#50 5/8/67

Memorandum 67-32

Subject: Study 50 - Rights Upon Abandonment or Termination of a Lease

Accompanying this memorandum you will find a revised statute relating to leases together with revised explanatory comments. Attached as Exhibit I (pink) you will find a recent Court of Appeal opinion discussing burden of proof problems in employment contract cases.

John DeMoully and I had a conference in Commissioner Keatinge's office on May 1, 1967, with three attorneys--Richard Roe, E. J. Caldecott, and F. W. Audrain--whose practices involve the use of leases for financing the construction and operation of shopping centers and other major commercial enterprises. They were seriously concerned with the effect that our lease statute would have on the financing of these projects. They related a variety of examples where the standard remedies provided in our original statute would seriously jeopardize the rights of the parties. You should receive a copy of a letter from Mr. Roe indicating some of the problems involved.

Some of the specific problems that were mentioned in our discussion were these: Sometimes a major lessee with a prime credit rating will be given a long term lease at a lower rent than would be asked of another lessee without a prime credit rating. If the original lessee abandons, the lessor may be able to relet at a higher rental--but the new lessee does not have the credit rating of the prior. What damages has the lessor suffered under the statute? Possibly none, yet the lessor does not believe that he is as well protected as he was under the previous lease. In such cases, the lessor would like to be able to preserve the original lessee's obligation at least to the extent of guaranteeing the

payment of at least the original rental over the whole life of the lease. In effect, the lessor would ge giving some consideration (a lower rental) in exchange for the lessee's guaranty contract to answer for the default of any new lessee to whom the property should be rented if the original lessee abandons.

Another case: Some eastern financiers wish to invest some money but do not wish to undertake the burdens of property management. They buy property subject to a long term lease to a major firm with a prime credit rating. If the lessee decides it no longer wants the location, they would like to have the lessee continue to pay the full rent but offset the lessee's potential losses by finding a new lessee. The investors do not have the facilities for managing the property or for finding a tenant, but the lessee does. Mr. Roe points out that it doesn't make a lot of financial difference to the lessee if the lessor performs these obligations and then seeks reimbursement from the lessee or if the lessee performs these obligations originally.

Another example: A lessor of a shopping center has leased an integrated series of stores and shops in the shopping center. Bullocks, or Broadway, or some similar store wishes to pull out, but there is no equivalent store willing to come in. Penney's--a prime credit risk, but not the same quality store--is willing to come in, but the lessor does not want Penney's because he wishes to preserve the quality of the merchandising in the shopping center. At the present time, the coercive effect of the full rental obligation can be used by the lessor to make Bullock's live up to its original bargain. What can be done under our statute?

There may be other problems, but I am sure Mr. Roe and Mr. Caldecott will point them out. In any event, it appeared to us that the primary problem with our statute is that it is too rigid. It confines lessors and lessees to the remedies provided in our statute and does not permit them to vary those remedies to meet the exigencies of their own situations.

To meet these objections, we suggest that the statute be modified along the lines proposed in the accompanying revision. Generally, this revision permits the parties to a lease to fashion their own remedies, subject to the limitation that forfeitures cannot be exacted and the lessor cannot recover damages without permitting mitigation. Some broadened language is proposed in the specific performance section, too, to meet some of the above problems. Specifically, the proposed changes are these:

Section 1951.5

Present 1951.5 is deleted as unnecessary (in light of the revisions) and a new 1951.5 is proposed. The new 1951.5 includes the first sentence of former 1951.7 and goes on to provide, in effect, that repudiation is an excuse for counterperformance but does not terminate many of the breaching party's obligations. The word "terminate" in regard to the lease has been avoided because past habits of thinking have caused some people to think that termination of the lease terminates all obligations--such as obligations to pay damages or not to engage in competition, etc.

Section 1952

This is largely the same as the previous version of the section, but a new subdivision has been added providing that a repudiation is nullified by a specific performance decree requiring performance of the repudiated obligations.

Sections 1953-1954

A new subdivision has been added to 1953 and 1954 to permit specific enforcement of some of the collateral agreements in a lease (such as an agreement not to compete) even though damages for repudiation are recovered.

Section 1954.5

This is the key section. It permits the parties to formulate their own remedies so long as they do not try to exact forfeitures. The comment explains the purpose of the section.

Sections 3320-3322

This is another important change. We here propose to make it clear that the lessor has the right to recover the full amount of the unpaid rent (discounted to present value) unless the lessee can prove that he has received rents under a new lease or that through the exercise of reasonable diligence he could obtain such rents. Thus, the burden or proof as to the mitigation of damages is clearly on the lessee. This is in accord with the rule relating to employment contracts (see Exhibit I). The employee has the right to recover the full amount of the contract except to the extent that the employer can prove that the employee has earned or could earn with reasonable diligence offsetting income.

Section 3322 also has a new provision permitting the parties to require the breaching lessee to find the new tenant to mitigate the damages.

Section 3328

At Mr. Roe's suggestion, we have specified a discount rate of four percent for unpaid future rental obligations.

Section 3387.5

Section 3387.5 has been modified in an effort to make it a little

clearer that leases may be specif cally enforced where the character of the lessee's contemplated use and occupation is so unique that the lessor cannot be compensated adequately by damages.

Statute as a whole

The revisions are extensive. The Commission should, therefore, consider whether the bill should be pushed now even if the present objections are met or whether the bill should be considered and circulated for some additional months and resubmitted at the next session.

Respectfully submitted,

Joseph B. Harvey
Consultant

EXHIBIT I

[Civ. No. 8416. Fourth Dist., Div. One. Mar. 17, 1967.]

VIRGIL J. ERLER, Plaintiff and Respondent, v. FIVE POINTS MOTORS, Defendants and Appellants.

[1a, 1b] Master and Servant—Contracts of Employment—Remedies for Wrongful Discharge—Evidence.—In an action for breach of an employment contract, although the contract wages are prima facie plaintiff's damage, his actual damage is the amount of money he was out of pocket because of the wrongful discharge, and neither surprise nor prejudice can result to plaintiff when asked whether he earned other income after discharge; and in an action for damages in such an action, the court erred in denying admission in evidence, under a general denial in defendant's answer, of plaintiff's earnings outside the contract during the balance of the contract period.

[2] Id.—Contracts of Employment—Remedies for Wrongful Discharge—Amount of Recovery.—The basic rule of damages for unlawful discharge in relation to a specific employment contract is the contract compensation for the unexpired period of the contract that affords a prima facie measure of damages; the actual measured damage, however, is the contract amount reduced by compensation received during the unexpired term, or by compensation for employment that the employee, by the exercise of reasonable diligence, could have procured during that time.

APPEAL from a judgment of the Superior Court of San Diego County. William A. Glen, Judge. Reversed with directions.

Action for damages for breach of an employment contract. Judgment for plaintiff reversed and remanded for further proceedings.

Condra & Baxley and Robert C. Baxley for Defendants and Appellants.

Harelson, Enright, Levitt & Knutson and Jack R. Levitt for Plaintiff and Respondent.

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[1] See Cal.Jur.2d, Master and Servant, § 72; Am.Jur., Master and Servant (1st ed §§ 57, 60).

McK. Dig. References: [1] Master and Servant, § 36; [2] Master and Servant, § 41.

LAZAR, J. pro tem.*—The subject action arises from breach of an employment contract in which the plaintiff was the employee and the defendants the employer. Plaintiff was engaged to manage an automobile business with compensation at the rate of $1,300 per month. The corporate employer-defendant was found to be the alter ego of the individual defendants. Plaintiff's employment commenced October 1, 1963, to run for one year; the wrongful discharge occurred February 1, 1964. These facts were determined by the trial court upon conflicting and substantial evidence.

At the trial defendants sought to prove by questions of the plaintiff that he had earned $9,100 during the remaining eight months of the contract period in similar work with other automobile dealers. This effort upon objection was disallowed on the ground mitigation of damages is an affirmative defense which must be pleaded as such and that the evidence was not admissible under defendants' general denial of damage. Defendants then asked leave to amend their answer to assert the affirmative defense and the motion was denied.

Certain procedural and chronological matter thus becomes of interest: The action was commenced February 26, 1964; plaintiff's second amended complaint was filed September 2, 1964; defendants' answer filed September 21, 1964, alleged three affirmative defenses, i.e., refusal to continue employment; mutual rescission; plaintiff's breach of contract by quitting. The parties eliminated pretrial under the aegis of Rule 222, California Rules of Court; no commitment as to issues was made in the Joint Statement Requesting Waiver of Pretrial Conference; trial commenced August 30, 1965; on the fourth day of trial defendants amended their answer in relation to plaintiff's asserted breach of the employment agreement and resignation; on the fifth and last day of trial, when the question of mitigation of damages arose, the motion to amend the answer was made and denied. Judgment was rendered for plaintiff with damages computed from the amount of the unpaid monthly salary less the 50 percent of operational losses chargeable to the plaintiff by the terms of the employment contract.

The questions to be answered are these:

[1a] *First*: Did the trial court err in denying admission in evidence of earnings outside the contract but during the bal-

*Retired judge of the superior court sitting under assignment by the Chairman of the Judicial Council.

ance of the contract period under the general denial of the answer?

Second: Did the trial court abuse its discretion in denying defendants' motion to amend their answer to raise the affirmative defense of mitigation of damages?

[2] A number of California cases have had occasion to discuss the basic rule of damages for unlawful discharge in relation to a specific employment contract. The most thorough consideration would seem to be that found in *Seymour* v. *Oelrichs*, 156 Cal. 782, 801-803 [106 P. 88, 134 Am.St.Rep. 154]. Stated simply, the contract compensation for the unexpired period of the contract affords a prima facie measure of damages; the actual measured damage, however, is the contract amount reduced by compensation received during the unexpired term; if, however, such other compensation has not been received, the contract amount may still be reduced or eliminated by a showing that the employee, by the exercise of reasonable diligence and effort, could have procured comparable employment and thus *mitigated the damages*. See also *Utter* v. *Chapman*, 38 Cal. 659 and 43 Cal. 279; *Hancock* v. *Board of Education*, 140 Cal. 554, 562 [74 P. 44]; *de la Falaise* v. *Gaumont-British Picture Corp.*, 39 Cal.App.2d 461, 469 [103 P.2d 477].

