IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT ANCHORAGE

BACHNER COMPANY, INC.,	)	
	)	
Appellant,	)	
vs.	)	
	)	
STATE OF ALASKA, Department Of Administration	)	
	)	
Appellee.	)	
	)	Case No. 3AN-16-06598CI

DECISION ON APPEAL

I. INTRODUCTION

Appellant Bachner Company, Inc. ("Bachner") is a property owner who rented space to The State of Alaska, Department of Administration ("DOA"). A contract dispute arose over renewal of the lease agreement and a hearing was held before an Administrative Law Judge. The ALJ found in favor of DOA and Bachner now appeals that decision.

Having listened to oral arguments from both parties, read the briefing and reviewed the decision of the ALJ, this court affirms in part and reverses in part.

II. FACTUAL BACKGROUND

On September 26, 2003, Bachner entered into a lease agreement with the DOA. The lease was awarded to Bachner after a competitive bidding process, the terms and conditions of which were made a binding

part of the final lease. The lease was for a term of ten years, ending September 30, 2013, and provided the DOA the option to unilaterally renew the lease for ten additional one year periods by giving written notice prior to the expiration of each term.

In the lease, Bachner agreed to lease the DOA 15,730 square feet of office space, but to charge for only 14,330 square feet of that space during the initial ten year term. The contract stated that the additional 1400 square feet of space ("Free Space") was free of charge for the initial ten year term and if the DOA exercised its right of renewal, the parties would negotiate a price for that space.

The lease states that if, at the end of the ten year term, DOA exercised one or more of its renewal options, the DOA would either vacate and discontinue use of the Free Space or negotiate with Bachner to pay the then-prevailing market lease rates for that 1400 square feet. If the parties were unable to reach an agreement of the fair market price, a mutually acceptable third party would be contracted to determine the market lease rates. On October 16, 2009, the DOA, with Bachner's consent, exercised one of the options in the lease, adding an additional 1,030 square feet of usable office space to the original 15,730 square feet.

On May 14, 2013, four months before the end of the first term, the DOA exercised its first renewal option by signing an amendment to the

original lease. In June 2013, Bachner raised the issue of the DOA's obligation to pay rent on the Free Space pursuant to the lease agreement. The DOA began corresponding with Bachner regarding the appropriate market price for the Free Space. Both parties agreed that the rate adjustment for the Free Space would be retroactive, dating back to the lease renewal on October 1, 2013.

In its first correspondence with the DOA, Bachner mentioned that the DOA was occupying more than the 1400 square feet of free space. The DOA was actually occupying 2834 square feet of free space.[1] Over the course of the following year, Bachner raised the issue of the additional 1434 square feet of space in each discussion of the market rate determination of the DOA's payment obligations. The parties were unable to come to an agreement about the fair market value and both parties agreed to hire a Fairbanks realtor to determine the fair market value.

The realtor sent a letter to the DOA on December 31, 2013, stating that $2.35 per square foot was an appropriate market value for the space in question. The DOA questioned that price and the realtor then provided a more detailed letter on January 16, 2014, explaining how he came to the $2.35 rate. In that letter, the realtor noted that the DOA had not

[1] 1400 is the Free Space accounted for in the original lease agreement and an additional 1434 square feet of free space, not included in the lease, was also being occupied by the DOA.

specified which 1400 square feet in the building were at issue and noted that the amount of free space occupied by the DOA appeared to be 2834 square feet.

From mid-January to early April, 2014, the parties did not communicate and the DOA continued paying the same rent amount it had been paying under the original ten year term, not paying for the Free Space. On April 8, 2014, Bachner sent a letter to the DOA stating, "Lessee (State of Alaska) is in default in their payment of rent on Lease #2532 and Lease #2530. Please consider this your official notification."

On May 27, 2014, the DOA sent Bachner a letter proposing an amendment to the lease that would have the DOA pay the $2.35 per square foot for the Free Space, effective October 1. 2013.[2] On June 4, 2014, Bachner responded, refusing to sign the amendment due to issues relating to the dispute over payment for the other 1434 of free space.

