noted that Biscayne unambiguously sought specific monthly rental payments in the previous litigation and never invoked any language relating to acceleration. Because Biscayne did not terminate the lease and had not previously sought acceleration, it was entitled to the rental payments it sued for in this case.

**Leases**

**The Supreme Court of Wyoming found that a provision of a lease agreement, providing that a tenant who was fitting out space in a shopping center for its restaurant had to pay for "all work" before the landlord was obligated to pay a finish allowance, required both the general contractor and all subcontractors to be paid in full. *P & N Investments, LLC, v. Frontier Mall Associates, LP,* 395 P.3d 1101 (Wyo. 2017).**

In *P & N Investments, LLC, v. Frontier Mall Associates, LP,* P & N Investments, LLC, ("P&N") entered into an agreement with Frontier Mall Associates, LP, ("Frontier") to lease space in a shopping center for a Dickey's Barbeque Pit restaurant. P&N hired CCI Builders and Developers, Inc., ("CCI") to handle the restaurant construction. As general contractor, CCI was in charge of hiring all subcontractors needed to complete the work. The lease required Frontier to pay P&N a finish allowance once "all

work" had been paid in full. The lease also required P&N to provide an affidavit to Frontier before the allowance became due, attesting that all work had been paid for and that no liens existed that were not waived or satisfied. When the restaurant construction was completed, P&N paid the general contractor, CCI, the full amount owed. P&N then gave Frontier an affidavit stating that the cost of construction had been paid in full.

After submitting the affidavit, P&N believed that it had satisfied its lease obligations and expected Frontier to pay the finish allowance. Frontier, however, refused to pay the allowance, arguing that P&N had not in fact met the lease's requirements because the general contractor, CCI, had failed to pay numerous subcontractors for work they performed on the project. P&N filed a claim against Frontier for breach of contract and unjust enrichment and asked for a declaratory judgment stating that it had fulfilled its lease obligations and that the finish allowance was due. In response, Frontier asked the court to instead declare that because numerous subcontractors remained unpaid, the lease obligations had not yet been satisfied and it did not have to pay P&N the finish allowance. The lower court granted summary judgment in Frontier's favor and issued a declaratory judgment stating that the allowance was not yet due.

On appeal, the Supreme Court of Wyoming affirmed the lower court's decision, concluding that P&N had not yet fulfilled its duties under the lease and was thus not yet entitled to the finish allowance. The court first had to interpret the language of the lease agreement, and in particular the meaning of the phrase "all work." The court determined that "all work" included the work done by the subcontractors, in addition to the work performed by the general contractor, CCI. Although P&N paid CCI the full amount due for the work, CCI had not passed that money on to the subcontractors. The court concluded that because the subcontractors had not received the payment to them, P&N had not met its obligation to pay for "all work" completed and was not yet entitled to the finish allowance. Stating that it could not "rewrite contracts under the guise of interpretation," the court maintained that the lease agreement's terms were unambiguous, and that all work would only be paid for when both the subcontractors and CCI had been paid in full. The court further noted that this interpretation of the lease was reasonable, because P&N was in a better position than Frontier to ensure that subcontractors were paid.

P&N argued that it had met its payment obligation because its contract with CCI restricted it from dealing with the subcontractors, leaving the responsibilities of organizing, communicating with and paying the subcontractors to CCI. Thus, P&N argued, when it paid CCI in full, that it had successfully discharged its duties and CCI was obligated to distribute the money owed to the subcontractors. As such, P&N maintained that its affidavit stating that it had paid CCI satisfied the affidavit requirement in the lease agreement, fulfilling all conditions precedent to Frontier paying the finish allowance. The court rejected P&N's argument, however, because the affidavit only stated that CCI had been paid in full, whereas P&N was required to certify that "all work" had been paid for. To fulfill

the affidavit obligation triggering payment of the finish allowance, P&N was required to certify that the subcontractors, and not just CCI, had also been paid. Despite P&N's arrangement with CCI with respect to payment of the subcontractors, the language of the lease was clear and provided that Frontier did not have to pay the finish allowance until the subcontractors were also paid and P&N submitted an affidavit to that effect.

