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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

BURLINGTON COAT FACTORY OF CALIFORNIA, LLC,

Plaintiff and Appellant,

v.

BELLA TERRA ASSOCIATES, LLC,

Defendant and Respondent.

G039699

(Super. Ct. No. 07CC02317)

O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, H. Warren Siegel, Judge. Reversed.

Tuchman & Associates, Aviv L. Tuchman, Loren N. Cohen; Greines, Martin, Stein & Richland, Robert A. Olson and Alana H. Rotter for Plaintiff and Appellant.

Seed MacKall, Peter A. Umoff and Alan D. Condren for Defendant and Respondent.

* * *

This case presents the question whether a commercial lease provision purporting to calculate the tenant's share of the real estate taxes in a manner requiring the tenant to pay *over three times* the assessed amount of real estate taxes can be viewed as so clear and unambiguous that the tenant is precluded from introducing any evidence demonstrating the parties may have intended a different result?

We conclude the answer is no, and reverse the trial court's decision sustaining the landlord's demurrers without leave to amend. We also conclude the trial court erred in granting summary judgment for the landlord on tenant's remaining cause of action for reformation. In moving for summary judgment, the landlord attempted to establish it was a bona fide purchaser (BFP) of the shopping center without notice of an alleged error in a number used to calculate the tenant's share of real estate taxes. But the tenant's estoppel certificate disclosed the tenant and landlord had not been using the disputed calculation to determine the tenant's share of real estate taxes, creating a triable issue of fact whether the landlord had a duty of inquiry which, if fulfilled, would have led to the landlord's discovery of the alleged mistake. Accordingly, we also reverse the trial court's summary judgment ruling as to the tenant's reformation claim.

I

FACTUAL AND PROCEDURAL BACKGROUND

Bella Terra Associates, LLC (Bella Terra) is the owner of a shopping center known as Bella Terra Huntington Beach (center). A portion of the center is leased to Burlington Coat Factory of California, LLC (Burlington) under a written lease executed in April 1995 between Burlington and MCA Huntington Associates, L.P. (MCA). Section 16.2 of the lease provides: "Tenant's Share of Real Estate Taxes for the period from the Rent Commencement Date through and including December 31, 1995 shall be One Hundred Thirty-Three Thousand Five Hundred and No/100 ($133,500.00) per Lease Year (the 'Base Tax Amount'). The Base Tax Amount for any partial Lease Year at the

beginning of the Term shall be appropriately prorated. For Lease Year 1996 and each Lease Year thereafter during the Term Tenant's Share of Real Estate Taxes shall be the Base Tax Amount increased by a percentage equal to the percentage increase in the total Real Estate Taxes levied and assessed against the land, buildings and all other improvements located on the Tax Parcel as compared to the total Real Estate Taxes levied and assessed against the land, buildings and all other improvements located on the Tax Parcel for tax fiscal year 1995-1996." The parties agree the tax levied on the Tax Parcel for fiscal year 1995-1996 is $42,552.54.

Bella Terra purchased the center in 2005, and obtained a Tenant Estoppel Certificate from Burlington stating the landlord was not in default under the lease, and that Burlington's "is currently paying . . . $11,125.00 per month as its current share of real property taxes." After Bella Terra's purchase of the center, the county assessor's office reassessed the value of the parcel upon which the premises were located. Bella Terra appealed the assessment, but failed to timely inform Burlington of the reassessment so it could participate in the appeal. Bella Terra also failed to provide documentation to Burlington required for a late appeal of the reassessment. Although the reassessed taxes on the parcel totaled only $378,362.58, Bella Terra charged Burlington $1,022,121.22 for its annual "Share of Real Estate Taxes" based on Bella Terra's interpretation of section 16.2 of the lease. Threatened with eviction, Burlington paid the increased taxes under protest.

