3601 Group, Inc. v. Alfalfa's Northwest, Inc.

Court of Appeals of Washington, Division One

December 1, 2003, Filed

No. 51329-0-1

Reporter
2003 Wash . App. LEXIS 2773 *

3601 GROUP, INC., a Washington Appellant, v. ALFALFA'S NORTHWEST, INC., a Colorado corporation; ALFALFA'S, INC., a Colorado corporation; and WILD OATS MARKETS, INC., a Delaware corporation, Respondents.

Notice: [*1] RULES OF THE WASHINGTON COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE WASHINGTON RULES OF COURT.

Prior History: Appeal from Superior Court of King County. Docket No: 00-2-27456-4. Date filed: 10/09/2002.

3601 Group, Inc. v. Alfalfa's Northwest, Inc., 119 Wn. App. 1036, 2003 Wash. App. LEXIS 3424 (2003)

Disposition: Reversed and remanded.

Counsel: For Appellant(s): Vincent T. II Lombardi, Short Cressman Burgess PLLC, Seattle, WA, Kenneth Wendell Masters, Attorney at Law, Bainbridge Island, WA, Charles Kenneth Wiggins, Attorney at Law, Bainbridge Island, WA.

For Respondent(s): H. Troy Romero, Romero & Montague PS, Bellevue, WA.

Judges: Authored by Anne L Ellington. Concurring: Ronald E. Cox, Susan R. Agid.

Opinion by: Anne L. Ellington

Opinion

ELLINGTON, J. The only question here is whether the jury was properly instructed as to damages flowing from breach of a commercial lease. Because the court instructed the jury to decide a question upon which no evidence had been presented, and

the record indicates the instruction may have affected the verdict, we reverse and remand for a new trial.

BACKGROUND

3601 Group, Inc. [1] entered into a commercial lease with Alfalfa's Northwest, Inc. (Alfalfa's), which Alfalfa's later breached. Following the breach, 3601 Group signed a long-term lease **[*2]** with its first replacement tenant, Thrifty Payless. Payless also broke its contract, however, and eventually settled its obligations by paying 3601 Group $ 1.5 million. 3601 Group later entered into a third lease with Fremont Fresh Market, a separate company having ownership in common with 3601 Group. 3601 Group then sued Alfalfa's Northwest for breaching the lease. Summary judgment was granted as to liability, and Alfalfa's does not appeal that ruling. A jury trial was set to decide damages.

Pretrial Rulings. With respect to remedies for breach of a commercial lease, a landlord in Washington has two options. The landlord may terminate a lease and relet to his own account, in which case the tenant's obligation for **[*3]** unaccrued rent ends when the new tenancy begins. [2] On the other hand, the landlord may elect to enforce the lease, and relet on the tenant's behalf, in which case the tenant remains liable for rent for the balance of the lease term (less rents actually received), and for reasonable costs of reletting. [3] There is no requirement that the landlord notify the tenant which remedy is chosen if the lease preserves both options. Here, the lease provided that 3601 Group could, at its option, treat the leases as terminated and relet the property for its own benefit, or hold Alfalfa's to the lease and relet on Alfalfa's behalf. The lease contained no requirement that 3601 Group notify Alfalfa's which remedy it chose.

Before trial, Alfalfa's proposed a jury instruction that 3601 Group had elected the first of these remedies unless **[*4]** it had given Alfalfa's specific notice to the contrary. [4] In response to this proposed instruction, 3601 Group moved in limine to preclude Alfalfa's from presenting any evidence or argument on this theory. In the same motion, 3601

Group argued in the alternative that the court should give 3601 Group's version of the instruction. That instruction gave the jury certain factors to consider in making its determination, which would necessarily lead to the conclusion that 3601 Group had elected to hold Alfalfa's to the lease. [5]

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[1] 3601 Group acquired the property in question from L & M Partners, a company with which 3601 Group had common ownership. L & M Partners was the original lessor, but for the purposes of this opinion, we follow the practice of the parties in their briefing, and refer to the lessor as 3601 Group.

[2] ***Hargis v. Mel-Mad Corp., 46 Wn. App. 146, 151, 730 P.2d 76 (1986)***.

[3] See ***id. at 153*** (quoting *Restatement (Second) of Property* § 12.1 cmt. i (1977)).

[4] This instruction is not part of the record on appeal. We rely on the description in the parties' briefs.

