BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS
ON REFERRAL FROM THE COMMISSIONER OF ADMINISTRATION

BACHNER COMPANY, INC.	)	
	)	
v.	)	
	)	OAH No. 15-1158-CON
DIVISION OF GENERAL SERVICES	)	Lease No. 2530
	)	

DECISION AND ORDER ON MOTION TO DISMISS AND CROSS-MOTIONS FOR SUMMARY ADJUDICATION

I. Introduction

Bachner Company Inc. ("BCI") leases office space in Fairbanks to the Department of Administration, Division of General Services ("DGS"). A dispute arose between them over the terms under which DGS could renew the lease for a new one-year term. BCI filed an action in the superior court, which was dismissed for failure to exhaust administrative remedies. BCI then filed this appeal, seeking among other things an order declaring that the lease was terminated when DGS defaulted and that DGS's occupancy of the office space is now subject to a month-to-month lease arrangement. DGS moved to dismiss, but its motion was orally denied during a November 9, 2015 status conference, as further discussed below.

Although there is a long, complex history between the parties regarding the lease at issue, the question presented in this matter is fairly narrow: did DGS commit a material breach of the lease by virtue of its late payment of rent in 2014 for 1,400 square feet of space that had formerly been "free space" during the first ten years of the lease term, thus causing the lease to be terminated? DGS denies that it materially breached; BCI argues that there was a material breach and that the lease was terminated, resulting in DGS occupying the premises on a month-to-month basis.

During the November, 2015 status conference, the parties stipulated that no evidentiary hearing was necessary and the case could be decided based on written briefs and the documentary record. The parties then submitted simultaneous cross-motions for summary adjudication, followed by simultaneous opposition briefs. Based on a careful review of the record and the parties' well-briefed arguments, BCI's motion for summary adjudication is denied, and DGS's motion for summary adjudication is granted. BCI's appeal, therefore, is hereby dismissed.

II. Factual and Procedural Background[1]

In 2003, DGS issued a request for proposals ("RFP") for office space in the Fairbanks area, to be occupied by staff of the Department of Natural Resources. BCI submitted a proposal, and DGS evaluated BCI's bid as "most advantageous to the state."[2] BCI's bid included an offer of 1,400 square feet of space free of charge to DGS, in addition to the approximately 14,300 square feet of leased space that would be subject to the formula for determining the rent that DGS would pay for the premises.[3] BCI and DGS then negotiated changes to the floor plan, a process that was contemplated in the RFP,[4] and they finalized and executed the floor plan as an exhibit to the lease.[5] The lease, denoted as lease #2530, covered a ten-year term (referred to by the parties as the "firm term") starting in October 2003, and gave DGS ten one-year renewal options, beginning in October 2013.[6]

BCI's principal was apparently dissatisfied with the final changes to the floor plan, believing that it resulted in DGS occupying far more than 1,400 square feet of free space.[7] BCI and DGS nonetheless executed the lease, and DGS took possession of the premises pursuant to the lease. It must be noted at this juncture, however, that BCI has waived any claim in this proceeding to past rent for any free space beyond the 1,400 square feet specified in the lease.[8]

As part of the lease, BCI and DGS agreed that, if and when DGS exercised its first renewal option, DGS would start paying rent at the "then-prevailing market lease rates" for the 1,400 square feet.[9] This provision was contained in section 4 of the lease, which provided that the parties would negotiate regarding the prevailing market lease rate, and, if they were unable to agree, would contract with a neutral third-party to determine the applicable rate.[10]

During the ensuing ten years of occupancy, the RFP and lease were formally amended several times.[11] In June 2013, apparently anticipating the end of the ten-year term and the need

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1 The factual findings in this decision are based on the documents and affidavits submitted by the parties.

2 *See* DGS's Motion to Dismiss or to Stay Proceedings, p. 2.

3 BCI's bid, exhibit 1 to DGS's Motion to Dismiss or to Stay Proceedings, p. 73.

4 RFP, exhibit 1 to Motion to Dismiss or to Stay Proceedings, pp. 35, 65.

5 Lease agreement, exhibit 1 to Motion to Dismiss or to Stay Proceedings, pp. 1-12, 91-92.

6 The lease incorporated the RFP by reference and made it binding on the parties. RFP, exhibit 1 to Motion to Dismiss or to Stay Proceedings, p. 30.

7 *See* Oct. 31, 2015 and Dec. 4, 2015 Affidavits of Andrew Bachner, submitted with BCI's Opposition to Motion to Dismiss or to Stay Proceedings and Opposition to Summary Adjudication, respectively.

