THE REAL PROPERTY SECTION

OF THE SAN DIEGO COUNTY BAR ASSOCIATION

Presents

DECONSTRUCTING COMMERCIAL LEASES

Speakers

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Chris Roth, Broker

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PRESENTER BIOGRAPHIES

RYAN P. McCRARY, ESQ.

Ryan McCrary is the owner of McCrary Law PC, a firm focused on helping business owners in their real estate transactional matters. Prior to founding his own firm, Ryan was general counsel for the San Diego based commercial real estate brokerage firm, Hughes Marino, and in private practice focusing on real estate transactional law.

Before practicing law, Ryan worked in both the real estate and construction industries. He owned and operated a real estate brokerage office in San Diego, and worked as a project engineer for the commercial general contractor Nielsen Dillingham. As an engineer, he oversaw construction on CCDC's downtown parking garage "Park-it-on-Market", SDSU's Athletic Administration Building and Hall of Fame, the luxury high-rise condominium Park Laurel, and numerous tenant improvement and tilt-up construction projects.

Ryan holds a Master of Law (L.L.M.) in Real Property Development from the University of Miami, and obtained his law degree from Thomas Jefferson School of Law. He holds a Bachelor of Science degree in Construction Engineering Technology from California State Polytechnic University, Pomona. He is also a licensed California real estate broker and a LEED for New Construction Accredited Professional.

Ryan was one of five California young lawyers recognized for their dedication and professional excellence in the practice of real estate law, and honored by the State Bar of California's Real Property Law Section with a 2014 Morning Star Award.

SEAN E. PONIST, ESQ.

Sean Ponist is the owner of the Law Offices of Sean Ponist, P.C., a firm specializing in real estate, construction defect and business litigation. Prior to founding his own firm, Mr. Ponist was a prosecutor with the Marin County District Attorney's Office and in-house counsel for Marcus & Millichap Real Estate Investment Brokerage Company. He has successfully tried over 25 cases to verdict. For the past five years, Mr. Ponist has been recognized as a Northern California Super Lawyer.

Mr. Ponist has also published numerous articles on real estate topics, including recent articles in The Daily Journal ("Recovering Lost Profits in Real Estate Transactions" and "Should Equitable Indemnity Apply Against Negligent Misrepresentation Claims?"), California Lawyer magazine ("The Nonrefundable Deposit – Not!") and Commercial Investment Real Estate ("Going to the Source: Minimize your liability by providing attributions").

He has further lectured for the San Francisco Bar Association ("Bringing Down the House: Assessing Damages in Real Estate Cases," "Best Use of Experts in Real Estate Cases," "The Rogue Agent: Agency Issues In Real Estate," "Private Investigation and the Legal Community," and "Commercial Real Estate Brokerage Standard of Care"), the San Mateo County Bar

Association (“When Real Estate Deals Go Bad,” “Expert Witnesses at Trial,” and the “Agent-Principal Relationship”), the San Diego County Bar Association (“Commercial Real Estate Brokerage Standard of Care”) as well as for the National Business Institute (“Direct and Cross-Examination for Civil Litigators”).
Mr. Ponist graduated from *UC Davis School of Law*, receiving his Juris Doctor degree in 1999. Prior to law school, Mr. Ponist attended *UCLA* where he earned a Bachelor of Arts in Philosophy in 1995 and was a Departmental Scholar.

CHRIS ROTH, BROKER

Chris Roth is a Principal with Lee & Associates North San Diego County located in Carlsbad, CA. Chris specializes in selling and leasing Industrial, R&D, and Office properties in San Diego County with a primary focus in North County San Diego.

Prior to joining Lee and Associates, Chris spent six years as a Corporate Real Estate Advisor with McKinney Advisory Group, a real estate firm focused on representing tenants with a national footprint. Chris was the lead contact for large firms such as Molina Healthcare (MOH) and Comex and collaborated with Corporate Officers to compile an approach to increase profits and reduce real estate costs. Chris completed transactions in all different product types negotiating complex lease and sale transactions across the country.

Chris was recently voted to the Real Estate Top 40 under 40 list by San Diego Business Journal for 2015 and was voted Rookie of the Year and Associate of the Year at Lee prior to becoming a principal. Chris was one of the fastest agent’s in the company history to qualify for Principal at Lee and Associates.

