Non-Disclosure Is Bad. Fraud is Worse.

COUNSEL'S CORNER

Tukua Investments entered into a commercial listing agreement with Century 21 Charlotte Banks, to sell Tukua's commercial property in Eagle Pass, Texas. The property was advertised as being benefited by a triple-net, licensed nursing and rehab center, with a Tenant paying base rental of $300,000 per year. The listed sales price was $2.75 million.

C-21 found a California buyer at the tail end of an IRS Section 1031 tax-deferred exchange. The Contract was prepared on August 16, 2007. In order to attain the benefits of IRS Section 1031, the buyer needed to identify exchange property candidates not later than October 1, 2007, and close not later than February 13, 2008.

The Contract was signed on September 12, 2007, and presumably Buyer timely identified the nursing / rehab center as a deferred exchange candidate. Buyer first learned of a problem with the new tenant, Signature Healthcare, one month later. At that time, it became evident that Signature was not going to fulfill the terms of the Lease.

As Buyer was exploring the reason and basis for the problem, Buyer inadvertently received a copy of a letter referring to an eviction notice from Tukua to Signature of August 8, 2007 – about one week before the first Contract was prepared and submitted to Tukua.

Since it was then too late for Buyer to designate new replacement property candidates, Buyer could only withdraw from the Contract and pay the gains generated from the sale of Buyer's California property. The extra income tax bite was over $240,000.

Buyer filed a lawsuit for fraud and negligent misrepresentation against the Seller, Tukua. The jury found for Buyer on both counts, and the trial court converted the verdict into Judgment, awarding over $1.3 million to Buyer. Since the underlying damages were $240k, one might assume that a substantial part of the verdict and Judgment was composed of exemplary or punitive damages – the type that is reserved only for fraud cases.

Tukua appealed.

The Court of Appeals carefully analyzed all of the elements of fraud, Texas style. Buyer claimed that Tukua represented to Buyer that there was a valid 10 year lease. The Appellate Court found that Tukua's representation was true when it was made. There was indeed a valid 10 year lease. The fact that Tukua claimed that Signature was in default did not affect the validity of the lease. That only gave Tukua the right to terminate the lease, evict Signature, or exercise other remedies.

Further, the Court allowed that the lease did not automatically terminate on default. In point of fact, even the delivery of an eviction notice does not serve to terminate the lease. Termination of rights of possession – *yes*; full-on lease termination; *no*.

On the fraud point the Appellate Court concluded that representations about future rents or income are typically statements of opinion. Not representations of fact. As such, there can be no actionable fraud claim.

The Buyer then claimed that Tukua had not truthfully represented the conditions, rights, benefits and validity of the lease and that there were serious issues existing with Signature Healthcare.

The Court of Appeals found an appellate decision from Dallas in 1961 stating "A company does not have a duty to disclose all of its financial difficulties while conducting business if it is actively working towards remedying the situation. Silence on the issue alone is not enough to constitute fraud."

Standing alone it seems this position is subject to challenge, given the facts of this case. However, the Appellate Court then uses several pages to investigate further, and conclude that for an unknown reason this Buyer did not complete the normal due diligence of a typical commercial real estate purchaser. No one from the Buyer's team really questioned Signature about why they weren't paying rent. No one asked about unresolved licensing issues.

It seems possible that no Estoppel Statement (or equivalent) was requested of Signature by the Buyer and basically the Buyer just assumed that all was well. That leads me to think that perhaps Buyer was purchasing this parcel for cash, since normally a lender would insist on an Estoppel in this situation.

The Appeals Court overturned the lower court's judgment. Tukua wins; Buyer loses.

See *Tukua Investments, LLC v. Spenst;* No. 08-11-00014-CV; Texas 8th Court of Appeals, August 14, 2013.

Lessons learned:

1. This case was decided on very narrow facts. Don't count on getting the same results. Our rule of law, to avoid the courthouse, is unchanged: Disclose too much, not too little. Err on the side of over-communications.

2. **Доверяй, но проверяй**. What's the matter - your Russian a bit rusty? It's from an old Russian proverb and rhyme – *doveryai, no proveryai*. **Trust, but verify**.

3. Practice Tip: I live in the world of Tenant-Estoppels. We don't obtain them in multi-family transactions because as a practical matter it is impossible. But we obtain them in every other commercial transaction involving tenants of a significant size. Even if a lender is not involved, commercial buyers need to receive updated, current Tenant Estoppel Certificates, signed by each Tenant. Not the kind that the Landlord signs through a lease-derived power-of-attorney paragraph.

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