On June 19, 2014, Bachner sent a letter to the DOA claiming that the DOA had failed to cure its breach of the duty to pay rent, pursuant to Lease provision 28 of Lease 2530, and section 3(c) of Lease 2530. Bachner considered the lease terminated and asked the DOA to negotiate a new lease or vacate. The letter stated that Bachner was willing to negotiate a new long-term lease for the property, or would accept $2.35

[2] The amendment did not address the other 1434 square feet of free space, just the 1400 square feet of free space included in the original lease agreement.

per square foot for the entire property square footage, which included the total 2834 square feet of free space occupied by the DOA.

On August 5, 2014, the DOA sent Bachner a modified amendment to the lease, Amendment No. 13, providing that the DOA would begin paying $2.35 per square foot for the contracted 1400 Free Space, effective October 1, 2013. Bachner contended that Amendment No. 13 was invalid because it had been signed on the DOA's behalf by a contracting officer who lacked the authority. Bachner notified the state it had failed to cure its default within 60 days of receiving notice and that it remained in breach.

On August 13, 2014, the DOA directly deposited a payment for the past-due rent on the Free Space into Bachner's account. The next day, Bachner wrote to the DOA, again stating that the DOA had materially breached the lease agreement, and offered the DOA three options: (a) to vacate the premises; (b) to pay $2.35 market rate for the entire 18,194 square feet, on a month-to-month basis; or (c) to negotiate a long-term lease. The letter stated that if the DOA failed to choose one of the three options, Bachner would file suit in the superior court. The DOA responded, taking the position that they were not in material breach of the lease and that renewal options were to be exercised at the sole discretion of the state.

III. PROCEDURAL BACKGROUND

September 2, 2014, Bachner filed an action in Fairbanks Superior Court. The court dismissed Bachner's complaint for failure to exhaust administrative remedies. Bachner appealed that dismissal to the Alaska Supreme Court on March 12, 2015. Bachner then filed a claim with the DOA contracting officer, who issued a decision in the form of a letter to Bachner dated July 31, 2015. The decision characterized Bachner's claim as consisting of two separate issues: (1) that the DOA defaulted by not timely paying rent on the Free Space and the additional 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 the DOA was obligated to pay market rate rent on 2834 square feet of free space starting on October 1, 2013.

The decision denied the claim as to both issues, finding that Bachner, among other things, needed to serve notice to quit pursuant to AS 09.45.100 as a prerequisite to terminating the lease. Bachner submitted a notice of appeal to the Commissioner of Administration on August 18, 2015, and the Commissioner then referred the case to the Office of Administrative Hearings on August 28, 2015.

April 14, 2016, the Administrative Law Judge issued its Decision and Order on Motion to Dismiss and Cross-Motions for Summary Adjudication, ruling in favor of the DOA. The ALJ concluded that the

DOA's late payment of rent for the Free Space did not constitute a material breach of the lease agreement and Bachner had waived any claim regarding its allegations that the DOA occupied the 1434 square feet of additional free space. The ALJ found that the lease did not automatically terminate in June 2014 and there was no genuine issue of material fact that Bachner took the steps necessary to cause it to terminate. The ALJ additionally found that the DOA cured its rent default, was current on rent obligations when it exercised its second renewal option in September 2014, and that renewal was a valid exercise of the DOA's rights under the lease agreement.

Bachner filed an appeal in the Superior court on June 8, 2017, and the court heard oral arguments from both parties on December 20, 2017.

IV. JURISDICTION AND STANDARD OF REVIEW

The superior court has jurisdiction to act as an intermediate appellate court and review appeals from administrative agencies pursuant to Alaska Statute § 22.10.020(d) and Appellate Rule 601(b).

