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Payments Made in Error: The Voluntary Payment Doctrine

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In the world of complex commercial leases, with the multitude of "additional rent" charges and escalation packages, it is not uncommon for there to be errors in the billing and collection of these varied obligations. Fertile ground exists for erroneous billings for consumer price index adjustments, porter's wage escalations, common area maintenance charges, real estate taxes, and utility charges, just to name a few, and those mistakes can result in significant overcharges to the unsuspecting or dilatory tenant or significant underpayments to the unaware landlord.

Tenants and landlords alike must therefore be vigilant, lest they be deemed to have waived any right to recovery of wrongful payments. With respect to overpayments in particular, a lack of vigilance can prove fatal to any chance of recovery in light of the voluntary payment doctrine, a common law doctrine that bars recovery of such overpayments.

Illustration of the Doctrine

A circumstance under which the voluntary payment doctrine might be applied is perhaps best explained by a simple illustration: XYZ Enterprises, the tenant under a long-term commercial lease for space in New York City, is responsible under its lease for a certain portion of the building's real estate taxes. The lease provides that XYZ's percentage of the taxes is computed based on the 5,000 square feet it occupies. For 10 years, XYZ has received periodic statements reflecting the amounts due, together with breakdowns reflecting the underlying computations. And for those 10 years, XYZ has timely paid those invoices. During the eleventh year, however, XYZ realizes that its most recent statement, and, upon further investigation, on all statements from the previous 10 years, the landlord was calculating XYZ's portion of the taxes based on the assumption that XYZ occupied 10,000 square feet of space, twice the amount of taxes for which it was otherwise responsible under the lease. XYZ immediately notifies the landlord.

The landlord acknowledges these errors and agrees to correct future statements, but does not agree to reimburse or credit the tenant for the prior overcharges. The landlord explains that all of the previous statements contained breakdowns plainly reflecting the erroneous calculations, and that XYZ, with reasonable diligence, could have spotted the overcharges and brought them

to the landlord's attention, but it didn't. XYZ sues for breach of contract. Landlord asserts as a defense that it is protected under the "voluntary payment doctrine."

Most situations are not nearly as clear cut as this example. But the same factors appear over and over in voluntary payment doctrine cases. The voluntary payment doctrine bars recovery of payments voluntarily made with full knowledge of the facts, and in the absence of fraud or mistake of material fact or law. *Dillon v. U-A Columbia Cablevision of Westchester*, 100 N.Y.2d 525, 526, 760 N.Y.S.2d 726, 727 (2003), citing *Gimbel Bros. v. Brook Shopping Ctrs.*, 118 A.D.2d 532, 535-536, 499 N.Y.S.2d 435, 438-39 (2d Dept. 1986).

Although arguably harsh in its consequences, the voluntary payment doctrine provides a measure of finality to payment, thereby motivating aggrieved parties to timely exercise their rights in seeking restitution. As the Second Department has explained, "[w]hen a party intends to resort to litigation in order to resist paying an unjust demand, that party should take its position at the time of the demand, and litigate the issue before, rather than after, payment is made." *Dillon v. U-A Columbia Cablevision of Westchester*, 292 A.D.2d 25, 28, 740 N.Y.S.2d 396, 398 (2d Dept. 2002), aff'd, 100 N.Y.2d 525, 760 N.Y.S.2d 726 (2003), quoting *Gimbel Bros. v. Brook Shopping Ctrs.*, 118 A.D.2d 532, 535, 499 N.Y.S.2d 435, 439 (2d Dept. 1986).

Application of the doctrine typically arises in situations like those in the example described above, where the payor remits erroneous payments repeatedly and voluntarily, even though the facts that would have exposed the error were within reach to the payor, whether in the erroneous statements themselves, or through diligent inquiry.

Application of the Doctrine

Following are a few examples of how the courts have applied this doctrine, especially against sophisticated tenants who, as far as the courts are concerned, should have known better or acted with greater diligence.

In *Citicorp North America v. Fifth Ave. 58/59 Acquisition Co.*, 70 A.D.3d 408, 409, 895 N.Y.S.2d 39, 39-40 (1st Dept. 2010), the First Department upheld the dismissal of a complaint brought by a sophisticated tenant alleging that it had been overcharged rent for nine years as a result of the landlord's alleged improper calculation of a specific rent-escalation provision. The Appellate Division held that the tenant's complaint was barred by the voluntary payment doctrine because the tenant made all rent payments without ever questioning or inquiring about the amounts it was being charged. The court was particularly focused on what proved to be a fatal combination of the level of sophistication of the payor and its inaction:

It is undisputed that plain- tiffs, highly sophisticated entities, made no inquiry for approximately nine years regarding the amount of rent they were paying, and never compared the rent provisions of their lease to the rent amounts invoiced by defendants in order to determine if they were being overcharged. Rather, they paid the invoiced rent amounts without protest or even inquiry, and were not laboring under any material mistake of fact when they did so. Making such payments without any effort to learn what their legal obligations were demonstrated a clear lack of diligence on plaintiffs' part. The complaint was thus barred under the voluntary payment doctrine.

Id.