Although the majority of the court ruled in Frontier's favor, two justices dissented from the decision, disagreeing with the majority's interpretation of the lease agreement and the phrase "all work." The dissenting justices wrote that the majority's ruling effectively creates an additional requirement for P&N that makes it "a guarantor under the separate contracts between CCI and the subcontractors." In their view, requiring P&N to ensure that CCI carries out its own, separate contract obligations before allowing P&N to recover its finish allowance is an unjust result. These justices believe that because P&N paid the entire amount owed for the work performed and issued an affidavit to that effect, P&N satisfied both its obligation to pay for all work and to prove that it had been paid in full.

**Lenders**

**The Court of Appeal of California determined that a lender who foreclosed on a delinquent tenant's leasehold interest and transferred that interest to a third party had not expressly assumed the lease, and was thus not liable for rent payments until the end of the lease term, when the third party surrendered the premises. *BRE DDR BR Whittwood CA LLC v. Farmers & Merchants Bank of Long Beach*, 14 Cal. App. 5th 992 (Cal. Ct. App. 2017).**

In *BDE DDR BR Whittwood CA LLC v. Farmers & Merchants Bank of Long Beach*, BRE DDR BR Whittwood CA LLC ("BRE") purchased a shopping center in Los Angeles County, California, from its original owner. An existing tenant of the shopping center, the Breckenridge Group ("Breckenridge"), had previously obtained a loan from Farmers & Merchants Bank of Long Beach ("Farmers & Merchants"), which was secured by a construction deed of trust on Breckenridge's leasehold interest. The lease agreement permitted the leasehold mortgage, but it provided that a lender who succeeded in interest to Breckenridge must assume all obligations under the lease. Within two years after obtaining the loan, Breckenridge defaulted, and Farmers & Merchants foreclosed on the leasehold interest. At the foreclosure sale, Farmers & Merchants acquired the leasehold estate.

Upon obtaining the leasehold estate, Farmers & Merchants transferred its interest to a third party, Whittier JC, LLC, ("Whittier") who became the successor in interest to Breckenridge. Five years later, Whittier ceased paying rent and gave possession of the former restaurant space in the shopping center back to BRE. As a result, BRE brought suit for breach of contract and damages against both Whittier and Farmers & Merchants. BRE included Farmers & Merchants because it believed that it was the successor in interest to Breckenridge and thus was obligated to comply with the lease terms —namely, to pay rent until the term expired in another nine years. Farmers & Merchants argued that

it never assumed the lease and was not bound by its obligations, despite the language in the lease requiring a transferee to assume all obligations. The trial court sided with BRE, however, determining that Farmers & Merchants was bound by the lease as the successor in interest to Breckenridge because the construction deed of trust and the notice of sale referenced the lease, which included language requiring the lender to assume the lease and be bound by its terms in the case of foreclosure. Farmers & Merchants appealed the judgment.

On appeal, the Court of Appeal reversed the judgment, finding that Farmers & Merchants was a mere assignee that never expressly assumed the lease obligations, freeing it from rental payment obligations once it gave up possession of the space. The court did not agree with the trial court's finding that mere references to the lease in the construction deed of trust and the notice of sale were enough to create an express assumption of the lease obligations beyond Farmers & Merchants' period of possession of the space. While in possession of the leased space, because it was in privity of estate, Farmers & Merchants was required to fulfill lease duties that included paying rent and taxes and maintaining the premises in good repair. However, once it gave up possession by transferring its interest to Whittier, Farmers & Merchants was no longer in privity of estate. Because it was not a party to the lease itself and did not expressly assume the lease obligations through "specific affirmation by the assignee to bind itself to the lease obligations," Farmers & Merchants was free from the lease obligations once it surrendered possession of the rented space. Without express assumption, no privity of contract was ever established, leaving Farmers & Merchants free from enduring lease obligations, and leaving BRE without recourse against it.

In its opinion, the court provided advice to commercial landlords like BRE that wish to avoid the result in this case. It advised landlords to require leasehold mortgage lenders, such as Farmers & Markets, to sign the lease or specifically affirm their assumption of the lease obligations when entering into a loan agreement with a tenant. By doing so, landlords will establish privity of contract with the lenders, preventing them from escaping lease obligations in case of default. The court reasoned that the landlord is in the best position to protect itself from the result in this case, and should therefore include "provisions in the lease requiring consent and assumption" of the lease by a lender. Without such provisions, commercial lenders risk an unfavorable outcome.