Chris is active in the community as well serving on numerous boards including Boys and Girls Club San Dieguito, San Diego North Economic Development Corporation, and SIOR San Diego Chapter.

DECONSTRUCTING COMMERCIAL LEASES

I. THE EVOLUTION OF A LEASING TRANSACTION

A. Market Knowledge
B. Understanding of Client Needs
C. Identification of Prospective Spaces
D. Letters of Intent
E. Lease Negotiation Strategies
F. Lease Agreements

II. LETTERS OF INTENT

A. PURPOSE

A letter of intent that is meant to come to an agreement on the main deal points.

B. MAIN DEAL POINTS

1. Square footage

Tenant – Wants to specify square footage and the rent on a per square foot basis. In the event the square footage is less, rent should be adjusted as well.

Landlord – I've been told in most leases to not include the square footage due to the issue above. Rent should be quoted as a monthly number, not based on monthly price per square foot. In the event square footage changes, rent stays the same.

2. Early Occupancy

This is typically two to three weeks prior to commencement. The idea is for the tenant a chance to move from their current facility to the new facility without having to pay double rent. Landlords understand a tenant needs time to get up and running and should not be paying double rent while getting set up. A lot of larger institutional landlords prefer to provide more time in early occupancy versus free rent because their effective rent is calculated based on the commencement date to the lease expiration. It does not include early occupancy which makes them look better to their investors.

3. Commencement Date

This is important as it determines when rent commences and is important as it will determine other important dates such as lease expiration and any option period dates.

4. Term

This is typically expressed in months. In the event any free rent is provided, typically a landlord will try to extend the term by the amount of free rent provided. For instance, if a 60 month term is negotiated and three months of free rent is provided, the term may get extended to 63 months so the landlord receives 60 payments. This again helps their effective rent. Term is also important as landlords sometimes may want a short term lease in the event they believe the market will outpace their lease. They may prefer a long term lease for a credit tenant to potentially position the property as a leased investment.

5. Base Rent

The most important aspect of the negotiation. As mentioned above, tenants want to express this number as a per square foot number versus a monthly rental number so if square footage changes, so does the rent. In that scenario, the tenant is subject to a potential rental increase in the event the square footage was less than what is actual. Three percent annual increases are market for today's standards.

6. Rental Abatement

Free rent is based on the Base Rent and does not include operating expenses and utilities. The amount of free rent the being provided in today's market has dropped due to the decline in vacancies. For a five year deal three months of free rent is about market with two month not being uncommon.

7. Security Deposit

The security deposit is provided at lease execution. The tenant typically makes this monetary value equal to last month's rent. Landlords do not like to make this equal to last month's rent as Tenant's may forgo their last month of payment in order to ensure they receive their security deposit back in full.

8. Tenant Improvement Allowance

A lot of times this is expressed as a price per square foot on the building. In other instances, tenants will specify exactly what they want completed in the building and then the landlord will obtain a bid from a contractor to understand the costs. This can be a big negotiation point if tenant improvements (TI's) are a large monetary value. Landlords will typically have a monetary value they are willing to spend on tenant improvements before marketing the space for lease. If a prospective tenant wants above and beyond the landlord's budget, landlord will amortize the additional amount over the course of the lease. There are also other issues such as obtaining multiple bids from multiple general contractors versus the landlord only allowing for their contractor to be the general contractor (GC) paying the landlord a "management fee" for overseeing the construction process, types of materials used in construction and the quality of the finishes, etc.

9. Commissions

It is typical for the tenant's broker to receive a 4% fee for years 1-5 and 2% for the remaining years on the lease. Due to the market tightening, this isn't necessarily a given anymore. The landlords' brokers commission is more negotiable depending on the quality of the real estate. It is typically 3% for years 1-5 and 1.5%-2% for the remaining years. It can also be a sliding scale starting with 7% in year one, 6% years two and three, and so on. This changes per brokerage firm and per broker. The commission is paid half upon lease execution and half upon lease commencement.

