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STATE OF NORTH DAKOTA

Case No.: 20140188

District Court No. 09-2012-CV-02902

IN THE SUPREME COURT

STATE OF NORTH DAKOTA

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Sterling Development Group Three, LLC,
Sterling Development Group Eight, LLC,

Plaintiffs/Appellants,

v.

James D. Carlson,

Defendant/Appellee.

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**APPELLANTS' REPLY BRIEF**

**DISTRICT COURT OF THE EAST CENTRAL JUDICIAL DISTRICT**

**THE HONORABLE STEVEN L. MARQUART PRESIDING**

**DISTRICT COURT NO. 09-2012-CV-02902**

**APPEAL FROM THE MEMORANDUM OPINIONS DATED MARCH 11, 2014 AND JUNE 25, 2014**

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**Erik R. Johnson & Associates, Ltd.**

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## LAW AND ARGUMENT

[1] The issue before this Court is the interpretation of two unambiguous Lease contracts, and two separate and distinct Personal Guarantees of those Leases. "The interpretation of a written contract is a question of law, if the parties' intent can be determined from the language of the writing alone. Whether a written contract is ambiguous is a question of law, which we review independently." Doeden v. Stubstad, 2008 ND 165, ¶ 14, 755 N.W.2d 859 (citations omitted) (emphasis added). Further, exoneration of a Personal Guaranty is a statutory provision. N.D.C.C. §22-01-15. "The interpretation and application of a statute is a question of law, which is fully reviewable on appeal." Larson v. Norheim, 2013 ND 60, ¶ 9, 830 N.W.2d 85 (citing Bragg v. Burlington Res. Oil and Gas Co. LP, 2009 ND 33, ¶ 8, 763 N.W.2d 481 (quotations omitted)) (emphasis added). Further, in order to exonerate a guarantor, an alteration of the original obligation must meet the essentials of a contract. Ag Services of America, Inc. v. Midwest Investment Limited, 1998 ND 189, ¶11, 585 N.W. 2d 571 (citing Thurber v. Fisher, 12 P.2d 481, 482 (Cal.App. 1932)).

[2] Carlson contends that the lease terms have been altered, exonerating his valid and enforceable personal guaranty obligations on both leases. N.D.C.C. §22-01-15. Carlson asserts that there are writings to support his assertion of alterations. Appellee's Brief at 18. Sterling Three and Sterling Eight disagree. In fact, the parties to the Sterling Three Lease and Sterling Eight Lease consciously and deliberately acted in conformance with the Sterling Three and Sterling Eight lease terms.

[3] The Consumer Price Index rate adjustments complied with the leases. Keith Hanson advised the tenant:

> Per the Lease Agreement, the annual rate shall be adjusted by the change in purchasing power every 5 years as shown in the Consumer Price Index from the first full month following the Commencement Date of September 1, 2000 for the original building.

Appendix 307 (emphasis added). Keith Hanson further stated: "As in 2005 we are using the first half number from the semi-annual report, as the 1967 index is no longer updated." Appendix 307 (emphasis added).

[4] The communications regarding the janitorial service in the tenant's space also evidences compliance with the lease terms. The tenant wrote:

> We have not made any decisions on anything- we are merely exploring options and know that we would have to ensure we complied with our lease agreement, which is why I am checking.

Appendix 330 (emphasis added).

[5] The tenant's responsibility for the real estate taxes never changed. Sterling Eight was entitled to the TIF payment, and Jim Richter so advised: "This is actually a better deal for PRACS and same deal for Sterling Development." Appendix 337 (emphasis added). Sterling Eight's entitlement to receive the TIF continued "regardless of any job or wage goals that might be applicable, under Minnesota law, including MSA §§116J.01 *et sequitor*." Appendix 349 (emphasis added).

[6] To find changes to the unambiguous terms of the Sterling Three Lease and Sterling Eight Lease here will have far reaching negative consequences on widely used terms in Commercial Leases. To find that these alleged changes result in exoneration of valid and enforceable personal guaranty obligations will impact Personal Guaranty law significantly.