8 BCI's Opposition to Motion to Dismiss or to Stay Proceedings, p. 9.

9 Lease sec. 4, exhibit 1 to Motion to Dismiss or to Stay Proceedings, pp. 10-11.

10 *Id.*

11 One of those amendments, "amendment number eleven," consisted of DGS's exercise of the first renewal option, dated May 14, 2013. *See* Exhibit E to BCI's Opening Brief on summary adjudication. The amendment did not mention the free space or market rate issues.

to determine market rate for the 1,400 square feet of free space, DGS initiated a series of correspondence with BCI via letter and email regarding the appropriate market rate. In its first correspondence to DGS, BCI noted that during the firm term of the lease, DGS had apparently been occupying far more free space than the 1,400 square feet offered in BCI's initial proposal. BCI proposed, therefore, that going forward DGS should pay for the full amount of free space occupied by DGS – 2,834 square feet. Over the course of corresponding with DGS during the following year, BCI raised this square footage issue in connection with each discussion of the market rate determination and DGS's related payment obligations.[12]

In the context of these discussions about market rate and the amount of square footage that should be covered, DGS and BCI were unable to reach agreement on the market rate, so a Fairbanks realtor who was acceptable to both parties was hired to determine the rate. The realtor provided a letter to DGS on December 31, 2013, stating that based on comparable property leases in Fairbanks, $2.35 per square foot was an appropriate rate. DGS believed this rate to be high, so it wrote a letter to the realtor asking for an explanation regarding his methodology. The realtor wrote a lengthy letter in response on January 16, 2014. In the letter, the realtor provided more information regarding how he had arrived at the $2.35 rate, while also noting that DGS had not specified "which 1400 square feet" in the building were at issue and discussing the fact that the amount of free space occupied by the state appeared to be 2,834 square feet.[13]

The record does not reflect any correspondence between the parties from mid-January to early April 2014. During this period, DGS continued paying rent pursuant to having exercised its first one-year renewal option, but it did not pay any rent for the free space. On April 8, 2014, BCI sent a letter to DGS containing two sentences, as follows: "Lessee (State of Alaska) is in default in their payment of rent on Lease #2532 and Lease #2530. Please consider this your official notification."[14] The letter provided no other information; it did not specify the nature of the default of either lease mentioned, nor did it indicate how DGS could cure the defaults.

Lease #2530 provides the following language regarding defaults.

> If the Lessee shall at any time be default in the payment of rent herein reserved ... and the Lessee shall fail to remedy such default within sixty (60) days after written notice thereof from the Lessor, it shall be lawful for the Lessor to enter upon said premises and again have, repossess, and enjoy the same as if the lease

[12] BCI has continued to raise this issue in the superior court and in this administrative appeal, as further discussed below.

[13] Exhibit 10 to Motion to Dismiss or to Stay Proceedings. pp. 2-5.

[14] Exhibit 12 to Motion to Dismiss or to Stay Proceedings. The record contains no information regarding the other lease mentioned in the letter, #2532.

> had not been made, and thereupon this lease and everything herein contained on the part of the Lessor to be done and performed shall cease and determine *[sic]* without prejudice however, it shall be the right of the Lessor to recover from the Lessee all rent due up to the time of such entry.[15]

The corresponding provision in the RFP contains nearly identical (but somewhat clearer) language:

> If the State shall at any time be default in the payment of rent ... and shall fail to remedy such default within sixty (60) days after written notice thereof from the Lessor, it shall be lawful for the Lessor to enter upon the premises and repossess and enjoy the same as if the lease and everything therein contained on the part of the Lessor to be done and performed shall cease and terminate without prejudice, however, to the right of the Lessor to recover from the State all rent due up to the time of such entry.[16]

On May 27, 2014 DGS sent BCI a letter conveying a proposed amendment to the lease (denoted amendment number 13), described in the letter as providing for DGS to pay $2.35 per square foot for "the 1,400 square feet of lease space referenced in Section 4 of the lease, effective October 1, 2013."[17] The proposed amendment included substantive language to the effect that the amendment "recognize[d] that the [1,400 square feet] has been included in the overall total square footage of Lease 2530 and has been recognized in the property description since inception of this lease."[18] The proposed amendment also apparently contained an error regarding the new overall monthly lease rate.[19] BCI's counsel sent DGS a letter on June 4, 2014 explaining that BCI "cannot sign the amendment as drafted" due to issues relating to the dispute over the amount of square footage of free space.[20]

BCI did not execute the proposed amendment number 13. On June 19, 2014 BCI's counsel sent a letter to DGS, stating that DGS "is in material breach of lease 2530 for failure to pay rent, and has failed to cure within 60 days" of receiving the above-referenced April 8 written notice from BCI.[21] The June 19 letter noted that the past due rent for 1,400 square feet, at the rate of $2.35 per square foot, totaled $29,610 at that time (accrued since October 1, 2013). It also stated that BCI was willing to negotiate a new long-term lease for the property, or would accept $2.35 per square foot for the entire property square footage, which included the total