10. Misc.

Different clients have different preferences. Building hours might be a sticking point for one tenant and another might be more concerned with parking. It all depends on the client and the client's business. Below is a list of additional points which are often negotiated in the leasing process:

a. Operating Expense exclusions—Many landlords may bill the tenant double management fees, labeling one a different type of management fee than the other. Some operating expenses may not be applicable to each tenant. What can and cannot be negotiated is really going to be determined by the strength of the tenant.

b. Right to audit operating expenses—Some tenants want to audit the expense reconciliations year to year. Human error occurs when reconciling expense estimates versus actual expenses. Tenants also want to review large jumps in one category to another and understand what occurred. Did the roof get replaced? If so, was the cost in line with market or did the landlord overpay?

c. Caps on controllable operating expenses—Strong credit tenants will cap the amount controllable expenses will rise year to year. They are leasing the space based on the base rent and cost of operating expenses. In the event landlord increases operating expenses dramatically, the rent savings at this location may not make sense anymore unless they are confident expenses will stay close to the same.

d. Signage Rights—This is a big sticking point for large office users. Monument signage could be a very important factor for larger corporate tenants looking for exposure. It's also important for every other user who needs to understand the CC&R's and city regulations to understand what they can install on the property.

e. Options to Renew—Standard options include language that states the tenant shall have the right to renew the lease for a certain period of time at specific price. Tenants want to specify a fixed price so if the market is higher than that number they can execute an extension under market rates. If it is lower than the fixed price they can forego the option to renew and renegotiate with their landlord. Typically the options are stated the renewal rate will be at the fair market value at time of renewal.

f. Right to Terminate—Government contractors will include this in their negotiations a lot of times as the government will sometimes have a rolling option to terminate or the contract expires at a certain time and they have to renegotiate with the government. In these instances the tenant will include a right to cancel. There are other reasons

such as a tenant trying to obtain a conditional use permit. In the event permit is not granted, the tenant can terminate the lease. Landlords will generally try to avoid this language at all costs.

g. Maintenance Responsibilities—Typical AIR leases put most of the day to day maintenance responsibilities on the tenant, whether it is a gross or net lease. Some tenants will try and negotiate the landlord be responsible for certain aspects of the building so they can focus on operating their business and not being hit with large unknown costs.

h. ADA Compliance and Responsibility—This is always a major sticking point in negotiations. Generally, leases provide that the tenant is responsible for ADA compliance. Typically, ADA is not an issue unless a permit is pulled from the city. This will occur if the tenant needs to modify the current premises and hence a further basis for landlord's belief that it is a tenant responsibility. Conversely, he tenant believes that it is upgrading the landlord's building beyond its lease term and hence should be a landlord responsibility.

i. Rights to sublease—Points of negotiation will include: Will tenant and landlord share in any potential profits of a sublease? Can tenant be let out of the lease in the event they locate a subtenant of equal or greater value? Is it a sublease if it's a subsidiary or sister company?

j. Non Disturbance Agreement—This is hard to get unless the tenant has strong financials. This states the tenant's lease will remain in place if the landlord gets foreclosed upon. This is a document between the lender and the tenant. This is very important if the tenant spent a lot of money moving into the space. If they do not have this document in place, they could lose a lot of money being forced out of a property they just spent a lot of money moving into.

k. Increased tax burden upon sale—In the event of a sale, the tax basis for the landlord may rise dramatically. These costs get passed on to the tenant. Some tenants may negotiate a cap on real estate tax increases upon sale.

l. Holdover rent—Some contracts state the tenant is responsible for 150% base rent in the event tenant holdover. Tenant's may try to negotiate this number to be closer to current base rent or provide for an extension on the amount of time after lease expiration before the increase occurs.

m. Personal Guaranty—Depending on the strength of the tenant, landlords may request a personal guaranty. This obviously opens up quite a bit of liability to the individual signing the guaranty.

n. Right of first refusal to expand—Depending on how this is written, this typically states the tenant has the right to a certain space within the building. The landlord will have the right to market the property, but in the event they get a ready, willing, and able tenant and have an agreed to price, the tenant with the right of first refusal shall have the option to match the offer within a certain amount of time.

III. LEASE NEGOTIATION STRATEGIES

Application of market principles.

IV. LEASE AGREEMENTS

A. THE PREMISES

In large part, the obligations and responsibilities between the LL and T are allocated geographically.

