

#50

5/7/65

Memorandum 65-18

Subject: Study No. 50 - Lessor's Rights Upon Abandonment by Lessee

Because of unforeseen circumstances, there was no quorum present when this subject was discussed at the April meeting. The committee present suggested that we present a statute to you spelling out the rights of lessors and lessees upon termination of a lease as a result of a breach or upon the abandonment or repudiation of a lease. The committee agreed that the measure of damages now specified in Civil Code Section 3308 is the proper measure. A suggestion was made that a statute attempt to deal with the problem of termination upon any material breach and not with abandonment only.

Accordingly, there appears below a draft statute to carry out some of these suggestions. Comments appear below each section of the draft to explain that section. In accordance with another suggestion made at the April meeting, alternative drafts are also presented together with comments thereon.

An act to repeal Section 3308 of, and to add Sections 1936, 1937, 3308, 3309, and 3310 to, the Civil Code, relating to lessors and lessees.

The people of the State of California do enact as follows:

SECTION 1. Section 3308 of the Civil Code is repealed.

~~3308.--The parties to any lease of real or personal property may agree therein that if such lease shall be terminated by the lessor by reason of any breach thereof by the lessee, the lessor shall thereupon be entitled to recover from the lessee the worth at the time of such termination, of the excess, if any, of the amount of rent and charges equivalent to rent reserved in the lease for the balance of the stated term or any shorter period of time over the then reasonable rental value of the premises for the same period.~~

~~The rights of the lessor under such agreement shall be cumulative to all other rights or remedies now or hereafter given to the lessor by law or by the terms of the lease; provided, however, that the election of the lessor to exercise the remedy hereinabove permitted shall be binding upon him and exclude recourse thereafter to any other remedy for rental or charges equivalent to rental or damages for breach of the covenant to pay such rent or charges accruing subsequent to the time of such termination:--The parties to such lease may further agree therein that unless the remedy provided by this section is exercised by the lessor within a specified time the right thereto shall be barred.~~

Comment. Section 3308 is repealed because the remainder of the draft statute makes it unnecessary. The remedy that Section 3308 states may be provided in a lease is made the general rule, whether or not provided in the lease, under the provisions of the remainder of the statute.

A defect in Section 3308 is that it does not require the lessor to resort to the damages remedy provided. He may still permit the property to remain idle and recover the full amount of the rent from the lessee. The draft statute changes this and brings the law relating to leases into conformity with the law relating to contracts generally:

Suppose . . . that the contract requires performance in instalments or continuously for some period and that there has been such a partial failure of performance as justifies immediate action for a partial breach. If this partial breach is accompanied by repudiation of the contractual obligation such repudiation is anticipatory with respect to the performances that are not yet due. In most cases the repudiator is now regarded as having committed a "total" breach, justifying immediate action for the remedies appropriate thereto. In determining the damages recoverable in such an action, it is necessary for the court to look into the future. In spite of the uncertainty involved in this, the trier of fact is permitted to make an estimate to be added to the damages awarded for the actual non-performance that has already occurred. In most cases this remedy is regarded as adequate and the injured party is allowed only one action for his wrong. The nonperformance plus the repudiation constitute one and only one cause of action.

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In any case of repudiation by one party, the injured party is expected to avoid losses if he can do so without unreasonable effort and expense, and his damages are limited accordingly. Where such avoidance is possible we have a sound reason for not permitting the injured party to proceed with his performance and compel payment of the agreed price. He must stop performance, avoid loss, and be content with compensatory damages contained in one action. [4 CORBIN, CONTRACTS 831-832 (1951).]

SEC. 2. Section 1936 is added to the Civil Code, to read:

1936. A hiring contract, including a lease of real property, is a contract for continuing performance by the lessor and lessee. An abandonment by the lessee of the thing hired is a breach of the contract and a repudiation of the remaining obligations of the contract.

[Another form of Section 1936 that is an alternative to this section and the entire remainder of the statute appears on pink.]

Comment. The purpose of this section is to declare that leases are contracts for continuing performance and are to be so construed. The section is also designed to make clear that an abandonment is a breach and anticipatory repudiation of the contract. Without such a declaration, the courts could hold that the lease may continue despite the abandonment.

The above section is designed to be added to Chapter 1 of Title 5 of Part 4 of Division 3 of the Civil Code. That title is called "Hiring" and the chapter is entitled "Hiring in General". The two succeeding chapters relate to hiring of real property and hiring of personal property. The language of the section reflects the context in which it appears: since the Civil Code talks in terms of hiring, Section 1936 does also. Section 1925 of the Civil Code defines a hiring as follows:

Hiring is a contract by which one gives to another the temporary possession and the use of property, other than money, for reward, and the latter agrees to return the same to the former at a future time.