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15 Lease para. 3(c), exhibit 1 to Motion to Dismiss or to Stay Proceedings, p. 8.
16 RFP, exhibit 1 to Motion to Dismiss or to Stay Proceedings, pp. 37-38.
17 Exhibit 11 to Motion to Dismiss or to Stay Proceedings, p. 1.
18 *Id.*
19 *See* BCI's Opposition to Summary Adjudication, p. 34.
20 June 4, 2014 letter from BCI's counsel to DGS, exhibit 2 to BCI's April 3, 2015 claim.
21 Exhibit 13 to Motion to Dismiss or to Stay Proceedings.

2,834 square feet of free space that BCI had previously argued DGS should be paying for.[22] Key language in the letter follows:

> If the State is unwilling to negotiate a long-term lease or pay the market rate, it will have to vacate, or file a declaratory judgment action so a judge can determine the rights and liabilities of the parties ....
>
> The State has been in material breach for over nine months, and has intentionally caused economic duress [to BCI] .... The State cannot use economic coercion to retroactively modify price terms, or exercise an option to extend a lease that has been previously terminated by a material breach of monetary terms.[23]

The letter then demanded payment for the 1,434 square feet of disputed free space, dating back to the inception of the firm term in September 2003, plus payment for the 1,400 square feet of agreed-upon free space since October 2013. The letter set a deadline of July 1, 2014 for DGS to "either vacate the space or negotiate a new lease," stating that "[o]therwise, [BCI] will file a declaratory judgment action."[24]

The record does not reflect any correspondence between the parties from June 19 until August 5, 2014, when DGS sent BCI a modified amendment number 13 to the lease. This amendment provided that "[e]ffective October 1, 2013, the Lessee shall begin paying a monthly lease rate of $3,290.00 for the 1,400 square feet of space ... in accordance with Section 4 ... of the lease agreement," and it did not contain a signature space for BCI to sign.[25] In this instance, DGS had executed the amendment unilaterally.[26]

On or about August 13, 2014, DGS paid BCI the past-due rent for the 1,400 square feet of agreed-upon free space, at the rate of $2.35 per square foot, dating back to October 1, 2013.[27] BCI alleges that this payment was accomplished through a direct deposit into its bank account which would have been difficult to reject. BCI does not suggest, however, that it made any attempt to reject or return the funds.

It is undisputed that throughout this period of time, as the parties were negotiating the market rate for the free space and discussing issues concerning the total square footage of free space, DGS continued to pay the agreed-upon rent for the square footage originally comprising the leased premises.

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22 *Id.*
23 *Id.*
24 *Id.*
25 Exhibit 14 to Motion to Dismiss or to Stay Proceedings, p. 3.
26 *Id.*
27 Exhibit 20 to DGS's Motion for Summary Adjudication.

On August 14, 2014, BCI's counsel wrote to DGS that BCI "considers the State in material breach, and will not accept any attempt to exercise a second option to extend."[28] The letter set out three options: (a) vacate the premises; (b) pay $2.35 market rate for 18,194 square feet[29] on a month-to-month basis; or (c) negotiate a long-term lease.[30] The letter stated that, in the absence of the state choosing one of these options, BCI would file suit in the superior court, and then reiterated that the state "has no right to continue its occupancy beyond September 30, 2014."[31]

On August 22, 2014, DGS responded to BCI, taking the position that the state was "not in material breach of the lease and that renewal options are exercised at the sole discretion of the state."[32]

On September 2, 2014, BCI filed an action in Fairbanks superior court in which BCI set out the basic factual history of the dispute, and then alleged that "[a]ccording to the lease terms, if a breach is not cured within 60 days, the lease is terminated," and further that the state "must vacate the premises, negotiate another long-term lease by October 1, 2014, agree to pay market rate on 2.35 square foot *[sic]* on the 18,194 square feet they occupy or they will be in trespass on the property."[33] BCI's complaint sought, among other things, a "temporary order evicting" the state and an award to BCI of "all available contract damages."[34]

On that same date, DGS executed a second one-year renewal of the lease, denoted as amendment number fourteen.[35] On September 16, 2014 BCI's counsel wrote a letter to DGS stating that BCI "does not accept your attempted amendment to lease 2530." The letter also asserted that DGS had "breached on multiple occasions," including "you never paid rent when due beginning October 1, 2013," the failure to "timely cure after notice of breach," and "you continue to occupy 18,194 feet of space and have refused to acknowledge the status of this additional space."[36]

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28 Exhibit B to BCI's Opposition to Motion to Dismiss or to Stay Proceedings.

