IN THE COURT OF APPEALS OF IOWA

No. 5-222 / 94-0875

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CLERK SUPREME COURT

EAST BROADWAY CORPORATION, An Iowa Corporation,

Defendant-Appellee,

vs.

TACO BELL CORPORATION, A California Corporation,

Defendant-Appellant.

Appeal from the Iowa District Court for Pottawattamie County, Glen McGee, Judge.

Taco Bell challenges the order entering judgment on the jury's verdict, finding it had an obligation to continue operations in order to pay the percentage of gross sales portion of its rent, under a lease agreement with East Broadway Corp. **REVERSED AND DISMISSED.**

A. W. Tauke of Porter, Tauke & Ebke, Council Bluffs, for appellant.

Robert J. Laubenthal of the Smith Peterson Law Firm, Council Bluffs, for appellee.

Heard by Hayden, P.J., and Sackett and Cady, JJ.

SACKETT, J.

Defendant-appellant Taco Bell Corporation appeals from a verdict finding there was an implied covenant to continue operation of its business in a location leased from plaintiff-appellee East Broadway Corporation and ordering defendant to pay plaintiff a percentage of its gross sales as rent after defendant ceased operating its business on plaintiff's premises. We reverse and dismiss.

This case concerns rent due in the twentieth year of a twenty-year lease. The lease was originally entered by a successor to plaintiff East Broadway Corporation with defendant Taco Bell Corporation. For purposes of this opinion, we treat plaintiff as the original lessor.

The lease entered on August 27, 1971. The lease was entered following negotiations where plaintiff agreed to build a restaurant to defendant's specifications in Council Bluffs, Iowa, and lease it to defendant for a twenty-year period. The lease provided a base rent of $1309. The rent was based on plaintiff receiving a thirteen percent return on the cost of the building and a thirteen percent return on the cost of the land. Defendant was required to pay property taxes and insurance and utilities in addition to the base rent. Additionally, defendant agreed to pay a percentage of gross sales after it reached a certain level under a first amendment to the lease entered September 2, 1971. That amendment, in applicable part, provided:

> Paragraph 7, Page 5 [1] is deleted in its entirety, and in consideration of deleting said paragraph, Lessee agrees to pay to Lessor as additional rent hereunder, an amount equal to five percent (5%) of gross sales in excess of sales of $17,000.00 per month (said sum shall be after any sales tax). Lessee shall furnish a statement to Lessor quarterly showing the sales for the period and a check in the amount of 5% of the gross sales called for in said report in excess of $17,000.00 per month.

In the last year of the lease, defendant ceased any operations of the leased premises and moved its business elsewhere in Council Bluffs. Defendant paid the base rent, property taxes, and insurance to the end of the term. No additional rent was paid. Plaintiff sued contending there was a breach of the lease in that there was an implied covenant to continue to operate the restaurant during the entire twenty-year period. The case was tried to a jury who found in plaintiff's favor and awarded damages of $53,805.64. This figure represented five percent of defendant's gross sales prior to closing the restaurant at plaintiff's location plus interest.

Defendant appeals the verdict contending (1) there was no implied covenant for continuation of the operation; (2) the court erroneously instructed the jury in two respects; (3) the court failed to properly instruct on implied covenants; and (4) evidence of the consumer price index was not material and should not have been admitted.

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[1] Paragraph seven had basically provided on the fifth anniversary of the lease, and on each two years thereafter, the rent would be adjusted to comply with any increase in the Consumer Cost Index and also any decrease but not to the extent to lower the rent below the original lease.

Defendant first contends there is not substantial evidence to support a finding there was an implied covenant and its motion for directed verdict and for judgment notwithstanding the verdict should have been sustained.

Findings of facts in a law action are binding on us if supported by substantial evidence. Iowa R. App. P. 14(f)(1). We construe the trial court's findings broadly and liberally. *Grinnell Mut. Reinsurance Co. v. Voeltz*, 431 N.W.2d 783, 785 (Iowa 1988). In case of doubt or ambiguity we construe the findings to uphold, rather than defeat, the trial court's judgment. *Id.* We are prohibited from weighing the evidence or the credibility of the witnesses. *Id.*

> A finding of fact is supported by substantial evidence if the finding may be reasonably inferred from the evidence. In evaluating sufficiency of the evidence, we view it in its light most favorable to sustaining the court's judgment. We need only consider evidence favorable to the judgment, whether or not it was contradicted.

Briggs Transp. Co. v. Starr Sales Co., 262 N.W.2d 805, 808 (Iowa 1978).

Evidence is substantial or sufficient when a reasonable mind could accept it as adequate to reach the same findings. *Waukon Auto Supply v. Farmers & Merchants Sav. Bank*, 440 N.W.2d 844, 846 (Iowa 1989). Evidence is not insubstantial merely because it could support contrary inferences. *Grinnell Mut.*, 431 N.W.2d at 785.