[1b] The first reference to the necessity for pleading mitigation of damages as an affirmative defense appears in *Rosenberger* v. *Pacific Coast Ry. Co.*, 111 Cal. 313 [43 P. 963]. That case involved employment for one year at $1,800, payable $150 per month. Wrongful discharge occurred and plaintiff sought to recover three months' salary. No mention of mitigation appears to have been made in the answer. With only implied reference to the pleadings the court said at page 318: "The court properly refused the instruction asked by the defendant. While it is the duty of an employee who has been wrongfully discharged to seek other employment, and thus diminish the damages sustained by him, he is not required, as a condition of recovery, to show that he has made such endeavor and failed. The burden is on the defendant to show that he could by diligence have obtained employment elsewhere. Whatever compensation may have been received in such employment is also to be shown by the defendant in mitigation of damages; otherwise the damages will be measured by the salary or wages agreed to be paid. (Sutherland on Damages, Sec. 693; *Costigan* v. *Mohawk etc. R.R. Co.* 2 Denio 609 [43 Am.Dec. 758];

Howard v. *Daly*, 61 N.Y. 362 [19 Am.Rep. 285]; *Utter* v. *Chapman*, 43 Cal. 279.)"

Vitagraph, Inc. v. *Liberty Theatres Co.*, 197 Cal. 694 [242 P. 709], involved the breach of a contract by the defendant to rent six motion picture films which were to be produced and delivered in turn. Defendant accepted the first two, received and returned the second two without exhibiting them and communicated a refusal of the fifth and sixth films before delivery. No affirmative defense pleading plaintiff's responsibility to minimize or mitigate damage was raised in the answer. Nevertheless, the court considered the contended applicability of the rule to the plaintiff in this language: "Assuming, however, the applicability to the present case of the rule which requires an injured party to minimize the damages, the appellant is not benefited thereby herein, at least in respect of the amount awarded on account of the third and fourth photoplays. The cases which recognize and give application to this rule uniformly hold that the burden of proof is upon the defendant to prove the facts in mitigation of damages. [Citations.] When respondent proved the contract, the performance thereof by the delivery of the third and fourth films, and appellant's refusal to pay therefor, it established at least a *prima facie* case entitling it to recover as damages the amount which appellant had agreed to pay for those films. [Citation.] It was then for the appellant to prove facts in mitigation of those damages, and this it did not do. It is generally held to be the duty of the defendant to plead the facts in mitigation of damages if he would rely thereon, and this the appellant did not do." [pp. 699-700.] Neither *Seymour* nor *Alderson* v. *Houston*, 154 Cal. 1 [96 P. 884], the only California cases cited in *Vitagraph* touch upon the pleading problem with which we are here concerned, each being restricted to the wrong-doers burden of proving the facts in mitigation. No authority is cited to the statement of the defendant's duty "to plead the facts in mitigation of damages. . . ."

The only question presented in *Palmer* v. *Harlow*, 52 Cal. App. 758 [199 P. 844], was the adequacy of the complaint as against general and special demurrers. For grounds of special demurrer it was said at page 761: "'That said complaint is uncertain in that it does not appear therein, nor can it be ascertained therefrom, whether or not plaintiff was engaged in any employment during the period from the twenty-fifth day of July, 1918, to and including the twenty-fifth day of October, 1919; nor does it appear therein, nor can it be ascertained

therefrom, whether or not plaintiff made an effort to obtain employment; that paragraph four of said complaint is uncertain in that it does not appear therein, nor can it be ascertained therefrom, where or in what place plaintiff was forced to rent other and different premises in which to live, as alleged in said paragraph; . . .' " Holding the complaint sufficient, the court said at page 764: "If, therefore, plaintiff, in other employments, during the term of the contract, and after he was prevented by defendant from performing the services under the contract in question, performed services for some other person or persons than the defendant for which he received compensation, or if he refused or negligently failed to seek other employment after his discharge, those facts or either of them constituted a matter of defense, which could be set up by the defendant as in abatement of damages or of any sum which it might be shown that the plaintiff would otherwise be entitled to." quoting thereafter from *Rosenberger* v. *Pacific Coast Ry. Co., supra*, 111 Cal. 313, 318.

Again, we find in *Ramsay* v. *Rodgers*, 60 Cal.App. 781, 785 [214 P. 261], the following language: "If it was the contention of the defendants that the plaintiff was not entitled to recover as actual damages the full amount to which he would have been entitled upon the fulfillment by him of the terms of said contract, which was interrupted by his discharge without cause, as, for example, that he had obtained or by the exercise of reasonable effort could have obtained employment elsewhere, these were defensive matters which could have been set forth if they existed, in the defendant's answer." [Citations.]

Steelduct Co. v. *Henger-Seltzer Co.*, 26 Cal.2d 634 [160 P.2d 804], cited by respondent does not help us since the trial court improperly rejected evidence of mitigation in the light of defendants' allegation that " 'plaintiff has been adequately represented in the whole of said territory since the 19th day of April, 1939, and that the sales of said agent so appointed have supplied the demand for plaintiff's product in said territory.' "

Danelian v. *McLoney*, 124 Cal.App.2d 435 [268 P.2d 775], also cited by respondent likewise does not assist us as it appears from the opinion that conflicting evidence was received on the question of plaintiff's failure to minimize damages with a resultant binding finding notwithstanding a failure to plead mitigation as an affirmative defense.

It would seem that appellants' observation is accurate in

stating that the California rulings on the necessity for raising an issue of mitigation of damages by pleading the appropriate affirmative defense appear only as dicta. We do not agree that *Guay* v. *American President Lines*, 81 Cal.App.2d 495 [184 P.2d 539], is decisive of the question we are considering. The uncertainty of the court on this point, which in fact had not been raised by the objection made in the trial court, is shown by the statements that: "While it is true that defendant did not plead these payments as an offset, and that it would have been better practice to have done so [Citations.], that was not indispensable under the circumstances. It is at least reasonably arguable that such evidence can be admitted under a general denial. (See cases collected 25 C.J.S. p. 780, § 142.)" [P. 519.]

We are directed to no case in this jurisdiction which discusses in any depth the reason for requiring that mitigation with respect to employment contracts be affirmatively raised in a defensive pleading. In the early cases reference is made to *Costigan* v. *Mohawk & Hudson R.R. Co.*, 2 Denio 609 [43 Am.Dec. 758], which in turn is considered in *King* v. *Steiren*, 44 Pa. 99 [84 Am.Dec. 419]. The holdings in those cases are summed up in *King, supra*, in this language at page 105: "Without referring to them more particularly here, it will suffice to say that they establish incontrovertibly the rule in England to be that, in such a case, the plaintiff is *prima facie* entitled to the stipulated compensation for the whole time. If so, the burden of proof in regard to his employment elsewhere, or his ability to obtain employment, must necessarily rest on the defendant. All evidence in mitigation is for a defendant to give. In its nature it is affirmative, and hence it is for him to prove who asserts it. But the possibility of obtaining other similar employment, or the fact that other employment was obtained, bears upon the case only in mitigation of damages, and is therefore a part of the defendants' case."

It is not difficult to see how such statements could readily be translated into a requirement that the issues to which they pertain would have to be brought forward by the defendant's affirmative pleading. But it must be kept in mind that reliance upon the burden of proof test can easily result in a circular confusion with the concepts of affirmative defense and new matter. See 2 Chadbourn, Grossman and Van Alstyne, California Pleading, section 1554, p. 590: "The rules for pleading new matter have sometimes been stated in terms of burden of proof. Thus, it has been said that the defendant must state as

new matter defenses as to which he would have the burden of proof at the trial. But this is actually of little help, because the question whether the defendant has the burden of proof at the trial is itself often referable to the question whether the defense is an affirmative one which must be stated as new matter (in which case the defendant generally has the burden of proof) or whether it simply involves the negation of an element of plaintiff's cause of action (as to which the plaintiff has the burden of proof). Hence, in the final analysis the question as so stated resolves itself into a determination whether the defense is or is not directed to the elements of plaintiff's cause of action." [Pp. 590-591]

And how do we distinguish the logic of such a case as *Bridges* v. *Paige*, 13 Cal. 640? The action was for attorneys' fees for professional services. The alleged value of the services was denied by the answer. Upon trial the court refused to allow examination of a plaintiff to show negligence in the performance of the legal services in reduction of their value. The trial court's ruling was held erroneous with this language: 'One of the reasons given for this ruling is, that this matter is not set up in the answer. It seems to be supposed that this was new matter, which should have been affirmatively pleaded. The rule invoked, however, does not apply to this case. Anything which shows that the plaintiff has not the right of recovery at all, or to the extent he claims, on the case as he makes it, may be given in evidence upon an issue joined by an allegation in the complaint, and its denial in the answer. Where, however, something is relied on by the defendant which is not put in issue by the plaintiff, then the defendant must set it up. That is new matter—that is, the defendant seeks to introduce into the case, a defense which is not disclosed by the pleadings. This case is a good illustration: the plaintiffs aver that the defendant is indebted to them in the sum of, say fifteen hundred dollars, for services rendered; that he is indebted to this amount because this was the value of these services. The defendant denies that he is indebted at all, and denies, further, that the services were of the value charged. He proposes to show that they were not of this value. He can do this by any legal proof, and he is not bound to set out his proofs in his pleading." [Pp. 641-642.] (Followed in *Jetty* v. *Craco*, 123 Cal. App.2d 876, 880 [267 P.2d 1055]; see also *Peters* v. *Papoulacos*, 218 Cal.App.2d 791 [32 Cal.Rptr. 689].)

A very illuminating discussion of this subject by the great judge Benjamin Cardozo is to be found in *McClelland* v. *Cli-*

max Hosiery Mills, 252 N.Y. 347 [169 N.E. 605]. The case arose upon a proceeding to fix damages after failure to answer, the defendant offering testimony upon damage only as allowed by New York practice. It was held that the failure to answer did not, under New York practice, admit the damage alleged, and therefore the defendant's evidence was admissible. The concurring opinion of Justice Cardozo puts in question the propriety of considering the matter of wages earned or which ought to have been earned as a matter of mitigation. "Proof of a prima facie case will charge the master with a duty of going forward with the evidence. This does not mean that he has the burden of proof in the strict sense, a burden that would require him to plead the matter to be proved. [Citations.]"