I. The Consumer Price Index Calculation Did Not Alter the Lease Terms.

[7] The Sterling Three and Sterling Eight Leases provide for a rate adjustment based on the Consumer Price Index ("CPI"), or a substitute index if necessary. The Sterling Three base rent was adjusted in 2005. Margaret Asheim communicated the rate adjustment to PRACS, stating "Per Article II, Section 2.1.1.1 of our lease…." Appendix 300. The rate of adjustment was 14.39%. PRACS accepted the rate increase without objection, and paid the increased rent without dispute. Steve Kiemele, Chief Financial Officer of PRACS, testified that PRACS was not "debating" or "contesting" the 2005 calculation. Transcript of Trial Proceeding, February 4, 2014, page 320, lines 4-15. The following table is representative of the 2005 CPI calculations:

| | | |
|---|---|---|
| Year 1 | 9/1/00 to 8/31/01 | 175.3-168.2 = 7.10/168.2 = 4.22% |
| Year 2 | 9/1/01 to 8/31/02 | 179.3-168.2 = 11.10/168.2 = 6.60% |
| Year 3 | 9/1/02 to 8/31/03 | 181.7-168.2 = 13.50/168.2 = 8.03% |
| Year 4 | 9/1/03 to 8/31/04 | 186.6-168.2 = 18.40/168.2 = 10.94% |
| Year 5 | 9/1/04 to 8/31/05 | 192.4-168.2 = 24.20/168.2 = 14.39 % |

[8] The next rent adjustment occurred in 2010. Keith Hanson advised the tenant he was making the rent adjustment "Per the Lease Agreement," and was using the same table, and the same methodology as was done in 2005. Appendix 307. The rate adjustment was an increase of 9.6492%. The following table represents the rate adjustment calculation in 2010:

| | | |
|---|---|---|
| Year 6 | 9/1/05 to 8/31/06 | 195.1-192.4 = 2.70/192.4 = 1.40% |
| Year 7 | 9/1/06 to 8/31/07 | 200.627-192.4 = 8.227/192.4 = 4.28% |
| Year 8 | 9/1/07 to 8/31/08 | 208.284-192.4 = 15.884/192.4 = 8.26% |
| Year 9 | 9/1/08 to 8/31/09 | 206.167-192.4 = 13.767/192.4 = 7.16% |
| Year 10 | 9/1/09 to 8/31/10 | 210.965-192.4 = 18.565/192.4 = 9.65% |

[9] Clearly the same methodology was used, and there was no change in the lease terms. The 4.21% rate Carlson advocates is simply not provided for by the lease terms. There is no evidence to support Carlson's assertion that "the plain reading of this obligation is that the rent will be increased to provide Sterling a rent increase for the average increase in purchasing power

equal to the average of the previous five year period." Appellee's Brief at 22-23. The leases do not provide for an "average," but rather the change in purchasing power. Transcript of Proceedings, February 4, 2014, page 280, lines 10-20.

[10] The CPI was adjusted using the same index and in the same manner in 2005 and 2010. There is no evidence of a contractual alteration to the unambiguous lease terms. Carlson's Personal Guaranty obligations are not exonerated.

II. The Tenant is Responsible for Cleaning in its Demised Space.

[11] The unambiguous lease contracts provide that the tenant is responsible for the cleaning in its own space. Appendix 84, 109. The leases do not dictate who must provide the cleaning. There was another tenant in the Sterling Three building (MeritCare), and there is common space associated with the occupancy of both buildings. The landlord was responsible for cleaning the common areas. Sterling Three and Sterling Eight contracted with Thur-O-Clean to provide that cleaning. By agreement, Thur-O-Clean also cleaned the tenants' demised space; a common Commercial Real Estate practice. Sterling Three and Sterling Eight disagree that it was "understood" they were responsible for securing the cleaning in the tenants' demised space. Appellee's Brief at 9. Further, Carlson's assertion that "the parties always acted in accordance with their understanding that the leases required Sterling to arrange for and provide the janitorial service in the PRACS space" is unsupported. Appellee's Brief at 21. Rather, the unambiguous lease terms do not impose any such obligation. Sterling Three and Sterling Eight facilitated the cleaning arrangements for the demised space, as is commonly done. Transcript of Proceedings, February 3, 2014, page 128, lines 20-25. There was no requirement to do so. Thur-O-Clean then

billed the property manager for the number of hours spent in each tenant's space, as well as the common area. Appendix 364. The cleaning expense for demised premises was passed through directly to PRACS, and identified as a separate line item on the Operating Summary- Janitorial-Direct Expense. Appendix 314, 320, 324.

[12] The direct expense and CAM expenses were estimated and collected on a monthly basis. Transcript of Proceedings, February 3, 2014, page 130, lines 12-25. When the actual bills were tallied, the account was "trued up" to reflect the actual expense attributable to the tenant.

[13] The tenant's decision to clean its space in-house in 2008 is entirely consistent with the unambiguous lease provisions. The separate line item on the Operating Expense Summary reflected a reduced pass through in 2008 because the change was made mid-year, resulting in a credit balance. Appendix 312, 314. The Janitorial- Direct Expense reflected a zero balance thereafter. Appendix 311.

