ARTICLE:
LANDLORD LEASING FRAUD: THE *OROZCO* CASE AND ITS IMPLICATIONS FOR LEASING LAWYERS AND THEIR CLIENTS

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Introduction

If a tenant receives a verbal assurance from a landlord while negotiating a lease, and the assurance is not written in the lease, does the tenant have any recourse if the assurance turns out to be false?

Does the answer change if the tenant did not fully read the lease, and took the landlord at his or her word? What if the lease contains an integration clause, or the parties agree to a separate estoppel certificate, stating that the written lease included all terms agreed to by the parties, and that no other terms or assurances outside of the written lease are part of the agreement?

These are questions that arose in a recent court of appeal case, *Orozco v. WPV San Jose, LLC*[1] (hereinafter "*Orozco*"), which held that a tenant may indeed seek damages against a landlord if the landlord made a verbal assurance to the tenant in negotiating a lease, the tenant reasonably relied on that verbal assurance, and the tenant then suffered damages when the assurance turned out to be false. The fact that the written lease did not contain the promise in question did not matter, even if the tenant did not read the lease. The answer did not change even though the lease contained an integration clause, and the parties executed a separate estoppel certificate.

The *Orozco* decision is a further application of the fraud exception to the parol evidence rule following the California Supreme Court's decision in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*[2] Courts in California are increasingly allowing evidence of representations beyond the four corners of a written lease if the representations are relied on in entering into the agreement.

This article provides a brief introduction to the parol evidence rule and the fraud exception to the rule, and discusses the *Riverisland* case and its progeny. The article goes on to discuss the recent *Orozco* case, and provides guidance based on *Orozco* for landlords and tenants negotiating agreements in the future.

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The Parol Evidence Rule and Fraud Exception

The parol evidence rule is intended to protect the integrity of written contracts by making the terms contained therein the exclusive evidence of the parties' agreement. Under the rule, extrinsic evidence may not be relied upon to alter or add to the terms of the writing. Parol, or extrinsic, evidence may include, but is not limited to, oral or written promises, representations, or agreements made before or contemporaneously with the execution of the written contract under consideration, and that is not included in the written contract. An integration clause confirms that a written agreement is integrated, i.e., the final expression of the parties' agreement, exclusive of all prior understandings, representations, agreements, or communications. Evidence of fraud, however, is not precluded by the parol evidence rule or by an integration clause, as *Orozco* demonstrates.

Prior to the California Supreme Court's 2013 ruling in *Riverisland*, California law excluded extrinsic evidence of promises that contradicted an integrated written agreement, even if the promisor never intended to keep the promise. Previously, and since its 1935 decision in *Bank of America etc. Assn. v. Pendergrass*,[3] the California Supreme Court declined to apply the fraud exception to the parol evidence rule to a scenario where a party misrepresents the written contents of an integrated written agreement. Rather, the written agreement controlled.

Riverisland and its progeny

The California Supreme Court in *Riverisland* explicitly overruled *Pendergrass* and admitted evidence of a misrepresentation made in the negotiation of the agreement that induced the agreement. The *Riverisland* case contained similar facts as the *Pendergrass* case, both involving borrowers that had worked with their lender to restructure their agreement to obtain more favorable terms. In *Riverisland*, the borrowers were told in an in-person meeting with the lender's representative that they had two years to pay back the loan, and would need to pledge *two* properties as additional collateral. Per the written agreement, the borrowers would have a much shorter duration to pay back the loan, and would need to pledge *eight* properties as additional collateral. The California Supreme Court stated that extrinsic evidence regarding the validity of an agreement is allowed if one of the parties intentionally misrepresents the written contents of an integrated written agreement. The *Riverisland* Court reiterated that the parol evidence rule was never intended to be used as a shield to prevent the proof of

fraud. Importantly, the *Riverisland* decision stated that the party claiming fraud in the inducement must prove reasonable reliance by such party.[4]

In *Julius Castle Restaurant, Inc. v. Payne*,[5] the court of appeal refused to limit the *Riverisland* decision to unsophisticated parties. There the landlord sought to prevent the application of the rule in *Riverisland* to a tenant that had engaged in extensive negotiations with the landlord. The court of appeal held that even sophisticated parties can assert the fraud exception to the parol evidence rule if they were intentionally misled. The court in *Julius Castle Restaurant* reiterated that sophisticated parties claiming fraud must still show reasonable reliance on extrinsic evidence, and that the determination of reasonable reliance must be made by a jury.[6] The fact that the defrauded party was sophisticated does not matter, if a jury finds substantial evidence that a party reasonably relied on another party's false promise to their detriment.