**Percentage Rent**

**The United States District Court for the Middle District of North Carolina held that a retail lease in which rent is based upon the sales of the tenant's business does not include an implied duty to operate such business in a commercially reasonable manner. *Holly Hill Mall, LLC, v. Sears, Roebuck and Co.*, 2017 WL 589123 (M.D. N.C. Feb. 14, 2017).**

Some 50 years ago, Sears, Roebuck and Co. ("Sears") entered into a long-term lease (the "Lease") for 65,000 square feet of space in a Burlington, North Carolina, shopping center (the "Premises"). The Lease does not require any minimum annual rent but instead requires that Sears pay to the landlord a percentage of its monthly net sales. To verify the percentage rent, Sears is to deliver to the landlord a monthly statement of net sales. Failure to deliver the statement of net sales constitutes a default under the Lease, which default may be cured by Sears within 15 days following notice of such default. If Sears fails to cure a default in a timely manner, the landlord may terminate the Lease and re-enter the Premises.

Holly Hill Mall, LLC, as successor in interest to the landlord under the Lease ("Landlord"), filed suit against Sears for breach of contract and summary ejectment, alleging that Sears defaulted under the Lease by failing to deliver the monthly sales reports for several months between 2014 and 2016 leading up to Sears's 2017 petition for bankruptcy, failed to cure such defaults in a timely fashion, failed to "direct an intensive and continuous merchandising and promotional program for its business" pursuant to the express terms of the Lease and breached the implied covenant in the Lease to operate its business in a commercially reasonable manner. Sears filed a motion to dismiss on the basis that Landlord's complaint failed to state a claim for which relief could be granted.

Landlord argued that "in every lease in which rent is based upon the sales of a business and there is no base rent, or base rent is insubstantial, there is an implied covenant to operate the business in a commercially reasonable manner" similar to the implied duty of good faith and fair dealing. As evidence of the implied covenant, Plaintiff quoted a Lease provision that states: "It is in [Landlord and Tenant's] mutual best interest to develop and maintain a shopping center which will contain a combination of merchants which…are well qualified and willing to direct an intensive and continuous merchandising and promotional program. In furtherance of such purposes, Landlord and Tenant agree…." The court was not persuaded that the language created an express or implied covenant. Without instruction on the meaning of the phrase "to operate in a commercially reasonable manner" or any supporting facts, the court found no such implied duty to operate in a commercially reasonable manner, nor did the court agree that a duty to operate in a commercially reasonable manner (whatever that might mean) is the same as the duty of good faith and fair dealing. For these reasons, the court granted Sears' motion to dismiss as to the implied covenant to operate in a commercially reasonable manner and express duty to direct an intensive and continuous merchandising and promotion program, but denied the motion to dismiss as to breach of contract and summary ejectment claims alleging the failure to provide net sales reports.

**Premises Liability**

**The Supreme Court of Wisconsin applied the common law concept of caveat emptor—buyer beware—and held that after a long-term commercial tenant terminated its lease and returned possession**

**of the space to the landlord, it owed no duty to subsequent occupants of the property, even where a condition created by the tenant led to a later injury. *Brenner v. Amerisure Mutual Insurance Co.*, 893 N.W.2d 193 (Wis. 2017).**

In *Brenner v. Amerisure Mutual Insurance Co.*, the Supreme Court of Wisconsin addressed whether a former long-term commercial tenant of property could be held liable for an injury that was caused by a condition the tenant had created but that occurred after the tenant turned over possession to the landlord and the landlord subsequently sold the property to a third party.

Before the initiation of the lawsuit, Charter Manufacturing Company ("Charter") leased property from Garland Brothers Joint Venture ("Garland") under a long-term triple net lease. Charter operated a wire manufacturing business at the property that required it to install heat treatment furnaces in a below-grade pit. In order to fit the furnaces into the facility, Charter cut holes into a metal grate floor above the space where the furnaces were located. When Charter later terminated the lease after 20 years of occupancy, Garland required it to remove the furnaces and leave the pit "in a clean and safe condition," but did not require Charter to fill in the pit. Consequently, Charter placed plywood boxes over the holes where the furnaces used to be located. Before retaking possession, Garland performed an inspection of the property and signed a release agreement, agreeing that Charter had surrendered the property "in the physical condition required under the Lease."

After retaking possession of the property, Garland entered into an agreement to sell the property to Milwaukee World Festival, Inc. ("MWF"). As part of its due diligence, MWF performed multiple inspections of the property. Apparently satisfied with its condition, MWF completed its purchase of the property and hired a construction company to perform demolition and renovation work. One of the construction company's workers, Russell T. Brenner, was working near the plywood boxes that Charter had left on the property. Without knowing that there were holes beneath them, Mr. Brenner removed one of the plywood boxes and fell through a hole, suffering injury.