29 This proposal would result in DGS paying rent far in excess of the rents paid to date. In addition, the basis for stating the leased area covers 18,194 square feet is unclear on this record. Adding the 2,834 square feet of "free space" to the original 14,330 square feet covered by the lease results in a total of 17,164 square feet.

30 Exhibit B to BCI's Opposition to Motion to Dismiss or to Stay Proceedings.

31 *Id.*

32 Exhibit 15 to DGS's Motion for Summary Adjudication.

33 Exhibit 16 to DGS's Motion for Summary Adjudication, p. 4

34 *Id.*

35 Exhibit F to BCI's Opening Brief on summary adjudication.

36 September 16, 2014 letter from BCI's counsel to DGS, exhibit 4 to BCI's April 3, 2015 claim.

On February 11, 2015, the Fairbanks superior court dismissed BCI's complaint for failure to exhaust administrative remedies.[37] BCI appealed that dismissal to the Alaska Supreme Court on March 12, 2015.[38]

BCI then filed a claim with the DGS contracting officer on April 3, 2015.[39] After an inquiry from DGS for more information about the claim,[40] BCI submitted a lengthy supplement on May 8, 2015.[41] In its claim, BCI continued to seek market rate on the full square footage of the premises.

BCI's counsel made an inquiry to DGS about the claim in early May 2015, and DGS's counsel wrote a letter in response, explaining the likely timeframe for the contracting officer's decision.[42] DGS's counsel also directed BCI's counsel to communicate with DGS only through DGS's counsel.[43]

The contracting officer issued a decision in the form of a letter to BCI dated July 31, 2015.[44] The decision characterized BCI's claim as consisting of two separate claim issues: (1) that DGS defaulted by not timely paying rent on the free space it occupied and by not curing the failure to pay rent by June 8, 2014 - 60 days after the April 8, 2014 notice of default; and (2) that DGS was obligated to pay market rate rent on 2,834 square feet of free space starting on October 1, 2013. The decision denied the claim as to both issues, finding that BCI, among other things, needed to serve a notice to quit pursuant to AS 09.45.100 as a prerequisite to terminating the lease.[45] The letter containing the decision, however, was sent directly to BCI and was not sent to BCI's counsel.

BCI's counsel submitted a one-sentence letter to the Commissioner of Administration on August 18, 2015, couched as a "notice of appeal" of the contracting officer's decision.[46] After an exchange of several emails between BCI's counsel and the office of the Commissioner, BCI's counsel submitted a detailed "supplement to [BCI's] notice of appeal," dated August 27, 2015.[47]

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37 Exhibit 18 to DGS's Motion to Dismiss or to Stay Proceedings.

38 Exhibit 19 to DGS's Motion to Dismiss or to Stay Proceedings. The case apparently has been designated as Supreme Court case no. S-15860.

39 BCI's April 3, 2015 claim, submitted to OAH as supplement to agency record.

40 April 24, 2015 letter from DGS Contracting Officer Ken Stewart to BCI.

41 May 8, 2015 letter from BCI to Ken Stewart.

42 May 20, 2015 letter from DGS's counsel to BCI's counsel.

43 *Id.*

44 July 31, 2015 letter from Ken Stewart to BCI.

45 *Id.*

46 Exhibit C to BCI's Opposition to Motion to Dismiss or to Stay Proceedings.

47 August 27, 2015 letter from BCI's counsel to Commissioner of Administration.

Counsel's supplement again raised the issue of the 1,434 additional square feet of free space, and concluded by stating:

> On appeal, the hearing officer must agree that 1) the lease terms are clear that failure to pay full rent due on the first of the month is a breach, 2) that notice of breach need not be formal or include a notice to quit under AS 09.45.100, 3) that the State had 60 days to cure, 4) that an offer of a bilateral contract with terms other than rent is not a cure, 5) that absent cure, the lease is terminated by operation of contract, and BCI is entitled to immediate possession.[48]

The Commissioner then referred the case to the Office of Administrative Hearings ("OAH") on August 28, 2015.[49]

III. DGS's Motion to Dismiss or to Stay Proceedings

DGS moved to dismiss this administrative appeal on timeliness grounds, arguing that (1) BCI's claim to the contracting officer was not timely filed, and (2) the appeal itself was not timely filed.[50] The motion was denied orally during the November 9, 2015 status conference; the rationale for denial of the request for dismissal is set forth below.

A. The Contract Claim Was Timely Filed

DGS argued that BCI's claim was not timely submitted to the contracting officer, because AS 36.30.620 requires that a claim be brought within 90 days of when the claimant "becomes aware of the basis of the claim or should have known the basis of the claim, whichever is earlier."[51] DGS accurately pointed out that BCI knew or should have known of the basis for its claim long before it filed the claim with the contracting officer. DGS failed to note, however, that AS 36.30.620 treats a claim relating to a "lease rate adjustment called for in the lease" differently than other types of claims. A claim relating to a lease rate adjustment must be filed

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[48] *Id.* at p. 4.