In *Thrifty Payless, Inc. v. Americana at Brand, LLC*,[7] the court of appeal relied on the *Riverisland* decision to allow a tenant to introduce extrinsic evidence of a landlord's alleged misrepresentations in a letter of intent. The court in *Thrifty Payless* reversed a trial court's dismissal on summary judgment of a tenant's allegation that a landlord intentionally or negligently misrepresented the tenant's common area maintenance ("CAM") charges in a letter of intent. The court also stated that the tenant had pled sufficient facts to show that the tenant reasonably relied on the landlord's estimates in the letter of intent.[8]

Several unpublished decisions have also carried on the logic of *Riverisland*.[9] In *Veta v. HDN Group,*[10] for example, the court of appeal reversed a trial court ruling that a tenant failed to state a claim for fraud against a landlord that verbally promised to install a sprinkler system on the property. The court of appeal based its reversal on the *Riverisland* decision, finding that because the tenant alleged that the landlord never intended to perform its promise of installing the sprinkler system for the tenant, the tenant had pled sufficient facts in its complaint to support a cause of action for fraud.[11]

Similarly, in *8451 Melrose Property, LLC v. Akhtarzad*,[12] the court of appeal overruled a trial court's ruling that a tenant had failed to present any evidence of being fraudulently induced into a lease. The court of appeal relied on *Riverisland*, which was decided while the *Akhtarzad* appeal was pending. In *Akhtarzad*, the tenant attempted to introduce evidence that the landlord had made misrepresentations that were extrinsic to the terms of the written lease

agreement. The false representations included that the leased space was zoned for retail use and that no portion of the property was added illegally. The court of appeal held that the change in law announced in *Riverisland* made the court's evidentiary rulings based on parol evidence inconsistent with the fraud exception to the rule.[13]

Finally, in *Kyung v. El Paseo South Gate, LLC*,[14] the court of appeal reversed a trial court's grant of summary judgment in favor of a landlord that had allegedly made verbal misrepresentations to a tenant on which the tenant relied. The court of appeal in *El Paseo South Gate, LLC* again relied on *Riverisland*, as *Riverisland* was also decided while the *El Paseo South Gate, LLC* case was pending appeal. The tenant in *El Paseo South Gate, LLC* alleged that the landlord promised to relocate the tenant to a new space if the tenant continued to operate in its present location, and to provide the tenant with a new lease. The tenant alleged that the landlord never intended to keep those promises, even though the tenant relied on those promises to sign a lease amendment. The court of appeal reversed and remanded to the trial court, stating that the tenant's allegation of promissory fraud must be submitted to a jury in light of *Riverisland*.[15]

The *Orozco* case is the most recent case allowing tenants to invoke the fraud exception to the parol evidence rule. Unlike the preceding three cases, *Orozco* is a published decision that can be cited for precedential value.

Orozco v. WPV San Jose, LLC

After several years in the restaurant industry, Paul Orozco decided to open a restaurant serving gourmet hot dogs, sausages, and specialty french fries at a shopping center in San Jose owned by a company named Vornado. The landlord had hired a single representative who was responsible for negotiating leases for the landlord at the shopping center. Orozco asked the landlord's representative whether restaurants with competing concepts or products were being considered for the vacant spaces at the shopping center and was told that these were not. Orozco was aware that other vendors at the shopping center sold hot dogs, but as ancillary products. For example, Orozco specifically investigated a hamburger chain (Five Guys) that had hot dogs on its menu, and concluded it would not compete with his own restaurant.[16]

Importantly, Orozco had multiple meetings with the landlord's representative, including approximately 10 phone conversations and at least six face-to-

face meetings, during which he raised this issue, before signing the lease at the shopping center in September 2011. Orozco wanted additional information about other tenants at the shopping center to confirm that there would not be any businesses competing with his hot dog restaurant. The landlord's representative told Orozco that she could not answer questions about other tenants because it was against the landlord's policy to discuss ongoing negotiations, when in fact, there was no such policy, and the landlord's representative admitted that she had only claimed that the landlord had such a policy as a negotiating tactic when dealing with the tenant.[17]

Orozco emphasized to the landlord's representative during the meetings that it was important for him to evaluate operations in the shopping center that were selling hot dogs. The landlord's representative responded each time that there would not be such competing businesses. At the same time she was making these assurances to Orozco, the landlord's representative was also negotiating a lease with Al's Beef, a national franchise selling hot beef sandwiches, hot dogs, and french fries. The landlord's representative never disclosed this fact to Orozco, and the landlord's representative executed a lease with Al's Beef before executing the lease with Orozco. In its lease negotiation, Al's Beef tried to obtain an exclusive use restriction that prevented other tenants at the shopping center from selling hot dogs. The landlord's representative refused, but gave Al's Beef a limited exclusive to sell hot beef sandwiches. The landlord's representative never told Orozco that Al's Beef had requested an exclusive for hot dogs, or even that Al's Beef was coming to the shopping center.

