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*** Electronically Filed ***
07/01/2008 8:00 AM

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2006-006541 06/13/2008

HONORABLE A. CRAIG BLAKEY II

CLERK OF THE COURT
L. Gilbert
Deputy

S M D I COMPANY

TIMOTHY H BARNES

v.

DYNAMIC DETAILS INCORPORATED ARIZONA, et al.

LARRY O FOLKS

T DAWN FARRISON

MINUTE ENTRY

This matter has been under advisement after a 10 Day Trial to the Court on Plaintiffs' Complaint for breach of contract and Defendant Dynamic Details Incorporated, Arizona's ("DDI-AZ") Counterclaim for breach of the covenant of good faith and fair dealing and for return of its security deposits. Having considered the evidence and arguments presented, including the parties' written closing arguments and proposed findings of fact and conclusions of law, the Court issues the following ruling.

The Court finds the following facts are pertinent to this matter:

1) In 1999, Plaintiffs became the owners of two industrial buildings located at 1117 and 1131 W. Fairmount Dr. in Tempe, AZ ("F-1" and "F-2").

2) Defendant Dynamic Details, Inc. ("DDI") is a California corporation and the parent entity of DDI-AZ, the latter subsequently changing its name to Laminate Technology Corporation ("LTC").

3) DDI-AZ entered into an assignment of lease agreement with Plaintiff's initial Lessee (Nelco Products, Inc.), and pursuant to which DDI-AZ became the Lessee of the above referenced buildings.

4) Section 202 of each of the Leases states that, without written consent of the Plaintiffs, if LTC remained in possession of the premises after expiration of the leases, then LTC was obligated to pay double the rent as "hold-over" rent.

5) Section 301 of each of the Leases states that the requisite monthly rent shall be paid on "the first day of each and every calendar month." This section also states that LTC shall pay Plaintiffs a late charge if the monthly rent is not received within 10 days of when it is due.

6) Section 601 of each of the Leases required the tenant to maintain and preserve the interior and exterior of the premises in a first-class and clean condition, with all repairs and restoration to at least be equal to the original construction.

7) Section 602 of each of the Leases requires that, at the termination of the lease, lessee shall deliver the premises in first-class condition and repair, subject to normal wear and tear. Lessee was also to take every reasonable effort to prevent the premises from falling into disrepair. Nowhere in the Leases is the term "first-class condition" defined.

8) In April 2005, LTC informed Plaintiffs that it would not exercise its option to extend the Leases past December 31, 2005. Prior to the tenant's notice, Plaintiffs performed a property inspection that identified necessary repairs to the two buildings that would return them to a "class A condition."

9) In May 2005, the tenant ceased all manufacturing operations. DDI assumed responsibility to restore the premises and continued paying the rent called for under the Leases. The actual tenant, LTC, no longer had anything to do with the properties.

10) Over the course of the Summer and Fall of 2005, DDI and Plaintiffs negotiated over the restoration of the premises. Both of the parties allege that the other is responsible for delaying the process. The Court finds each party's gamesmanship throughout the negotiations was responsible for the delay.

11) DDI paid for and obtained a Phase II Environmental Report that showed the property to be "clean" and well within acceptable guidelines.

12) DDI conducted restoration and repairs to the premises during the winter of 2005 and spring 2006. With few exceptions as set forth below, the Court finds that DDI surrendered the premises in a condition contemplated by the Leases.

DDI contends it is not liable to Plaintiffs for the repair of and restoration work to the F1 and F2 facilities because it was not a party to the lease agreements between LTC and Plaintiffs. Plaintiffs respond that LTC is an instrumentality of its parent company, DDI, and, thus, DDI should be held liable for the actions of LTC. Plaintiffs additionally assert that DDI is directly liable for the actions of LTC and has submitted a Motion for Leave to File Third Amended Complaint to conform to the evidence introduced at trial.