When the superior court acts as an intermediate appellate court, it reviews: "(1) [W]hether the agency has proceeded without, or in excess of jurisdiction, (2) whether there was a fair hearing and (3) whether there

was a prejudicial abuse of discretion." [3] Abuse of discretion is established if the agency has not proceeded in the manner required by law, the order or decision is not supported by the findings, or the findings are not supported by the evidence.[4]

In reviewing the evidence, the court is to exercise its independent judgment. If it is claimed on appeal that the agency's findings are not supported by the evidence in the record then abuse of discretion is established if the court decides that the findings are not supported by "(1) the weight of the evidence, or (2) substantial evidence in the light of the whole record."[5] Substantial evidence is defined as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."[6]

Where the agency's decision is within its ambit of specialized knowledge, such as cases concerning administrative expertise as to complex subject matter or policy, the Alaska Supreme Court has adopted the reasonable basis standard of review.[7] Under this standard, deference is given to the agency's determination "so long as it is reasonable, supported by the evidence in the record as a whole, and there is no

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[3] AS § 44.62.570 (b).
[4] *Id.*
[5] *Id.* at (c).
[6] *George Easley Co. v. Estate of Lindekugel*, 117 P.3d 734, 740 (Alaska 2005) (internal quotations omitted).
[7] *Kelly v. Zamarello,* 486 P.2d 906, 917 (Alaska 1971).

abuse of discretion."[8] In applying the reasonable basis test, the court merely determines whether the agency's decision is supported by the facts and not whether the reviewing court agrees with the decision.[9]

V. DISCUSSION

The ALJ determined that the question presented in this case is: "did [the State] 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?" This court believes that if there was a breach, material or not, an additional question exists: did the State cure that breach?

Bachner argues that: (1) the DOA committed a material breach by failing to pay rent for the free space starting on October 1, 2013; (2) that the lease terminated by operation of law after Bachner gave notice of the breach and the DOA failed to cure within 60 days; (3) that the DOA could not renew the lease once it had breached; and (4) that once the lease was terminated, the DOA's occupancy became a month-to-month lease for which the DOA must pay market rate for the full square footage of the premises.

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[8] *Cook Inlet Pipe Line Co. v. Alaska Pub. Util. Com'n*, 836 P.2d 343, 348 (Alaska 1992).

[9] *Tesoro Alaska Petroleum Co. v. Kenai Pipe Line Co.*, 746 P.2d 896, 903 (Alaska 1987).

The DOA argues that its actions did not constitute a breach of the lease, that, even if they did breach, it was not a material breach, that the lease did not automatically terminate due to their non-material breach, and that Bachner did not take the necessary steps to terminate the lease.

A. Material Breach

The ALJ found that the DOA's late payment of rent for the Free Space was not a material breach. After the ten year term was over, the DOA continued to pay rent on time for the space covered in the original lease agreement, while the parties negotiated the new terms that would apply to the Free Space. The ALJ looked to the Restatement of Property and the Restatement of Contracts to define material breach. 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."[10] Additionally, when determining if a breach is material, a court can look at:

> (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
> (b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
> (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
> (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;

[10] Restatement (Second) of Property, Landlord & Tenant, section 13.1 (1977).

> (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.[11]

This court finds that the DOA's failure to pay for the Free Space was not a material breach. Because the parties agreed that the Free Space would be free for the first ten years, it cannot be claimed that the Free Space was material to the contract. "A determination that a failure is not material means only that it does not have the effect of the non-occurrence of a condition . . . [e]ven if not material, the failure may be a breach and give rise to a claim for damages for partial breach."[12] If the DOA had been withholding the entire rent payment during the negotiation over the Free Space, it would have been a material breach, however, the negotiation was an expected result of the original contract, since the contract allowed for a third party to determine the market rate in the event that the parties failed to agree during initial negotiations.

The ALJ claimed that Bachner "overshadowed and unduly complicated" the negotiations by including the additional free space the DOA had taken over without permission in the negotiation process. This court recognizes the frustration Bachner experienced over the additional free space. However, this court finds that the additional free space was never part of the original contract. The additional free space should have

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[11] Restatement (Second) of Contracts § 241 (1981).