Orozco again asked on the day he signed lease about competing businesses in the shopping center, and the landlord's representative again stated that there would not be any businesses competing with the tenant. Orozco, through his company, signed a 10-year lease at the shopping center. Orozco personally guaranteed the lease. Orozco admitted that he did not fully read the 80-page lease. The lease contained an integration clause stating that the agreement was the sole agreement between the parties and superseded any extrinsic evidence regarding the agreement. The lease also contained several disclaimers indicating that the landlord had not made any representations about other tenants, including future tenants, at the shopping center. Orozco also signed an estoppel document attached separately from the lease that disavowed any representations made by the landlord to Orozco. In addition, Orozco's lease included an exhibit entitled "Prohibited Uses and Exclusive Uses" listing the exclusive use restrictions imposed by the landlord for the benefit of other tenants. Al's Beef's use

exclusive did not appear on the lease executed by Orozco and was not referenced anywhere in the lease for the Orozco's restaurant.

The first time that Orozco learned of Al's Beef was when he saw a sign two doors down in the shopping center while he was constructing his restaurant, but he was told by another one of landlord's employees to not to worry about Al's Beef because Al's Beef was going through financial difficulties. Orozco opened his hot dog store for business in October, 2012 with great success and increasing sales. After Orozco's first six months of successful operation, Al's Beef opened two doors down in April, 2013, and sales at Orozco's hot dog restaurant dropped by 24 percent within the first week, eventually declining by 30 percent overall. Orozco closed the business in November 2013 due to declining sales. Orozco sued the landlord for fraud in inducing him to enter into the lease. Specifically, Orozco alleged intentional fraud, fraudulent concealment, and negligent misrepresentation. The jury found in favor of Orozco at trial and awarded damages, including lost profits. However, the trial court denied rescission of the guaranty.[18]

The landlord appealed the jury's verdict, claiming that the jury's verdict of intentional misrepresentation and the jury's award of lost profits lacked substantial evidence. The court of appeal upheld both the verdict and the award of damages. In addition, the court of appeal reversed the trial court's denial of the tenant's personal guaranty, and awarded the tenant attorney's fees based on the attorney's fees provision in the guaranty.

The court cited *Thrifty Payless* in reiterating that the reasonableness of a plaintiff's reliance on a misrepresentation is a question of fact. In its appeal, the landlord argued that Orozco's reliance was not reasonable because the tenant was negligent in failing to read the lease, and failing to negotiate a use exclusive for hot dogs. The court of appeal stated that even if Orozco had read the lease, he would not have been alerted to landlord's false representation. The court distinguished the situation from cases where parties claiming to have been defrauded did not ask questions or take any other action to determine status of other tenants in the shopping center.[19] Here Orozco would not have known about Al's Beef even if he had read the lease.

The court of appeal also stated that it is well established that disclaimers and exculpatory documents such as the estoppel certificate attached to the lease that the tenant signed do not operate to insulate defrauding parties from liability or

preclude the tenant from demonstrating justifiable reliance on misrepresentations. The jury was given a special instruction on reasonable reliance and disclaimers instructing that such disclaimers were not conclusive but rather one of the "factors" they could consider in their determination. The instruction read as follows:

> [p]rovisions in contracts stating that the agreement is the sole agreement between the parties and supersedes any and all prior oral or written agreements or understandings among them pertaining to the transaction and that no express or implied representations have been made, as well as other absolving contractual provisions, do not insulate a party from the consequences of its fraud. However, in determining whether Solid Restaurant Ventures, LLC's reliance on the alleged misrepresentation or alleged concealment was reasonable, you may consider whether the lease agreement and/or Tenant's Estoppel expressly disavowed any purported representations. You may also consider whether Solid Restaurant Ventures, LLC had a lawyer assist with lease review, whether Solid Restaurant Ventures, LLC asked for changes in the lease documentation, whether Solid Restaurant Ventures, LLC asked questions and any responses given, whether Solid Restaurant Ventures, LLC communicated the importance of its concerns about whether others were being considered as prospective tenants who offered competing concepts or who offered competing products.

The court of appeal found the jury instruction was proper and found that there was substantial evidence for the jury's findings. In all, Orozco recovered approximately $870,000 in damages, of which almost $700,000 were lost profits, as well as an additional $700,000 in attorney's fees.