[5] 3601 Group's proposed instruction provided, in pertinent part:

To determine whether the landlord relet the space for its own account, you should consider the following factors: Did the parties agree in their lease that Alfalfa's would be liable for 3601's damage in the event of a breach by Alfalfa's? or (2) Did 3601 give notice to Alfalfa's that it would relet the premises and hold Alfalfa's responsible for damages resulting from Alfalfa's breach?

If your answer is "Yes" to either question, then you shall decide that

[*5] The trial court issued an oral ruling on this motion, which both parties apparently treated as granting 3601 Group's motion to preclude Alfalfa's from presenting the lease termination theory to the jury. Accordingly, neither party addressed the issue or introduced evidence on the matter.

Instructions. Following trial, Alfalfa's proposed instruction was again considered. [6] **[*6]** 3601 Group once more objected that the jury should not be asked to decide which remedy 3601 Group had elected, and further argued that Alfalfa's proposed instruction did not accurately state the law, was not supported by sufficient evidence, and was inconsistent with the court's pretrial ruling. The court agreed that Alfalfa's proposed instruction was an inaccurate statement of the law. [7] The court also acknowledged that no evidence existed to support Alfalfa's theory that 3601 Group had elected to terminate the lease for its own benefit. Nevertheless, the court decided to put the issue to the jury, and crafted an instruction requiring the jury to determine which remedy 3601 Group had elected. [8]

[*7] In the face of this instruction, 3601 Group requested that the court admit additional portions of Exhibit 83, a three-page letter written by 3601 Group's counsel

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3601 relet the space for Alfalfa's account.

If your answer is "No" to both questions, then you shall decide that 3601 relet the space for its own account.

A tenant who contends the landlord chose to relet the property for the landlord's own account . . . has the burden of proving the landlord made that choice.

Clerk's Papers at 314.

[6] It is not clear from the record why this issue was revisited.

[7] Alfalfa's proposed instruction relied on a misinterpretation of *Pollock v. Ives Theatres, 174 Wash. 65, 24 P.2d 396 (1933)*, where the court held a landlord may seek damages after acceptance of surrender and termination by clearly manifesting an intent to do so, even when the contract does not specifically provide this option. The case does not address a situation where, as here, the lease does specifically include this option.

[8] This instruction provided:

When a tenant breaches a lease and abandons the premises, the landlord has a duty to mitigate the tenant's damages by reletting the property. A landlord may choose (1) to complete surrender and termination by re-entering the premises and reletting "for his own account"; or (2) to re-enter and relet "for the tenant's account," charging to the tenant any difference between his agreed rent and the rent received from the replacement tenant.

Under option 1, if the landlord accepts the tenant's surrender of the premises and relets the property for its own account, the tenant's liability for unaccrued rent ends when the landlord finds a new tenant for the premises. The tenant is only liable for unpaid rent until the premises is actually relet to a new tenant who begins paying rent, plus the reasonable costs of reletting the premises, such as real estate commissions and reasonable costs incurred for renovating or improving the space for any new tenant.

Under option 2, the tenant remains liable for future rent for the balance of the lease term, the reasonable costs of reletting the premises, and reasonable costs of renovating or improving the space for any new tenant, amortized over the term of the new lease, all of which amount is to be offset by any rent received from future tenants.

If you determine that option 2 was chosen by the landlord, then in your determination of damages you should use the following measure of damages for any amounts proven by 3601 Group:

(1) The full amount of the rent and other payments Alfalfa's was obligated to pay to 3601 Group under its leases from the time the rent and other payments were due to commence until 3601 Group secured another tenant for the space and it began paying rent. Other payments may include but are not necessarily limited to so-called "triple-net" charges and late fees due under the leases;

(2) Any lost rental amounts due on the parking lot;

(3) The difference between: a) the rent and other payments Alfalfa's was obligated to pay to 3601 Group, under the term of its leases; and b) the amount of rent and other payments that 3601 Group actually received from other tenants it obtained to replace Alfalfa's;

(4) 3601 Group's reasonable expenses it incurred in renovating or improving the space for any new tenant, amortized over the term of the new tenant's lease; and

(5) 3601 Group's reasonable expenses it incurred in reletting the space, including real estate commissions.

Clerk's Papers at 704-05.

to Alfalfa's counsel shortly after the breach. During trial, the court had admitted only two statements from the letter as relevant to mitigation: "L & M Partners [3601 Group's predecessor] has several very interested prospective tenants for the Fremont site which Alfalfa's promised to lease," and "It is very likely that a new lease could be in place in a matter of weeks." [9] **[*8]** The rest of the letter explained that if Alfalfa's would sign a subordination agreement that would protect the 3601 Group's construction financing, 3601 Group would "use every effort to find a new tenant so that it can release Alfalfa's from the leases." [10] Should Alfalfa's refuse to sign the agreement, however, the letter stated that 3601 Group would "have no recourse but to immediately commence a lawsuit . . . for breach of contract" and that the potential damages "far exceed lost rents, but will include all damages which result from the breach." [11] These portions tended to demonstrate 3601 Group's intent to enforce the terms of the lease.