[12] Id.

been addressed as an entirely separate matter. Bachner's inclusion of the additional 1434 square feet of space in the negotiations on the contracted 1400 square feet of free space compromised the DOA's ability to promptly cure the breach of contract. Since the notice of default could not have included space that was not a part of the lease agreement, adding it as a condition of the cure was legally impermissible.

The only firmly expected benefit of the contract was the original rent payment, which is the amount the DOA continued to pay when the ten year term was up. In addressing whether Bachner can be adequately compensated for the rent for the Free Space, the court finds that the DOA's payment of the fair market value, beginning the day the original lease ended, would be adequate compensation for the loss. At the time of this appeal, the evidence indicated that the DOA had initiated back payment for the Free Space and was current on rent.[13] Whether or not the DOA's behavior fell below expectations of good faith and fair dealing would concern this court, however, no evidence of bad faith has been offered that would justify a finding of material breach.

B. Termination of Lease and Prevention of Cure

This court agrees with the findings of the ALJ regarding the termination of the lease. Because this court found that the failure to

[13] How and when the Additional Space will be paid for is an issue not being addressed by this court.

immediately pay for the Free Space was not a material breach, there is no need to address the issue of automatic termination.

The court would like to add that, even if there had been a material breach, the DOA's May 27, 2014 proposed lease amendment was a good faith effort to cure and meet the requirements of the lease. Bachner's response, which demanded a resolution of the dispute over the additional space, did not allow the DOA to cure within the 60 day period. Viewing the evidence and the contract terms in a light most favorable to Bachner, a cure would have required the DOA to be current on the rent stated in their original lease agreement, as well as current on the fair market value of the Free Space. On August 13, 2014, the DOA made a payment of past-due rent, totaling $36,190, which covered rent for the fair market value of the Free Space, dating back to October 1, 2013. At that point, Bachner had been compensated for the loss of rent and the DOA was current on all rental payments reasonably expected from the terms of the original lease agreement.

Bachner's attempt to force the DOA to include the additional space in the new lease agreement is exactly what prevented the DOA from being able to cure and, even when the DOA did sufficiently cure the breach of the written lease agreement, Bachner refused to accept it, insisting on an agreement to resolve the issue of the additional space.

D. The Additional Space

Throughout these proceedings, the ALJ, the DOA and the Commissioner have noted that the additional free space was confusing the matter and that, because it was not contracted for in the original lease, it could not be the hold-up as the DOA attempted to cure. Bachner, on the other hand, has maintained that this case is a simple contract dispute that should be subject to simple contract law. However, looking at the additional 1434 square feet of free space, in terms of simple contract law, Bachner's complaint about the additional space is a completely different claim, separate of the contract in question. Thus, the additional free space remains unresolved.

This court finds that Bachner did not waive the right to enforce payment for the additional free space being occupied by the DOA, rather, Bachner improperly attempted to bring the claim for the space in this contract action. This court will not address what date rent for the additional space should have become effective or any other issues relating to that space because neither party has had an opportunity to sufficiently address the issue.

VI. CONCLUSION

As to the issues of whether the DOA materially breached its contract with Bachner, whether that breach resulted in automatic

termination, and whether the DOA cured any breaches that occurred, this court AFFIRMS the decision of the ALJ.

As to Bachner's claims relating to the additional free space, this court finds that Bachner did not waive those claims and the ALJ's decision was not supported by the findings. The ALJ's determination that Bachner had waived those claims is REVERSED.

Dated this 5th day of June, 2018 at Anchorage, Alaska.

Signed
Pamela Scott Washington
Superior Court Judge *pro tem*

I certify that on 6/5/18 a copy
of this order was mailed to counsel
at their address of record.
Grahame/Weinstein/Moderow/Moore/McGowan/Royce

Signed
Shayne Wright
Administrative Assistant

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