". . . . . .

"The servant is free to accept employment or reject it according to his uncensored pleasure. What is meant by the supposed duty is merely this: That if he unreasonably reject, he will not be heard to say that the loss of wages from then on shall be deemed the jural consequence of the earlier discharge. He has broken the chain of causation, and loss resulting to him thereafter is suffered through his own act." [*McClelland, supra*, 169 N.E. 605, 609.] And further at page 610, the court said: "In these and countless other instances, the course of justice will be greatly embarrassed if the damage actually suffered as a jural consequence of the wrong may not be proved to be less without a plea in mitigation. Often the truth does not come out without the probe of cross-examination in the progress of the trial. The defendant cannot know it in advance, or even have information about it, so as to supply a basis for a pleading. This is conspecuously so in the very class of actions now before us, where the servant often sues immediately after his discharge, and the employer does not know until the trial whether there has been diligence or inaction in looking for employment elsewhere. We encourage reckless pleading if we say that in such circumstances there can be no reduction of the damages, no proof that they were not actual, unless the defendant has the hardihood to assert a plea in mitigation."

With respect to the instant problem it would seem that a logical division may be made which will afford to the plaintiff protection from surprise and unfairness and in turn eliminate pleading pitfalls to which a defendant may be subject as here illustrated.

The plaintiff has the burden of proving his damage. The law

is settled that he has the duty of minimizing that damage. While the contract wages are prima facie his damage, his actual damage is the amount of money he was out of pocket by reason of the wrongful discharge. It can be no surprise nor result in prejudice to a plaintiff to be asked whether after discharge he earned other income. It honors form over substance and makes the trial a game rather than a search for truth to say that a defendant may not ask such a question unless in addition to denying that the plaintiff was damaged in the amount claimed he asserted that the plaintiff had earned an off-setting amount of X dollars. In the usual case this latter pleading would be unknown and speculative, and in effect a reversion to the formalistic days of common-law pleading. The "elementary principles" of logic and fair play of which Mr. Justice Peters speaks in *Guay* v. *American President Lines, supra*, 81 Cal.App.2d 495, 519, would surely be violated if the plaintiff were not to be subject to cross-examination as to his own activities in relation to the case he has the burden of proving.

On the other hand, when we come to the issue of true mitigation of damage, we face a situation in which the plaintiff is entitled to be alerted to contentions not implicit in his complaint. We conceive a substantial difference between what a plaintiff has actually done and what he could have done with the exercise of reasonable diligence and effort. It is true that it is the plaintiff's responsibility to seek comparable employment, but if he has had no actual earnings then in the nature of things the defendant will be faced with showing that employment could and should have been had. This would constitute new matter, the proper subject of defensive pleading, for to say otherwise would be to hold the plaintiff to proving a negative, which by well accepted general rules he is not required to do. Such an issue presumably involves matter and proof outside the conduct of the plaintiff; it would follow that he is entitled to be alerted to meet the case that the defendant may make out in that regard.

We see the question as one of computation (diminution of prima facie damage by earnings) on the one hand, and evaluation (mitigation from proof of potential earnings) on the other. In the absence of a precedent of clear and abiding force, and upon analysis the further absence of any reason why under a general denial of damage the plaintiff's own activity should not be subject to scrutiny to establish the actual value

of his alleged damage, we hold that the examination should have been allowed by the trial court within the limits defined by this opinion.

The ruling hereinabove expressed eliminates the necessity of considering whether the court abused its discretion in disallowing the proposed amendment of the defendants' pleadings.

The judgment is reversed as to the damages allowed and remanded for further proceedings consistent with the foregoing opinion on that issue alone. Appellants to recover costs on appeal.

Coughlin, Acting P. J., and Whelan, J., concurred.

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May 4, 1967

John H. DeMoully
Executive Secretary
Calif. Law Revision Commission
School of Law
Stanford, California

Re: Senate Bill No. 252

Dear Mr. DeMoully:

I am writing to confirm to you the basis and the scope of the interest and concern which we have discussed relative to Senate Bill No. 252.

I should state at the outset how particularly grateful we all are for the immediate and most considerate attention which William T. Bagley, and which your Commission have afforded to the concerns expressed by myself and my colleagues. I feel that our meeting in Los Angeles was most salutary and particularly the objective discussions which you and Mr. Harvey had with Mr. Caldecott, Mr. Audrain and myself on that occasion.

By reason of the specialized field in which my colleagues and I find ourselves, we have, as you know, concluded that the Bill in its present form presents substantial problems, largely due to its approach to all leases in general.

By way of background I felt it might be useful and appropriate to provide a letter describing what we feel to be some of the consequences involved. For this purpose it seems to me that a useful point of departure is a discussion of the magnitude of leasing activities in terms of economy of the State of California.

As we are all aware, California has been since its founding, a so-called "capital import" state. The data for

measuring the magnitude of capital import in California becomes rather complex. For example, in the measurement of capital import information, a distinction must be made between outside funds deposited in California institutions and administered and invested by California institutions as distinguished from funds directly invested by non-California institutions. One measurement in the first category can be approached by the fact that in excess of 20% of all savings held by Savings and Loan Associations in California are from depositors having addresses outside of the state. I mention this circumstance at the outset because, while it is not the economic area with which we are concerned in addressing ourselves to the proposed legislation, I have found in discussions that there is a tendency to confuse this kind of information with the data to which I will now refer.

A useful starting point can be found in an article entitled: "California's Imports of Mortgage Funds", by Dr. Leo Grebler, Director Real Estate Research Program U.C.L.A., which appeared in the June, 1963 issue of the Savings and Loan Journal of the California Savings and Loan League. In the year 1960, out-of-state capital invested in California non-farm mortgages represented 23.2 billion dollars in funds. Of this amount nearly $9,000,000,000.00, or 38.5%, can be attributed to out-of-state sources. Of this $9,000,000,000.00, $4,000,000,000.00 is attributed to the out-of-state life insurance companies and 1.6 billion is attributable to out-of-state mutual savings banks. We do not know of any study which attempts to isolate from data of this type the non-farm and non-residential dollar volume and this data as reported does not indicate the magnitude of mortgage investments by pension funds from out-of-state, nor is there any data available at all on the subject of a purchase and leaseback type of financing from out-of-state sources.

We do know that since 1960 there has been a substantial uptrend in the flow of absolute dollars into the state from institutional sources, both in mortgage lending and in purchase leaseback financing. We also know that out-of-state insurance money invested in non-farm, non-residential loans and purchase leasebacks represents several billions per year.

To this must be added California insurance companies California banks and pension funds. Clearly, importation of capital funds to California is an essential ingredient in its economy. It is also clear that the California economy must have assured out-of-state (as well as in-state) funds for non-residential investments on a scale in the billions per year to support its economy.

While residential properties are the subject of loan investments on the basis of appraised values, this is generally untrue on the subject of shopping centers, many types of commercial buildings, such as office buildings and hotels, but also, to a substantial degree, on the subject of industrial parks and other types of industrial facilities.

In this area of lending, the lenders look directly to the financial responsibility of the tenant. In this respect, I must lay emphasis upon the fact that it makes no difference whether the form of investment is a mortgage or a deed of trust or a purchase leaseback (or in the case of personal property, a security agreement). The initial test is directed to the question of the reliability and continuity of the rental payments. The only difference is that in a purchase leaseback the rental payments go directly to the financial institution and in the case of mortgage or trust deed loans, they are the indirect source of repayment by virtue of an assignment of rents under the provisions of a deed of trust or a separate assignment accompanying the lien documents, variously entitled "Assignment of Lessors' Interest in Leases", "Assignment of Leases for Security", "Assignment of Rents," etc.

As Mr. Harvey so well expressed it at the time of our conference, non-farm and non-residential lenders habitually read a lease just as though they were reading a promissory note. The lenders' lawyer goes through the same mental process. For example, he asks himself whether there are any available offsets or deductions against the promised periodic payment, such as a lessor's obligation to pay taxes, provide insurance, etc. In case there is not a reliable predictability of these offsets or deductions, the lender is not inclined favorably towards the loan. Similarly the

lawyer inqures into the possibility that eminent domain proceeds might not be adequate to acquire the balance of the indebtedness; and the lawyer also examines the full range of California's common law obligations of landlords as against the recitals in the lease (including problems of mitigation of damages, present worth concepts, remedies and the like) so that he may ascertain how certain the income stream may be and how it might become altered, in the event of a breach or default on the part of the landlord or the tenant. You have no doubt heard the expression "absolutely net", which is a lender's expression describing the most desirable kind of lease under which all burdens are upon the tenant and the rent will flow out of the lease without any offset of deduction or without any genuine differences to a continuing duty to pay. It is absolutely net leases upon which much of these annual billions are based.

Variations of the traditional relationships between landlord and tenant, whether by statute or judicial decision, represent a major difficulty to institutions of this kind, for the simple reason that the "status quo" has been modified. Lending patterns must be reexamined and modified. Rates, loan-to-value ratios, and other investment considerations must be reexamined. Interpretations of the new law are called for and until procedures are again clarified there is a marked tendency for investment activities to decline substantially.

I think that I can fairly state that this interim dip in lending activities is not, in my opinion, a sufficient basis for opposing any improvements to our legal system.

However, if, for example, legislation is not clear, it does become a basis of opposition for the simple reason that lenders are not willing to invest money in the magnitude of billions until the legislation is made clear. The law must be just as clear as the lease, the note and the deed of trust.

As Chairman of the Los Angeles Bar Association on Real Property, our Executive Committee asked me to form a special committee to study and report upon Senate Bill 252.

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It is our concensus that the provisions of the Bill do contain a number of expressions and concepts which are not clear and which may take a great deal of time and perhaps substantial litigation to clarify. In the ordinary landlord-tenant situation this might not be very serious, but any frame of reference wherein it will have a substantial and immediate effect upon a major segment of our economy, it does become a different matter.