The court refused to admit additional portions of Exhibit 83. In closing argument, Alfalfa's used the admitted portion to argue that 3601 Group's failure to obtain substitute tenants within a couple of weeks was evidence of its intent to terminate the lease and relet for its own benefit.

The jury concluded 3601 Group had incurred damages as a result of Alfalfa's breach. In the special verdict the jury found positive damages in seven of eight enumerated categories (e.g., tenant improvements, interest costs, etc.). But the jury offset these damages by a negative figure of almost $ 1.3 million under the category "Realization of Rents." This resulted in a net award of <$ 579,620>.

An offset was authorized by the instructions only if it constituted "damages that [3601 Group] should not recover . . . as a result of [its] failure to mitigate its damages." [12] 3601 Group moved for judgment as a matter of law or a new trial, arguing, inter alia, that the election of remedies instruction confused the jury, misstated the law, and was not supported by substantial evidence, **[*9]** and that the verdict was inconsistent with the law and was so inadequate as unmistakably to indicate it was the result of passion or prejudice. The court denied the motion and entered judgment on the verdict.

DISCUSSION

A challenge to jury instructions is reviewed for abuse of discretion. [13] Instructions must be supported by substantial evidence, must allow the parties to argue their theories of the case, and must properly inform the jury of the applicable law. [14] It is prejudicial error to instruct the jury on a question upon which there is not substantial evidence to

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[9] Brief of Appellant, App. D; Ex. 83.

[10] Id.

[11] Id.

[12] Clerk's Papers at 724.

[13] ***Goodman v. Boeing Co., 75 Wn. App. 60, 68, 877 P.2d 703 (1994)***.

[14] ***State v. Riley, 137 Wn.2d 904, 908 n.1, 909, 976 P.2d 624 (1999)***.

support a decision. [15]

[*10] 3601 Group argues the remedy instruction was improper, because the court's pretrial ruling excluded evidence on that very issue. Alfalfa's contends the ruling merely clarified that Alfalfa's could not argue that 3601 Group had itself breached the lease. Any ambiguity in the court's words, however, is belied by the parties' understanding of the ruling, as evidenced by their clear conduct at trial.

In its pretrial motion, 3601 Group requested exclusion of any evidence or argument that its post-breach actions or omissions indicated a decision on its part to treat the leases as terminated and to relet the premises for its own benefit, thereby releasing Alfalfa's from future rent obligations. 3601 Group argued Alfalfa's lease termination theory was an affirmative defense that was neither adequately pleaded nor preserved, and that the argument was simply an attempt to relitigate liability. Alfalfa's responded it had properly pleaded and preserved this affirmative defense and should be permitted to argue the theory to the jury, but characterized the theory as part of its defense that 3601 Group failed to mitigate its damages.

The court first stated, "The liability issues will not be before **[*11]** this jury." [16] The court went on to say, however: "The issue or issues relating to all of the affirmative defenses that were, in the Court's view, properly pled, will be before this jury." [17] By this the court appeared to accept that Alfalfa's was attempting not to relitigate liability, but merely to advance its affirmative defense of failure to mitigate.

But the court's decision became less clear when it continued, "I will not allow this jury to be presented with evidence that is sought to be used to establish that somehow the [3601 Group] terminated this lease by their actions." [18] This ruling would seem to grant exactly the request made by 3601 Group, and was bolstered when the court addressed Alfalfa's pretrial request to admit Exhibit 83, the letter between the parties' counsel stating that replacement tenants might be found within weeks of Alfalfa's breach. The court reserved ruling on the exhibit, indicating that its decision **[*12]** would depend on whether Alfalfa's offered it as evidence of failure to mitigate or as evidence that 3601 Group elected to treat the leases as terminated. The court later admitted only the parts relevant to mitigation.

Finally, the court concluded:

But at this point I will grant [3601 Group's] Motion in Limine [to exclude Alfalfa's lease termination theory], I guess, in part and reserve in part. I'm granting it to the extent of precluding any reference in opening statement to [Alfalfa's] theory . . . that [3601 Group] breached this lease by their actions. Their actions themselves, however, are still admissible, so that's part of the Motion in

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[15] ***Manzanares v. Playhouse Corp., 25 Wn. App. 905, 910, 611 P.2d 797 (1980)***.