Mr. Brenner sued MWF, Garland and Charter, seeking damages resulting from his injury, claiming that the defendants were negligent and violated state safe-place statutes. Brenner argued that Charter was liable, despite not having possession of the premises, because it concealed or failed to disclose to MWF the existence of the holes beneath the plywood boxes. On summary judgement, however, the trial court applied the doctrine of caveat emptor, or buyer beware, and dismissed both Garland and Charter from the case. MWF appealed Charter's dismissal, seeking to decrease its liability for Mr. Brenner's injury by shifting some of the responsibility onto Charter. The appeals court affirmed the lower court's ruling, emphasizing the applicability of caveat emptor, and MWF petitioned the Wisconsin Supreme Court for review.

On review, the Supreme Court of Wisconsin affirmed Charter's dismissal from Mr. Brenner's suit, finding that Charter owed no duty to Mr. Brenner or to any parties who may be injured on the premises after Charter had terminated its lease and given up possession of the property. MWF attempted to argue that as a long-term tenant, caveat emptor should not apply to Charter. The court disagreed, however, stating that the doctrine of caveat emptor insulates a vendor of land from liability for injury to anyone on the premises after the vendor has transferred possession of the land to a vendee. As a long-term tenant with exclusive possession of the property, Charter was considered a vendor at the time it terminated its lease and gave possession over to Garland, which was then considered a vendee. At that point, Charter was no longer liable for subsequent injuries, while Garland was freed from the same potential liability once it sold the property to MWF.

Failing to convince the court that caveat emptor should not apply to Charter, MWF argued that the doctrine is outdated and should be retired. Again, the court did not agree, reasoning that abandoning the doctrine of caveat emptor would have negative consequences on everyday real estate transactions. Without the doctrine, parties who are not in possession of property, and thus cannot control its condition and safety, would be liable for injuries occurring on the property. Essentially, a former possessor of the property would be made "the insurer of all its successors" even if the former possessor had disclosed any potential risks of harm, which would be an untenable result. Additionally, countless buyers and sellers have factored caveat emptor into their real estate transactions, with buyers often agreeing to assume risks associated with property in exchange for paying a lower purchase price. Eliminating caveat emptor, the court stated, would "distort" the real estate market going forward, and would "effectively renegotiat[e], retroactively," deals already made in consideration of the doctrine.

The court also rejected MWF's argument that Charter concealed or failed to disclose the risk of harm to Garland when it relinquished possession of the property. Garland was aware of Charter's past use of the furnaces and inspected the property thoroughly when Charter terminated the lease, eventually accepting its conditions without exception. Further, MWF itself had ample opportunity to inspect the premises and did so before completing its purchase. As such, the principles of "freedom of contract and right of inspection" supported the application of caveat emptor and insulated Charter from liability.

**Florida's Fourth District Court of Appeal found that a pedestrian injured by a fall at a shopping center was an uninvited licensee to which no duty was owed by the owner of the shopping center. *Arp v. Waterway East Association, Inc.*, 217 So. 3d 117 (Fla. Dist. Ct. App. 2017)**

Plaintiff Delores Arp and a companion sought to shorten their walk home from a dinner cruise by cutting through a shopping center parking lot and adjacent pathway made of paver stones. The pathway was subject to an exclusive easement in favor of the City of Delray Beach for the

installation and maintenance of public utilities. The plaintiff was injured on the pathway when she stepped on a cracked paver stone, rolled her ankle and fell. The plaintiff filed a negligence action against the owner of the shopping center, alleging that she was an implied invitee of the shopping center because the pathway was open for public use and her injury was a result of the defendant's failure to properly maintain the pathway. The defendant moved for summary judgment on the basis that (1) the defendant had not breached any duty to the plaintiff, who was either a trespasser or uninvited licensee, and (2) the defendant had no duty to maintain an area that was subject to an exclusive easement. The trial court granted the defendant's motion for summary judgment, finding no issues of material fact and reasoning that the plaintiff was "at best a licensee," and as such, the defendant's only duty to the plaintiff was not to harm her willfully or wantonly.