Burlington sued Bella Terra for, inter alia, breach of contract, declaratory relief, and reformation. The complaint alleges Bella Terra incorrectly interpreted section 16.2 of the lease by calculating Burlington's "Share of Real Estate Taxes" in a manner that unreasonably increased the amount Burlington owed. In its breach of contract claim, Burlington alleged Bella Terra breached the contract by demanding, under threat of eviction, an inflated amount of its share of real estate taxes under the lease. Burlington also alleged Bella Terra breached the implied covenant of good faith and fair

dealing by failing to notify Burlington of the increased tax reassessment until after the time to appeal had lapsed, failing to provide documents Burlington requested to file a late appeal of the reassessment, and entering into agreements with the city to increase property taxes not contemplated under the lease. Burlington's declaratory relief claim seeks a judicial declaration of the appropriate methodology for calculating Burlington's share of real estate taxes. Burlington asserts the correct amount of the base tax amount as used in section 16.2 is $42,552.54, and that Burlington is entitled to a refund, with interest, of all taxes overpaid under Bella Terra's interpretation of the lease.

In its reformation cause of action, Burlington seeks to reform section 16.2 of the lease to redefine the base tax amount to $42,552.54, and ensure that the taxes Burlington owes under the lease reflect the actual tax assessments on the parcel. Burlington also seeks to impose a constructive trust on Bella Terra as to the approximately $800,000 Burlington allegedly overpaid because of Bella Terra's interpretation of the lease.

Burlington attached to its complaint a letter written by Jan de Leeuw, distinguished professor and chair of the UCLA statistics department. In the letter, Leeuw observes that Bella Terra is interpreting section 16.2 as applying the following formula: BTA + BTA x (CT-PT/PT), or simplified, BTA x (CT/PT), where BTA is the base tax amount, CT is the current tax, and PT is the 1995-1996 tax. Leeuw notes that Burlington asserts the following formula is correct: BTA + PT x (CT-PT/PT), which simplifies to BTA + (CT-PT). Leeuw observes that under Bella Terra's calculation, for each dollar real estate taxes increase, Burlington must pay $3.13. Leeuw also notes that under Burlington's interpretation, Burlington would pay one dollar for each dollar taxes increase.

Leeuw then provides the following opinion: "Because the language is unclear in a critical place it is difficult to decide what formula is the correct or intended one. If the provision had said 'increased by a percentage *of the Base Tax Amount* equal

to the percentage increase . . .' then the landlord's interpretation may be the correct one. If it means 'increased by a percentage *of the 1995-1996 Real Estate Taxes* equal to the percentage increase . . .' then the tenant's formula is correct. Observe that tenant's interpretation conforms to the language 'increase by a percentage equal to the percentage increase . . .[.'] Also observe that if BTA had been set to PT initially, then both the landlord's formula and the tenant's formula would equal CT for every tax year, i.e., the tenant would simply pay the real estate taxes. [¶] It seems that section 16.2 is intended to ensure the tenant pays the property taxes, but never less than the BTA. A rule that adds more than three dollars to the tenant's payment for each single dollar increase in taxes cannot properly describe[d] as a rule that determines the tenant's 'share of the real estate taxes[.'] Although the language is ambiguous, use of the word 'share' suggest[s] that CT should be considered to be an upper bound to the amount of additional rent paid." (Original italics.)

The trial court sustained Bella Terra's demurrer to the breach of contract cause of action, determining section 16.2 was clear and not reasonably susceptible to the meaning Burlington alleged. The trial court later granted Bella Terra's summary judgment motion on Burlington's reformation cause of action. The trial court concluded Burlington failed to show that Bella Terra knew or suspected that MCA and Burlington intended to employ a different tax assessment than the one Bella Terra utilized when it acquired the lease, and Burlington failed to demonstrate the original contracting parties' intent. The trial court entered judgment, and Burlington now appeals.