As was indicated to you at our meeting, we are of the general view if the Bill were adopted in its present form it could represent a substantial inhibition to investments, not only by out-of-state institutions, but by in-state institutions as well, in those kinds of real property transactions wherein a lease and the financial responsibility of the tenant is a major inducement. For my own part, I would not be inclined to approve financing transactions for my client in the face of the language of the Bill. But we are also of the view that much of the problem is semantics and, where it is not, the philosophy of the Bill can be "opened up" to permit the highly sophisticated tenant, landlord and lender to set their own agreements to meet their respective needs, even though the Bill could cover the ordinary landlord and tenant.

For this reason I am personally grateful for the opportunity of meeting with members of the Commission and I will look forward to seeing you again on Saturday, May 13th at 9:00 A.M, here in Los Angeles, at the office of Mr. Keatinge.

Very truly yours,

Richard P. Roe

Richard P. Roe

RPR:dg

SECTION 1. Section 1951 is added to the Civil Code, to read:

1951. A lease of real property is repudiated when, without justification:

(a) Either party communicates to the other party by word or act that he will not or cannot substantially perform his remaining obligations under the lease;

(b) Either party by voluntary act, or by voluntarily engaging in a course of conduct, renders substantial performance of his remaining obligations under the lease impossible or apparently impossible; or

(c) The lessor actually evicts the lessee from the leased property.

Comment. Section 1951 is definitional. The substantive effect of a repudiation as defined in Section 1951 is described in the sections that follow in this chapter.

Subdivisions (a) and (b) follow the definition of an anticipatory repudiation that appears in Section 318 of the Restatement of Contracts.

Under the preliminary language of Section 1951, subdivision (c) applies only when the eviction is " without justification." Such an eviction is one that the lessor did not have a right to make under the terms of the lease or under the substantive law governing the rights of lessors and lessees generally. If the lessor did not have the right to evict, the eviction would not terminate the lease if the lessee sought and obtained specific enforcement of the lease. See Section 1952. Subdivision (c) refers only to actual eviction, not "constructive eviction." Under Section 1951.5, a lessee must treat an actual eviction as a termination of his possessory rights under the lease unless he can obtain a decree for specific or preventive relief. For wrongful conduct not amounting to an actual eviction (sometimes referred to as "constructive eviction"),

the lessee may elect to treat the lease as continuing and recover damages for the detriment caused by the wrongful conduct. See Section 1954.

SEC. 2. Section 1951.5 is added to the Civil Code, to read:

1951.5. A repudiation of a lease of real property is a breach of the lease in a material respect. Upon repudiation, the obligation of the lessor to permit the lessee to possess and use the property and the obligation of the lessee to pay rent and other charges equivalent to rent for such possession and use are terminated, but without prejudice to the right of the aggrieved party to seek remedies for such breach or to enforce any other provisions of the lease.

Comment. Section 1951.5 changes the prior California law. Under the prior law, repudiation of a lease by a lessee and his abandonment of the property did not terminate the lease. The lessor remained obligated to preserve the property for the lessee and perform all his other obligations under the lease, and the lessee remained obligated to pay the rent. Consequently, the lessor could regard the lease as continuing in existence and could recover the rents as they came due; but if he violated any of the provisions of the lease, he in effect excused the lessee from further rental payments and from any liability for prospective damages caused by the lessee's repudiation. See Kulawitz v. Pacific Woodenware & Paper Co., 25 Cal.2d 664, 155 P.2d 24 (1944); Welcome v. Hess, 90 Cal. 507, 27 Pac. 369 (1891). Section 1951.5 makes it clear that, in the usual case, a lessor may no longer regard the repudiated lease as continuing and enforce the payment of rental as it falls due unless the repudiation is nullified as provided in Section 1952. Moreover, he is no longer required to act as if the lessee's rights to possession were valid and enforceable. Instead, Section 1953 permits the lessor to recover all of the damages caused by the lessee's repudiation.

§ 1951.5

Section 1951.5 is consistent with the prior California law relating to a lessee's remedies. Under Section 1951.5, as under prior law, a lessee may regard his obligations under the lease as terminated by the lessor's repudiation and either sue for his damages under Section 1953 or rescind the lease as to executory provisions. Under some circumstances, the lessee may also seek specific performance of the lease. See Sections 1953 and 3387.5.

SEC. 3. Section 1952 is added to the Civil Code, to read:

1952. The effect of a repudiation of a lease of real property is nullified if:

(a) Before the other party has brought an action for damages caused by the repudiation or otherwise changed his position in reliance on the repudiation, the repudiator becomes ready, willing, and able to perform his remaining obligations under the lease and the other party is so informed; or

(b) The aggrieved party obtains a judgment granting specific or preventive relief requiring the repudiator to perform all of his remaining obligations under the lease.

Comment. Subdivision (a) of Section 1952 codifies the rule applicable to contracts generally that a party who repudiates a contract may retract his repudiation, and thus nullify its effect, if he does so before the other party has materially changed his position in reliance on the repudiation. RESTATEMENT, CONTRACTS §§ 280, 319 (1932); 4 CORBIN, CONTRACTS § 980 (1951).

Subdivision (b) of Section 1952 codifies the rule applicable to contracts generally that the effect of a repudiation as ending the performance obligations of the parties and substituting remedial rights for the aggrieved party is nullified if the aggrieved party obtains a judgment requiring specific performance of the contract.

SEC. 4. Section 1953 is added to the Civil Code, to read:

1953. When a party repudiates a lease of real property, the other party may do any one of the following:

(a) Rescind the lease as to its executory provisions in accordance with Chapter 2 (commencing with Section 1688) of Title 5 of Part 2 of Division 3.

(b) Recover damages in accordance with Article 1.5 (commencing with Section 3320) of Chapter 2 of Title 2 of Part 1 of Division 4.

(c) Obtain specific or preventive relief in accordance with Title 3 (commencing with Section 3366) of Part 1 of Division 4 to enforce any or all of the provisions of the lease if such relief is appropriate.

(d) Obtain any combination of the forms of relief specified in subdivisions (a), (b), and (c) that are not inconsistent with each other.

Comment. Except where a mining lease is involved (see Gold Mining & Water Co. v. Swinerton, 23 Cal.2d 19, 142 P.2d 22 (1943)), the California courts have not applied the contractual doctrine of anticipatory repudiation to a lessee's abandonment of the leasehold or repudiation of the lease. See Oliver v. Loydon, 163 Cal. 124, 124 Pac. 731 (1912); Welcome v. Hess, 90 Cal. 507, 27 Pac. 369 (1891). Section 1953 is designed to overcome the holdings in these cases and to make the contractual doctrines of anticipatory breach and repudiation applicable to leases generally. Cf. 4 CORBIN, CONTRACTS §§ 954, 959-989 (1951).

Under the prior California law, when a lessee abandoned the leased property and repudiated the lease, the lessor had three alternative remedies: (1) to consider the lease as still in existence and sue for the unpaid rent as it became due for the unexpired portion of the term; (2) to consider the lease

as terminated and retake possession for his own account; or (3) to retake possession for the lessee's account and relet the premises, holding the lessee at the end of the lease term for the difference between the lease rentals and the amount that the lessor could in good faith procure by reletting. Kulawitz v. Pacific Woodenware & Paper Co., 25 Cal.2d 664, 671, 155 P.2d 24, 28 (1944); Treff v. Gulko, 214 Cal. 591, 7 P.2d 697 (1932).

Under Section 1953, a lessor may still terminate the lease and retake possession for his own account by rescinding the lease under subdivision (a). But a lessor cannot permit the property to remain vacant and recover the rent as it becomes due, for Section 1951.5 provides that the lessee's repudiation terminates the obligation of the lessee to pay rent under the lease and, hence, there is no more rent due. Under Section 1953, if a lessor wishes to nullify the effect of the lessee's repudiation and retain his right to the accruing rental installments, the lessor is required to seek specific enforcement of the lease under subdivision (c). Under subdivision (b), the lessor may recover damages for the loss of the bargain represented by the original lease--i.e., the difference between the rent reserved in the lease and the fair rental value of the property together with all other detriment proximately caused by the repudiation. See Section 3320. Under the prior law, too, the lessor could recover such damages; but under subdivision (b), the lessor's cause of action accrues upon the repudiation while under the prior law the lessor's cause of action did not accrue until the end of the original lease term. See Treff v. Gulko, 214 Cal. 591, 7 P.2d 697 (1932).

The remedies specified in Section 1953 may also be used by a lessee when the lessor breaches the lease, but in this respect Section 1953 merely continues the preexisting law without significant change. See 30 CAL. JUR.2d Landlord and Tenant § 314 (1956).

Subdivision (d) is designed to make it clear that the obtaining of one form of relief specified in subdivisions (a), (b), or (c) does not necessarily preclude obtaining another form of relief in appropriate cases. For example, a lessor of property in an integrated shopping area may include a covenant in a particular lease that the lessee shall operate a particular business in the leased property and shall not open another business engaged in the same activity within a specified area. If the lessee repudiates the lease and the lessor, to minimize his damages, relets the property to another for the same or a similar purpose, the seeking of damages from the first lessee for the repudiation and abandonment should not preclude the lessor from also obtaining specific enforcement of that lessee's covenant not to compete. The right to specific enforcement of the lessee's covenant not to compete would be in addition to the lessor's right to damages for loss of rent, for the failure to continue in business, and for other damages resulting from the repudiation of the lease.

§ 1953.5

SEC. 5. Section 1953.5 is added to the Civil Code, to read:

1953.5. The time for the commencement of an action based on the repudiation of a lease of real property begins to run:

(a) If the repudiation occurs before any failure of the repudiator to perform his obligations under the lease, at the time of the repudiator's first failure to perform the obligations of the lease.

(b) If the repudiation occurs at the same time as, or after, a failure of the repudiator to perform his obligations under the lease, at the time of the repudiation.

Comment. Section 1953.5 clarifies the time the statute of limitations begins to run on a cause of action for repudiation of a lease. The rule stated is based on Section 322 of the Restatement of Contracts and is consistent with the California law applicable to repudiation of contracts generally. See Brewer v. Simpson, 53 Cal.2d 567, 593, 2 Cal. Rptr. 609, 622-623, 349 P.2d 289, 302-303 (1960). Cf. Sunset-Sternau Food Co. v. Bonzi, 60 Cal.2d 834, 36 Cal. Rptr. 741, 389 P.2d 133 (1964). Under the preexisting California law, the statute of limitations did not begin to run upon a cause of action for repudiation of a lease until the end of the lease term. See De Hart v. Allen, 26 Cal.2d 829, 161 P.2d 453 (1945).