1. How do we describe the Premises?

a. Street Address
b. Legal Description
c. Site Plans/Floor Plan
d, Square Footage

2. How do we measure the Premises?

a. BOMA and Re-measurement
b. Useable area v. Rentable area v. Leasable area: R/U Ratio, Load factor, core factor, loss factor

3. How do we create flexibility?

a. Options:

1. Right of first negotiation
2. Right of first offer
3. Right of first refusal
4. Option to expand
5. Option to contract
6. Option to purchase
7. Right of first refusal to purchase

b. Misc:

1. Relocation
2. Parking
3. Roof rights

B. THE RENT

1. How do we describe the rent? Fixed Rent, Base Rent, Minimum Rent

a. Gross v. NNN

(1) Gross
(2) NNN
(3) Full Service

(4) Modified Gross
(5) Industrial Gross

b. Additional Rent

2. Free Rent Arrangements and Claw-backs

3. Escalations

a. Fixed Annual Increases
b. COLAs and Caps

4. Percentage Rent

a. Break Point
b. Appropriate percentage
c. Landlord Audit

5. Late Payments

C. THE TERM

1. How do we describe the Term?

a. Commencement
b. Duration
c. End (expiration v. termination)

2. Commencement

a. Hard v. Soft date
b. Delivery (early v. late) and Abated Rent
c. Substantial Completion

3. Work Letter

a. Landlord Goals

(1) Prompt Commencement
(2) Control of design and construction
(3) Least possible cost
(4) Allocation of hard v. soft cost

b. Tenant Goals

(1) Maximizing the tenant allowance

(2) Timely completion
(3) Controlling design and construction

c. Landlord build-out v. Tenant build-out.

4. Early Occupancy

a. License
b. Prior access
c. Beneficial occupancy

5. Duration

6. End

a. Expiration date
b. Commencement Date memorandum

7. Options

a. Extension Option

(1) Fixed Rent v. Fair Market Rent and Dispute resolution
(2) Tenant's in default.

b. Termination Option

(1) Conditional
(2) Termination Fee
(3) Unconditional

c. Landlord right to Terminate

(1) Taking
(2) Casualty
(3) Relocation

D. THE OPERATING EXPENSES

The most heavily negotiated provision in the Lease.

1. Essential Parts

a. What is the Tenant's share of the Operating Expenses?
b. What are the Operating Expenses?

2. Tenant's share

a. Percentage interest in the project based on square footage.
b. Grossing Up—Variable Costs are grossed up.
c. Taxes

(1) Prop 13
(2) Prop 8

3. What are the Operating Expenses?

a. Landlord wants:

(1) Maintain their asset
(2) Consistency
(3) Allocate the risk of operating cost increases to the tenant (inflation can erode Landlord profit)

b. Tenant wants:

(1) Consistency
(2) Cap—Compounded v Cumulative and Year to year v. Year over Base
(3) Audit Rights
(4) Gross Up
(5) Reconciliation Statement
(6) Exclusions
(i) Capital expenditures
(ii) Repair v. Replace
(iii) Typically agreeable exclusions

V. <u>INTERPRETING CONTRACTS</u>

A. WHO DECIDES MEANING?

1. Generally, the Courts

Determining what a disputed contract provision means is generally left to the court to decide. (See *City of Hope Nat'l Med. Ctr. v Genentech, Inc.* (2008) 43 Cal.4th 375, 395.)

2. Limited Exception

When there are disputed issues of fact and contract interpretation turns on the credibility of witnesses or disputed evidence, those disputed factual issues will be submitted to a jury. Once the jury decides the facts, the court may either interpret the contract in light of those findings or

allow the jury to do so. (*City of Hope Nat'l Med. Ctr. v Genentech, Inc.* (2008) 43 Cal.4th 375, 395.)

B. INTERPRETATIVE PROCESS

1. Contract Language Itself

First, the court looks to the contract's language. If it is clear and explicit, it governs. (Civ. Code §1638.) (Nonetheless, even at this stage, however, the court will provisionally consider evidence outside the contract to determine whether the language is reasonably susceptible to more than one interpretation (see discussion *infra*).)

2. Parol/Extrinsic Evidence

Second, to the extent a term is ambiguous (or may be ambiguous), the court will attempt to discern the parties' intent from extrinsic evidence related to the contract's purpose, formation, and performance. (See Civ. Code §1647; *City of Hope Nat'l Med. Ctr. v Genentech, Inc*., supra.)