Takeaways from *Orozco*

- The court disregarded the sophistication, or lack thereof, of the tenant in this case. Orozco had been in the restaurant business for 10 years prior to entering into the lease for the hot dog restaurant. He did not fully read the 80-page lease, but instead read the main provisions of the lease, and he did not appear to have been represented by counsel in negotiating the lease. The court emphasized repeatedly that even if Orozco had read the lease, he would not have been alerted to the broken promises, i.e., that there would be a competing business setting up shop a few doors from his gourmet hot-dog restaurant.

- The fact that the lease contained an integration clause and had an estoppel certificate attached was not relevant to the outcome. The court viewed integration clauses and estoppel certificates as a factor to be considered by

the jury, but not conclusive. The trial court specifically instructed the jury that integration clauses and estoppel certificates and other "exculpatory statements" do not insulate a party from fraud.

- The jury identified other factors that may provide clues as to what courts may look for in determining whether a party reasonably relied on fraud in the inducement based on parol evidence. Such evidence may include whether a party had counsel assist with the lease review, whether a party asked for a change to the written documentation of the lease, whether a party asked specific questions and/or received any responses, and whether a party communicated its concerns regarding the statement upon which it relied. In the event that a party to a lease agreement accuses or is accused of misrepresentation, the above factors may be relevant to determine whether there was reasonable reliance on the misrepresentation.

- It is important to note that the jury did not reach the issue of negligent misrepresentation because of its verdicts on intentional misrepresentation and fraudulent concealment. Orozco had asserted causes of actions for both intentional misrepresentation and negligent misrepresentation. It is unclear whether these same factual requirements would be relevant to a jury's determination that a party's misrepresentation was negligent, but not intentional.

- The *Riverisland* line of cases, including *Orozco*, beg the question as to what contracting parties can do to ensure that parties are prohibited from relying on matters outside of their written agreement. Below is some guidance for parties to a lease, as well as their counsel, on best practices in drafting an enforceable written lease agreement.

Recommendations

Limit pre-contract communications

The best way to avoid fraud claims is to limit pre-contract communications in the process leading up to the execution of a written lease agreement in order to eliminate or limit pre-contract representations and factual statements about the contemplated lease agreement. A party claiming fraud cannot argue that its counterpart made a false promise if no promise of any sort was made in the first place. In light of the *Orozco* case, it would be wise to limit pre-contract communications to major terms of the lease agreement, such as rent, lease term, lo-

cation of the premises, etc. It would be unwise to engage in extensive pre-contract communications on items that will not be part of the final written lease agreement, such as the names of anticipated or potential tenants, use of exclusives, common area maintenance charge estimates, or overall leasable square footage of the property.

Make accurate factual representations and statements

Each party must always take great measures to ensure that all representations and statements made to the other party are accurate in all material respects. If a party makes an estimate, it should do so in good faith and provide the basis for such an estimate. If the estimates require revision, the party should also communicate the revised estimate and the reason for the revision as soon as practicable. Prior to executing a lease, the parties should review all prior and subsequent communications (letters of intent, e-mails, notes from meetings, etc.) to confirm that all representations made in such communications are accurate. Any misrepresentations should be corrected prior to the execution of the written agreement. If a misrepresentation is made (or discovered) after the execution of the written agreement, the parties should amend the lease.

Limit the number of individuals responsible for communication

To avoid intentional or negligent misrepresentations in negotiating a contract, it would be advisable to limit the number of individuals permitted to engage in communicating to the other party during lease negotiations. The individuals that are ultimately made responsible for lease negotiations should fully understand the risks involved in making inaccurate statements as part of lease negotiations.

Include due diligence or inspection periods

To ensure that the negotiating parties do not merely rely on verbal statements or other communications made outside of the written lease agreement, it is advisable to include due diligence or inspection contingencies in a lease agreement. If a party has the opportunity to perform their own due diligence or inspection prior to entering into a lease agreement, it becomes more difficult for that party to bring a claim of fraud against the other party to the lease.

Leave in the integration clause

The lease agreement should include a solid integration clause affirming that neither party is relying on extrinsic representations or promises. The court in

Orozco emphasized that such integration clauses do not insulate a party from fraudulent misrepresentation. However, the court did view integration clauses as a factor in determining whether there was justifiable reliance based on such misrepresentation. Unless a party has made a misrepresentation that cannot be discovered even upon reading the written lease agreement, the inclusion of an integration clause can potentially foreclose some claims against the validity of the written lease agreement. The integration clause should also be coupled with acknowledgements that each party has read the lease and was given the opportunity to have it reviewed by the party's own counsel.