Granting or denying a motion to amend a pleading so it may conform to the evidence is in the sound discretion of the trial court. Hill v. Chubb Life American Ins. Co., 182 Ariz. 158, 161 (1995). An amendment "should be permitted when neither party is surprised nor prejudiced by the allowance of the amendment." Eng v. Stein, 123 Ariz. 343, 347 (1979).

DDI objects to Plaintiffs' amendment, arguing that it is contrary to Arizona law to permit Plaintiffs to circumvent their burden of proving the elements required to pierce the corporate veil. Relying on Gatecliff v. Great Republic Life Ins. Co., 170 Ariz. 34 (1991), Plaintiffs respond that a parent company can be held directly liable for the contracts of its subsidiary, regardless of its status as a non-party to the contract.

The Court finds Plaintiffs' theory of direct liability is a cognizable claim in Arizona. The Court notes the fact that Gatecliff involved a bad faith insurance claim and not a claim for breach of a commercial lease; however, the Court further notes the rationale behind recognizing direct liability is pertinent here. As with the parent corporation found directly liable in Gatecliff, DDI had direct involvement with Plaintiffs and their alleged injury. At trial, Plaintiffs proffered the deposition testimony of Brad Tesch, former Chief Operating Officer of DDI, which affirmed that DDI assumed responsibility for the restoration and repair of the facilities and the return of them to Plaintiffs. Accordingly, as Plaintiffs claim is viable and properly supported, *see* In re McCauley's Estate, 101 Ariz. 8 (1966), and because the Court finds neither party would be surprised nor prejudiced by allowing the amendment,

IT IS ORDERED granting Plaintiffs' Motion for Leave to File Third Amended Complaint to Conform to Evidence.

Prior to commencement of the repairs and restoration, DDI directly negotiated with Plaintiffs and proposed a lump sum cash payment to allow Plaintiffs to complete the work to their own satisfaction. When the parties were unable to reach a settlement, the record reveals

that DDI personally undertook the responsibility of repairing and restoring the facilities in accordance with the lease provisions. DDI directly hired and paid for the contractors and surveyors utilized in this process. All communication during this process was between DDI and Plaintiffs. Since DDI assumed direct responsibility for contracting, supervising, and financing the repair and restoration work at the facilities, it follows that it should be held directly accountable to Plaintiffs for any resulting harm.

The Court further finds DDI is liable to Plaintiffs because LTC is the instrumentality of DDI. The facts demonstrate a unity of interest and control between DDI and LTC. Mr. Tesch testified DDI assumed the responsibilities of LTC in dealing with LTC's creditors and paid LTC's bills and expenses, including the monthly rent owed Plaintiffs. Three was also evidence that when DDI transferred some of LTC's equipment to other DDI subsidiaries, or sold other equipment to unrelated third-parties, DDI did not repay LTC for those assets. In light of the assumption of all of LTC's affairs and operating as if there was an assignment by LTC to DDI, it would be unjust to allow DDI to hide behind its corporate shield.

In this matter, resolution of liability depends upon what conditions the facilities were required to be in when they were surrendered to the Plaintiffs. If DDI did not surrender the facilities in the appropriate condition as required by the leases, then DDI and LTC are liable for any resulting damages.

The leases specifically provide that the facilities be returned to Plaintiffs "in first class condition and repair as obtained therein at the commencement of the term of the Leases, subject, however, to normal (or ordinary) wear and tear." With no definition of "first-class condition" in either lease, the parties submitted expert testimony and case law to establish what this language means. Plaintiffs maintain that this standard mandates a return of the facilities in their original conditions and that "first class" is a higher standard than a "normal wear and tear" standard. Plaintiffs' representative, W. Scott Schirmer, testified that these conditions should be closer to "new" than something lesser than that. Defendants highlight the "subject to…wear and tear" language in the leases and contend the standard only requires the facilities to be in no better condition than the existing conditions of the facilities at the start of the leases, subject to normal wear and tear. Defendants' expert architect, Phillip Coppola, testified that first class condition means "neat, clean, repaired with everything in working order."