The parol evidence rule prohibits the introduction of extrinsic evidence to vary or contradict the express terms of an integrated written instrument. The terms of a writing that the parties intend as a final expression of their agreement cannot be contradicted by evidence of a prior agreement or a contemporaneous oral agreement. (Miller & Starr, 1 Cal. Real Est. (3d ed. 2015) § 160 (emphasis added), citing, *inter alia*, Code Civ. Proc., § 1856, *Hayter Trucking, Inc. v. Shell Western E&P, Inc.* (1993) 18 Cal.App.4th 1, 15; *EPA Real Estate Partnership v. Kang* (1992) 12 Cal.App.4th 171, 175-176 [final draft controls].

"The decision as to whether to admit extrinsic evidence is a two-step process. First, the court provisionally receives (without actually admitting) all credible evidence concerning the parties' intentions in order to determine if any ambiguity exists, i.e., whether the language is "reasonably susceptible" to the interpretation urged by a party. If, in light of the extrinsic evidence, the court decides that the language is "reasonably susceptible" to the proposed interpretation, the extrinsic evidence is admitted to aid in the second step of interpreting the contract and the intent of the parties. When the language is reasonably susceptible to two interpretations, extrinsic evidence of either meaning is admissible. The extrinsic evidence is not admissible on the issue of contract interpretation when the terms of the contract are not reasonably susceptible of the proposed interpretation." (*Ibid*.)

Admission of Party Opponent—has the opposing party ever stated an intent inconsistent with its current position and/or consistent with your position?

3. Rules of Construction

Third, if extrinsic evidence does not resolve any ambiguity, the court will fall back on default rules of construction. (See Civ. Code §1649; Code of Civ. Proc. §1864.)

VI. RULES OF CONSTRUCTION

A. GENERAL RULES

1. The Intent of the Parties

"A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful." (Civ. Code §1636.) California follows an objective approach to interpreting contracts, meaning that the parties' outward manifestation of intent controls. As a general rule, a party's subjective, unexpressed understanding of a term's meaning is irrelevant in determining what the contract means.

2. Language of Contract

a. Contractual Language Controls

"The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity." (Civ. Code § 1638.) "When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this Title." (Civ. Code § 1639.)

b. Exception for Fraud, Mistake or Accident

However, "When, through fraud, mistake, or accident, a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded." (Civ. Code § 1640.)

c. Failure to Read no Excuse

Failure to read all or part of contract, however, does not invalidate the agreement in whole or in part. In *Stewart v. Preston Pipeline, Inc.*, for instance, the court held that plaintiff's claim that he did not read or understand the agreement before signing it did not even raise a triable issue as to whether he was bound by the terms of the agreement. (134 Cal.App.4th 1565, 1587 (2005).) The *Stewart* Court further noted that it was aware of no cases "that stand for the extreme proposition that a party who fails to read a contract but nonetheless objectively manifest his assent by signing it," may avoid the legal implications thereof. (*Ibid*.)

3. Whole of the Contract / Effect to Every Part

"The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other." (Civ. Code 1641; see also, *Mitchell v. Exhibition Foods, Inc.* (1986) 184 Cal.App.3d 1033.)

4. Several Contracts Taken Together

"Several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together." (Civ. Code § 1642.)

5. Interpretation In Favor Of Contract

"A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties." (Civ. Code § 1643.)

6. The Meaning of Words

a. Ordinary Meaning

"The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed." (Civ. Code § 1644.)

b. Technical Terms

"Technical words are to be interpreted as usually understood by persons in the profession or business to which they relate, unless clearly used in a different sense." (Civ. Code § 1645.)

Trade usage evidence can also be persuasive in resolving ambiguities or establishing that the parties intended to place special meanings on terms. To use this evidence, a party first must establish that a relevant trade usage or custom existed. This usually requires expert testimony. Even if a trade usage is established, it might not be not binding on the parties unless it is sufficiently certain, continuous, and uniform. Both parties must have actual knowledge of the practice, or it must be so well known in the industry as to create a presumption of knowledge. (See *Heggblade-Marguleas-Tenneco, Inc. v Sunshine Biscuit, Inc.* (1976) 59 Cal.App.3d 948.)

A court of appeal ruled that industry custom and practice was relevant in establishing that a talent agent's commission agreement with actress Lisa Kudrow required the payment of post termination commissions for engagements entered into before termination. (See *Howard Entertainment, Inc. v. Kudrow* (2012) 208 Cal.App.4th 1102.)

7. Law of the Place

"A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made." (Civ. Code § 1646.) Expert testimony regarding usage of the place is not limited to the same place; expert testimony regarding the usage of a similar place is admissible. (*Jeffer, Mangels & Butler v. Glickman* (1991) 234 Cal.App.3d 1432, 1442.)

