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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

WRI GOLDEN STATE, LLC, Plaintiff and Respondent, v. MICHAEL LIU et al., Defendants and Appellants.	A132328 (Solano County Super. Ct. No. FCS031990)

Defendants Michael Liu, Nancy Ko, John Liu, and Min Hui Liu (jointly referred to as appellants) executed a 10-year lease with a predecessor in interest of plaintiff WRI Golden State, LLC (WRI). After five years, appellants were allowed to assign the lease to another tenant, but under the terms of the assignment appellants continued to be liable under the lease. The assignee sold the business several months later, and the purchasers eventually stopped paying rent. WRI brought an action against appellants and the other tenants and was awarded over $100,000 in rent. Appellants contend WRI was barred from collecting back rent from them because it failed to enter into a formal agreement with the purchasers of the business. We affirm.

I. BACKGROUND

WRI filed an action to collect back rent against appellants, Mun Mantione, Yan Nian, and Zhang Li Yu on August 26, 2008. The complaint alleged appellants leased property (premises) in Vacaville from WRI in 2000, executing a 10-year lease (lease). After an intervening assignment and the addition of two new tenants, neither of which

excused appellants from liability under the lease, the premises were abandoned in 2008. The action sought unpaid rent and attorney fees.

According to the evidence at a bench trial, Michael Liu and his brother John opened the Mongolian Bistro in the premises in 2000. They and the other appellants executed a 10-year lease with BPP/Golden State Acquisitions, apparently a predecessor in interest of WRI.[1] In 2005, the brothers sold their business to Mantione. The lease was assigned to Mantione in a "LEASE ASSIGNMENT & ASSUMPTION AND SIXTH AMENDMENT TO LEASE" (hereafter Sixth Amendment), executed by WRI, Mantione, and appellants. Although the Sixth Amendment imposed on Mantione all "the covenants, duties and obligations of 'Tenant' " under the lease, it did not excuse appellants from further liability. Paragraph 3 of the Sixth Amendment stated: "[WRI] hereby consents to this Assignment with the express understanding that . . . this Assignment shall in no way relieve [appellants] of liability for the performance of the covenants, duties and obligations of Tenant under said Lease Contract, including liability for the full amount of rental and any additional charges, provided to be paid by Tenant to [WRI] pursuant to said Lease Contract; and [appellants] shall continue to be directly and primarily liable to [WRI] for the performance of all covenants, duties and obligations of Tenant under such Lease Contract, including payment of rental, and such liability shall remain and continue in full force and effect as to any further assignment or transfer of the Lease Contract . . . ."

Less than two years later, Mantione told WRI she wanted to sell the restaurant to Nian and Yu, and sought permission to assign them the lease. Because WRI deemed Nian and Yu "unqualified" to assume the lease, it proposed adding the pair as cotenants with Mantione. WRI prepared an amendment to the lease adding Nian and Yu as tenants, designated "SEVENTH AMENDMENT TO LEASE" (hereafter Seventh Amendment), and sent it to Mantione on February 1, 2007. WRI soon discovered the draft contained an

[1] We found no explanation in the record of the relationship between WRI and the initial landlord, but WRI is the signatory on later amendments to the lease. It was not disputed at trial that WRI was entitled to enforce the lease.

error. Although the parties had agreed to increase the security deposit to $5,000, the draft of the Seventh Amendment sent to Mantione reflected a security deposit of $500. WRI sent a corrected draft to Mantione on February 5. Mantione, Nian, and Yu nonetheless executed and returned a copy of the first version to WRI, dated February 17, 2007. Nian and Yu took over operation of the restaurant at about the same time. WRI never executed either version of the Seventh Amendment, nor did WRI send Nian and Yu a copy of the original lease.

No later than mid-March 2007, WRI learned Nian and Yu had purchased the business and, without authorization, begun altering the premises, including changing the restaurant's menu. WRI sent Mantione a notice of default and engaged outside counsel to negotiate with attorneys for Nian, Yu, and Mantione over the issues raised by the change in ownership, including a dispute that had arisen between Mantione and Nian and Yu. A third version of the Seventh Amendment, dated August 1, 2007, was prepared by WRI's outside counsel based on these negotiations. A copy of this third version of the Seventh Amendment was signed by Nian and Yu, but Mantione and WRI never executed it. WRI was willing to sign the document, but it declined to sign until Mantione had done so. Although WRI's attorney contacted counsel for Mantione "twice, or possibly three times" about her failure to execute the document, no explanation was provided for Mantione's apparent refusal. At trial, WRI took the position Nian and Yu "were not tenants under the lease" as a result of the failure of all parties to execute some version of the Seventh Amendment.

In November, Mantione, Nian, and Yu stopped paying rent; WRI filed an unlawful detainer action; and Nian and Yu were evicted. At trial, Nian testified he and Yu stopped paying rent because, "I felt I was insecure there. If I continued to invest into it I don't know what I was going to do. [¶] . . . [¶] [b]ecause I did not get a lease."