[49] While this OAH case has been pending, in November, 2015 BCI filed a second lawsuit in the Anchorage superior court regarding the same set of facts and issues. BCI's rationale for this filing is unclear; its counsel stated on the record during the November 9 status conference that the filing "was not meant to supersede this [OAH case] but rather to have that judge declare whether in fact we have a remedy available in the third judicial district as an original action, or not." BCI's complaint in the Anchorage superior court seeks the following relief: (1) "a speedy hearing... in light of the potential for inconsistent rulings in Supreme Court Case No. S-15860 and [OAH] Case No. 15-1158-CON;" (2) "a declaration recognizing the express terms of the lease contract ... concerning the terms and conditions including lease payments, breach, remedy and agreed dispute resolution forum control over any inconsistent terms in the procurement code....;" (3) "a declaration that [DGS] was in default of its obligation to pay all rent payments ... and that [DGS] failed to cure the default within 60 days...;" and (4) an award of costs and fees. Exhibit 1 to DGS's Notice of Filing Additional Support for Motion to Stay.

[50] DGS's motion also requested the alternative relief of a stay of the administrative appeal until the Alaska Supreme Court decides BCI's appeal of the dismissal of its Fairbanks superior court action. The request for a stay was denied, however, because it was appropriate to allow BCI to exhaust its administrative remedies in this proceeding, as BCI's prior failure to exhaust was the basis for the superior court's dismissal.

[51] AS 36.30.620(a).

"prior to the expiration date of the lease."[52] BCI argued persuasively that its claim related to a lease rate adjustment, i.e., the establishment of the market rate for the free space upon DGS's exercise of its first renewal option,[53] and that because DGS had exercised its renewal option, the claim had been submitted prior to expiration of the lease.

BCI also argued that the doctrine of equitable tolling should be applied in this instance, because (1) BCI filed its Fairbanks superior court action based on a good faith belief that the lease authorized an original action in the court system to enforce lease terms, (2) DGS was on notice of the claim by virtue of the parties' correspondence and negotiations, as well as BCI's court filings, and (3) DGS did not demonstrate any prejudice that would result from allowing the claim to go forward. BCI persuasively argued that under these facts, the timeframe for filing the claim was tolled while the Fairbanks superior court action was pending.

BCI's arguments under both AS 36.30.620 and the equitable tolling doctrine provided sufficient grounds for establishing that its claim to the contracting officer was timely filed.

B. The Appeal Was Timely Filed

DGS argued that BCI did not timely file its appeal to the Commissioner, citing AS 36.30.625, which requires that an appeal of the appeal be filed "within 14 days after the contracting officer's decision is received by the contractor."[54] BCI argued in response that the decision was not received by BCI until August 4, 2015, and therefore its one-sentence "notice of appeal" was timely when it was filed with the Commissioner on August 18, 2015. BCI also argued in the alternative that the decision was never served on its counsel, who had given notice that he was representing BCI in its dispute with DGS regarding this lease, and therefore, the 14-day period never actually began to run.

Given the direct involvement of BCI's counsel in communications between the parties regarding this dispute throughout 2014 and early 2015, and given the fact that DGS's counsel had directed BCI's counsel to communicate with DGS only through its counsel in May 2015, the contracting officer's decision should have been served on BCI's counsel. BCI's argument that the 14-day period never started to run has merit. In addition, it is also noted that BCI submitted a

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[52] *Id.*

[53] Perhaps seeking to limit its claim in this appeal to the lease rate adjustment issue, BCI stated in its opposition to the motion to dismiss that it "voluntarily waives any rent claim for the 1,434 square feet up until the first renewal on October 1, 2013," and "[o]n the issue of the breach, BCI will only rely on the failure to pay for the undisputed 1,400 square feet ... starting on January 1, 2014." BCI's Opposition to Motion to Dismiss or to Stay Proceedings, p. 9.

[54] AS 36.30.625(a).

detailed supplement to its "notice of appeal" on August 27, 2015, only nine days after the earliest date on which it could be argued that the appeal deadline should fall. Taking all of these circumstances into consideration, BCI set forth adequate grounds for a determination that its appeal was timely filed.