Plaintiff appealed, arguing that her status on the property was a question of fact for the jury, as the pathway was open to and frequently utilized by the public as a convenient "short-cut" between the shopping center and adjacent residences. As evidence of the open nature of the pathway, the plaintiff cited a lack of "no trespassing" signs.

On appeal, the Fourth District Court of Appeal affirmed the trial court ruling, finding that the determination of the plaintiff's status could be decided as a matter of law based on the fully developed trial court record, which established that the plaintiff entered the property late at night, without the intent to visit any business in the shopping center, and that the plaintiff's purpose of entry was to shorten her path home for her own convenience. In rejecting the plaintiff's claim, the court noted that the absence of a "no trespassing" sign does not constitute an implied invitation by the owner, nor can an implied invitation be inferred from the fact that others may have habitually trespassed upon the property.

**Professional Licensing**

**The Supreme Court of Oregon found that the creation of master plans for a planned shopping center constitutes the practice of architecture under Oregon law. In so ruling, it determined that two individuals who were not licensed to practice architecture in Oregon violated state law when they created master plans depicting a shopping center that a developer intended to build, even though the developer ultimately did not use those plans. *Twist Architecture & Design, Inc., v. Oregon Board of Architect Examiners*, 395 P.3d 574 (Or. 2017).**

In *Twist Architecture & Design, Inc., v. Oregon Board of Architect Examiners*, the Oregon Supreme Court ruled on what constitutes the practice of architecture with respect to designing shopping center master plans. In the case, two individuals, Kirk Callison and David Hansen, formed the company Twist Architecture & Design, Inc. ("Twist"). Neither Callison nor Hansen were licensed to

practice architecture in Oregon, but Twist used a logo that included the words “Architecture” and “Design,” and Twist’s website stated that Callison and Hansen were “Licensed in the State of Oregon (pending),” although neither of them had in fact applied for licensure.

Despite not being licensed to practice architecture, Twist entered into agreements with Gramor Development (“Gramor”) to provide “concept master planning design services” for three separate shopping center projects in Oregon. Pursuant to those agreements, Twist provided master plans for the shopping centers, which included technical drawings of the property detailing the locations and shapes of potential buildings, the locations of access points to and from the property, the location of parking spaces, and surrounding streets. Gramor paid Twist for its planning services, but Gramor ultimately only built one of the three proposed shopping centers, and it did not use Twist’s plans in its construction.

The Oregon Board of Architect Examiners (the “Board”) took notice of Twist’s activities and the representations it made in its logo and website. Believing that Twist was in violation of several Oregon statutes for the unlicensed practice of architecture and misleading representation, the Board initiated a proceeding, seeking to impose civil penalties on Twist. After a hearing, the Board determined that Callison and Hansen had violated Oregon’s statutes, and Twist appealed to the court of appeals. The court of appeals largely found for Twist, concluding that Twist’s master plans were “feasibility studies” that could not be used as a basis for construction, and thus could not constitute the practice of architecture. The Board then appealed to the Supreme Court of Oregon.

The Supreme Court of Oregon reversed much of the court of appeals’ findings, ruling that Twist and its principals, Callison and Hansen, had violated Oregon law. On the issue of the practice of architecture, the court found that Twist’s development of master plans met the statutory definition of the “practice of architecture.” In Oregon, the practice of architecture includes both “planning” and “designing.” While planners and designers of certain small-scale projects are exempt from licensure requirements under Oregon’s statute, the shopping centers for which Twist developed plans were of sufficient size and were intended to hold large enough crowds to place them within the scope of the licensure statute. The court noted that by requiring licensure for the practice of architecture, the legislature intended to “safeguard health, safety and welfare” and to prevent monetary waste by shopping center developers who hire people unqualified to create master plans. Although Gramor ultimately did not use Twist’s master plans, the fact that those plans had been developed enough to serve as the basis for constructing commercial shopping centers was sufficient to allow the court to categorize their creation as the practice of architecture. The court determined that without being licensed to practice architecture in Oregon, Twist violated state law by creating the master plans.

The court also found that Twist's inclusion of the words "Architecture" and "Design" on its master plans and in its logo violated Oregon law, which prevents non-licensed individuals from "using 'any (P1) title, sign, cards or device indicating or tending to indicate, that the person is practicing architecture.'" The court further determined that Callison and Hansen had, at a time when they were not licensed to practice architecture, represented that they were doing so. In making this determination, the court stated that the issue was not whether they represented that they were licensed, but whether they indicated that they were practicing architecture at a time when they were not licensed to do so. Twist's claim that Callison's and Hansen's licensure was pending, in conjunction with its advertisement of architectural projects, violated Oregon law and further indicated that these unlicensed individuals were engaged in the practice of architecture.