The trial court issued an extensive "Revised Tentative Statement of Decision" in favor of WRI in December 2010, which was incorporated into the court's final judgment, entered in April 2011. Among other findings, the court held (1) through the Sixth Amendment, appellants became sureties under the lease and waived their surety defenses;

(2) Nian and Yu were deemed to be cotenants under the lease on the basis of a judicial admission in WRI's complaint; (3) WRI performed its material obligations under the lease; and (4) Mantione would not, in any event, have been entitled to withhold rent on the basis of any defaults. Relating specifically to the primary issue raised in this appeal, the trial court noted, "the actions and/or inactions of [WRI] did not constitute Bad Faith under *Ely v. Liscomb* (1914) 24 Cal.App. 224." The court awarded WRI $107,192 in rent, as well as costs and attorney fees.[2]

II. DISCUSSION

Appellants contend WRI is precluded from recovering under the Sixth Amendment because it breached the covenant of good faith and fair dealing by failing to accept Nian and Yu as tenants and because it failed to prove it performed all of its obligations under the lease when it submitted no evidence regarding the Seventh Amendment.

A. *Breach of the Implied Covenant*

" 'The covenant of good faith and fair dealing, implied by law in every contract, exists merely to prevent one contracting party from unfairly frustrating the other party's right to receive the *benefits of the agreement actually made*.' " (*American Express Bank, FSB v. Kayatta* (2010) 190 Cal.App.4th 563, 570.) "The implied covenant protects the reasonable expectations of the contracting parties based on their mutual promises. [Citations.] The scope of conduct prohibited by the implied covenant depends on the purposes and express terms of the contract." (*Digerati Holdings, LLC v. Young Money Entertainment, LLC* (2011) 194 Cal.App.4th 873, 885.) " 'The covenant thus cannot " 'be endowed with an existence independent of its contractual underpinnings.' " ' " (*Durell v. Sharp Healthcare* (2010) 183 Cal.App.4th 1350, 1369.)

"The implied covenant 'finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must

[2] An amended judgment including specific amounts for the costs and attorney fees was later entered and is not separately challenged in this appeal.

be exercised in good faith.' " (*Ladd v. Warner Bros. Entertainment, Inc.* (2010) 184 Cal.App.4th 1298, 1306.) However, "[t]he implied covenant cannot contradict the express terms of a contract. [Citation.] Similarly, the implied covenant cannot be used to limit or restrict an express grant of discretion to one of the contracting parties." (*Thrifty Payless, Inc. v. Mariners Mile Gateway, LLC* (2010) 185 Cal.App.4th 1050, 1061–1062, fn. omitted.) Accordingly, the implied covenant of good faith and fair dealing "cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement." (*Guz v. Bechtel National, Inc.* (2000) 24 Cal.4th 317, 349–350.)

With respect to "ASSIGNMENT AND SUBLETTING" of the lease, section 19.2 states that "Tenant shall not enter into or consent to any Transfer or Change of Control without the prior written consent of Landlord, which Landlord shall not withhold unreasonably. Although the following list shall not be deemed exclusive, it shall be reasonable for Landlord to withhold its consent in any of the following situations: [¶] (i) Landlord has a reasonable basis for disapproving the use to be made of the Premises by the Transferee . . . ; [¶] (ii) In Landlord's reasonable business judgment, the Transferee lacks sufficient experience to operate a successful business of the type and quality permitted under the Lease; [¶] (iii) In Landlord's reasonable business judgment, the present net worth of the Transferee is less than the greater of Tenant's net worth at the Lease Reference Date or Tenant's net worth at the date of Tenant's request for consent; [¶] (iv) In Landlord's reasonable business judgment, the Transferee lacks sufficient creditworthiness to provide assurance that it will discharge its responsibilities under this Lease; [¶] . . . [¶] (vi) The proposed Transfer or Change of Control would breach any covenant of Landlord respecting radius, location, use, prohibited use or exclusivity in any other lease, financing agreement, or other agreement relating to the Shopping Center. . . ."

Under the implied covenant of good faith and fair dealing, WRI had a duty to Mantione to exercise good faith in considering a transfer to Nian and Yu, consistent with the terms of section 19.2. As noted above, however, the covenant of good faith and fair

dealing "cannot be used to limit or restrict an express grant of discretion to one of the contracting parties." (*Thrifty Payless, Inc. v. Mariners Mile Gateway, LLC, supra,* 185 Cal.App.4th at p. 1062, fn. omitted.) WRI's duty was therefore no greater than that described in section 19.2.

Appellants contend WRI acted in bad faith because "[WRI] had paying tenants at the property (Nian and Yu) but [WRI] refused to sign the amendments to the Lease (Seventh Amendments) that it prepared that would legally acknowledge Nian and Yu as tenants." As demonstrated below, we find no evidence of bad faith in WRI's dealings with Nian, Yu, and Mantione with respect to the Seventh Amendment.[3]

When first asked to accept Nian and Yu as assignees, WRI examined their finances, as it was permitted to do under section 19, and found the pair financially unqualified for an assignment. Appellants submitted no evidence to suggest this determination was unreasonable or not made in good faith.