Section 1953.5 merely sets forth the time the statute of limitations begins to run. It does not purport to prescribe the earliest date for the commencement of an action based on repudiation. Nothing here forbids the commencement of such an action prior to the date the statute of limitations commences to run.

SEC. 6. Section 1954 is added to the Civil Code, to read:

1954. When a party breaches a lease of real property in a material respect without repudiating the lease, the other party may do any one of the following:

(a) Rescind the lease as to its executory provisions in accordance with Chapter 2 (commencing with Section 1688) of Title 5 of Part 2 of Division 3.

(b) Terminate the lessee's right to the possession and use of the property and the lessor's right to receive rent and other charges equivalent to rent, and recover damages in accordance with Article 1.5 (commencing with Section 3320) of Chapter 2 of Title 2 of Part 1 of Division 4.

(c) Without terminating the lessee's right of possession and the lessor's right to rent, recover damages for the detriment caused by the breach in accordance with Article 1 (commencing with Section 3300) of Chapter 2 of Title 2 of Part 1 of Division 4.

(d) Obtain specific or preventive relief in accordance with Title 3 (commencing with Section 3366) of Part 1 of Division 4 to enforce the provisions of the lease if such relief is appropriate.

(e) Obtain any combination of the forms of relief specified in subdivisions (a), (b), (c), and (d) that are not inconsistent with each other.

Comment. If a party to a lease repudiates the lease, whether or not he commits any other breach of the lease, the remedies of the aggrieved party are governed by Section 1953. Section 1954 prescribes the remedies available to the aggrieved party when a lease is breached in a material respect but there is no repudiation of the lease. The remedies prescribed are those that are

usually available to an aggrieved party to any contract when that contract is breached in a material respect without an accompanying repudiation. See Coughlin v. Blair, 41 Cal.2d 587, 262 P.2d 305 (1953); 4 CORBIN, CONTRACTS § 946 (1951).

Under Section 1954, the aggrieved party may simply rescind or cancel the lease without seeking affirmative relief. He may regard the lease as ended for purposes of performance and seek recovery of all damages resulting from such termination, including damages for both past and prospective detriment. He may regard the lease as continuing in force and seek damages for the detriment caused by the breach, resorting to a subsequent action in case a further breach occurs. In appropriate cases the aggrieved party may seek specific performance of the other party's obligations under the lease, or he may seek injunctive relief to prevent the other party from interfering with his rights under the lease. And, finally, he may seek some combination of the specified forms of relief so long as the forms of relief obtained are consistent with each other. He could not, for example, obtain a judgment requiring specific performance of some covenant and obtain at the same time a judgment for the damages that will result from the nonperformance of the same covenant.

Section 1954 makes little, if any, change in the law insofar as it prescribes a lessee's remedies upon breach by the lessor. See 30 CAL. JUR.2d Landlord and Tenant §§ 313-320 (1956). Subdivisions (a), (c), and (d) make little change in the remedies available to a lessor upon breach of the lease by the lessee. See 30 CAL. JUR.2d Landlord and Tenant § 344 (1956). Subdivision (b), however, probably changes the law relating to the remedies of an aggrieved lessor. Although the prior law is not altogether clear, it seems likely that, if a lessor terminated a lease because of a lessee's breach and evicted the

lessee, his cause of action for the damages resulting from the loss of the rentals due under the lease did not accrue until the end of the original lease term. See De Hart v. Allen, 26 Cal.2d 829, 161 P.2d 453 (1945); Treff v. Gulko, 214 Cal. 591, 7 P.2d 697 (1932). Under subdivision (b), an aggrieved lessor may terminate the lease and immediately sue for the damages resulting from the loss of the rentals that would have accrued under the lease.

§ 1954.5

SEC. 7. Section 1954.5 is added to the Civil Code, to read:

1954.5. (a) The legal consequences of the actions of the parties to a lease of real property as provided in Sections 1951, 1951.5, and 1952 are not subject to modification by the prior agreement of the parties.

(b) The parties to a lease of real property may, in the lease or by other contract made at any time, modify or change the legal remedies available to the aggrieved party for a breach of the lease; except that the provisions of Sections 3322 and 3325 may not be waived or modified by the parties except to the extent provided in those sections.

Comment. Sections 1951, 1951.5, and 1952 are designed to make the ordinary rules of contract law applicable to leases of real property and thus relieve both lessors and lessees of the forfeitures to which they had been subjected by the application of feudal property concepts. Subdivision (a) of Section 1954.5 will secure to the parties the benefits of the preceding sections by prohibiting the restoration of the previous system of lease law by standard provisions in leases.

Subdivision (b) is included in Section 1954.5 to provide the parties to leases with considerable flexibility and freedom in specifying the remedies they may pursue in particular cases. The only limitations are that the lease contract cannot be so drawn that the aggrieved party is entitled to exact forfeitures--payments unrelated to the damages suffered--from the breaching party. Within this limitation, the parties may provide a variety of remedies tailored to their particular needs.

For example, the parties may agree that the lessor, after termination of the lessee's possessory rights because of the lessee's breach, may make a reasonable effort to relet the property and may recover from the lessee either periodically

or at the end of the original term any deficiencies in the rentals actually realized upon the reletting. Such a provision would not result in any forfeiture; it would merely delay the payment of damages so that the damages could be determined by actual experience. Again, under some circumstances, the parties might agree that the breaching lessee should remain primarily liable for the payment of rent and charges equivalent to rent as provided in the lease, but that the lessee would have the right to minimize his loss by obtaining a new tenant acceptable to the lessor. Such an agreement would not be unreasonable where the lessor's interest is solely that of providing financing at a reasonable return and the lessor does not have the facilities nor ability to manage the property and to supervise the location of a suitable tenant.

Other variations from the usual contract remedies may be conceived which would not unreasonably penalize the parties to the lease. Because the purposes for which leases are executed vary to such a wide extent, subdivision (b) authorizes the parties to prescribe by contract whatever remedies seem most appropriate for their particular lease while protecting both parties against forfeitures. Thus, the remedies specified in Sections 1953 and 1954 will be the usual remedies for the breach of a lease only where there are no valid contrary provisions in the lease.

SEC. 8. Section 1954.7 is added to the Civil Code, to read:

1954.7. (a) An agreement for the exploration for or the removal of natural resources is not a lease of real property within the meaning of this chapter.

(b) Where an agreement for a lease of real property from or to any public entity or any nonprofit corporation assisting any public entity would be invalid if any provision of this chapter were applicable, such provision shall not be applicable to such lease. As used in this chapter, "public entity" includes the state, any county, city and county, city, district, public authority, public agency, or other political subdivision or public corporation.

Comment. An agreement for the exploration for or the removal of natural resources, such as the so-called oil and gas lease, has been characterized by the California Supreme Court as a profit a prendre in gross. See Dabney v. Edwards, 5 Cal.2d 1, 53 P.2d 962 (1935). These agreements are distinguishable from leases generally. The ordinary lease contemplates the use and preservation of the property with compensation for such use, while a natural resources agreement contemplates the destruction of the valuable resources of the property with compensation for such destruction. See 3 LINDLEY, MINES § 861 (3d ed. 1914).

The sections in this chapter dealing with leases of real property are intended to deal with the ordinary lease of real property, not with agreements for the exploration for or the removal of natural resources. Accordingly, subdivision (a) of Section 1954.7 limits these sections to their intended purpose. Of course, some of the principles expressed in this chapter may be applicable to natural resources agreements. Subdivision (a) does not prohibit application to

such agreements of any of the principles expressed in this chapter; it merely provides that the statutes found here do not require such application.

Subdivision (b) is included in Section 1954.7 merely to prevent the application of any provision of this chapter to a lease of real property from or to a governmental entity if such application would make the lease invalid.

§ 1954.8

SEC. 8.5. Section 1954.8 is added to the Civil Code, to read:

1954.8. This chapter does not apply to any lease that was executed before January 1, 1968, or to any lease executed on or after January 1, 1968, if the terms thereof were fixed by a lease or other contract executed prior to January 1, 1968.

SEC. 9. Section 3308 of the Civil Code is amended to read:

3308. (a) If a lease of personal property is 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 sum of the following:

(1) The present worth 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 specified in the lease over the reasonable rental value of the property for the same period.

(2) Any other 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. The lease may limit the damages or kinds of damages that may be recovered under this paragraph.

(b) Nothing in this section precludes the lessor from resorting to any other rights or remedies now or hereafter given to him by law or by the terms of the lease.

Comment. The reference to leases of real property has been deleted from Section 3308 because, insofar as the section relates to real property, it has been superseded by Sections 1951-1954.5 and 3320-3326.

Section 3308 has also been revised to eliminate the implication that, unless the lease so provides, a lessor of personal property is not entitled to recover damages for prospective detriment upon termination of the lease by reason of the breach thereof by the lessee. No California case has so held, and the cases involving leases of real property that have held that a lessor cannot immediately recover all of his future damages have been based on feudal real property concepts that are irrelevant when personal property is involved.

See Harvey, A Study to Determine Whether the Rights and Duties Attendant Upon the Termination of a Lease Should Be Revised, 54 CAL. L. REV. 1141 (1966), reprinted with permission in 8 CAL. LAW REVISION COMM'N, REP., REC. & STUDIES at 731 (1967).

SEC. 10. Article 1.5 (commencing with Section 3320) is added to Chapter 2 of Title 2 of Part 1 of Division 4 of the Civil Code, to read:

Article 1.5. Damages for Breach of Lease of Real Property

3320. Subject to Section 3322, if a lease of real property is terminated because of the lessee's breach thereof, the measure of the lessor's damages for such breach is the sum of the following:

(a) The present worth of the rent and charges equivalent to rent reserved in the lease for the portion of the term following such termination or any shorter period of time specified in the lease.

(b) Subject to Section 3324, any other 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 article sets forth in some detail the damages that may be recovered upon a total breach of a lease of real property. Some of the rules stated are also applicable in cases involving a partial breach. The article also sets forth the lessee's right to relief from any forfeiture of advance payments made to the lessor. The remainder of the article is designed to clarify the relationship between the right to damages arising under this article and the right to obtain other forms of relief under other provisions of California law.