SEC. 3. Section 1937 is added to the Civil Code, to read:

1937. When a hiring, including a lease of real property, is terminated by the lessor by reason of the lessee's breach thereof or is abandoned by the lessee, the lessor may:

(a) Recover damages in the amount specified in Section 3308.

(b) Obtain specific or preventive relief if the damages specified in Section 3308 are inadequate to put the lessor in as good a position as would full performance by the lessee.

Comment. Section 1937 is designed to tell a lessor that he may either sue for damages when the lessee abandons or seeks specific or preventive relief. There are some situations where damages would not provide adequate compensation and specific performance might be warranted. The language of subdivision (b) is based on some similar language that appears in Section 2708 of the Commercial Code.

The measure of damages is specified in Section 3308 and referred to here because that is the part of the Civil Code that spells out the measure of damages for breach of contract.

SEC. 4. Section 3308 is added to the Civil Code, to read:

3308. If any lease or real or personal property is terminated by the lessor by reason of the lessee's breach thereof, or if the lessee abandons the leased property or otherwise repudiates the lease, the lessor is entitled to recover:

(a) An amount specified in the lease in accordance with Section 1671.

(b) If no amount is specified in the lease in accordance with Section 1671, the amount to which he is entitled under Section 3309.

(c) If no amount is specified in the lease in accordance with Section 1671, and if the lessor is not entitled to recover in accordance with Section 3309, the excess if any of the amount which would have been due to the lessor under the lease for the remainder of the term over the then reasonable rental value of the property for the same period, together with any incidental damages necessary to compensate the lessor for all the detriment proximately caused by the lessee's breach or which, in the ordinary course of things, would be likely to result therefrom.

[A possible additional subdivision appears on green. An alternative form of the section appears on yellow.]

Comment. Generally, Section 3308 limits the lessor's damages upon abandonment of the lease by the lessee, or upon termination of the lease because of the lessee's breach, to the difference between the value of the lessee's remaining rental obligation and the value of the remainder of the term. In addition, the lessor is entitled to his incidental damages.

By limiting the lessor's damages to the amount specified in Section 3308, the section precludes the lessor from recovering the full amount of the remaining rent due while leaving the property idle. Section 3310 makes it doubly clear that the lessor may not do so for it provides the lessee with

a right to recover any amounts paid to the lessor in excess of the damages here specified.

Subdivision (a) may be unnecessary in the light of the changes made by this statute. Under the former law, a liquidated damages provision was void because a lessor's damages were easily ascertainable. Since he had to wait until the end of the term to recover for the entire amount of the rent due, he would always know at the time of bringing the action exactly what his damages were. Section 3308 now fixes his damages as of the time of the breach. Hence, it seems likely that a reasonable liquidated damages provision would be held valid. Nonetheless, it seems desirable to cross refer to Section 1671 just to make sure that the section contemplates a valid liquidated damages clause.

The significance of subdivision (b) appears in the comment to Section 3309.

The language of the remainder of the section is based on several other sections of the Civil Code. It is based in part on Section 3307 which provides the measure of damages for breach of an agreement to buy real property.

Section 3307 provides:

The detriment caused by the breach of an agreement to purchase an estate in real property, is deemed to be the excess, if any, of the amount which would have been due to the seller, under the contract, over the value of the property to him.

The language is also based in part on some of the language in repealed Section 3308. The language relating to incidental damages is based on language appearing in Section 3300, which provides:

For the breach of an obligation arising from contracts, the measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.

SEC. 5. Section 3309 is added to the Civil Code, to read:

3309. (a) If any lease of real or personal property is terminated by the lessor by reason of the lessee's breach thereof, or if the lessee abandons the leased property or otherwise repudiates the lease, the lessor may relet the property. Where the reletting is made in good faith and in a reasonable manner, the lessor may recover the difference between the amount which would have been due to the lessor under the original lease for the remainder of the term over the amount due to the lessor under the new lease for the same period, together with any incidental damages necessary to compensate the lessor for all the detriment proximately caused by the lessee's breach or which, in the ordinary course of things, would be likely to result therefrom.

(b) The lessor is not accountable to the lessee for any profit made on a reletting of the property.

[See the green and blue pages for possible additional subdivisions.]

Comment. Section 3309 provides that the lessor may relet the property and recover the difference between the amount due under the original lease over the amount specified for the same period in the new lease. Subdivision (a) is based on subdivision (1) of Section 2706 of the Commercial Code. The advantage of subdivision (a) is that the reletting price fixes the lessor's damages. It is not merely evidence of the value of the remainder of the term.

The provisions of Section 2706 of the Commercial Code relating to public and private sales upon a resale of personal property have been omitted because they do not seem readily adaptable to the reletting of property. Subdivision (b) of Section 3309 is based on subdivision (6) of Commercial Code Section 2706.