**Restrictive Covenants**

**The South Carolina United States District Court held that a grocery store anchor tenant was entitled to a permanent injunction against construction in violation of restrictions set forth on a missing exhibit to a shopping center declaration because the defendant property owner had constructive knowledge of the restrictions set forth on the missing exhibit. *Ingles Markets, Inc., and Sky King, Inc., v. Maria, LLC*, 2016 WL 6080426 (D. S.C. Oct. 18, 2016).**

Plaintiffs Ingles Markets, Inc., a grocery anchor tenant ("Ingles"), and Sky King, Inc., Ingles' landlord and shopping center owner ("Sky King"), brought an action for specific performance and declaratory and injunctive relief against defendant, Maria, LLC, ("Defendant") seeking to prevent Defendant from constructing a building adjacent to the shopping center owned by Sky King in violation of the terms of a recorded Declaration of Reciprocal Easements (the "REA"). Defendant sought declaratory relief and counterclaimed for tortious interference with contract, unfair trade practices and abuse of process.

The lease agreement between Ingles and Sky King, as successor in interest to the original shopping center developer, Jaylin Spartanburg South, LLC, ("Developer") required landlord to impose certain development restrictions (the "Development Restrictions") on all owners and tenants of the shopping center and adjacent land controlled by Developer. Developer so imposed the Development Restrictions by inclusion in the REA, which was filed by Developer and recorded in the Spartanburg County Register of Deeds on June 10, 2002. Section 5.3 of the REA stated as follows: "Development and use restrictions shall limit the construction to be performed on Parcels 1, 2 and 3 to the construction of one building of one story and no more than twenty-four (24) feet in height in the locations and with the requisite parking spaces, shown on Exhibit 'E' attached hereto." Although the REA referenced Exhibit "E' in four provisions, Exhibit "E" was not attached to the recorded REA.

In 2011, Defendant entered into a contract with Developer to purchase 0.91 acres of land comprised of portions of Parcel 2 and Parcel 3 described in the REA. During the contract due diligence period, Developer provided Defendant with a copy of the recorded REA but did not produce the missing Exhibit "E." None of Defendant, its broker or its legal counsel inquired about the missing exhibit. Some years later, Defendant obtained a construction loan and entered into an agreement with a construction company for the construction of a single building spanning Parcel 2 and Parcel 3.

When Ingles and Sky King learned of Defendant's construction plans, they sought a permanent injunction, alleging that the proposed building would violate Section 5.3 of the REA and Exhibit "E," thereby causing irreparable harm to Plaintiffs. Defendant countered that the proposed building was not in violation of any restriction in the REA of which Defendant had notice or should have known, as Exhibit "E" was not attached to the recorded REA; such exhibit was the type of document that Developer was required to deliver to Defendant during the contract due diligence period but was not provided to Defendant, and Developer had no burden to make any inquiry after the missing exhibit. Further, Defendant contended that an injunction would be inequitable because Defendant had already drawn on the construction loan funds and entered into a construction contract.

Following discovery, the parties filed competing motions for summary judgment. The court denied Defendant's motion for summary judgment and granted that portion of Plaintiffs' motion for summary judgment that sought dismissal of Defendant's counterclaims, leaving the court to address only whether Plaintiffs were entitled to a permanent injunction.

After hearing testimony from Ingles' attorney and Defendant's real estate broker and attorney, the court found that Plaintiffs were entitled to enforce the properly recorded REA, as Defendant was on actual notice that it could not construct one building spanning Parcel 2 and Parcel 3 per Section 5.3 of the REA, and further, Defendant had constructive notice of Exhibit "E" and its contents because a prudent purchaser would have made further inquiry about the missing exhibit.

As to the permanent injunction, Ingles' president testified that construction of the proposed building would obstruct the Ingles' premises line of sight, resulting in an approximate 10 percent reduction in sales. Sky King presented evidence that development of Parcel 2 and Parcel 3 in a manner inconsistent with the terms of the REA would result in a landlord default under the Ingles lease. The court deemed the foregoing sufficient evidence that failure to enforce the terms of the REA would result in irreparable harm to the Plaintiffs, which was not outweighed by the harm to the Defendant, that it would be impossible to calculate the damage done to the shopping center should Ingles vacate, and that the public interest and laws of South Carolina were best served by granting the injunction. Accordingly, the court held that Plaintiffs were entitled to the permanent injunction.

