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Estimates in Letters of Intent Can Come Back to Bite

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With the beginning of the new year, it is important to remember that letters of intent—and landlord generated items delivered pursuant to a letter of intent - have legal consequences, even when the terms of the letter of intent clearly state that matters covered in the letter of intent are "estimates", and that the letter of intent does not evidence a "binding contract." A recent case in point is the *Thrifty Payless v. The Americana at Brand* case decided in 2013.[1]

Background and Issues Raised

The case arose from a lease transaction between Thrifty and The Americana at Brand at its shopping center in Glendale, California. Landlord's agent prepared a letter of intent that, among other things, listed Thrifty's share of "estimated" real property taxes, insurance and common area expenses for the first year of the lease term. The letter of intent clearly identified the dollar amounts for these charges as estimates. Thrifty requested a budget and, in response, landlord's vice president for leasing provided Thrifty with a budget and wrote "[p]lease remember that the costs reflected are purely estimated values."

Americana and Thrifty ultimately entered into a lease for premises at the shopping center that required Thrifty to pay its pro rata share of common area operating expenses based on the ratio of the floor area of its premises to the floor area of the shopping center, excluding the floor area of "Other Stores", where tenants were permitted to contribute to Common Area Operating Expenses "on a basis other than that described herein," and also excluding certain "Non-Retail Portions" of the center. Landlord reserved the right to allocate expenses between the retail portions and the non-retail portions of the center.

When the first bill was generated by landlord under the lease, the charges for "Common Area Operating Expenses," including insurance and property taxes, were billed at rates twice or three times higher than the estimated amounts. The difference amounted to over $300,000 for the first year alone. The lease contained an "integration" clause that made the lease the final and binding agreement of the parties, and provided that Thrifty was entering into the lease without reliance on "any statement or representation of … Landlord or Landlord's employees or agents." Nevertheless, Thrifty sued the landlord for fraud, rescission, breach of contract and breach of the implied covenant of good faith and fair dealing.

The case centered on two key legal issues: (a) Could Thrifty rely on the estimates in the letter of intent despite the statement in the lease that the lease was the final and binding agreement of the parties? (b) Does a landlord breach the implied covenant of good faith and fair dealing by improperly exercising its discretion in allocating common area expenses between retail and non-retail portions of a shopping center? Unfortunately, while the landlord was able to get a dismissal of the case at the trial level, the court of appeal reversed the trial court and allowed Thrifty to proceed on all causes of action, answering the two legal issues in favor of Thrifty. The case makes it clear that estimates in letters of intent can be a basis for a fraud claim despite language in a letter of intent that amounts stated are merely estimates and are not binding, and despite the attempt to limit the contractual agreement between landlord and tenant to the four corners of the lease.

Why did this happen and what lessons do brokers and landlords need to learn from this case?

It is a fundamental principle of contract law that written contracts are to be interpreted based on the written terms of the contract and the assumption that the written agreement evidences the exclusive terms of the parties' agreement. Yet, there is an established exception to this rule—called the "parol evidence" rule which allows a party to present evidence other than from the written contract to show that the agreement was obtained by fraud. In order to state a cause of action for fraud a party must allege a misrepresentation, negligently made or made with the intent to defraud, and the "justifiable reliance" by the damaged party on the representation. The Court, in the Thrifty case, relied on a recent decision, handed down by the California Supreme Court in 2013 (that itself overruled a 1935 decision of the same court) to find that "oral promises" made outside of a written contract can be the basis for a fraud claim where a party can show it "justifiably relied" on the promise.[2]

But, what of the landlord's argument that it only gave an "estimate" and that no representation or promise was made by the landlord or its agent in the letter of intent with respect to the budget that was delivered to Thrifty. The Court answered this argument directly by stating that a party that commits fraud cannot "absolve himself from fraud by any stipulation in the contract, either that no representations were made or that any right that might be grounded upon them was waived." In other words, statements to the effect in a letter of intent that square footage figures or budgeted operating expenses are "estimates" cannot protect a landlord from a claim of fraud if the two key elements of fraud are satisfied: "negligent or intentional misrepresentation" and "justifiable reliance." This holding is consistent with other California cases in the lease context.[3]

How did The Americana at Brand breach the lease and the implied covenant of good faith and fair dealing? The implied covenant of good faith is read into every contract and supplements the express terms of a contract to prevent a contracting party from engaging in conduct that frustrates the other party's rights and benefits under the contract. As the Court noted, "merely charging higher rates for [certain] items than estimated during negotiations does not ostensibly breach the express language of the lease." But, in the Thrifty lease, the landlord agreed to allocate common area expenses between the retail and non-retail portions of the shopping center based on "its reasonable discretion" using "sound accounting and management principles," and that was enough for the Court to uphold Thrifty's allegation that landlord had improperly allocated expenses in violation of the implied covenant of good faith and fair dealing. This gives renewed strength and weight to these common tenant-requested lease revisions.

The Take Away

The conclusion from this case is for landlords and brokers to be careful what they put in a letter of intent and in any pre-lease deliverables given to tenants, and to work with counsel to condition any statements in such deliverables. Landlords should not rely on statements in letters of intent and in leases that purport to waive a tenant's rights to look outside the four corners of the contract.

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[1] The published opinion appears at 218 Cal.App. 4th 1230.

[2] See *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association*, 55 Cal.4th 1169 (2013), overruling *Bank of America v. T.S. Pendergrass*, 4 Cal. 2d 258 (1935). In 1935, the California Supreme Court in *Pendergrass* held that a contracting party could not prove fraud by alleging that the parties had agreed to terms different from those in their written agreement. In *Riverisland*, the Supreme Court overruled *Pendergrass* and held that a party can force a trial of a fraud claim by merely alleging that other side orally promised terms that differed from those in the written contract. Interestingly, on remand for trial, the *Riverisland* trial court held that the borrowers had failed to prove that they justifiably relied on the bank's alleged oral promises, primarily because the parties' written agreement directly contradicted the allegedly promised terms.

[3] See *McClain v. Octagon Plaza, LLC* 159 Cal. App. 4th 784 (2008), which found in favor of the tenant that a landlord had misrepresented the square footage of the leased premises, notwithstanding a lease provision that the all square footage figures in the lease are "an approximation which the parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less." The Octagon Plaza case is also considered noteworthy for its holding that tenants are entitled to verify expenses incurred by the landlord that are passed through as additional rent, but that this right falls short of being able to demand an audit.