

## Case Study Analysis

Atwell-Hicks, Inc.'s Comments

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Survey – City of Detroit property is notoriously poorly surveyed so clearly identifying the leased area and the owned property, and having all parties agree to those boundaries, could be an issue.

Environmental – Again, because the property is in Detroit, environmental issues will most likely be identified in any review. The extent of those issues, how they are mitigated, the cost of that mitigation, who pays the cost, the level of clean-up needed (if any), potential deed and use restrictions, and marketing impacts are all issues that will probably need to be addressed.

Traffic – With the proposed project being in the immediate vicinity of a new retail center, existing and future traffic patterns could become an issue. The use of the office building has unique traffic patterns that are different in terms of magnitude and peaking when compared to the existing residential zoning. Additionally, will the State of Michigan's use be more or less intensive than a traditional office use? These issues could result in required traffic improvements – Who pays for these, do they impact the owned parcel, the leased parcel, or both, could it potentially change the leased parcel area (and hence the economics of the deal)? These issues should be understood or addressed in the Purchase Agreement.

Zoning – The property is currently zoned residential and will need to be rezoned to office. Who is responsible for the rezoning, who is paying for it, what happens if the rezoning is not successful, what if rezoning to a PUD is possible but comes along with other, costly, requirements, is the project moving forward during a rezoning period (when all time and money being invested is completely at risk), how does a delay during rezoning (usually, very likely) affect the overall project schedule?

Planning – As the project goes through the planning process, the parking, building, landscaping, and other improvements could be required to move. The lease area agreement needs to have the flexibility to adjust throughout the process to reflect these changes, and any associated liabilities (e.g. the liability of having only a building on the lease area versus a parking lot is obviously different).

Construction Delays – Working in Michigan, a State with winter conditions, and in the City of Detroit, an area where the development and permitting departments are under staffed, will almost guarantee that you encounter construction delays. The impacts of these problems could significantly delay building occupancy. How these delays are addressed, the cost of mitigating the constructions problems, and the costs / penalties of the delay in occupancy are all issues that could significantly impact the project.

## Comments Regarding Legal Issues

Since the State of Michigan will be the tenant for this office building, this fact pattern presents unique problems. The State will approve the lease for the building in advance. The lease will set a firm date by which construction will be completed and will attach the specifications for the construction of the building. Your client will discover that once the lease is approved, it will be difficult to negotiate any amendments to the lease. It will be nearly impossible to change the specifications for the building. Your client will not be able to recoup any construction cost overruns by raising the rent. Therefore, your client will want a Guaranteed Maximum Price Construction Contract. Your client will also want to be certain that the contract has some stringent provisions or economic incentives to motivate the contractor to finish in a timely manner. The contract will also provide for regular reporting on the progress of construction.

The purchase agreement must allow your client to conduct as much due diligence as possible so that your client can ensure that the site conditions are suitable for what is to be built. The purchase agreement must specifically address the contingencies that will allow your client to terminate the purchase agreement and obtain a return of any earnest money deposit.

The Notice of Commencement must be prepared carefully. Since your client will own a portion of the property in fee simple and a portion will be a ground lease, those interests must be identified property. It may be wise to prepare two separate Notices so that a contractor working on the parking lot is not able to file a lien that attaches to the fee simple interest of your client in the land and building. Your client must also keep precise records on the number of payment applications, change orders and items directly impacting the bottom line for the project.

Your client must also understand the impact of any change orders and the impact upon the schedule for completion. Any change orders requested by the State will probably require an amendment to the lease.

## Other Drafting Considerations

1. (i) The Parole Evidence Rule. Extrinsic evidence (oral or written) of prior or contemporaneous agreements or negotiations is not admissible to contradict, vary, or modify an unambiguous written contract intended by the parties to be the final and complete expression of their agreement. The policy underling the rule is to reduce the possibility of perjured testimony and the use of non-binding preliminary agreements as evidence. (Letters and drafts and therefore marked accordingly by some counsel).
- ii) Evidence. A Court may consider all relevant evidence to determine if the parties intended a document to be a "final and complete" expression of their agreements. In legal terms, a final and complete expression of the agreement of the parties is a "totally integrated" agreement.
- iii) The Integration Clause in the Commitment. Counsel will usually insert an "integration clause" in the Construction Contract. In the absence of fraud or mistake, an integration clause can be effective to establish the intent of the parties to make a final agreement:

"No statements, agreements or representations, oral or written, which may have been made to Contractor or to any employee or agent thereof, either, by Developer or by an employee, agent or broker acting on Developer's behalf, with respect to the Project, shall be of any force or effect, except to the extent stated in this Agreement, and all prior agreements and representations regarding the Project are merged herein."
- iv) Side Letters Changing the Construction Agreement. Counsel should be aware of the significance of a merger clause in the Construction Agreement. The merger clause prevents the owner or contractor from claiming any change in the terms of the Construction Agreement through prior or contemporaneous written or oral agreements. Some judges, however, and some legal scholars believe that a party may use prior agreements, both oral and written to prove that despite the merger clause, the party did not intend the Construction Agreement to be the final agreement of the parties.
- v) Subsequent Modification of the Commitment. Evidence of subsequent agreements or transactions will always be relevant. Such subsequent agreements should be clearly marked as the "First Amendment" or "Second Amendment" to the Construction Agreement. These amendments should always conclude with the language that unless specifically modified by the amendment, all other terms of the Construction Agreement shall remain in full force and effect.

2. Pay if Paid Clause. In Christman Company v Anthony S Brown Company, Inc. 210 Mich App 416 (1995), the Court of Appeals affirmed the trial court's ruling denying payment to the subcontractor and enforcing the applicable clause as a pay if paid clause which shifted the risk of owner non-payment from the general contractor to the subcontractor. The Court found the language in the subcontractor's bid proposal to be irrelevant where it was not specifically incorporated into the subcontract.