8. Contracts Explained By Circumstances

"A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates." (Civ. Code § 1647.)

9. Interpretation Restricted to Object of Intent

"However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract." (Civ. Code § 1648.)

10. Contract, Partly Written and Partly Printed

"Where a contract is partly written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and the particular contract in question, the written parts control the printed parts, and the parts which are purely original control those which are copied from a form. And if the two are absolutely repugnant, the latter must be so far disregarded." (Civil Code § 1651; see also, *Integrated, Inc. v. Alec Fergusson Elec. Contractors* (1967) 250 Cal.App.2d 287 [If a contract is comprised of a pre-printed form and handwritten or typed modifications, the handwritten or typed material will prevail].)

11. Reconciliation of Repugnancies

"Repugnancy in a contract must be reconciled, if possible, by such an interpretation as will give some effect to the repugnant clauses, subordinate to the general intent and purpose of the whole contract." (Civil Code § 1652.) In essence, where two clauses of contract appear to be contradictory, the court should attempt to reconcile conflicting clauses so as to give effect to whole of instrument, assuming that is possible within framework of general intent of the contract.

12. Inconsistent Words Rejected

"Words in a contract which are wholly inconsistent with its nature, or with the main intention of the parties, are to be rejected." (Civil Code § 1653.)

13. Interpretation Against Drafter

"In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist." (Civ. Code § 1654.)

In light of this rule of construction, many contracts include a clause states, in part, that the contract should be construed as though both parties to the agreement drafted it.

14. Reasonable Stipulations Implied and the Implied Covenant of Good Faith and Fair Dealing

"Stipulations which are necessary to make a contract reasonable, or conformable to usage, are implied, in respect to matters concerning which the contract manifests no contrary intention." (Civil Code § 1655.)

"It is well settled that, in California, the law implies in every contract a covenant of good faith and fair dealing. Broadly stated, that covenant requires that neither party do anything which will deprive the other of the benefits of the agreement. In addition to this principal function, the covenant has a subsidiary use for the parties' predicament. In the case of a contradictory and ambiguous contract ... the implied covenant may be applied to aid in construction." (*Mitchell v. Exhibition Foods, Inc.* (1986) 184 Cal.App.3d 1033, 1043 (emphasis added).)

"The scope of the covenant of good faith derives substance from its contextual setting. The precise nature and extent of the duties imposed ... will depend upon the contractual purposes." (*Id*. at 1043, citing *Egan v. Mutual of Omaha Ins. Co*. (1979) 24 Cal.3d 809, 818; accord *Betts v. Allstate Ins. Co*. (1984) 154 Cal.App.3d 688, 705; *National Life & Accident Ins. Co. v. Edwards* (1981) 119 Cal.App.3d 326, 339.)

15. Necessary Incidents Implied

"All things that in law or usage are considered as incidental to a contract, or as necessary to carry it into effect, are implied therefrom, unless some of them are expressly mentioned therein, when all other things of the same class are deemed to be excluded." (Civil Code § 1656; see also, *Armstrong v. Smith* (1942) 49 Cal App.2d 258 [where contractor undertook to construct a dwelling house for owner, the law implied a promise on the part of owner to permit the plaintiff to build according to the details of the contract and entry upon the land].)

16. Time for Performance

"If no time is specified for the performance of an act required to be performed, a reasonable time is allowed. If the act is in its nature capable of being done instantly--as, for example, if it consists in the payment of money only--it must be performed immediately upon the thing to be done being exactly ascertained." (Civ. Code § 1657; see also, *Schmidt v. Callero* (1950) 97 Cal.App.2d 582 [where neither contract for sale of resort nor any parol agreement specified definite time within which vendors should complete title search and furnish clear title, vendors were entitled to reasonable time to deliver title].)

17. Uniform Vendor and Purchaser Risk Act

"Any contract hereafter made in this State for the purchase and sale of real property shall be interpreted as including an agreement that the parties shall have the following rights and duties, unless the contract expressly provides otherwise: (a) If, when neither the legal title nor the possession of the subject matter of the contract has been transferred, all or a material part

thereof is destroyed without fault of the purchaser or is taken by eminent domain, the vendor cannot enforce the contract, and the purchaser is entitled to recover any portion of the price that he has paid; (b) If, when either the legal title or the possession of the subject matter of the contract has been transferred, all or any part thereof is destroyed without fault of the vendor or is taken by eminent domain, the purchaser is not thereby relieved from a duty to pay the price, nor is he entitled to recover any portion thereof that he has paid. (Civ. Code § 1662.)