II

DISCUSSION

A. *The Trial Court Erred in Granting Bella Terra's Demurrer*

"'[W]here an ambiguous contract is the basis of an action, it is proper, if not essential, for a plaintiff to allege its own construction of the agreement. So long as

the pleading does not place a clearly erroneous construction upon the provisions of the contract, in passing upon the sufficiency of the complaint, we must accept as correct plaintiff's allegations as to the meaning of the agreement.' [Citation.] . . . [¶] Where a complaint is based on a written contract which it sets out in full, a general demurrer to the complaint admits not only the contents of the instrument but also any pleaded meaning to which the instrument is reasonably susceptible. [Citation.] While plaintiff's interpretation of the contract ultimately may prove invalid, it was improper to resolve the issue against her solely on her own pleading. 'In ruling on a demurrer, the likelihood that the pleader will be able to prove his allegations is not the question.'" (*Aragon-Haas v. Family Security Ins. Services, Inc.* (1991) 231 Cal.App.3d 232, 239 (*Aragon-Haas*).) Moreover, "[t]he fact that the terms of an instrument appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms." (*Pacific Gas & E. Co. v. G. W. Thomas Drayage etc. Co.* (1968) 69 Cal.2d 33, 39.) On the other hand, if the language is not reasonably susceptible to the interpretation urged by the plaintiff, "the case is over." (*Southern California Edison Co. v. Superior Court* (1995) 37 Cal.App.4th 839, 847.)

As noted above, section 16.2 of the lease reads, in part: "Tenant's Share of Real Estate Taxes shall be the Base Tax Amount increased by a percentage equal to the percentage increase in the total Real Estate Taxes levied and assessed against the land, buildings and all other improvements located on the Tax Parcel as compared to the total Real Estate Taxes levied and assessed against the land, buildings and all other improvements located on the Tax Parcel for tax fiscal year 1995-1996." Burlington interprets the foregoing to require an increase in the base tax amount measured by the amount of the increased tax on the parcel. As Bella Terra points out, however, had the parties intended this meaning, it could have been expressed more clearly, and the phrases, "increased by a percentage," and "percentage increase" could have been eliminated.

On the other hand, Bella Terra's interpretation, that the base tax amount be multiplied by the current tax year divided by the 1995-1996 tax year, also could have been stated more simply if that was what the drafter intended. Moreover, Bella Terra's interpretation produces a strange result in that the phrase "Tenant's Share of Real Estate Taxes" suggests some lesser portion of the specified "total Real Estate Taxes." Yet Bella Terra's interpretation calls for Burlington's share of the taxes to be 3.13 times the actual taxes, no matter how high the actual taxes rise. Indeed, application of Bella Terra's interpretation meant that upon its acquisition of the center, Burlington's share of real estate taxes increased from $11,125 per month to approximately $85,176 per month, far outstripping Burlington's $37,486.75 monthly rent payment. Given that Bella Terra's actual taxes on the parcel rose to only $31,530.15 per month, Bella Terra was making significantly more money on Burlington's tax payments than it was from Burlington's rent payments. But nothing in the lease suggests Burlington's tax payments were intended as a major source of profit to Bella Terra.[1]

In sum, we cannot say as a matter of law that Bella Terra's interpretation is correct, and extrinsic evidence may be necessary to resolve the issue. Accordingly, we conclude the trial court erred in sustaining Bella Terra's demurrers without leave to amend.

B. *The Complaint States a Cause of Action for Breach of the Covenant of Good Faith and Fair Dealing*

Burlington alleged Bella Terra breached the covenant of good faith and fair dealing, as follows: "Defendant further breached the lease and the covenant of good faith and fair dealing by unreasonably failing to notify plaintiff of the alleged increase in Real

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[1] We recognize that even without Bella Terra's interpretation, the lease sets Burlington's initial share of the taxes at $133,500, even though the actual tax in the initial year was only $42,552.54. But this difference is only $7,578.95 per month, far less than the rent Burlington was paying.

