TENANTS:

BEWARE THE BUILD-TO-SUIT

COUNSEL'S CORNER

I love Supreme Court case opinions. The Supremes don't take on commercial real estate cases very often. But when they do, we always receive a well-reasoned, uber-researched opinion.

And sometimes the Supremes are right!

More than 10 years ago ECO Resources, Inc., entered into a build-to-suit lease with its landlord TA / Sugar Land-ECO, Ltd. for the construction of a 32,000 SF office and lab. TASL then agreed to sell the property to Ashford Partners, Ltd. Closing was within 30 days after the commencement date of the ECO lease.

Construction was completed in about six months. ECO accepted the building as "substantially complete," but submitted to TASL an 8-page punch list of items in need of repair. As required by the lease, ECO then executed an Estoppel Certificate (verifying the validity of the lease and other similar matters). TASL doubtless submitted the Estoppel to Ashford. Then TASL sold the building to Ashford two weeks later.

ECO's building problems started two years later. Water collected under the foundation, evidently caused by the failure to caulk between the tilt wall panels below grade.

Ashford spent more than $313,000 to repair the problem, and then sued the construction contractor TASL had used and ECO. The claim against the contractor was settled. However, ECO filed a counterclaim against Ashford for breach of lease, and ECO did not abandon its claim.

At trial the jury found that ECO had been damaged because the value of its lease was diminished. The trial court rendered judgment for ECO against Ashford for almost $1.5 million.

Ashford appealed. The Court of Appeals concurred with the trial court, and accordingly affirmed the trial court's judgment.

So Ashford appealed again, essentially claiming that since ECO complained of construction issues, Ashford had the building repaired and consequently ECO suffered no damages.

The Texas Supreme Court determined that the trial court and court of appeals had applied an improper damages test of the difference between rent and the value of the leasehold. Instead, the Supremes determined that the landlord's obligations in the lease – to repair construction defects – had been adequately satisfied. Consequently, ECO had not been damaged and should not have prevailed in either the trial court or court of appeals.

The lower court judgment was reversed. Ashford wins. ECO loses.

See *Ashford Partners Ltd. v ECO Resources Inc.*; No. 10-0615; Supreme Court of the State of Texas; April 23, 2012.

Lessons learned:

1. Build-to-suit leases are inherently risky for both landlord and tenant.

2. If a tenant has a problem regarding construction that cannot be resolved, the tenant – at least in Texas – needs to argue this point in court: "*business disruption*."

3. If a landlord has a problem with a pesky tenant, the landlord – in Texas – should be able to respond with this statement in court: "*I had it repaired*."

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