18. Specific over General

"[U]nder well established principles of contract interpretation, when a general and a particular provision are inconsistent, the particular and specific provision is paramount to the general provision." (*Prouty v. Gores Tech. Group* (2004) 121 Cal.App.4th 1225, 1235; see also Civ. Code § 3534 ("particular expressions [in a contract] qualify those which are general"). "[I]t is settled that when, as here, a general and a specific provision of a contract are inconsistent, the specific provision will control." (*Sanserino v. Shamberger* (1966) 245 Cal.App.2d 630, 635, citing *Wilder v. Wilder* (1955) 138 Cal.App.2d 152, 158.)

19. Course of Performance

Aside from drafting history, courts recognize that the parties' course of performance after contract inception, but before a dispute arises, is good evidence of intent. Cases sometimes refer to this conduct as the 'parties' practical construction.' (*Employers Reinsurance Co. v. Superior Court* (2008) 161 Cal.App.4th 906, 922). Course of performance not only is relevant in construing ambiguous terms but also can "'supplement or qualify the terms of the agreement' or 'show a waiver or modification of any term inconsistent with the course of performance.'" (161 Cal.App.4th at 920 [internal citation omitted].)

20. Internal Memos/Practice

A party's internal, practical construction of an agreement can be relevant to interpret a term even if the other contracting party was not aware of the words or acts or did not concur in them. A court invoked this rule in a licensing dispute involving systems designed to prevent the unauthorized copying of movies and other copyrighted content stored on DVDs. (See *DVD Copy Control Ass'n, Inc. v Kaleidescape, Inc.* (2009) 176 Cal.App.4th 697.) The parties disagreed about whether certain content-protection specifications applied to their licensing agreement. One of defendant's employees had prepared an internal memorandum acknowledging that its technology had to comply with the specifications. The court held that this memorandum was admissible against the defendant, even though the other side never received the document or was even aware of it before the litigation. (*Ibid*.)

B. RULES SPECIFIC TO LEASES

1. Uncertainty Interpreted Against Landlord

"Generally, ambiguities or uncertainties in the terms of an option to renew or extend are construed against the landlord on the theory that he or she is the party who caused the

ambiguity." (Miller & Starr (3d ed. 2015) 7 Cal. Real Est. § 19:36; see also, *Erickson v. Boothe* (1947) 79 Cal.App.2d 266, 272; see also, *Buck v. Cardwell* (1958) 161 Cal.App.2d 830, 836.).) "It is generally held that in construing provisions of a lease relating to renewals, if there is any uncertainty, the tenant rather than the landlord is to be favored." (*McAulay v. Jones* (1952) 110 Cal.App.2d 302, 306.)

2. Promotion of Continued Use

"One of the covenant's components which has been established in the field of commercial leases is a duty on the part of a landlord to promote the continued use and occupancy of the premises by an existing tenant." (*Mitchell v. Exhibition Foods, Inc.* (1986) 184 Cal.App.3d 1033, 1043, citing *Lippman v. Sears, Roebuck & Co.* (1955) 44 Cal.2d 136, 142–143; *Cordonier v. Central Shopping Plaza Associates* (1978) 82 Cal.App.3d 991, 999–1000; *Edmond's of Fresno v. MacDonald Group, Ltd.* (1985) 171 Cal.App.3d 598.) "Our decision is in accord with the general rule that contracts should be construed to make them effective and lawful. (*Klepper v. Hoover* (1971) 21 Cal.App.3d 460, 465; see also, Civ. Code §§ 1643, 3541.)

3. Lease Forfeiture Disfavored

The law construes ambiguous provisions so as to avoid a forfeiture which is disfavored by the law. (*Ballard v. MacCallum* (1940) 15 Cal.2d 439, 444; 1 Witkin, Summary of Cal.Law, Contracts, § 251, p. 282.)