Estate Taxes for the Demised Premises as a result of reassessment by the Orange County Assessor's Office. Defendant appealed Assessor's reassessment of the demised property without notifying plaintiff of the appeal process and plaintiff is now unable to assert its rights to timely appeal the reassessment. Plaintiff asked defendant for documents necessary for the tax appeal to attempt a late appeal of the reassessment. Defendant has failed to provide necessary assistance or access to documentation to assist plaintiff's right to appeal the reassessment. The redevelopment of the mall and the agreements made between the City of Huntington Beach and BELLA TERRA or its predecessor has created a tax assessment not contemplated under the lease."

The implied covenant of good faith and fair dealing is implied in every contract in California, including commercial leases. (*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 372 (*Carma Developers*); *Andrews v. Mobile Aire Estates* (2005) 125 Cal.App.4th 578, 589.) It "implies a promise that each party will refrain from doing anything to injure the right of the other to receive the benefits of the agreement." (*Aragon-Haas, supra*, 231 Cal.App.3d at p. 240.) The implied covenant "can be breached for objectively unreasonable conduct, regardless of the actor's motive." (*Carma Developers*, at p. 373; see also 1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 801, p. 895 ["The essence of the good faith covenant is *objectively reasonable conduct*"].) Nor does a breach of the implied covenant require breach of a specific contract term. (*Carma Developers, supra*, at p. 373.) "Were it otherwise, the covenant would have no practical meaning, for any breach thereof would necessarily involve breach of some other term of the contract." (*Id.* at p. 373.)

Nonetheless, the covenant may not be used to create new terms and conditions not implicit within the parties' agreement. On this point, the Supreme Court observed: "The covenant of good faith and fair dealing . . . exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the *benefits of the agreement actually made.* [Citation.] The covenant thus cannot '"be endowed with

an existence independent of its contractual underpinnings."' [Citation.] It cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement." (*Guz v. Bechtel National, Inc.* (2000) 24 Cal.4th 317, 349-350, original italics.)

Bella Terra contends its duties to Burlington regarding tax assessments are spelled out in the lease, and that Burlington may not use the implied covenant to impose new duties. Bella Terra also contends that Burlington's right to pursue its own tax appeal did not depend on whether Bella Terra gave notice of its own appeal.

Regardless of the merits of these arguments, Burlington stated a cause of action for breach of the implied covenant when it alleged that Bella Terra entered into agreements with the city to increase property taxes not contemplated under the lease. The benefit Burlington sought under the lease was to operate its store at a profit. Because of the threefold multiplier effect of Bella Terra's reading of section 16.2, Bella Terra has an incentive to increase income taxes on the parcel underlying Burlington's store which, if acted upon, will reduce or destroy Burlington's profit. Absent application of the covenant of good faith and fair dealing, nothing would prevent Bella Terra from taking additional steps to raise its taxes, thereby enriching itself at Burlington's expense in a manner not contemplated under the lease. Accordingly, we conclude the complaint adequately states a cause of action for breach of the implied covenant.

C. *The Trial Court Erred in Granting Summary Judgment*

In its reformation cause of action, Burlington seeks to reform the contract to replace the $133,500 figure for the base tax amount in the lease with $42,552.54, the 1995-1996 assessment on the tax parcel. Reformation is governed by Civil Code section 3399, which provides: "When, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised on the

application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value." Burlington seeks reformation on the basis of its unilateral mistake, and therefore must establish two facts: First, that Bella Terra's predecessor knew or suspected section 16.2 of the lease did not express the parties' intention; second, that Bella Terra is not a BFP. Although Burlington must ultimately prove both of these facts, Bella Terra's summary judgment motion focused *solely* on the question whether Bella Terra was a BFP.