Execute Estoppel Certificates

It is recommended that an estoppel certificate should be executed separately from the written lease agreement. The estoppel certificate should state, among other things, that the executing party: (i) is not relying on any promise or representation not contained within the contract; (ii) has read and understands the content of the lease, (iii) understands that preliminary discussion or negotiating drafts have been superseded by the final executed document, and (iv) has had, or was given the opportunity to have, its counsel review the contract or lease. As with integration clauses, the court in *Orozco* did state that estoppel certificates do not insulate a party from fraudulent misrepresentation. Nevertheless, estoppel certificates would serve as a factor in determining whether there was justifiable reliance based on the misrepresentation. It would also be advisable to execute the estoppel certificates after executing the written lease agreement, and perhaps even during a due diligence/inspection period.

Conclusion

Since the California Supreme Court's 2013 ruling in *Riverisland*, courts in California have greatly expanded the fraud exception to the parol evidence rule. Courts have also given great deference to juries as fact-finders in determining whether a party claiming fraud reasonably relied upon the other party's misrepresentations in a lease agreement. The *Orozco* case serves as a reminder that integration clauses and estoppel certificates may not insulate a party from liability resulting from intentional representation. Whether and to what extent courts will allow a finding of negligent rather than intentional misrepresentation based on extrinsic evidence to invalidate a lease agreement remains to be seen.

Although the misrepresentations of the landlord's representative in the *Orozco*

case were particularly egregious, each party to a lease agreement must take precautions to ensure that the written agreement that the parties execute maintains its integrity. As the *Orozco* case demonstrates, parties to a lease may be liable for significant damages such as lost profits and attorney's fees in the event that one of the parties is able to prove fraud based on parol evidence. Both landlords and tenants should ensure that the leases that they agree to remain accurate and unambiguous in their content. The parties should use the above guidance to ensure that the written lease agreement conforms to any other communications between them.

ENDNOTES:

[1]*Orozco v. WPV San Jose, LLC*, 36 Cal. App. 5th 375, 248 Cal. Rptr. 3d 623 (6th Dist. 2019).

[2]*Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*, 55 Cal. 4th 1169, 151 Cal. Rptr. 3d 93, 291 P.3d 316 (2013).

[3]*Bank of America Nat. Trust & Savings Ass'n v. Pendergrass*, 4 Cal. 2d 258, 48 P.2d 659 (1935) (overruled by, *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*, 55 Cal. 4th 1169, 151 Cal. Rptr. 3d 93, 291 P.3d 316 (2013)).

[4]*Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*, 55 Cal. 4th at 1183.

[5]*Julius Castle Restaurant Inc. v. Payne*, 216 Cal. App. 4th 1423, 157 Cal. Rptr. 3d 839 (1st Dist. 2013).

[6]*Julius Castle Restaurant, Inc. v. Payne*, 216 Cal. App. 4th. at 1441-1442.

[7]*Thrifty Payless, Inc. v. The Americana at Brand, LLC*, 218 Cal. App. 4th 1230, 160 Cal. Rptr. 3d 718 (2d Dist. 2013).

[8]*Thrifty Payless, Inc. v. The Americana at Brand, LLC*, 218 Cal. App. 4th at 1241-1242.

[9]Though not citeable as precedent, we reference these cases to demonstrate consistency in subsequent decisions and highlight various factual scenarios. See Cal. Rules of Court, Rule 8.1115.

[10]*Veta v. HDN Group*, 2013 WL 2576892 (Cal. App. 1st Dist. 2013), unpublished/noncitable.

[11]*Id.*

[12]*8451 Melrose Property, LLC v. Akhtarzad*, 2013 WL 3947144 (Cal. App. 2d Dist. 2013), unpublished/noncitable.

[13]*Id.*

[14]*Myung Ho Kyung v. El Paseo South Gate, LLC*, 2013 WL 4016985 (Cal.

App. 2d Dist. 2013), unpublished/noncitable.

[15]*Id.*

[16]*Orozco v. WPV San Jose, LLC*, 36 Cal. App. 5th at 383.

[17]*Id.* at 384.

[18]Although not specifically relevant to the topic of this article, the trial court found the guaranty and lease to be essentially one agreement, and on that basis refused to order rescission of the guaranty based on Orozco's election of damages rather than rescission. The court of appeal reversed, finding the trial court to have been in error, not so much in treating the lease and guaranty as one contract, but rather, in failing to note that there were two legally separate entities that were parties to the contracts. *Id.* at 404-405.

[19]E.g., *Hinesley v. Oakshade Town Center*, 135 Cal. App. 4th 289, 37 Cal. Rptr. 3d 364 (3d Dist. 2005).

