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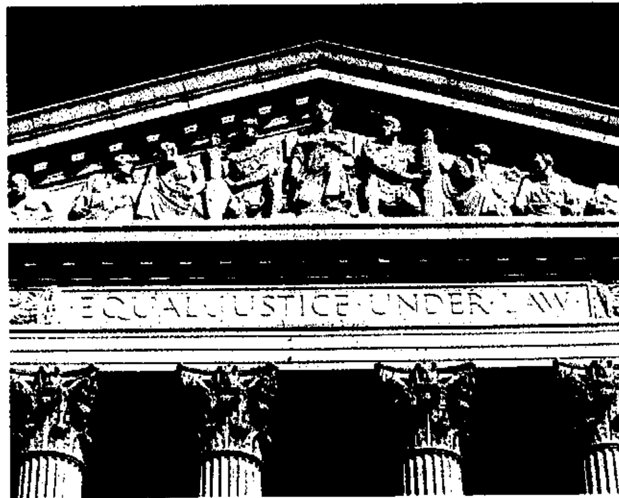
Courts View Management Fees Dimly

Over the past decade, shopping center owners have viewed management fees as an important new source of CAM revenue. Although management fees can quickly raise millions of dollars, this solution to a landlord's cost problems may end up to be too good to be true.

The management fees passed on to tenants through CAM usually mirror the fees the shopping center owner pays to the company managing the center, often an affiliate or subsidiary of the landlord. Typically, these fees range from 3% to 5% of the gross revenue of the center.

Management fees are relatively new. Most leases drafted more than a few years ago don't mention the fee in the typical operating cost provision that permits a landlord to pass on its costs of "operating, managing and maintaining" the common areas. For many landlords, the absence of an explicit provision doesn't mean the fee can't be charged. Many landlords added the management fee years after the commencement of their leases, so that tenants once paying only actual management charges discover that their CAM costs substantially increased with this new charge. Landlords considered this fee another cost of mall management, and in many cases added the fee to the CAM bill without telling the tenant. The fee was included in the operating cost statement but rarely identified.



The reaction among tenants was predictable. Many voiced objections. In some cases, landlords returned the management fees to tenants who undertook audits and demanded reimbursement. In other cases, tenants sued. The first widely publicized lawsuits were brought in the early 1990s against the Pyramid shopping centers and its affiliated management firm, the Pyramid Management Group of Syracuse, N.Y. In these cases, tenants claimed that the management fee, usually 3% of gross revenue, was unfair because the leases required the tenant to reimburse the landlord only for the actual cost of on-site and off-site management.

Surprisingly, while litigation against Pyramid has continued for nearly a decade, there has yet to be a decision as to whether this landlord's practices violate the leases. The only court ruling has said the fees are not illegal on their face, as the tenants had claimed.

Other courts have been more willing to decide whether a landlord has a right to pass on its management fee. While the Pyramid litigation continued in New York, the Supreme Court of Nebraska decided a case in 1997 brought by the McDonald's Corp. that appeared to come down on the side of the landlord (McDonald's Corp. v. Goler). In that case, the court ruled the landlord could pass on the management fee it paid to its subsidiary management firm, notwithstanding the absence of any explicit language in the lease permitting it to do so.

At first glance, the McDonald's decision was a green light to management fees, and it is likely that a number of landlords and their counsel viewed it precisely that way. However, it also was clear that this Nebraska case would not end the debate. First, unlike the typical situation where the landlord seeks to pass on its management fee in addition to its actual costs of on-site management, McDonald's landlord did not charge any management costs other than the management fee. Second, in the McDonald's case, the court insisted that the landlord prove that all of its management fee charges were related only to the common areas.

More recent decisions have been far less favorable to management fees. In August 1999, a state appellate court in Minnesota and a federal court in Kansas ruled within days of each other that the landlords could not pass on the costs of their wholly-owned management subsidiaries. In each case, the landlord argued that the management fee was simply another cost associated with managing the shopping center.

But, in each case, the court noted that very little of the management companies' expenses related directly to managing the common area, finding instead that they were engaged primarily in "tenant-specific" activity, such as leasing or billing or "capital" activity, such as construction or remodeling, that would benefit the center as a whole.

In one of these cases, the court described the 5% management fee as an overhead charge, not an expenditure that could be passed through under the tenant's lease. Shortly after these decisions in the Minnesota and Kansas cases, a state appeals court in Virginia likewise held that the landlord could not pass on its management fee without an explicit lease provision.

What conclusions can safely be drawn by these decisions? First, courts are likely to scrutinize carefully any management fee not expressly permitted in the lease. Even if the lease permits a management fee charge, courts also look at the rest of the operating cost statement to see if other costs also have been included. If there is no provision in the lease for a management fee, at a minimum, the burden will be on the landlord to prove it is not duplicating other charges paid by the tenant. If the tenant is already paying actual management charges for the common area, the fee will not be permitted.

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