In granting Bella Terra summary judgment, however, the court confused these two issues: "The only one directly involved in the original deal — Kassner at paragraph 12 of [his] declaration says [he] doesn't recall issue being discussed — so his stated intent in paragraph 10 is inconsistent with paragraph 12. Moreover his unilateral intent is not binding on a B[FP]. Actual notice must be shown to not be a B[FP]. Constructive notice . . . does not defeat Motion for Summary Judgment. [Citation.] Responding party has failed to show that the original contracting parties had responding party's now postulated intention, or that moving party knew or suspected."

True, constructive notice of the other party's unilateral mistake is insufficient to allow reformation. (*La Mancha Dev. Corp. v. Sheegog* (1978) 78 Cal.App.3d 9, 16 ["constructive notice of the unilateral mistake of the other party is not a sufficient ground for reformation"] But as one court noted, "The protected 'third persons' referred to in section 3399 are not those who purchase with notice, *actual or constructive*, of the rights of other persons whose interests have been described defectively in written instruments [citation]. Notice is a question of fact [citation]." (*Shupe v. Nelson* (1967) 254 Cal.App.2d 693, 698-699.)

Constructive notice sufficient to defeat BFP status may arise in different ways. For example, if a tenant is in possession of leased premises, and the circumstances are such as to put a purchaser on inquiry, the purchaser is charged with knowledge of all those facts a reasonably diligent inquiry would have disclosed. (*Claremont Terrace*

Homeowners' Assn. v. United States (1983) 146 Cal.App.3d 398, 408 [holding purchaser was charged with knowledge of an option to purchase contained in an unrecorded lease, because the optionee was in possession of the premises and paying taxes and the monthly mortgage payments due on the property].)

This principle was applied in *Three Sixty Five Club v. Shostak* (1951) 104 Cal.App.2d 735 (*Three Sixty Five Club*). There, a tenant leased three floors of a building to operate a nightclub. The recorded lease included a clause allowing the landlord to recapture the second floor at any time. The landlord and tenant orally agreed to waive the recapture provision, and the tenant made improvements to the second floor. A third party later purchased the building and, in reliance on the recorded lease, attempted to recapture the second floor. The appellate court held the new landlord was bound by his predecessor's oral waiver of the recapture clause. (*Id.* at p. 739.) The court determined the substantial improvements the tenant had made to the second floor were inconsistent with a lease provision permitting the landlord to recapture the floor at any time. The improvements put the new landlord on notice, triggering a "duty of making a reasonable inquiry as to rights of the tenant not included in the lease" (*ibid.*) and imputing to him "knowledge of all that a reasonably diligent inquiry as to the rights and claims of the occupant might have disclosed," including the oral waiver (*id.* at p 738).

Although Bella Terra relies heavily on Burlington's estoppel certificate to demonstrate its BFP status, the document also undercut's Bella Terra's position. Specifically, the estoppel certificate notified Bella Terra that Burlington was paying the base tax amount of $133,500 per year (expressed in the certificate as $11,125 per month) as its "Share of Real Estate Taxes," despite annual fluctuations in the parcel's annual tax assessments. In his deposition, Sahn testified that in performing due diligence for the proposed purchase of the center, he had looked at the amount being assessed for each parcel and the amount being collected from each tenant.

We conclude Bella Terra's knowledge that the prior landlord had not been applying the formula in section 16.2 placed it upon a duty of further inquiry, just as if the tenant has declared that it was paying rent in an amount less than that called for in the lease. In either case, the purchaser has a duty to make reasonable further inquiry, and will be charged with the knowledge such an inquiry might have disclosed. Given that Burlington objected strongly when Bella Terra first presented it with a tax bill based on the formula in section 16.2, we may assume, drawing all reasonable inferences in Burlington's favor (see *Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 843), that Burlington would have asserted a mistake in the lease had Bella Terra brought the matter up before it purchased the center. We therefore conclude the trial court erred in granting summary judgment.

III

DISPOSITION

The judgment is reversed. Burlington is entitled to its costs of this appeal.

ARONSON, J.

WE CONCUR:

SILLS, P. J.

O'LEARY, J.