SEC. 6. Section 3310 is added to the Civil Code, to read:

3310. If any lease of real or personal property is terminated by the lessor by reason of the breach thereof by the lessee, or if the lessee abandons the leased property or otherwise repudiates the lease, the lessee may recover from the lessor the amount paid to the lessor in consideration for the remainder of the term that is in excess of the damages to which the lessor is entitled under Section 3308. The rights of a lessee under this section may not be waived by contract entered into prior to the termination or repudiation of the lease or the abandonment of the leased property.

Comment. Section 3310 is designed to make the rules contained in Freedman v. the Rector, 37 Cal.2d 16 (1951), and Caplan v. Schroeder, 56 Cal.2d 515 (1961), applicable to cases arising out of the breach of a lease. The Freedman case held that a wilfully defaulting vendee under a contract for the sale of real property may recover the excess of his part payments over the damages caused by his breach. Caplan v. Schroeder involved the same problem. In the Caplan case, part of the total consideration given to the seller was a \$15,000 note. The agreement recited that the \$15,000 was given in consideration of the execution of the agreement, but the amount paid on the note was to be credited against the total purchase price of the property. The note was to be returned to the buyer or the amounts paid upon it refunded if the seller defaulted on the contract. The Supreme Court held that the recital in the agreement that the \$15,000 was in consideration of the execution of the contract did not entitle the seller to keep the \$15,000 upon the buyer's default. The court looked beyond the recital and held that there was in fact no separate consideration for the \$15,000 (aside from the sale of the property

itself) and, hence, the buyer was entitled to recover any portion of the \$15,000 in excess of the actual damages caused the seller by reason of the buyer's refusal to buy.

Under these cases, Section 3310 will permit a lessee to recover advance payments of rental, deposits, liquidated damages, or bonuses if the court is able to find that such payments are in fact in consideration for the remainder of the term and are in excess of the lessor's damages. This will clearly be the case where the lease provides that the lessee is to receive credit for the payment sometime before the termination of the lease. Whether this provision will apply to a bonus paid for the execution of the lease for which the lessee is not to receive later credit against the rent due may depend upon the facts of the particular situation. If, in fact, there is a separate consideration supporting the bonus, it would not be affected by Section 3310.

The last sentence of Section 3310 is probably unnecessary. The Freedman and Caplan cases are based upon the provisions of the code prohibiting forfeitures. The same rules that prohibit forfeitures in contracts for the sale of real property would be applicable here. Nonetheless, we think it desirable to place this provision in the section in order to make it clear that provisions may not be added to leases waiving rights under this section.

The preceding statutory program seems adequate to relieve the hardships to lessors and lessees that were revealed in the study. There are set forth below some alternative statutory provisions for your consideration. All of them assume the repeal of Section 3308.

Section 1936 is added to the Civil Code, to read:

1936. A hiring contract, including a lease of real property, is a contract for continuing performance by the lessor and lessee. An abandonment by the lessee of the thing hired is a breach of the contract and a repudiation of the remaining obligations of the contract. The remedies of the lessor and lessee upon such abandonment are the same as those available to the parties upon breach and repudiation of the remaining obligations under any other contract calling for continuing performances by the contracting parties. If the hiring contract is terminated by reason of its breach, the remedies of the lessor and lessee are the same as those available to the parties to any other contract calling for continuing performances upon the termination of such contract by reason of its breach.

Comment. This draft of Section 1936 is designed to bring the law relating to leases and their abandonment within the cases dealing with breach and anticipatory repudiation of contracts generally. Some jurisdictions have done so without the aid of such a statute. As noted in Corbin:

An especially notable conflict and confusion may be found in the law of landlord and tenant. . . . It has been held that on repudiation or other total breach of a long-term lease by the lessee the lessor can not maintain an action at once for his entire future injury. The contrary has been held, however, and is supported by reasoning that is quite consistent with the law of remedies that is applicable to breaches of contract in general. [4 CORBIN, CONTRACTS 833-834 (1951).]

The last sentence is supported in the notes by a 1935 Connecticut case and (in the 1964 pocket supplement) by a 1963 Texas case.

This draft of Section 1936 is designed to meet the problems raised by the cases dealing with landlords and tenants by starting the courts off in

another direction. The draft is designed to free the courts from the precedents binding them in this area and to permit them to develop the law of landlord and tenant in the same way that the law relating to contracts generally has been and is being developed. In Cardozo's words:

The rule that is to emancipate is not to imprison in particulars. It is to speak the language of general principles, which, once declared, will be developed and expanded as analogy and custom and utility and justice, when weighed by judges in the balance, may prescribe the mode of application and the limits of extension. The judicial process is to be set in motion again, but with a new point of departure, a new impetus and direction. [Cardozo, A Ministry of Justice, 35 HARV. L. REV. 113, 117 (1921).]