[14] The parties to the leases clearly intended to, and in fact did, act in conformance with the unambiguous lease terms. There was never any contractual agreement to the contrary. The janitorial provision of the Sterling Three and Sterling Eight leases was not altered. Carlson's Personal Guarantees of the Sterling Three and Sterling Eight Leases are not exonerated.

## III. The Tenant's Obligation to Pay the Real Estate Taxes Pursuant to the Sterling Eight Lease Term Did Not Change.

[15] The Sterling Three Lease and the Sterling Eight Lease specifically provide that the lessee (PRACS) is responsible for the payment of real estate taxes. Appendix 84, 109. Sterling Three and Sterling Eight received a separate and distinct TIF for the development of the properties occupied in part by PRACS in East Grand Forks. Appendix 349 (Sterling Eight Purchase

Agreement). Only the TIF on the Sterling Eight property was implicated by Carlson's JOBZ application. Appendix 315, 326, 336, 338. Carlson's assertion that "Sterling and PRACS negotiated an alteration to the Sterling Three and Sterling Eight leases…" is simply wrong. Appellee's Brief at 7. The JOBZ application identifies construction set to start in June 2004, and the credit attained only impacted the Sterling Eight TIF. PRACS's compliance report is irrelevant. The Sterling Three TIF was not impacted. The Sterling Three Lease terms were undisputedly not altered, and Carlson's Personal Guaranty of the Sterling Three Lease is not exonerated.

[16] The Sterling Eight Lease was not contractually altered by the parties to the lease. In 2004, Carlson signed a JOBZ agreement with the State of Minnesota on behalf of PRACS. Appendix 342. (emphasis added). The JOBZ credit incents job and equipment growth. PRACS was required to meet the JOBZ requirements by the end of 2005, while Carlson was still the sole shareholder of PRACS. Appendix 342 ("The qualified business shall create eighteen (18) new FTE jobs by or before December 31, 2005"). The JOBZ benefit was a real estate tax credit.

[17] The overseeing governmental entities failed to recognize the impact the JOBZ credit had on Sterling Eight's TIF. However, the TIF provides for its continuation, regardless of any other tax incentive programs, including the JOBZ credit. PRACS, Jim Richter, and Sterling Eight resolved the conflict so that Sterling Eight received the same deal, and PRACS received a better deal. Carlson owned (until January 2006) or was President (until June 2007) of PRACS at the time. There is no mention of the TIF or JOBZ credit in the unambiguous Sterling Eight Lease. The alternative would be to deny PRACS the JOBZ credit. PRACS was responsible for the payment of the real estate taxes. The Sterling Eight Lease was not altered. Carlson's Personal Guaranty of the Sterling Eight Lease was not exonerated.

IV. Carlson Actually or Impliedly Consented to Alleged Contract Alterations, If Any.

[18] N.D.C.C. § 22-01-15 provides for exoneration of a Personal Guaranty if there is a contract alteration, made without the consent of the Guarantor. Carlson actually or impliedly consented to the alleged changes, if in fact there were any. Estate of Murphy, 554 N.W.2d 432, 436 (N.D. 1996) stands for the proposition that consent may be implied from the parties' conduct. Carlson's assertion that implied consent is inadequate, "Indeed, actual consent is and should be required," Appellee's Brief at 24, is wholly unsupported. Carlson consent is evidenced by his signing of the leases and Personal Guarantees, payment of rent, receipt of the Operating Summaries, and signature on the JOBZ application. Carlson actually and impliedly consented to the alleged alterations by his clear actions as President and sole shareholder of PRACS, and thereafter as President during the relevant time period.

V. The Trial Court Awarded Costs Not Provided for by Statute.

[19] The lower court abused its discretion by allowing costs not provided for by statute. N.D.C.C. § 28-26-06. Further, the expert fee award was premature. The parties stipulated to bifurcate liability and damages, and agreed that Sterling Three and Sterling Eight were not waiving any objections to Konrad Olson's testimony.

Dated this 12th day of September, 2014.

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## CERTIFICATE OF COMPLIANCE

The undersigned, as attorney for Appellants Sterling Development Group Three, LLC, and Sterling Development Group Eight, LLC and as the author of the above brief, hereby certifies, in compliance with Rule 32 of the North Dakota Rules of Appellate Procedure, that the brief was prepared with proportional typeface (Times New Roman) and the brief, excluding the table of contents, the table citations, and certificate of compliance, does not exceed 2,000 words.

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## CERTIFICATE OF ELECTRONIC SERVICE

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I hereby certify that on September 12, 2014, a true and correct copy of **Appellants' Reply Brief** was served electronically upon the following:

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