WRI then suggested a cotenancy, which from appellants' perspective would have been similar to an assignment, since it made Nian and Yu jointly liable for rent. WRI negotiated an agreement with Mantione, Nian, and Yu to add the cotenants and sent them an erroneous draft. When it discovered the error, WRI sent a draft reflecting the actual agreement. Whether judged under the doctrines of mistake or offer and acceptance, the sending of the second draft revoked the first draft. Yet Mantione, Nian, and Yu signed and returned the first draft, although Mantione acknowledged at trial she was aware it did not reflect the parties' true agreement. Appellants provided no evidence suggesting WRI acted unreasonably or in bad faith when it insisted on the agreed $5,000 deposit and declined to execute the draft requiring a $500 deposit, which WRI had revoked prior to its execution by Mantione, Nian, and Yu.

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[3] Contrary to appellants' claim in their reply brief, WRI was not required affirmatively to prove it had complied with the implied covenant of good faith and fair dealing as part of its cause of action for breach. Any breach of the implied covenant was an affirmative defense, on which appellants bore the burden of proof.

Finally, when WRI learned Nian and Yu had assumed operation of the business prior to obtaining approval from WRI, as required by the lease, WRI commenced further negotiations with counsel for them and Mantione, reached a further agreement, and prepared an appropriate draft. By sending out the draft, WRI communicated its willingness to sign. Again, appellants have provided no evidence suggesting these negotiations were not undertaken in good faith or that WRI acted unreasonably or in bad faith during the course of the negotiations. Yet this time, Mantione refused to execute the resulting agreement. Accordingly, the only conclusion that can be drawn from the record is that it was Mantione, and not WRI, who prevented Nian and Yu from entering into a cotenancy agreement with WRI.[4] Based on the record before us, we find no evidence suggesting WRI acted in bad faith or unreasonably in its dealings with Mantione, Nian, and Yu, and we accordingly affirm the trial court's decision as supported by substantial evidence.[5]

Appellants rely heavily on *Ely v. Liscomb, supra*, 24 Cal.App. 224, in which the court held, "it is the duty of a creditor to act in the utmost good faith toward a surety, and so far as he can consistently with the security of his own rights, protect the interest of the former, as well as his own." (*Id.* at pp. 228–229.) Nothing in *Ely* dictates a different result here. To the extent appellants contend *Ely* imposes a higher standard of conduct than the standard created by the implied covenant of good faith and fair dealing under modern law, we disagree. On the contrary, the standard of "utmost" good faith, consistent with the creditor's protection of its own interests, is not materially different from existing law of the implied covenant. Nor do the facts of *Ely* dictate a different result here. In *Ely*, a creditor who had foreclosed on a mortgage on certain personal property refused a tender of the property, instead contending he would prefer to receive

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[4] Although Mantione testified at trial, she was never asked to explain her reasons for refusing to execute the renegotiated Seventh Amendment.

[5] Appellants contend we should review the trial court's ruling de novo. While we believe a substantial evidence review is appropriate (*Hicks v. E.T. Legg & Associates* (2001) 89 Cal.App.4th 496, 509), we would reach the same result reviewing de novo.

the fair value. (*Id.* at pp. 225–226.) Because the defendants were entitled to respond to the foreclosure with a return of the property, the court found a violation of the duty of good faith. (*Id.* at pp. 228–229.) There is no parallel here. WRI never refused a tender of rent from its tenants, and, as discussed above, it acted in good faith in attempting to accommodate Mantione, Nian, and Yu.

B. *WRI's Failure to Prove its Case*

Appellants contend WRI should be denied recovery because it "did not meet its burden that it complied with the Lease." According to appellants, WRI was required to introduce the Seventh Amendment into evidence because WRI argued the tenants were not allowed to withhold rent. In order to apply this argument to Nian and Yu, appellants argue, WRI was required to submit proof they were tenants.

For at least three reasons, the argument makes no sense. First, *appellants* persuaded the trial court to rule Nian and Yu were tenants on the basis of a judicial admission. Once the trial court ruled Nian and Yu were tenants as a matter of law, it was unnecessary for WRI to submit proof they were tenants.

Second, Nian and Yu's status as tenants was irrelevant to the issue of the right to withhold rent. Regardless of whether Nian and Yu were cotenants, Mantione remained a tenant under the lease. When no rent was paid, Mantione was in default. WRI then had the right under the Sixth Amendment to proceed against appellants, regardless of whether Nian and Yu were also tenants who were also in default.

Third, the trial court found WRI was not in default under the lease. It therefore became unnecessary for WRI to demonstrate the tenants were not permitted to withhold rent in the event of WRI's default, since there was no default by WRI that might otherwise have justified the tenants' refusal to pay rent.

We also find no merit in appellants' claim the complaint was a sham pleading. There was no inconsistent pleading in separate actions. (See *Cantu v. Resolution Trust Corp.* (1992) 4 Cal.App.4th 857, 877–878.)

Finally, WRI requests an award of appellate attorney fees. The request must be addressed to the trial court in the first instance. (Cal. Rules of Court, rule 3.1702(a) & (c).)

III. DISPOSITION

The judgment of the trial court is affirmed.

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Margulies, J.

We concur:

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Marchiano, P.J.

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Banke, J.