Section 3308 is added to the Civil Code, to read:

3308. If any lease of real or personal property is terminated by the lessor by reason of the lessee's breach thereof, or if the lessee abandons the leased property or otherwise repudiates the lease, the measure of the damages to the lessor is:

(a) An amount specified in the lease in accordance with Section 1671; or

(b) If no amount is specified in the lease in accordance with Section 1671, the excess, if any, of the amount which would have been due to the lessor under the lease for the remainder of the term over the then reasonable rental value of the property for the same period, together with any incidental damages necessary to compensate the lessor for all the detriment proximately caused by the lessee's breach or which, in the ordinary course of things, would be likely to result therefrom.

Comment. This section is merely the proposed Section 3308 on white paper with the reference to Section 3309 deleted. This section would be coupled with Sections 1936, 1937, and 3310 as they appear on the white. This form of the statute would adopt the general contract measure of damages for the breach and repudiation of a contract for continuing performance. The defaulting lessee would of course receive credit for any reletting of the property in reduction of the damages; but the reletting would not fix the value of the remainder of the term as it would under the statute on white. The advantage of this form of statute is that it gives the courts more flexibility. It should not be difficult to apply; the courts apply the same rules under other forms of contracts quite frequently. The advantage of the white statute, however, is that the lessor knows that if he acts reasonably in reletting the property he can recover everything he lost by reason of the lessee's default that he has failed to recoup through the new lease.

The following subdivision could be added to Section 3308 as proposed on either the white or the yellow:

If the measure of damages provided in subdivision (c) [(b) on the yellow] is inadequate to put the seller in as good a position as performance would have done then the measure of the damages under subdivision (c) [(b) on yellow] is profit (including reasonable overhead) which the lessor would have made from full performance by the lessee, together with any incidental damages, due allowance for costs reasonably incurred and due credit for payments or proceeds of reletting the property.

Comment. The above subdivision is based on subdivision (2) of Section 2708 of the Commercial Code. We did not include it in the basic statute because it seems difficult to apply it to a lease. Moreover, the condition of its application is the condition for specific performance, and the lessor would be entitled to get everything he can get under this subdivision either through specific performance plus incidental damages or damages in lieu of specific performance plus incidental damages.

The following subdivisions could be added to Section 3309 as proposed on the white (an alternative version of these subdivisions follows on blue):

(c) If the lessor is unable after reasonable effort to relet the property at a reasonable rental or the circumstances indicate that such effort will be unavailing, the lessor may recover the unpaid rentals provided in the lease as they fall due, together with any incidental damages caused by the lessee's breach or which, in the ordinary course of things, would be likely to result therefrom.

(d) Where the lessor sues for the rentals remaining due under the lease as provided in subdivision (c), he must hold the leased property for the lessee; but if reletting becomes possible before the lessee has complied with the judgment, he may relet the property and recover the amount to which he is then entitled under the provisions of subdivision (a) and Section 3308.

Comment. Subdivision (c) is based on subdivision (1)(b) of Section 2709 of the Commercial Code. Subdivision (d) is based on subdivision (2) of Section 2709 of the Commercial Code. We omitted these provisions from the statute on white because they provide, in effect, for specific performance. The right of the lessor to specific performance where appropriate is indicated in Section 1937 (white). The specific performance to which the lessor is entitled under these subdivisions might not be subject to the equitable doctrines that would be applicable to specific performance in the traditional sense and that are designed to protect both lessor and lessee. Thus, we left these subdivisions out because we felt they were unnecessary and would create more uncertainty than they would eliminate.

Another form of the additional subdivisions to Section 3309 (white) suggested on green is:

(c) If the lessor is unable after reasonable effort to relet the property at a reasonable rental or the circumstances reasonably indicate that such effort will be unavailing, the lessor may recover the then value of the total amount remaining due under the lease together with any incidental damages caused by the lessee's breach or which, in the ordinary course of things, would be likely to result therefrom.

(d) Where the lessor sues for the amount remaining due under the lease as provided in subdivision (c), he must hold the leased property for the lessee; but if reletting becomes possible, he may relet the property at any time prior to the collection of the judgment. The net proceeds of any such reletting must be credited to the amount remaining due from the lessee.

Comment. Subdivision (c) is based on subdivision (1)(b) of Section 2709 of the Commercial Code. Subdivision (d) is based on subdivision (2) of Section 2709 of the Commercial Code. The draft of these section provides that the lessor may recover the total amount due under the lease. This acceleration of the lease seems unduly harsh; hence, we believe these provisions should not be added.

There may be other ways to resolve the difficulties in landlord and tenant law; but they have not occurred to us as yet. We submit the foregoing, therefore, for your consideration.

Respectfully submitted,

Joseph B. Harvey
Assistant Executive Secretary