Sections 3320 and 3322 prescribe the measure of the damages a lessor is entitled to recover when a lease is terminated because of the lessee's breach.

Under subdivision (a) of Section 3320, the basic measure of the lessor's damages is the present worth of the unpaid "rent and charges equivalent to rent" under the lease. In this context, the phrase "rent and charges equivalent to rent" refers to all obligations the lessee undertakes in exchange for the use of the leased property. For example, if the defaulting lessee had promised to pay the taxes on the leased property and the lessor could not relet the property under a lease either containing such a provision or providing sufficient additional rental to cover the accruing taxes, the loss of the defaulting lessee's assumption of the tax obligation would be included in the damages the lessor is entitled to recover under Section 3320. Under Section 3322, the defaulting lessee is entitled to a credit against the unpaid rent not only of all sums the lessor has received or will receive upon a reletting of the property, but also of all sums that he can show the lessor could obtain upon reletting through the exercise of reasonable diligence.

The measure of damages described in subdivision (a) and Section 3322 is essentially the same as that formerly described in Civil Code Section 3308. The measure of damages described in Section 3308 was applicable, however, only when the lease so provided and the lessor chose to invoke that remedy. The measure of damages described in Section 3320 is applicable in all cases in which a lessor seeks damages upon termination of a lease of real property because of a lessee's breach. Moreover, subdivision (a) and Section 3322 make it clear that the defaulting lessee has the burden of proving the amount he is entitled to have offset against the unpaid rent, while Section 3308 was silent as to the burden of proof.

Subdivision (b) is included in this section in order to make it clear that the measure of a lessor's recoverable damages when the lease is terminated by reason of the lessee's breach is not limited to the damages for the loss of future rentals.

When a lease is terminated, it will usually be necessary for the lessor to take possession for a time in order to prepare the property for reletting and to secure a new tenant. The lessor should be entitled to recover for those expenses in caring for the property during this time that he would not have had to bear if the lessee had not abandoned the property or breached the lease.

In some cases, too, a lessor may wish to give a lessee an opportunity to retract his repudiation or cure his breach and resume his obligations under the lease. If the lessor does so and the lessee does not accept the opportunity to cure his default, the lessor should be entitled to recover not only the full amount of the rentals due under the lease for this period of negotiation but also his expenses in caring for the property during this period.

In addition, the lessor should be entitled to recover for his expenses in retaking possession of the property, making repairs that the lessee was obligated to make, and in reletting the property. There may be other damages necessary to compensate the lessor for all of the detriment proximately caused by the lessee; if so, the lessor should be entitled to recover them also. Subdivision (b), which is based on Civil Code Section 3300, provides that all of the other damages a person is entitled to recover for the breach of a contract may be recovered by a lessor for the breach of his lease. This would include, of course, damages for the lessee's breach of

specific covenants of the lease.

Subdivision (b) is made "subject to Section 3324" in order to make it clear that any attorney's fees incurred by the lessor in enforcing his rights under the lease are not recoverable as incidental damages unless the lease specifically provides for the recovery of such fees.

3321. Subject to Section 3322, if a lease of real property is terminated because of the lessor's breach thereof, the measure of the lessee's damages for such breach is the sum of the following:

(a) The present worth of the excess, if any, of the reasonable rental value of the property for the portion of the term following such termination over the rent and charges equivalent to rent reserved in the lease for the same period.

(b) Subject to Section 3324, any other damages necessary to compensate the lessee for all the detriment proximately caused by the lessor's breach or which in the ordinary course of things would be likely to result therefrom.

Comment. Section 3321 prescribes the basic measure of the damages a lessee is entitled to recover when a lease is terminated because of the lessor's breach. It is consistent with the prior California law. Stillwell Hotel Co. v. Anderson, 4 Cal.2d 463, 469, 50 P.2d 441, 443 (1935)("The general rule of damages is that the lessee may recover the value of his unexpired term and any other damage which is the natural and proximate result of the eviction."). Where appropriate, a lessee may recover damages for loss of good will, loss of prospective profits, and expenses of removal from the leased property. See, e.g., Beckett v. City of Paris Dry Goods Co., 14 Cal.2d 633, 96 P.2d 122 (1939); Johnson v. Snyder, 99 Cal. App.2d 86, 221 P.2d 164 (1950); Riechhold v. Sommarstrom Inv. Co., 83 Cal. App. 173, 256 Pac. 592 (1927).

Section 3321 is subject to Section 3322 to make clear that the defaulting lessor is not liable for any consequences that the lessee can reasonably avoid. Subdivision (b) is subject to Section 3324 in order to make clear that attorney's fees incurred by the lessee in enforcing his rights under the lease are not recoverable as incidental damages unless the lease specifically provides for the recovery of such fees.

3322. (a) A party to a lease of real property that has been breached by the other party may not recover for any detriment caused by such breach that the breaching party proves could have been avoided through the exercise of reasonable diligence without undue risk of other substantial detriment.

(b) When a lease of real property is terminated because of the lessee's breach thereof and the lessor relets the property, the lessor is not accountable to the lessee for any rent or charges equivalent to rent received on the reletting, but any such rent or charges shall be set off against the damages to which the lessor is otherwise entitled.

(c) Nothing in this section shall prevent the parties to a lease from providing therein or by any other contract that the breaching party shall have the obligation of minimizing the loss to the aggrieved party resulting from the breach.

Comment. Under prior California law, a lessor could decline to retake possession of leased property after it had been abandoned by the lessee and could recover the rent as it became due from time to time under the lease. See De Hart v. Allen, 26 Cal.2d 829, 832, 161 P.2d 453, 455 (1945). Subdivision (a) of Section 3322 substitutes for this rule the rule applicable to contracts generally that a party to a lease that has been breached by the other party may not recover for any detriment caused by such breach that could have been avoided through the exercise of reasonable diligence. See RESTATEMENT, CONTRACTS § 336 (1932). It is clear under the section, however, that the breaching party has the burden of proving the amount of offset to which he is entitled in mitigation of damages. The rule stated is similar to that now applied in actions for breach of employment contracts under

California law. See discussion in Erler v. Five Points Motors, 249 A.C.A. 644, (1967).

Under prior law, a lessor could relet property after the original lessee had abandoned the lease if he did so either to his own account (in which case the lessee's rental obligation was terminated) or for the account of the lessee. See discussion in Dorcich v. Time Oil Co., 103 Cal. App.2d 677, 685, 230 P.2d 10, 15 (1951). Although no decision so holding has been reported, the rationale of the California cases indicates that, if the lessor received a higher rental when reletting for the account of the lessee than was provided in the original lease, the lessee was entitled to the profit.

Under Section 3322, a lessor who relets property after the original lessee has abandoned it does so for his own account; and under subdivision (b), any profit received belongs to the lessor rather than to the defaulting lessee. Any rent received on the reletting, however, reduces the damages suffered by the lessor for which the lessee is liable.

The rule stated in subdivision (b) is similar to the rule applicable when the buyer under a sales contract repudiates the sale and the seller resells the goods to mitigate damages. See COM. CODE § 2706(6).

Subdivision (c) is included in Section 3322 in order to permit the parties to allocate by their own agreement the responsibility for minimizing the losses caused by a breach of the lease. Thus, the parties may provide that the lessor need not exercise diligence to find a new tenant and the attempt to recover the cost of such efforts from the lessee and may provide that the lessee must assume the responsibility of finding a suitable new tenant.

3323. Notwithstanding Sections 3320 and 3321, upon breach of a provision of a lease of real property, liquidated damages may be recovered if so provided in the lease and if they meet the requirements of Sections 1670 and 1671.

Comment. Section 3323 does not create a right to recover liquidated damages; it merely recognizes that such a right may exist if the conditions specified in Civil Code Sections 1670 and 1671 are met. Provisions in leases for liquidated damages upon repudiation of the lease by the lessee have been held to be void. Redmon v. Graham, 211 Cal. 491, 295 Pac. 1031 (1931); Jack v. Sinsheimer, 125 Cal. 563, 58 Pac. 130 (1899). Such holdings were proper so long as the lessor's cause of action upon repudiation of a lease was either for the rent as it became due or for the rental deficiencies as of the end of the lease term. Under such circumstances, there could be little prospective uncertainty over the amount of the lessor's damages. Under Section 1953 and this article, however, the lessor's right to damages accrues at the time of the repudiation; and because they must be determined before the end of the term, they may be difficult to calculate in some cases. This will frequently be the case, for example, if the property is leased under a percentage lease. It may be the case if the property is unique and its fair rental value cannot be determined. Accordingly, Section 3323 is included as a reminder that the prior decisions holding liquidated damages provisions in leases to be void are no longer authoritative and that such provisions are valid in appropriate cases.

So far as provisions for liquidated damages upon a lessor's breach are concerned, Section 3323 is declarative of the preexisting law under which such provisions were upheld if reasonable. See Seid Pak Sing. v. Barker, 197 Cal. 321, 240 Pac. 765 (1925).

3324. In addition to any other relief to which a lessor or lessee is entitled in enforcing or defending his rights under a lease of real property, he may recover reasonable attorney's fees incurred in obtaining such relief if the lease provides that he may recover such fees.

Comment. Leases, like other contracts, sometimes provide that a party is entitled to recover reasonable attorney's fees incurred in successfully enforcing or defending his rights in litigation arising out of the lease. Section 3324 makes it clear that the other sections in this article do not impair a party's rights under such a provision.

3325. (a) If a lessee's right of possession under a lease of real property is terminated because of the breach of the lease by the lessee, the lessee may recover from the lessor any amount paid to the lessor in consideration for such possession (whether designated rental, bonus, consideration for execution thereof, or by any other term) that is in excess of the sum of:

(1) The portion of the total amount required to be paid to or for the benefit of the lessor pursuant to the lease that is fairly allocable to the portion of the term prior to the termination of the lessee's right of possession; and

(2) Any damages, including liquidated damages as provided in Section 3323, to which the lessor is entitled by reason of such breach.

(b) The right of a lessee to recover under this section may not be waived prior to the accrual of such right.