The Court finds that the language, "subject to normal (or ordinary) wear and tear," is not superfluous and must be given effect. As a result, the language, "first class," does not entitle Plaintiffs to a return of the facilities in their original, when built, condition, which unfortunately is unknown. Regardless, to find that the facilities should be in a like new condition, particularly when one of the buildings is approximately twenty years old and the other ten years of age strains credulity. To hold otherwise would ignore the express language of the leases and provide

Plaintiffs with a windfall. Construing the leases in their entirety, the Court concludes that the leases demanded return of the facilities in a condition no better than the conditions then existing at the commencement of the leases, subject to normal wear and tear. Indeed, the parties' agreed to forego regular maintenance and address the topic later; hence the Plaintiff's inspection of April 2005.

The fact that it is unclear as to what the original condition of the facilities were in does not preclude an award of damages, particularly when both sides operated under the assumption that restoration was required under the leases. Plaintiffs claim DDI's repair and restoration of the large pit, roofs, elevator, and HVAC systems were deficient. Plaintiffs additionally claim they incurred damages as a result of a hydrochloric acid spill caused by the tenant as well as for general architectural and construction repairs not addressed or properly corrected by Defendants. Finally, Plaintiffs seek unpaid rent and associated late fees and attorneys' fees.

Plaintiffs claim they are entitled to $37,008 in damages to re-fill and compact the pit at the F-2 facility. Plaintiffs submit this is necessary because if the backfill material was not compacted in layers during installation, then there is the possibility that the cement floor may settle below its intended surface. The Court finds no appreciable damage with respect to the condition of the pit. Defendants' sump pit expert opined that there was a low likelihood that there would be any settlement because the backfill is completely enclosed in concrete, thereby protecting the pit from water intrusion. Plaintiffs' expert testified that there is a potential for minor settlement, but the likelihood of any settlement impacting the function of the floor is "low." Therefore, the Plaintiffs not meeting their burden, they are not entitled to damages to re-fill and compact the pit.

Plaintiffs claim that they are entitled to $100,000 to $120,000 to replace the allegedly non-fire rated roofs at the facilities, $9,800 to replace counter flashing, $1,500 to seal coping tiles and $3,500 to $5,000 to seal expansion joints. In the event the Court finds the roofs should not be replaced, Plaintiffs seek additional damages of approximately $7,600 to $11,600 for stanchion and other repairs.

DDI installed new roofs at the facilities. Plaintiffs assert that DDI did not take the necessary actions to certify that the roofs had Class B fire ratings. However there is no evidence that the original roofs had Class B fire ratings and even assuming they had the appropriate fire ratings, Defendants' expert testimony showed that there is a high probability that the roofing assemblies are Class B fire rated. In contrast, Plaintiffs' expert testified that the roofs were not fire rated, but agreed there was no evidence that the roof assemblies were not appropriately rated. Therefore, there being no evidence that at the time of surrender the new roofs were in a lesser condition than that existing at the commencement of the leases, Plaintiffs are not entitled to damages to replace each roof. However, the Court finds Plaintiffs are entitled to damages for the

repair of the stanchions, counter-flashings, the lower equipment wells, sealing of expansion joints, roof drains and the sealing of coping tiles in the amount of $7,500.

As to Plaintiffs' claim for $18,327 to repair the elevator located in the F-2 facility, the Court finds that DDI hired a licensed contractor to repair and restore the elevator. The elevator was inspected by the Elevator Safety Section of the State of Arizona Occupational Safety Division and was found compliant with all applicable safety standards and regulations. At the time of surrender, Plaintiffs received a fully functional and operational elevator. Plaintiffs assert that the rails or tracks that the elevator rides on have rusted due to the aforementioned acid spill. However, there was no testimony directly connecting this rust to the spill or, more important, that the rust is dangerous to the safe operation of the equipment. Therefore, Plaintiff's request for damages to conduct further restoration of the elevator is denied.