4. Option Rights Vest

"An option to extend or renew the term of the lease gives the optionee a specifically enforceable right to compel the extension or renewal of the lease upon the terms of the option. A tenant who has exercised the option properly is entitled to specific performance of the renewal for the additional term." (Miller & Starr (3d ed. 2015) 7 Cal. Real Est. § 19:36.) Similarly, in the matter of *In re Marriage of Joaquin* (1987) 193 Cal.App.3d 1529, 1532-1533, the appellate court held that, once exercised, "an option [becomes] an indefeasible right in the optionee to have real property transferred to him." "Indefeasible," of course, means "[t]hat which cannot be defeated, revoked, or made void." (Gilbert, Law Dictionary (1994) p. 124.)

D. RULES SPECIFIC TO PUBLIC CONTRACTS

1. Same Rules for Private and Public

"All contracts, whether public or private, are to be interpreted by the same rules, except as otherwise provided by this Code." (Civ. Code § 1635.)

2. Public Entity Favored

"A grant is to be interpreted in favor of the grantee, except that a reservation in any grant, and every grant by a public officer or body, as such, to a private party, is to be interpreted in favor of the grantor." (Civ. Code § 1069.) In order for section 1069 to apply, the ambiguity

must be in the grant or reservation language itself. (Contracts, 21 No. 5 Miller & Starr, Contracts, Real Estate Newsletter, citing *Coronado Cays Homeowners Ass'n v. City of Coronado* (2011) 193 Cal.App.4th 602, 611.)

3. Interplay Between the Two Statutory Provisions

In *City of Stockton v. Stockton Plaza Corp*., City of Stockton and a private party had a leasing dispute over the terms of the lease. (261 Cal.App.2d 639 (1968).) The appellate court summarily rejected the notion that the city should be held to any different standard, instead, citing section 1635, it held that "the city shall be held to the same standard as a private person." (*Id*. at 646.)

Section 1635 requires governmental agencies to contract equitably. (*Schultz v. Contra Costa County* (1984) 157 Cal.App.3d 242, 247) and further requires that such contracts be interpreted pursuant to the same rules as any other contract (*M. F. Kemper Const. Co. v. City of Los Angeles* (1951) 37 Cal.2d 696, 705 (special rules of law will not be applied merely because a governmental body is a party to a contract).) The foregoing is especially true where the government acts in a proprietary or business capacity. (*Corporation of America v. Durham Mut. Water Co.* (1942) 50 Cal.App.2d 337, 340.)

VII. CUSTOM AND PRACTICE AND USE OF EXPERTS

A. CUSTOM AND PRACTICE

Evidence of custom and practice is admissible to establish the general custom and practice in the industry as well as the significance of terms and conditions used in the industry. Similarly, custom and practice can supplement missing terms and conditions.

B. EXCLUSION OF EXPERT REVERSIBLE ERROR

Exclusion of expert testimony has generally been found to be reversible error. (*Howard Entertainment, Inc. v. Kudrow* (2012) 208 Cal.App.4th 1102, 1121 (reversible error not to admit expert testimony of custom and practice re right to commissions after termination of entertainment agreements); see also, *Bell v. Mason* (2011) 194 Cal.App.4th 1102 (same); *PM Group, Inc. v. Stewart* (2007) 154 Cal.App.4th at 63-64 (custom and practice admissible to establish significance of industry terms and conditions), citing with approval *Marx & Co. v. The Diners' Club, Inc.* (2d Cir.1977) 550 F.2d 505, 508–509 (custom and practice admissible re significance of terms in the securities business).)

Failing to have excluded expert testimony of custom and practice on a relevancy objection, a trial attorney may seek to exclude the expert on the ground that he is not qualified to render an opinion on custom and practice. Some trial judges apply a strict standard of qualifications. However, the California Supreme Court generally applies a broad standard of qualifications. (*Brown v. Colm* (1974) 11 Cal.3d 639, 646; see further, *Jeffer, Mangels & Butler v. Glickman* (1991) 234 Cal.App.4th 1432, 1439.)

Also, a trial attorney may attempt to exclude custom and practice testimony by mischaracterizing it as a legal opinion. It is generally inappropriate for an expert to testify as to the law. (S*ummers v. A.L.Gilbert Co.* (1999) 69 Cal.4th 1155.)

C. FAILURE TO CALL EXPERT WITNESS MALPRACTICE

Attorney alleged to have committed malpractice for failing to call expert witness on issue of how to interpret lease. (*Kasem v. Dion-Kindem* (2014) 230 Cal.App.4th 1395.)