IV. Summary Adjudication Motions

As mentioned above, the parties stipulated that an evidentiary hearing would not be necessary and that the case could be resolved based on written summary adjudication briefs and the documentary record.[55] Summary adjudication motions in administrative proceedings are analyzed according to the same principles applied to motions for summary judgment in Alaska court proceedings. Summary adjudication will be granted if there are no material facts in dispute and one party is entitled to prevail as a matter of law.[56]

The narrow question presented in this appeal is whether DGS committed a material breach of the lease by virtue of its late payment of rent in 2014 for the 1,400 square feet of formerly free space, thus causing the lease to be terminated.[57] Bearing this in mind, the parties' arguments on summary adjudication can be summarized as follows. BCI argues that DGS committed a material breach by failing to pay rent for the free space starting on October 1, 2013; that the lease terminated by operation of law after BCI gave notice of the breach and DGS then failed to cure within 60 days; that DGS could not renew the lease once it had breached; and that once the lease was terminated, DGS's occupancy became a month-to-month lease for which DGS must pay market rate for the full square footage of the premises.[58]

In response, DGS argues that its actions regarding the rent owed for free space under the renewal terms of the lease did not constitute a breach of the lease; that, even if it did commit a breach, its breach was not a material breach; and that, even if it did commit a material breach, the lease did not automatically terminate and BCI did not take the necessary steps to terminate the lease.

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[55] 2 AAC 64.250 authorizes parties to submit motions for summary adjudication in matters before OAH.

[56] *See Smith v. State of Alaska*, 790 P.2d 1352, 1353 (Alaska 1990); *Estate of Miner v. Commercial Fisheries Entry Commission*, 635 P.2d 827, 834 (Alaska 1981); 2 Davis & Pierce, *Administrative Law Treatise* § 9.5 at 54 (3d ed. 1994).

[57] This decision does not address any questions regarding BCI's claim that DGS occupied greater than 1,400 square feet of free space, because BCI has explicitly waived any such claim.

[58] In addition, although BCI has expressly waived its claim to any rent for the 1,434 square feet of disputed free space "up until the first renewal on October 1, 2013" (BCI's Opposition to Motion to Dismiss or to Stay Proceedings, p. 9), it has continued to argue in its summary adjudication briefs that DGS must pay for that additional, disputed square footage going forward from that date.

A. DGS's Late Payment of Rent for 1,400 Square Feet Was Not a Material Breach

It is undisputed that, since the inception of the lease in October 2003, DGS has timely paid the rent on the square footage of space covered by the lease's original term. After the original ten-year lease term expired, DGS continued to timely pay the required amount each month. Beginning in October 2013, however, DGS was obligated to begin paying rent on the additional amount of formerly "free" space offered in BCI's original proposal—1,400 square feet. Although a neutral realtor agreed to by the parties identified a market rate for this space by January 2014 at the latest, DGS did not begin paying rent on the additional 1,400 square feet of formerly free space until its late payment on August 13, 2014. BCI contends, and DGS denies, that the late payment of rent for the additional 1,400 square feet of space was a material breach of the lease agreement.

A broad standard for determining whether a breach is a "material breach," and thus provides grounds for termination of a lease, is found in the Restatement (Second) of Property, Landlord & Tenant. Section 13.1 of the Restatement provides that if a tenant fails to perform a valid promise contained in the lease, the landlord may terminate if he "is deprived of a significant inducement to the making of the lease and the tenant does not perform his promise within a reasonable period of time after being requested to do so."[59] Another useful standard for determining if a breach is material is set out in the Restatement (Second) of Contracts, cited by DGS in its opening motion for summary adjudication. The elements of this standard are:

> (i) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
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> (ii) the extent to which the injured party can be adequately compensated [by damages] for the part of that benefit of which he will be deprived;
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> (iii) the extent to which the party failing to perform ... will suffer forfeiture;
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> (iv) the likelihood that the party failing to perform ... will cure his failure, taking account of all the circumstances including any reasonable assurances;
>
> (v) the extent to which the behavior of the party failing to perform ... comports with standards of good faith and fair dealing.[60]

Under either standard, DGS's failure to timely pay the rent for the 1,400 square feet of free space did not rise to the level of a material breach of the lease agreement. Under the first standard, because BCI offered the 1,400 square feet of free space in its original proposal in response to the RFP, it cannot establish that the delay in timely payment of rent for that space ten

[59] Restatement (Second) of Property, Landlord & Tenant § 13.1 (1977).
[60] Restatement (Second) of Contracts, § 241.

years later deprived it of a "significant inducement to the making of the lease." In addition, regarding the second element of this standard, there can be no dispute that it was BCI that interjected the issue of additional square footage into the parties' negotiations on the market rate for the 1,400 square feet. A close reading of the parties' correspondence demonstrates that those negotiations were overshadowed and unduly complicated by BCI's consistent posturing regarding the *additional* square feet that it believed should be paid for (more than doubling the amount of square footage under negotiation). Under these facts, BCI cannot establish that it made a clear request for DGS to make timely payment for the 1,400 square feet, or that DGS failed to pay within a reasonable period after such a request was made. Given these circumstances, DGS's payment was made within a reasonable period of time.