Plaintiffs further claim $56,299.67 in damages to replace eleven faulty HVAC units. The Court finds the out of balance fan blades, dirty or missing air filters, and dirty or deteriorated coils are the result of normal wear and tear. Evidence presented at trial shows the usual life expectancy of a commercial HVAC unit is fifteen years. However, this general expectancy should be considered in light of the specific use of the units. LTC operated the facilities continuously and nonstop for well over a decade. While the Court finds this nonstop use of the HVAC units is a significant factor that would diminish their useful life expectancy, the evidence shows several of the HVAC units were intentionally re-wired by LTC. Specifically, two of the HVAC units originally operated as heat pumps, but had been reconfigured by Defendant to operate as air conditioning units. The Court finds these damages are not the result of normal wear and tear. Furthermore, three of the HVAC units had been rewired such that the units functioned solely as air conditioning units. The Court similarly finds these damages are not the result of normal wear and tear. According to Plaintiffs' HVAC expert, two other units had essentially worn out. Therefore, the Court finds the Defendants are liable to Plaintiffs for the cost of repair or restoration of the HVAC systems in the amount of $10,000.

Plaintiffs additionally claim damages in the amounts of approximately $18,000 as a result of hiring a consulting firm to investigate whether any environmental issues remained from the acid spill and whether DDI correctly repaired and restored the pit.

At the time of the acid spill, LTC washed down the affected areas and made the facilities safe for its employees. During the repair and restoration process DDI conducted further environmental remediation. These efforts resulted in a clean ESA Phase II environmental report which was provided to Plaintiffs prior to completion of the restoration process. The Court finds that Plaintiffs' environmental investigation was unwarranted and that Defendants are not liable for Plaintiffs' costs in conducting further investigation.

Similarly, the Court finds Defendants are not liable to Plaintiffs for the $11,338.30 incurred as a result of their investigation into the adequacy of DDI's filling of the pit. Although they had no obligation to absolutely trust the work performed by DDI, Plaintiffs should have stopped the sealing of the pit and conducted their investigation. Waiting until after the sealing was needless and the investigation proved to be of little consequence.

Plaintiffs also seek damages for certain architectural and construction aspects of the facilities that were not adequately addressed or corrected. Specifically, Plaintiffs contend Defendants are liable for patching and painting of the walls, repairing corroded window mullions, the epoxy flooring, the utility room and for minor cosmetic issues including mismatched ceiling tiles, inoperable light fixtures and exhaust fans, missing cover plates and mismatched tinted window panes. Plaintiffs also submit plumbing lines were not tacked and certain electrical conduits were not removed or labeled. The parties disagree as to the extent of these claimed damages. Plaintiffs' figures range from $153,322 to $250,000, while Defendants maintain only minor repairs of approximately $12,000 are necessary.

With respect to the window mullions, Plaintiffs' expert opined that replacement of all the window mullions in both facilities was necessary and would cost $48,500. The Court finds a portion of the window mullions were surrendered to Plaintiffs in a corrosive state not subject to normal wear and tear. However, the Court further finds full replacement of all window mullions to be unnecessary and wasteful. As Defendants' expert testified, repairs can be made to these window mullions at a fraction of the Plaintiffs' alleged cost.

With respect to the epoxy flooring, the Court finds minor damage. The testimonial evidence shows that, with the exception of hot solder drippings, the flooring was in good shape at the time of surrender. Therefore, except where hot solder dripped onto the floor, Plaintiffs are not entitled to recover any damages attributable to the repair and restoration of the flooring.

With respect to the lack of patching and painting of the walls and minor cosmetic issues, the Court finds that either such patching never existed or that the vast bulk of these issues are the result of normal wear and tear. However, the Court finds that repairs need to be made to the floor and utility room.

Accordingly, with respect to architectural and construction damages sought by Plaintiffs, the Court finds Defendants are liable in the amount of $20,000.

As to Plaintiffs claim that they are entitled to two additional months rent after the date of surrender as a result of Plaintiffs having to conduct an investigation regarding the pit and environmental issues, as stated above the Court finds Plaintiffs' claim is not properly attributable

to Defendants. Thus, once DDI surrendered the property to Plaintiffs, Defendants' obligation to pay rent past April 2006 ceased.

