

## Stipulation of Square Footage in Lease Does Not Insulate Landlord from Measurement Fraud Claim

BY DAVID W. CREEGGAN

Many commercial leases, including American Industrial Real Estate Association forms, include a stipulation by the parties that the premises contain a certain number of rentable square feet and that such number will not be changed during the lease term, irrespective of any subsequent measurements of the premises. The California Court of Appeal, Second Appellate District, ruled this year in *McClain v. Octagon Plaza LLC* that such provisions do not insulate landlords from claims of fraud and misrepresentation when it is later discovered that the stipulated square footage was incorrect.

Octagon Plaza LLC, as landlord, and Kelly McClain, doing business as A+ Teaching Supplies, as tenant, entered into a commercial shopping center lease in February 2003 for five years and two months. The parties executed a standard form agreement prepared by the AIREA. The lease described the size of the unit leased by McClain as "approximately 2,624 square feet" and attached a diagram of the shopping center. When McClain was investigating whether to lease the unit in January of 2003, she attempted to confirm the size and was told by Octagon that measuring the unit would be "unreasonably costly due to the unit's unusual angles." Octagon insisted it had "intimate knowledge" of the space and that it was 2,624 rentable square feet. Because the base rent in the shopping center was \$1.45 per square foot per month, McClain's resulting base rent was \$3,804 per month. Moreover, because the unit occupied 23 percent of the shopping center, McClain would be responsible for a corresponding share of the common area maintenance expenses.

Paragraph 2.1 of the lease provided, in part, that "any statement of size set forth in this Lease, or that may have been used in calculating Rent, is 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 lease further provided: "Lessee acknowledges that: (a) it has been advised by Lessor ... to satisfy itself with respect to the

condition of the Premises ... and their suitability for Lessee's intended use, [and] (b) Lessee had made such investigation as its [sic] deems necessary with reference to such matters and assumes all responsibility therefore as the same relate to its occupancy of the Premises."

In early 2005, McClain discovered the correct size of the shopping center was 12,800 square feet, rather than the 11,835 square feet Octagon had used in calculating McClain's share of the common expenses. She also discovered her unit occupied approximately 2,438 square feet, rather than the 2,624 square feet represented in the lease. Accordingly, the base rent for the unit should have been \$3,535.10 per month, rather than \$3,804, and McClain's share of the common expenses should have been 19 percent, rather than 23 percent. As a result, the lease as written purportedly required her to pay "excess" rent of more than \$90,000 over the term.

McClain filed suit alleging, among other things, fraud by intentional or negligent misrepresentation, breach of covenant of good faith and fair dealing and failure to provide an accounting for common area expenses.

With respect to the fraud claim, Octagon defended on the ground that Paragraph 2.1 is an exculpatory provision that bars McClain's claim. The court disagreed, noting that Civil Code § 1668 provides that "[a]ll contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud ... whether willful or negligent, are against the policy of the law." The court then stated that "a stipulation intended to bar a party's fraud claims does not bind the party, and thus the insertion of language agreeing that a material misrepresentation is reasonable is of no effect."

With these principles in mind, the court found the language of the lease, including the exculpatory clause in Paragraph 2.1, did not bar McClain's claim for fraud or a showing that the misrepresentations reasonably induced her to accept the lease. The discrepancy between the measurement in the lease and the true measurement was substantial. The fact that Paragraph 2.1 put McClain on notice that the representations of size were

approximations does not preclude her from asserting that they were, in fact, materially and unreasonably inaccurate.

Although the court held McClain could state a claim for fraud, it ruled she could not claim breach of the implied covenant of good faith and fair dealing based on the allegation that Octagon negotiated a per-square-foot price for the premises and then intentionally, or negligently, overstated the true size of the premises. The basis for the court's decision to deny this claim was that the "implied covenant is a supplement to an existing contract, and thus it does not require parties to negotiate in good faith prior to any agreement."

The court also denied McClain's request for a declaration that she was entitled to an accounting beyond that which Octagon previously provided on the basis that the lease requires the parties to share the common expenses of the shopping mall, but provides Octagon exclusive management and control over those expenses.

Octagon would have the right to satisfy its obligation to provide a "reasonably detailed statement of the expenses" in any reasonable manner it selects, including providing McClain with copies of the pertinent documents or giving her an opportunity to view the original documents. McClain would not be entitled to dispute the need for expenses or to audit the records as she requested.

In sum, the lesson here is that a landlord must be cautious in the statements it makes during lease negotiations and in the lease with respect to the size of a particular premises. If the statement is incorrect, and the mismeasurement caused the tenant to pay more than it should have and there is evidence that the landlord was aware of it or discouraged the tenant from having the space re-measured, the standard AIREA exculpatory clause and similar clauses in non-form leases will not shield the landlord from a fraud claim. ■

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