Comment. Section 3325 is designed to make the rules stated in Freedman v. The Rector, 37 Cal.2d 16, 230 P.2d 629 (1951), and Caplan v. Schroeder, 56 Cal.2d 515, 15 Cal. Rptr. 145, 364 P.2d 321 (1961), applicable to cases arising out of the breach of a lease. The Freedman case held that a willfully 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. The Caplan case held that a willfully defaulting vendee could recover such an advance payment even though the contract recited that the advance payment was in consideration for the execution of the contract. The court looked beyond the recital and found that there was in fact no separate consideration for the advance payment aside from the sale of the property itself.

Similarly, Section 3325 will permit a lessee to recover advance payments, regardless of how they are designated in the lease, if the court finds that such payments are in fact in consideration for the right of possession under the lease and are in excess of the amount due to the lessor as compensation for the use and occupation of the property and as damages for the detriment caused by the lessee's breach. Section 3325 does not require a pro rata allocation of the total consideration. The court must consider the entire agreement, the circumstances under which it was made, and the understanding of the parties. For example, the parties may have understood that the rental value of the property would rise during the term of the lease. The parties may have contemplated some initial compensation for special preparation of the property or to compensate for the surrender of a now-vanished opportunity to lease to someone else. In each case, the court must determine the consideration fairly allocable to the portion of the lease term prior to termination and, in addition, the lessor's damages so that the lessor can retain the full amount necessary to place him in the financial position he would have enjoyed had the lessee fully performed. Since any sum paid by the lessee in excess of this amount is a forfeiture insofar as the lessee is concerned and a windfall to the lessor, it is recoverable under Section 3325.

Subdivision (b) of Section 3325 is probably unnecessary. The Freedman and Caplan cases are based on the provisions of the Civil Code prohibiting forfeitures. These rules are applied despite contrary provisions in contracts. Nonetheless, subdivision (b) is included to make it clear that the provisions of this section may not be avoided by the addition to leases of provisions waiving rights under this section.

§ 3325

Section 3325 changes the prior California law. Under the prior California law, the right of a lessee to recover an advance payment depended on whether the advance payment was designated a security deposit (lessee could recover), liquidated damages (lessee could recover), an advance payment of rental (lessee could not recover), or a bonus or consideration for the execution of the lease (lessee could not recover), Compare Warming v. Shapiro, 118 Cal. App.2d 72, 257 P.2d 74 (1953)($12,000 forfeited because designated as both a bonus and an advance payment of rental), with Thompson v. Swiryn, 95 Cal. App.2d 619, 213 P.2d 740 (1950)(advance payment of $2,800 held recoverable as a security deposit). See discussion in Joffe, Remedies of California Landlord upon Abandonment by Lessee, 35 SO. CAL. L. REV. 34, 44 (1961), and 26 CAL. L. REV. 385 (1938). See also Section 3323 and the Comment to that section.

3326. (a) Nothing in this article affects the provisions of Chapter 4 (commencing with Section 1159) of Title 3 of Part 3 of the Code of Civil Procedure, relating to actions for unlawful detainer, forcible entry, and forcible detainer.

(b) The bringing of an action under the provisions of Chapter 4 (commencing with Section 1159) of Title 3 of Part 3 of the Code of Civil Procedure does not affect the right to bring a separate action to recover the damages specified in this article; but there shall be no recovery of damages in the subsequent action for any detriment for which a claim for damages was made and determined on the merits in the previous action.

Comment. Section 3326 is designed to clarify the relationship between this article and the chapter of the Code of Civil Procedure relating to actions for unlawful detainer, forcible entry, and forcible detainer. The actions provided for in the Code of Civil Procedure are designed to provide a summary method of recovering possession of property. Those actions may be used by a lessor whose defaulting lessee refuses to vacate the property after termination of the lease.

Section 3326 provides that the fact that a lessor has recovered possession of the property by an unlawful detainer action does not preclude him from bringing a separate action to recover the damages to which he is entitled under this article. Some of the incidental damages to which the lessor is entitled may be recovered in either the unlawful detainer action or in an action to recover the damages specified in this article. Under Section 3326, such damages may be recovered in either action, but the lessor is entitled to but one determination of the merits of a claim for damages for any particular detriment.

3327. (a) An agreement for the exploration for or the removal of natural resources is not a lease of real property within the meaning of this chapter.

(b) Where an agreement for a lease of real property from or to any public entity or any nonprofit corporation assisting any public entity would be made invalid if one of the remedies under this chapter were applicable, such remedy shall not be applicable to such lease. As used in this chapter, "public entity" includes the state, any county, city and county, city, district, public authority, public agency, or other political subdivision or public corporation.

Comment. An agreement for the exploration for or the removal of natural resources, such as the so-called oil and gas lease, has been characterized by the California Supreme Court as a profit a prendre in gross. See Dabney v. Edwards, 5 Cal.2d 1, 53 P.2d 962 (1935). These agreements are distinguishable from leases generally. The ordinary lease contemplates the use and preservation of the property with compensation for such use, while a natural resources agreement contemplates the destruction of the valuable resources of the property with compensation for such destruction. See 3 LINDLEY, MINES § 861 (3d ed. 1914).

The previous sections in this article are intended to deal with the ordinary lease of real property, not with agreements for the exploration for or the removal of natural resources. Accordingly, Section 3327 limits these sections to their intended purpose. Of course, some of the principles expressed in this article may be applicable to natural resources agreements. Section 3327 does not prohibit application to such agreements of any of the

principles expressed in this article; it merely provides that the statutes found here do not require such application.

Subdivision (b) is included in Section 3327 merely to prevent the application of any provision of this chapter to a lease of real property from or to a governmental entity if such application would make the lease invalid.

3328. For the purpose of this article, the present worth of an unpaid rental installment shall be taken as that sum which, together with four percent simple interest on such sum from the present time to the due date of the rental installment, shall be equal to the amount of the rental installment.

Comment. Section 3328 is designed to provide a certain discount rate for discounting all future rental installments in order that the appropriate discount rate need not be made a matter to be proved in each case.

3329. This article does not apply to any lease that was executed before January 1, 1968, or to any lease executed on or after January 1, 1968, if the terms thereof were fixed by a lease or other contract executed prior to January 1, 1968.

SEC. 11. Section 3387.5 is added to the Civil Code, to read:

3387.5. (a) The obligations of a lease of real property, including the lessee's obligation to occupy the property or to pay rent as it accrues, may be specifically enforced:

(1) When a purpose of the lease is (i) to provide a means for financing the acquisition of the leased property, or any improvement thereon, by the lessee, or (ii) to finance the improvement of the property for the use of the lessee during the term of the lease, or (iii) to provide, by means of an agreement in connection with a lease of real property from or to any public entity or any nonprofit corporation assisting any public entity, that the public entity shall acquire title to the real property so leased or to otherwise provide the public entity with the right to acquire title in any manner. As used in this paragraph, "public entity" includes the state, any county, city and county, city, district, public authority, public agency, or other political subdivision or public corporation.

(2) When the character of the use for which the lease contemplates the property will be used is sufficiently unique that damages would not adequately compensate for the loss of the lessee's continued possession and use of the property.

(3) When the character of the property is sufficiently unique that damages would not adequately compensate the lessee for the loss of the continued right to possess and use the property.

(4) In any other case when damages would not adequately compensate for the loss of the aggrieved party's rights under the lease.

(b) Nothing in this section affects the right to obtain specific performance or preventive relief in any other case where such relief is appropriate..

Comment. Under the prior California law, if a lessee defaulted in the payment of rent, abandoned the property, or otherwise breached the lease, the lessor could refuse to terminate the lease and sue to collect the rental installments as they accrued. Because the lessee's obligation under a lease was, in effect, specifically enforceable through a series of actions, leases have been utilized by public entities to finance the construction of public improvements. The lessor constructs the improvement to the specifications of the public entity-lessee, leases the property as improved to the public entity, and at the end of the term of the lease all interest in the property and the improvement vests in the public entity. See, e.g., Dean v. Kuchel, 35 Cal.2d 444, 218 P.2d 521 (1950); County of Los Angeles v. Nesvig, 231 Cal. App.2d 603, 41 Cal. Rptr. 918 (1965).

Similarly, a lessor may, in reliance on the lessee's rental obligation under a long term lease, construct an improvement to the specifications of the lessee for the use of the lessee during the lease term. The specifically enforceable nature of the lessee's rental obligation gives the lessor, in effect, security for the repayment of the cost of the improvement.

These systems of financing the purchase or improvement of real property would be seriously jeopardized if the lessor's only right upon repudiation of the lease by the lessee were the right to recover damages measured by the difference between the worth of the remaining rentals due under the lease and the rental value of the property. See Section 3320.

Subdivision (a) of Section 3387.5 is designed, therefore, to make it clear that a lease is specifically enforceable if it is actually a means for financing the acquisition by the lessee of the leased property or improvements thereon, or for financing the construction of improvements to be used

by the lessee during the term of the lease. Because of Section 3387.5, it will be clear that a lessee may not avoid his obligation to pay the lessor the full amount due under the lease by abandoning the leased property and repudiating the lease.

Subdivision (a) is also designed to make it clear that a lease is specifically enforceable when the character of the lessee's use and occupation of the property or the character of the property itself are so unique that damages would not adequately compensate for the loss of the lessee's continued possession and rental payment or the lessor's continued permission for the lessee to possess the property.

SEC. 12. Section 1174 of the Code of Civil Procedure is amended to read:

1174. If upon the trial, the verdict of the jury, or, if the case be tried without a jury, the findings of the court be in favor of the plaintiff and against the defendant, judgment shall be entered for the restitution of the premises; and if the proceedings be for an unlawful detainer after neglect , or failure to perform the conditions or covenants of the lease or agreement under which the property is held, or after default in the payment of rent, the judgment shall also declare the forfeiture of such lease or agreement.

The jury or the court, if the proceedings be tried without a jury, shall also assess the damages occasioned to the plaintiff by any forcible entry, or by any forcible or unlawful detainer, alleged in the complaint and proved on the trial, and find the amount of any rent due, if the alleged unlawful detainer be after default in the payment of rent. Judgment against the defendant guilty of the forcible entry, or the forcible or unlawful detainer may be entered in the discretion of the court either for the amount of the damages and the rent found due, or for three times the amount so found.