There is no specific language in the lease reciting defendant promises to continue operation of its business at plaintiff's location for twenty years. Consequently, to recover, plaintiff must show, by substantial evidence, an implied

contract. A contract can include not only that which is expressly stated but also what is necessarily implied from the language used. *See Fashion Fabrics of Iowa, Inc. v. Retail Investors Corp.*, 266 N.W.2d 22, 27 (Iowa 1978). Terms that may be implied from the consideration of the entire contract are as much a part thereof as though plainly written. *Id.* However, courts are slow to find implied covenants. *Id.* The obligation must rise from the language used or it must be indispensable to give effect to the intent of the parties; it must have been so clearly within their contemplation that they deemed it unnecessary to express it. *Id.*

To be implied, the covenant must originate in the language of the contract itself and be indispensable and legally necessary to effect the intent of the parties. *Id.* It must be so obvious to the reasonable person that the covenant was clearly within the contemplation of the parties that they found it unnecessary to express it and it would have been made a part of the agreement if attention had been called to it. *Id.* at 27-28.

Defendant argues a provision for continued operation was not a part of the contract negotiations. Defendant also points out the lease unambiguously states it shall have the right to assign or sublet its interest in the premises under all the terms, conditions, and restrictions in the lease. We note the right to assign is subject to plaintiff's approval which approval cannot be unreasonably withheld.

Defendant advances the language authorizing assignment clearly negates any intent it stay the twenty years and continue its business on the premises. Defendant takes the position the right to sublease is inconsistent with a promise to remain for the

lease period and carry on the business. Defendant also argues the percentage of gross sales was not intended to be the primary source of rent so the lessor was not significantly economically dependent on the lessee's business.

Plaintiff contends it introduced substantial evidence to prove there was an implied contract that defendant continue operation during the twenty years of the lease. Plaintiff argues the lease called for the building to be built to suit defendant; the original lease contained a cost of living escalation clause as a hedge against inflation which defendant rejected by substituting the percentage of rent clause and defendant reserved no right to discontinue operations during the twenty-year term. Plaintiff also contends the assignment clause does not control. It advances the rent it received when the store was closed was primarily percentage rent and when defendant discontinued operations in July 1991, nearly seventy-five percent of the rent received was based on the percentage. Plaintiff reasons we should look at the relationship of fixed rent to percentage rent in the nineteenth year. Defendant contends we should look at the relationship of fixed rent to percentage rent in the year the lease was made.

Plaintiff contends the implied lease is justified. It contends the building was built to specification. The percentage of profits replaced an adjustment under the original lease. Plaintiff also contends there is an economic gap between the fixed rent and the percentage.

Courts have recognized implied covenants to continue operations in commercial leases where rent is fixed exclusively or primarily on a percentage of the lessee's gross revenues or profit. *Fashion Fabrics*, 266 N.W.2d at 28. However, absent evidence the minimum rent is not substantial, courts generally do not infer a covenant to continue operations. *Carl A. Schuberg, Inc. v. Kroger Co.*, 317 N.W.2d 606, 609 (Mich. App. 1982).

There is no evidence there was an economic gap between the fixed rent and a fair rent in 1971. The fixed rent provided plaintiff a fair, thirteen percent annual return on its 1971 investment. Additionally, defendant assumed responsibility for real estate taxes and insurance expenses that frequently escalate.

There was little evidence there was an economic gap between the fixed rent and a fair rent in the last year of operation. However, in the nineteenth year, the percentage of profits was seventy-five percent of the rent and the fixed rent (not counting real estate taxes and insurance) was twenty-five percent. Plaintiff contends we should look at this differential in the nineteenth year as substantial evidence supporting the verdict. Defendant contends we should look at the anticipated differential in 1971.

The question is whether the covenant was implied when the lease was written. *See Schuberg*, 317 N.W.2d at 610.

When the lease was drawn, the type of food defendant sold was just being introduced in the midwestern part of the United States. Defendant made no

representation of anticipated gross sales. The lease was void of any provisions for time of operation.

There was no history of operations of similar restaurants in the Council Bluffs area. In a letter of April 21, 1971, prior to negotiations, defendant made the following representation, "Since we feel that average annual sales on any location can be misleading, we do not quote such figures. TACO BELL stores range from the area of $6,000 per month to $25,000.00 per month with those figures varying, depending on the time of the year."

We determine the rent at the time of the original lease was primarily based on the fixed rent.

A contract will not be interpreted giving discretion to one party in a manner that would put one party at the mercy of another, unless the contract clearly requires such an interpretation. *See Midwest Management Corp. v. Stephens*, 291 N.W.2d 896, 913 (Iowa 1980); *Harvey Constr. Co. vs. Parmele*, 253 Iowa 731, 741-42, 113 N.W.2d 760, 766 (1962). To accept plaintiff's position would be to change a percentage of income rental into a fixed rental based on past sales. *See Williams v. Safeway Stores, Inc.*, 198 Kan. 331, ___, 424 P.2d 541, ___ (1967). This is a position we are not willing to accept.

There is not substantial evidence to support the finding there was an implied covenant for continued operation. We have considered plaintiff's other arguments and

find them to be without merit. We find it unnecessary to address defendant's other challenges.

REVERSED AND DISMISSED.