**Subleases**

**The Alabama Supreme Court held that the statutory requirement to record a lease for a term of 20 years or more does not apply to a sublease. R*ochester-Mobile, LLC, v. C & S Wholesale Grocers, Inc.*, 2017 WL 2610508 (Ala. June 16, 2017).**

In July 1974, Multiple Properties, Ltd., entered into a ground lease with Casto Developers ("Casto") for a parcel of land in a Mobile County, Alabama, shopping center (the "Premises") for an initial term of 31 years with 5 successive 10-year renewal options (the "Lease"). The Lease was recorded in the probate office for Mobile County on August 21, 1974. Casto subsequently assigned its leasehold interest to Bruno's Inc. ("Bruno's").

In June 1997, Bruno's sold its leasehold interest to Rochester-Mobile, LLC, and Salzman-Mobile, LLC, (collectively, "Rochester-Salzman") in a sale-leaseback transaction pursuant to which Bruno's assigned its interest in the Lease to Rochester-Salzman, and Rochester-Salzman subleased the Premises to Bruno's for a term of 25 years with 5 successive 5-year option terms (the "Sublease"). The Sublease was not recorded in the public records.

In 2009, Bruno's filed for bankruptcy, and in connection therewith, assigned its interest in the Sublease to Southern Family Markets of Mobile South University BLVD, LLC ("SFM"). C&S Wholesale Grocers, Inc., ("C&S") guaranteed SFM's obligations under the Sublease.

In 2015, Multiple Properties, LLC, ("Multiple Properties") (successor in interest to Multiple Properties, Ltd.) sought a declaratory judgment as to whether Rochester-Salzman, as tenant under the Lease, had timely exercised its option to renew the Lease. Sometime thereafter, C&S was added as a defendant, and Rochester-Salzman filed a cross-claim against C&S and a third-party claim against SFM alleging violations of the Sublease. C&S and SFM responded by filing a cross-claim and a counterclaim, respectively, against Rochester-Salzman alleging that because the Sublease had not been recorded, the Sublease would terminate on the twentieth anniversary of the Sublease effective date pursuant to § 35-4-6, Ala. Code (1975), which provides, in part, "[l]eases for more than 20 years shall be void for the excess over said period unless the lease or a memorandum thereof is acknowledged or approved as required by law in conveyance of real estate and recorded within one year after execution in the office of the judge of probate in the county in which the leased premises is situated." Rochester-Salzman responded with an additional counterclaim requesting the court to declare the Sublease valid and enforceable for the entire 25-year term and moved for summary judgment on the basis that the recording of the Lease satisfied the recording requirements of § 35-4-6.

The trial court entered an order granting C&S and SFM's motion for judgment on the pleadings and denying Rochester-Salzman's motion for summary judgment, holding that because the Sublease had not been recorded in accordance with § 35-4-6, the Sublease was void and unenforceable beyond the statutory 20-year term.

On appeal, the Supreme Court of Alabama reversed the trial court's ruling, concluding that the term "lease" as used in §35-4-6 does not include a sublease. In considering the parties' arguments, the court found that the terms "lease" and "sublease" are not synonymous, as the legislature has often used both terms in the same provision, and the legislative purpose of the statute—to prevent a person from tying up property by leasing for a lengthy term—is inapplicable to a sublease, the term of which cannot exceed the term of the prime lease. Finally, the court noted a statute or ordinance that restricts the use of private property must be strictly construed with the narrowest reasonable construction.

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**George J. Kroculick**, a partner in the Philadelphia, PA, office of Duane Morris, practices in the area of real estate law with a focus on eminent domain and highway access management and control, land use and land use litigation, relocation assistance, tax appeal matters and general commercial litigation. Mr. Kroculick has represented clients before local and county land use boards and has worked on lease litigation matters as well as title disputes.

**Heather R. Rosser** is a senior associate in the Atlanta, GA, office of Eversheds Sutherland (US) LLP. Ms. Rosser advises clients on a variety of real estate transactions, including acquisitions and sales, development, joint ventures, leasing and financing. She devotes substantial time to retail and mixed-use development.