When the proceeding is for an unlawful detainer after default in the payment of rent, and the lease or agreement under which the rent is payable has not by its terms expired, and the notice required by Section 1161 has not stated the election of the landlord to declare the forfeiture thereof, the court may, and, if the lease or agreement is in writing, is for a term of more than one year, and does not contain a forfeiture clause, shall order that execution upon the

judgment shall not be issued until the expiration of five days after the entry of the judgment, within which time the tenant, or any subtenant, or any mortgagee of the term, or any other party interested in its continuance, may pay into the court, for the landlord, the amount found due as rent, with interest thereon, and the amount of the damages found by the jury or the court for the unlawful detainer, and the costs of the proceedings, and thereupon the judgment shall be satisfied and the tenant be restored to his estate.

But if payment as here provided be not made within five days, the judgment may be enforced for its full amount, and for the possession of the premises. In all other cases the judgment may be enforced immediately.

Comment. The language deleted from Section 1174 was added by prior amendment to permit a lessor to evice a defaulting lessee and relet the premises without forfeiting his right to look to the lessee for any resulting deficiencies in the accruing rentals. Prior to that amendment, a lessor whose lessee defaulted in the payment of rent had to choose between (a) suing the lessee from time to time to collect the accruing rentals and (b) completely terminating the lease and the lessee's obligation to pay any more rent. Costello v. Martin Bros., 74 Cal. App. 782, 786, 241 Pac. 588, 589 (1925).

Inasmuch as Civil Code Sections 1953 and 1954 permit a lessor to recover his damages for the loss of the future rentals due under the lease despite the termination of the lease, the deleted language is no longer necessary.

§ 13

SEC. 13. This act does not apply to any lease that was executed before January 1, 1968, and does not apply to any lease executed on or after January 1, 1968, if the terms thereof were fixed by a lease or other contract executed prior to January 1, 1968. Leases executed prior to January 1, 1968, and leases whose terms were fixed by a lease or other contract executed prior to January 1, 1968, shall be governed by the law that would be applicable to such leases had this act not been enacted.

Comment. Section 13 provides that this act is to be applied to leases executed before as well as after its effective date. The purpose of Section 13 is to permit, insofar as it is possible to do so, the courts to develop and apply a uniform body of law applicable to all cases involving a repudiation or material breach of a lease that arise after the effective date of the act. The section recognizes that the constitutional prohibition against the impairment of the obligation of contracts may limit the extent to which this act can be applied to leases executed before its effective date. Whether there is such a constitutional limitation on the retroactive application of this act, and the extent of such possible limitation, must be determined by the courts.

SEC. 14. If any provision of this act or application thereof to any person or circumstance is held invalid, such invalidity shall not affect any other provision or application of this act which can be given effect without the invalid provision or application, and to this end the provisions of this act are declared to be severable.

RECOMMENDATION OF THE LAW REVISION COMMISSION TO THE LEGISLATURE

Relating to Reletting of Premises by the Landlord for the Account of the Tenant

A tenant's liability for future rent ceases upon termination of the lanlord-tenant relation, and his remaining liability is for damages for breach of the covenant to pay rent, measured by the difference between the agreed rent and the amount realized upon a reletting. See *Hermitage Co. v. Levine*, 248 N. Y. 333 (1928). Leases of real property commonly provide that if the tenant abandons the premises, the landlord may relet them. It has been held in New York that in the absence of such a clause in the lease, a landlord who relets without the consent of the tenant thereby evidences acceptance of a surrender and terminates the lease. *Gray v. Kaufman Dairy & Ice Cream Co.*, 162 N. Y. 388 (1900). This rule discourages attempts by the landlord to minimize the tenant's damages. The Commission believes that it should be changed.

A clause permitting the landlord to relet the premises if the tenant abandons them, or if they become vacant, gives the landlord a privilege of reletting without relinquishing his right to rent as it becomes due. If the landlord does relet without accepting a surrender by the tenant, the net rent received from a new tenant, after deduction of the expenses of the reletting, is credited to the account of the defaulting tenant and set off against his liability for rent. See *Kottler v. New York Bargain House, Inc.*, 242 N. Y. 28 (1926). A surplus resulting from the reletting will belong to the tenant.

A clause permitting the landlord to relet does not, however, impose any duty to relet. In New York the landlord may allow the premises to remain vacant and recover rent from the tenant as it accrues. The liability for rent, unless the lease has been terminated, is fixed at the execution of the lease, which effects a present transfer, and the tenant is in the same position as a buyer of goods who has received title to the goods. *Becar v. Flues*, 64 N. Y. 518 (1876); *Sancourt Realty Corporation v. Dowling*, 220 App. Div. 660, 222 N. Y. Supp. 288 (1st Dep't 1927). Although this is the prevailing rule, it has been rejected by decision in some states, which have applied general principles with respect to mitigation of damages for breach of contract.

In 1960 the Commission proposed a statute providing that a reletting of premises abandoned by the tenant should not be evidence of acceptance of a surrender, and providing also that in any action brought for rent accruing after an abandonment the tenant might show as a defense or partial defense that opportuni-

ties for reletting were offered to the landlord, and that the landlord unreasonably failed or refused so to relet. The proposed statute made the defense effective to the extent of the amount that the landlord might reasonably have beeen expected to receive as a result of the reletting, less the reasonable expenses of the reletting. (1960 Senate Int. No. 1315, Pr. No. 1318, Assembly Int. No. 1862, Pr. No. 1864. See Leg. Doc. (1960) No. 65 (A); 1960 Report, Recommendations and Studies of the Law Revision Commission.) The Commission withdrew its recommendation for further study in the light of criticisms of the part of the 1960 proposal creating this affirmative defense.

The rule that the landlord has no duty to relet is especially harsh where the tenant is forbidden by the lease to sublet the premises or to assign his term, and the landlord, by his privilege of reletting, thus controls the only means by which the premises can be made to yield a pecuniary benefit to be applied on the obligation for rent. The Commission believes that it should be changed in at least these cases.

In the statute proposed this year, the provision creating a defense to an action upon the tenant's liability for rent is limited to cases where the tenant is prohibited by the lease from assigning or subletting. In such cases the proposed statute provides an affirmative defense or partial defense to an action against the tenant upon his liability for rent for any period in which the landlord is authorized to relet for the account of the tenant. As in the statute proposed in 1960, the tenant would be required to show that an opportunity to relet was offered to the landlord and that the landlord unreasonably failed or refused so to relet, and the defense would be effective to the extent of the amount that the landlord might reasonably have been expected to receive as a result of the reletting. The tenant would of course, have the burden of proof on all elements of the affirmative defense.

A major criticism of the statute proposed in 1960 was the absence of any statutory criterion for determining whether the conduct of the landlord in refusing or neglecting an opportunity for reletting was unreasonable. The statute proposed by the Commission this year specifies a number of factors to which consideration is to be given in making this determination. Since these tests may be inappropriate or inadequate for determining whether a landlord should be compelled to accept a prospective tenant of a one-family or two-family dwelling, the proposed statute also makes the provision creating an affirmative defense in favor of the tenant inapplicable to residential leases of such dwellings, using the definitions employed in the Multiple Dwelling Law and Multiple Residence Law to exclude such dwellings from regulations under those statutes.

The proposed statute also provides that the defense it creates cannot be waived by any provision of the lease and cannot be limited by any provision of the lease setting unreasonable standards for reletting. This limitation, invalidating a contractual privilege

of the landlord to act unreasonably, is necessary to prevent frustration of the statute.

The Commission therefore recommends:

I. Enactment of the following new section 220-a of the Real Property Law:

§ 220-a. Reletting of premises for the account of the tenant. 1. Where the tenant under a lease of real property has abandoned the premises before the end of the term of his lease, a reletting of the premises by the landlord, or an attempt by the landlord to relet the premises, shall not be evidence of acceptance of a surrender of the lease. If the landlord in such case relets the premises without termination of the lease, amounts received by the landlord as a result of such reletting, less the reasonable expenses of the reletting, shall be credited to the tenant. If the reletting is for a term extending beyond the term of the abandoning tenant, the amounts received by the landlord as a result of such reletting, less the reasonable expenses of such reletting, shall be credited to the abandoning tenant to the extent of the amount thereof equitably apportionable to the unexpired term of his lease.

2. If a tenant is prohibited by the lease from assigning or subletting, or from assigning or subletting without the consent of the landlord, then in an action against the tenant upon his liability for rent for any period in which the landlord is authorized to relet for the account of the tenant, the tenant may plead and prove as a defense or partial defense that an opportunity to relet all or part of the premises, for all or part of the period for which recovery is sought, was offered to the landlord, and that the landlord unreasonably failed or refused so to relet. Such defense or partial defense shall be effective to the extent of the amount that the landlord might reasonably have been expected to receive as a result of the reletting, less the reasonable expenses of the reletting.

3. In determining whether the conduct of the landlord in refusing or neglecting opportunities for reletting was unreasonable, consideration shall be given to the following factors, together with any other matters that may be relevant:

(a) the interest of the landlord in the preservation of the character and condition of the premises or in limiting the purposes for which the premises are occupied or used;

(b) the financial responsibility of the tenant and the financial responsibility of the prospective tenant in any proposal for reletting;

(c) the relative duration of the unexpired portion of the term of the tenant and of the term under any proposal for reletting;

(d) the consequences of a reletting of less than all of the premises;

(e) the nature and extent of alterations or improvements that would be required in connection with a proposed reletting;

(f) the amount of rent offered by the prospective tenant.

4. The defense provided for in subdivision two of this section cannot be waived by any provision of the lease and cannot be limited by any provisions of the lease setting unreasonable standards for reletting.

5. This section applies to a lease for business, industrial, commercial, agricultural or residential purposes, except that subdivision two does not apply to a lease for residential purposes of premises designed and occupied exclusively for residence purposes by not more than two families living independently of each other, or a lease of any part of such premises. For the purpose of this subdivision, "family" means one or more persons with whom there may be not more than four boarders, roomers or lodgers all living together in a common household.

II. The following provision, to be included in the statute enacting the proposed new section 220-a of the Real Property Law:

§ 2. This act shall take effect September first, nineteen hundred sixty-one and shall apply to leases executed on or after that date.

Dated *February* 19, 1961.

BY THE LAW REVISION COMMISSION:

WALTER C. O'CONNELL,
Executive Secretary;

LAURA T. MULVANEY,
Director of Research.