[16] Report of Proceedings (RP) (July 22, 2002) at 22.

[17] Id.

[18] Id. at 23.

Limine that I'm not granting, I guess. [19]

While the court expressly granted 3601 Group's motion, it stated that what was precluded was reference to Alfalfa's theory that 3601 Group "breached this lease by their actions." The court did not expressly mention Alfalfa's theory that 3601 Group elected to terminate the lease, retake possession **[*13]** of the property, and relet it for 3601 Group's own benefit--which was the subject of the motion.

The parties each argue the interpretation of the ruling that supports their respective positions on appeal. But whatever confusion appears on the cold record, it is apparent that both parties treated the ruling as excluding reference to Alfalfa's termination remedy theory. This is so because neither party referred to the theory during opening remarks and neither presented any evidence relating to this issue during trial.

After the close of evidence, Alfalfa's argued that certain evidence--including Exhibit 83--supported giving the proposed remedy election instruction. But the court rejected Alfalfa's arguments and conceded that no evidence supported a conclusion either way. The court also repeatedly remarked that the jury would need to be instructed as to what factors to consider in deciding the issue. Nevertheless, when the court could not determine any suitable factors to include in the **[*14]** instruction, it simply gave an instruction directing the jury to decide the issue, without explaining how it should do so. The court then denied 3601 Group's request to admit additional portions of Exhibit 83. In closing argument, Alfalfa's used the exhibit as evidence that 3601 Group had elected to treat the lease as terminated and relet the premises for its own benefit:

So when the plaintiff made the decision not to put in these very interested prospective tenants in a couple of weeks . . . it decided, I am going to do this for my own account. As the judge has instructed you on the law, that means that Alfalfa's is released of all future rent obligations from the time that tenant starts paying rent. [20]

Evidence to support an instruction must rise above speculation and conjecture. [21] Contending the evidence was sufficient, Alfalfa's points to the lease itself, which established the landlord had the two remedies available; to redacted Exhibit 83, which indicated **[*15]** 3601 Group had other prospective tenants and could have a replacement lease signed within weeks; to the 3601 Group's failure to relet the property for several months; to 3601 Group's lease to its owner ("himself") in the form of Fremont Fresh Market, a separate company with common ownership, after Thrifty Payless bought out of its lease; and the fact that 3601 Group waited several years before filing suit.

Even cumulatively, however, these facts do not rise above "mere speculation and conjecture" that 3601 Group elected one

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[19] Id. at 24-25.

[20] RP (Jul. 26, 2002) at 215.

[21] See ***Bd. of Regents of Univ. of Washington v. Frederick and Nelson, 90 Wn.2d 82, 86, 579 P.2d 346 (1978)***.

remedy over the other. [22] **[*16]** As the court repeatedly acknowledged, there was no evidence to support the instruction. In the absence of such evidence, the decision to instruct the jury to decide which remedy 3601 Group had elected was manifestly unreasonable, and therefore was an abuse of discretion. [23]

Alfalfa's argues that any error was harmless, first because the jury could have reached the same result by concluding that 3601 Group failed to mitigate its damages, and second because so long as the jury offset the entire $ 1.5 million from Payless, the net award would be a negative number, regardless of the remedy theory. But the first argument assumes the jury accepted certain evidence and rejected other evidence, which we may not do on review, and the second argument ignores the fact that the jury had to decide not just how much of the settlement should be offset, but also the total against which any offset was calculated--a figure which would have changed significantly if the jury found 3601 Group relet to its own account at some point. Indeed, extrapolating from the amount awarded as late fees, 3601 Group's expert concluded that the likely explanation for the verdict is that the jury decided 3601 Group elected to terminate the lease and relet to its own account when it leased to Fremont Fresh **[*17]** Market. The expert's calculation matched within a few dollars the result obtained by the jury.

Whether the jury could have come to the same or to a similar verdict absent the erroneous instruction is not the question. A harmless error is one that is trivial and in no way affected the outcome of the case. [24] Because we cannot say that the court's error in giving the instruction had no effect on the outcome, it was not harmless. We reverse and remand for a new trial.

Reversed.

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[22] See id.

[23] See ***State ex. rel. Carroll v. Junker, 79 Wn.2d 12, 26, 482 P.2d 775 (1971)***.

[24] ***Crittenden v. Fibreboard Corp., 58 Wn. App. 649, 659, 794 P.2d 554 (1990)***.