The same reasoning applied in *Eighty Eight Bleecker Co. v. 88 Bleecker St. Owners*, 34 A.D.3d, 244, 246-47, 824 N.Y.S.2d 237, 239-40 (1st Dept. 2006), where the tenant alleged, among other things, that the landlord had been overcharging for taxes due pursuant to a tax escalation

clause in the lease. Id. at 245, 824 N.Y.S.2d at 238. The First Department granted summary judgment to the owner and dismissed the cause of action, holding that "[P]laintiff's failure to make inquiry regarding the tax increase and computations made to arrive at those increases for over 20 years raises the applicability of the voluntary payment doctrine." Id. at 247, 824 N.Y.S.2d at 240. Again the court emphasized that it had little appetite for equity where the payor was highly sophisticated and sat on its hands:

Computation of the taxes was not an overly burdensome task, particularly for a sophisticated entity such as plaintiff…Review of the tax bills, to which it was entitled pursuant to the terms of the lease, would have allowed plaintiff readily to ascertain the appropriate amount of its liability under the tax escalation clause for each of the years in question. Id. (internal citations omitted).

Competing Interpretations

Decisions such as *Citicorp* and *Eighty Eight Bleecker* reveal that courts will not reward inaction, even where the result is harsh, particularly where the contracting parties are highly sophisticated.

Notably, payors have frequently claimed that the relevant lease provision was subject to a competing interpretation—the payor's interpretation. That argument can backfire, however, because a central reason why courts apply the voluntary payment doctrine in the first place is the parties' course of conduct; it is that course of conduct that also evinces the parties' understanding of the contractual language at issue. In other words, not only can the parties' course of conduct justify application of the voluntary payment doctrine, it also serves as the best evidence of the parties' understanding of the lease language if that language is arguably ambiguous.

In *Murray Hill Mews Owners Corp. v. Rio Restaurant Assocs.*, 92 A.D.3d 453, 938 N.Y.S.2d 59 (1st Dept. 2012), the court adopted precisely that reasoning. There, the First Department affirmed application of the voluntary payment doctrine in concluding that two sophisticated parties' course of dealing for eight years under a lease precluded an interpretation of the lease that would have reduced the lessor's rent obligations. The plaintiff-landlord in *Murray Hill* sued the defendant-tenant for past due rent, and the defendant asserted as an affirmative defense that the plaintiff had miscalculated the rent escalation under the lease. Id. at 453-54, 938 N.Y.S.2d at 60.

The court rejected that argument, finding that the rent escalation provision of the lease unambiguously supported the plaintiff's method of calculation. Id. The court also found that in any event, the defendant's failure to timely challenge the plaintiff's method of calculation further undermined its position. Further, the fact that it paid the invoices without protest over such a long period of time—its own course of conduct—actually proved fatal:

[W]hen viewing the parties' course of conduct—including respondent's consistent payment for over eight years, without protest, of rent increases based on a compounded fixed rent figure, and its renegotiation of the renewal lease on the same terms as the original lease—it is clear that petitioner's construction of the escalation clause comports with the parties' intent.

Id. at 454, 938 N.Y.S.2d at 60 (internal citations omitted).

Mistake of Fact

As these cases demonstrate, the courts will not hesitate to invoke the voluntary payment doctrine, even if the consequences are severe. But the doctrine is not without its limitations. The doctrine does not apply where, for example, the case involved fraud or the payments in question were made under mistake of fact.

One case involving mistake of fact, or lack of full knowledge of the facts, was *Barnan Assocs. v. 196 Owners Corp.*, 56 A.D.3d 309, 868 N.Y.S.2d 174 (1st Dept. 2008), rev'd on other grounds, 14 N.Y.3d 780, 899 N.Y.S.2d 724 (2010), in which the court again dealt with a real estate tax overcharge. There, the tenant's proportionate share failed to reflect the proper subtractions for rebates, abatements and refunds. Because the tenant had no knowledge of those subtractions, the First Department rejected the lower court's application of the voluntary payment doctrine, noting:

It is undisputed that the real estate tax statements issued by defendant to plaintiff made no mention of the abatements and/or refunds in question. Hence, the voluntary payment doctrine does not apply because full knowledge on the part of plaintiff has not been established.

Id. at 311, 868 N.Y.S.2d at 176.

See also *Kirby McInerney & Squire v. Hall Charne Burce & Olson, S.C.*, 15 A.D.3d 233, 233, 790 N.Y.S.2d 84, 85 (1st Dept. 2005). (holding, where one party, a law firm, overpaid fees under a retention agreement that was subject to a cap, that "the voluntary payment doctrine…does not apply here, where the overpayments were clearly made to defendants based on a mistake of fact, namely, the amount of fees actually owed by plaintiff to defendants") (internal citation omitted).

Conclusion

The takeaway message is relatively simple: overpayments made in error over a substantial period of time may not be recoverable (subject to the exceptions noted above). And the greater the sophistication of the tenant, the more harsh the treatment, particularly if the tenant has failed during that period to protest or otherwise raise inquiry. For tenants, leases need to be monitored regularly and invoices ought to be reviewed with diligence. Challenges ought to be presented promptly and in writing.

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