Plaintiffs lastly claim entitlement to $23,837.25 for Defendants' incomplete payment of April, 2006 rent as well as for damages resulting from Plaintiffs' late payment of January, 2006 rent, which resulted in damages of $4,057.94 for accrued late charges and $608 in attorneys' fees.

The Court finds Plaintiff is entitled to the full amount of the April 2006 rent. Section 202 of both leases state in the event of a hold over, LTC will be considered a month to month tenant and is liable for double the rate of the rental amount then existing. The record reveals DDI initially tendered a $55,009.03 rental payment for the April. However, Defendant stopped payment on this amount and thereafter transmitted payment in the amount of $31,171.78. Although DDI surrendered the facilities to Plaintiffs on April 7, 2006, Defendant remains liable for the entire month. Therefore, DDI owes a balance of $23,837.25.

The Court further finds that Plaintiffs are entitled to the damages resulting from the late payment of the January, 2006 rent. Section 301 of both leases provide that if payment is not received within ten days after rent is due, Defendant is liable for 5% interest under to the F-1 lease and 8% interest under the F-2 lease. Section 1101 of both leases further provides that interest accrues from the date payment is due at 18% per annum under the F-1 lease and at 15% per annum under the F-2 lease. The January, 2006 rent was not tendered to Plaintiffs until January 13, 2006. Since rent is due on the first of every month, Plaintiffs are entitled to $4,057.94 in accrued late charges. Section 701 of both leases also provides that tenant shall indemnify Plaintiffs for all attorneys' fees incurred to enforce the terms of the leases. Thus, Plaintiffs are entitled to recover the $608 in attorneys' fees incurred in enforcing the late charge provisions.

Defendants' Counterclaim asserts that Plaintiffs breached their covenant of good faith and fair dealing for the unreasonable demands regarding repair and restoration, and by delaying the restoration process. Defendants further seek return of the security deposits by alleging the facilities were properly returned to Plaintiffs.

The restoration work performed by Defendants was the fruit of ongoing communications with Plaintiffs to negotiate a possible settlement and determine what work was required pursuant to the leases. Beginning in late June 2005, the parties discussed the concept of a lump sum settlement so that Plaintiffs could perform the work to their own satisfaction. Communication between the parties continued through a serious of conference calls over the Summer, 2005. Defendants submitted its first settlement proposal on October 25, 2005, in the amount of $320,639. Plaintiffs countered this offer on November 18, 2005, with a settlement offer of

$710,662.61. On November 21, 2005, Defendants' counter-offered at $551,643.37. The next day, Plaintiffs rejected this offer and settlement discussions between the parties ceased. Defendants thereafter assumed the repair and restoration work of the facilities.

As a result of their discussions with Plaintiffs, Defendants began the repair and restoration work they believed necessary to conform the facilities to what was required under the leases. In this regard, it is disingenuous for Defendants to claim that their work was the result of any unreasonable demands by Plaintiffs. What they felt was unreasonable was not done by the Defendants and there is no credible evidence to support their assertion that Plaintiffs acted in bad faith by delaying the restoration process. Therefore, Defendants are not entitled to reimbursement for repairs completed during the restoration process or for any holdover rent. Because DDI did the restoration work voluntarily and, in its own view, according to the requirement of the lease, the Court further finds that DDI is not entitled to a credit for the value of "over-improvements" to the facilities. The Court does find that Plaintiffs' awarded damages are properly offset by Defendants' security deposits. Accordingly, the Court finds that Defendants are entitled to a credit for their security deposits.

The Court finds the aforementioned damages need not be reduced because of any failure to mitigate damages. The Court rejects Defendants' testimony on this issue and specifically finds that the cost of restoration does not exceed the diminution in value to the facilities.

In accordance with the foregoing, Plaintiffs shall lodge the appropriate form of Judgment. Because Defendants contributed to the delay more than the Plaintiffs and the latter over-reached in its demands for damages, thereby precluding a reasonable settlement of this matter, the parties shall be responsible for their own attorneys' fees and costs.