Under the Restatement (Second) of Contracts standard,[61] BCI can meet the first element, in that it could reasonably expect to be paid for the 1,400 square feet, and the breach did deprive BCI of that benefit for a period of time. But as to the second element, BCI clearly could be adequately compensated by damages (the amount of the unpaid rent, if DGS had not cured) - and, in fact, it has been compensated by DGS's curing payment. The third element also clearly weighs in favor of DGS, in that a finding of materiality resulting in termination of the lease would cause an extreme forfeiture of DGS's interest in the leasehold. DGS has also satisfied the fourth element by its curative payment.

As to the fifth element, BCI has failed to adduce any evidence that DGS did not act in good faith in negotiating the market rate for the 1,400 square feet. BCI argues that DGS's very low initial market rate offer,[62] and the language of the proposed bilateral lease amendment that DGS submitted in May 2014, constitute evidence of bad faith on the part of DGS. These documents, however, amount to nothing more than evidence of DGS attempting to negotiate the terms of its lease renewal. At most, the documentary record demonstrates that the parties were engaged in good faith negotiations as to market rate, and that in that process BCI conflated the additional square footage issue with the market rate negotiation, leading DGS to attempt to resolve the entire set of issues raised by BCI in order to move the matter forward. Even viewed in a light most favorable to BCI, this does not constitute bad faith by DGS.

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[61] *See Foundation Dev. Corp. v. Loehmann's, Inc.*, 788 P.2d 1189, 1197 (Ariz. 1990) (citing the Restatement (Second) of Contracts standard and finding no material breach where lessee cured short-term failure to pay portion of rent due under lease).

[62] *See* September 9, 2013 DGS email to BCI, offering $0.60 per square foot (exhibit A to BCI's Opposition to Summary Adjudication).

If anything, the evidence would suggest that BCI was engaged in manipulation of the negotiations to attempt to effect a termination of the lease and then execute a better deal with DGS. BCI's intentions in this context are evidenced by the fact that BCI did nothing to help resolve any perceived problems with DGS's proposed bilateral amendment *as it related to the 1,400 undisputed square feet*. For example, BCI could have suggested carving that issue out and reaching agreement on it, knowing from its long dealings with the State that until a lease amendment was executed no payment could be made for the 1,400 square feet. Instead, BCI sent a letter from counsel continuing to argue about the issue of total square footage,[63] and then shortly thereafter issued another letter from counsel declaring that DGS had failed to cure its breach "for failure to pay rent,"[64] again without specifying that the breach related to rent as to the 1,400 square feet.[65]

BCI failed to establish a genuine issue of material fact that DGS's behavior in connection with the renewal of the lease failed to "comport with standards of good faith and fair dealing."[66] Based on either of the Restatement standards, DGS's late payment of rent for the 1,400 square feet of formerly free space did not rise to the level of a material breach of the lease agreement.

B. The Lease Did Not Automatically Terminate Upon DGS's Breach

The parties next disagree on whether DGS's breach, even if material, served to automatically terminate the lease, as BCI suggests. Even if DGS's failure to pay the rent on the 1,400 square feet, and then failure to cure within 60 days after receiving BCI's April 8, 2014 letter, were deemed a material breach, the plain language of the lease itself did not provide for automatic termination upon DGS's breach. While the relevant provision of the lease is not a model of clarity, it clearly contemplates that BCI had to take unequivocal steps to terminate the lease, rather than the lease terminating automatically once DGS failed to cure a breach within 60 days of receiving notice from BCI.[67]

This approach is consistent with that of the Restatement (Second) of Property, Landlord & Tenant, which states:

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63 June 4, 2014 letter from BCI's counsel to DGS, exhibit 2 to BCI's April 3, 2015 claim.

64 June 19, 2014 letter from BCI's counsel to DGS, exhibit 13 to Motion to Dismiss or to Stay Proceedings.

65 Other evidence of BCI's intentions is the fact that, despite having explicitly waived its claim regarding the 1434 disputed square feet of free space, BCI raised the issue again in its summary adjudication briefs (*see* BCI's Opp. to Summary Adjudication, pp. 19-20, 27-28), and yet again in its November 2015 Anchorage superior court complaint (Exh. 1 to DGS's Notice of Filing Additional Support for Motion to Stay, p. 4).

66 Restatement (Second) of Contracts, § 241.

67 *See* Lease para. 3(c), exhibit 1 to Motion to Dismiss or to Stay Proceedings, p. 8; RFP, exhibit 1 to Motion to Dismiss or to Stay Proceedings, pp. 37-38.

