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## Rent Overpayments: Return to Sender?

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For a tenant, a lease is a major operational expense, and for a landlord, a source of revenue. Although a written lease may appear straightforward, the agreement itself is rather complex. Adding to the complexity, the current economy is leading to continued rate negotiations, contract changes in regard to sublets and the departure of tenants. As such, it is not uncommon for payments to be made based on old contracts, making regular reviews vital for both landlords and tenants.



Not only do overpayments result in the expenditure of tenant capital, they also have legal implications for the landlord. Perhaps not surprisingly, the law generally requires landlords to refund excess money accidentally paid by lessees. However, the legalities of overpayments are evolving, and both tenants and landlords need to be aware of their rights.

If a tenant overpays rent, the California Supreme Court's 1914 ruling in *National Bank of California v. Miner* allows for accidental payments to be recovered. The law even applies if the tenant acted with negligence - for example, by misreading, or even failing to read, the terms of a lease. The only exception is if the landlord has "changed its position" in reliance on the windfall.

Typically, the only factor working against a tenant's reimbursement is the statute of limitations, which generally starts to run when the tenant knows or should know the facts necessary to make its claim. A lawsuit must be filed within three years of an overpayment caused by a mistake or within four to recover for an overpayment caused by a breach of contract. Such a breach, for example, might exist if a landlord had a duty to calculate rent due and provided incorrect calculations.

A tenant may also gain the benefit of a four-year statute of limitations period by characterizing the landlord's erroneous rent invoices and/or acceptance of overpayments as a breach of "the implied covenant of good faith and fair dealing." Under California law, it is implied in a contract that each party agrees "to do every-

thing that the contract presupposes that he will do to accomplish its purpose."

Depending on the facts, it could be argued that the landlord breached the implied covenant of good faith when it retained payments exceeding those provided in the lease. In this way, a tenant who makes overpayments by mistake can use the longer breach of contract statute of limitations.

In addition, if it can be proven that the landlord purposely misled a tenant to pay excess rent; the tenant has a strong chance of recouping the overpayments. While the statute of limitations for claims based on fraud is three years, courts are more willing to entertain the idea that a tenant was not "on notice" of the relevant facts - even the language of the lease - when the landlord actively engaged in deceptive practices.

Tenants can also take advantage of a potential exception to the statute of limitations. In a recent unreported case, *Western General Insurance Co. v. Encino Executive Plaza, Ltd.*, a tenant offset its rent payments by deducting for overpayments dating several years earlier. When the landlord sued for the offset, unpaid rent, it argued that the tenant should not be able to offset its rent with claims for reimbursement predating the statute of limitations period. In disagreeing with the landlord, the appellate court found that the statute of limitations was inapplicable. The court reasoned that the tenant merely withheld payments and did not actually make an affirmative claim for reimbursement. "The statute of limitations," wrote the court "is not a bar to defensive, as opposed to affirmative, relief."

If a commercial tenant can establish that it overpaid its rent, there are generally only two effective arguments a landlord can use to retain the overpayment.

The landlord should point to any applicable statutes of limitations that might bar or limit the tenant's recovery. A landlord should note that, to the extent overpayment was merely the result of a mistake (and not caused by the landlord's breach of contract), the tenant can generally only sue for the return of overpayments made within three years of the filing of a claim.

The landlord should also marshal any evidence that it can find to demonstrate its own

reliance on the overpayments or on any representations made by the tenant waiving the ability to sue for excess payments. If the landlord can show this kind of reliance, it may be able to defeat even timely claims for reimbursement.

Demonstrating reliance on a tenant's overpayment requires a fact-intensive analysis. The landlord needs to show specific decisions and conduct that were influenced by the overpayments.

Moreover, with regard to promises not to sue, recent cases appear to support the view that even a signed estoppel certificate may not be enough to conclusively establish "reliance." Rather, a landlord needs to have actually relied on the certificate and probably needs to have been unaware of any overpayments at the time the certificate was signed.

A landlord confronted with a demand for overpayments should carefully explore the possibility that the payments were arguably required under the lease (including any theories of modification) - and therefore not "overpayments" in the first place. If it appears that the claim for overpayments is accurate, the landlord should systematically evaluate its legal obligations.

The landlord should pay close attention to the dates of the overpayments, and the nature of the commercial tenant's claim for reimbursement, with an eye toward any applicable statutes of limitations. The landlord and counsel must work diligently to investigate and develop any evidence that could show reliance on overpayments or legal waiver by the tenant. Courts likely will not entertain late evidence of reliance and, regardless, the longer it takes to produce evidence of reliance, the less persuasive that evidence will be.

Ultimately, even if there is no legal obligation to return overpaid money, the landlord will want to consider whether it would be prudent to do so in order to avoid conflict and preserve its reputation. In this regard, an ounce of business sense can be worth a pound of legal advice.

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