> The lease is not automatically terminated by the tenant's failure to perform a promise. The right to terminate given the landlord under the rule of this section is an option to terminate the lease. The exercise of this option requires that the landlord notify the tenant he has elected to terminate the lease for the failure of the tenant to perform a promise within a reasonable time after being requested to do so.[68]

Given that the lease did not automatically terminate, under the Restatement approach BCI could have exercised its option to terminate by notifying DGS that it "elected to terminate the lease." But in order to do this, as discussed above, BCI first was required to lay a foundation for termination by providing DGS with a coherent and specific notice of default. The evidence is undisputed, however, that the notice BCI sent to DGS was vague, failed to inform DGS how to cure the default, and also referred to an alleged rent default on a second lease between the parties. In addition, the notice was sent within the context of the parties' ongoing discussions about the terms of DGS's renewal, highlighted by BCI's posturing about the disputed issue of the additional square footage of free space. Under these circumstances, it would be entirely reasonable for a tenant on the receiving end of such a notice to believe that the entire package of issues had to be resolved in order to cure the default. The notice of default provided by BCI, therefore, was an insufficient foundation on which to base a termination.

The contracting officer ruled that BCI needed to serve a notice to quit on DGS, per AS 09.45.100, in order to cause the lease to be terminated. This aspect of the contracting officer's ruling raises the question whether BCI should be held to that statutory requirement while at the same time being held to an exhaustion requirement before being able to sue under the statute. The parties, however, did not present any authority or argument on either side of the question in their briefs in this matter.

Whether or not the statutory requirement had to be met, however, DGS has persuasively argued that BCI at least was required to take clear steps to terminate the lease—steps that are consistent with an intent to terminate. Under the undisputed facts of this case, BCI did anything but that. After delivering the notice of default, followed by counsel's June 19, 2014 letter stating that DGS had failed to cure, BCI just continued negotiating. The key language of counsel's June 19 letter was "[i]f the State is unwilling to negotiate a long-term lease or pay the market rate, it will have to vacate."[69] In addition, BCI continued accepting DGS's monthly payments of rent for the undisputed square footage; it accepted DGS's August payment for the 1,400 square feet;

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[68] Restatement (Second) of Property, Landlord & Tenant § 13.1, comment para. (k) (1977).

[69] June 19, 2014 letter from BCI's counsel to DGS, exhibit 13 to Motion to Dismiss or to Stay Proceedings

and, importantly, it continued insisting that payment for the disputed free space square footage was part of the equation for resolving the matter. These are not steps that are consistent with an intent to terminate the lease.

In short, the lease did not automatically terminate upon DGS's breach, and BCI did not take the steps necessary to terminate the lease.

C. DGS Was Entitled to Renew Despite BCI's Notice of Default

The parties also disagree on whether DGS was entitled to renew the lease in 2014. BCI contends that DGS's renewal in September 2014 was invalid because, by that time, DGS had breached and the lease had been terminated by operation of contract. BCI argues that a tenant in breach cannot exercise an option to renew, citing language from a 1990 Alaska Supreme Court decision to the effect that "an implied condition precedent for renewing a commercial lease is that rent be current,"[70] and DGS presents no authority to the contrary. More importantly, however, DGS was current on its rent when it renewed the first time, effective October 1, 2013. And by the time it renewed the second time, on September 2, 2014 (effective October 1, 2014), it had already cured its late payment default on August 13. BCI argues that the second renewal was invalid because *the lease had been terminated* as of June 19, 2014. But it has already been established that the lease did not automatically terminate by operation of law or contract, nor is there a genuine issue that BCI took the steps necessary to terminate the lease. DGS, therefore, was entitled to renew the lease, and its September 2, 2014 renewal was valid.

V. Conclusion

DGS's late payment of rent for the 1,400 square feet of free space did not constitute a material breach of the lease agreement, and BCI has waived any claim regarding its allegations that DGS occupied additional square feet of free space. The lease did not automatically terminate in June 2014, and there is no genuine issue of material fact that BCI took the steps necessary to cause it to terminate. DGS cured its rent default, so it was current on its rent obligations when it exercised its second renewal option in September, 2014, and that renewal was a valid exercise of DGS's rights under the lease agreement. Therefore, BCI's motion for

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[70] *Berrey v. Jeffcoat*, 785 P.2d 20, 22 (Alaska 1990).

summary adjudication is denied, and DGS's motion for summary adjudication is granted. BCI's appeal is hereby dismissed.

Dated this 29th day of February, 2016.

Signed
Andrew M. Lebo
Administrative Law Judge

Adoption

The undersigned, in accordance with AS 44.64.060, adopts this Decision and Order as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska R. App. P. 602(a)(2) within 30 days after the date of this decision.

DATED this 14th day of April, 2016.

By: *Signed*
Signature
Sheldon Fisher
Name
Commissioner
Title

[This document has been modified to conform to the technical standards for publication.]