

Seventh Supplement to Memorandum 88-64

Subject: Study H-111 - Commercial Lease Law (Assignment and Sublease--
application to residential tenancies)

The attached memorandum from Professor Coskran discusses issues involved in whether the commercial assignment and sublease provisions developed so far by the Commission should be extended to residential leases.

Professor Coskran concludes that the basic Kendall rule should apply--if a residential lease requires the landlord's consent for a transfer but is silent as to the applicable standard, a reasonableness standard should be implied. Professor Coskran believes it is not so clear whether residential tenancies should be also be subject to the right of the parties to contract for absolute restrictions on transfer; he sees conflicting policies on this issue, including the inferior bargaining position of the tenant, the special nature of individual residential units, and the small bonus value ordinarily associated with residential tenancies.

The Commission needs to resolve this issue in the course of the preparation of its recommendation to the Legislature.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

CLRC H-111. 8/31/88.



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CA LAW REV. COMM'N

SEP 02 1988

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FM BILL COSKRAN

DT 8/31/88

RE APPLICATION OF CONCLUSIONS TO RESIDENTIAL TENANCIES.
Study H-111. RESTRICTIONS ON LEASE TRANSFERS: VALIDITY AND
RELATED REMEDIES ISSUES.

Dear Nat:

On July 19, 1988, I sent a letter to about 50 real property lawyers (members of the State Bar Association Real Property Law Section Executive Committee, members of the Los Angeles County Bar Association Real Property Section Executive Committee, the Northern California and Southern California Chairs of the Landlord/Tenant Subsection and the Commercial & Industrial Development Subsection of the State Bar Real Property Law Section, and a few others.) The letter gave a brief update on the progress of the studies, and requested views on whether the rules developed from the studies should be the same or different for residential tenancies. I have not yet received any responses.

The study I prepared concentrates on commercial leases because the major assignment/sublease restriction problems arise with those leases. However, if the Commission wishes to address

the application of the general conclusions and specific legislation to residential tenancies, I believe the following factors should be considered.

UNCERTAINTY. The rules applicable to assignment and sublease restrictions in residential tenancies are even less certain than those applicable to non-residential leases. The Kendall decision which applied a reasonableness standard to a "silent consent standard" type clause expressly refrained from deciding whether its opinion extended to residential leases. So far, no reported California decision has dealt specifically with a residential lease. There is no clearcut pattern in out of state cases since most of them involve commercial leases.

CONSUMER PROTECTION. Generally there is stronger concern for "consumer" protection when dealing with tenant occupied housing, than there is when dealing with a commercial lease. Residential tenants generally do not get a lawyer to advise and negotiate concerning the terms the tenancy. The amount of rent is the major concern in a residential tenancy, and I think it is reasonable to assume that there is less bargaining over the other terms of the tenancy. If the residential rental occurs at a time and place of unit shortages, there is little practical bargaining power.

SHORT TERM. I have not seen any empirical studies, but it has been my experience that residential tenancies are typically

month-to-month tenancies, and if they are for a fixed term, it is seldom for more than a one year term. When longer terms are involved, they are usually for a single family residence (free standing or condominium).

A local rent control ordinance that prohibits the lessor from terminating a tenancy except for "just cause" can obviously convert a short term tenancy into a long one, but the impact of a rent control ordinance should be considered separately.

In a short term tenancy, it is unlikely that a significant "bonus value" (difference between the agreed rent and the market rental value) will build up. Thus it is unlikely that a short term residential tenant will be concerned about the ability to reap the benefit of this bonus value by receiving consideration from a third party assignee or subtenant. Also, a lessor in this situation is not likely to be concerned about getting the bonus value upon a transfer because the rent can be raised to the market in the short term whether there is a transfer or not. For example, a "Profit Sharing" or "Possession Recovery" type of a transfer clause would not likely be worth the time it takes to draft and enforce it.

In a short term tenancy, the duration of a transfer restriction is limited, so there is less of a practical impact. If a month-to-month tenant wishes to get out of the agreement, a short time notice (typically 30 days) will do the job. In a fixed short term tenancy (e.g. a one year lease), a tenant who elects to get out by a breach and abandonment will have a relatively short time

left for exposure to damages under C.C. 1951.2, and the section provides for an offset of "reasonably" avoidable rent losses. If the lessor uses the "lock-in" remedy under C.C. 1951.4, the lessor is subject to a mandatory reasonableness standard.

In a short term tenancy, it is not very practical to litigate over a "reasonableness" standard.

RENT CONTROL TERMINATION LIMITATIONS. If a local jurisdiction adopts rent control, it is likely that the ordinance will contain some form of "just cause" limitations on the lessor's power to end the tenancy (e.g. rent default, extensive rehabilitations, move-in by lessor or family, etc.). These limitations can convert a short term tenancy into a long term one. However, the tenant remains free to terminate the tenancy. A tenant enjoys the benefits of a bonus value (here the difference between the controlled rental and a free market rental) while occupying the premises, and this seems to serve the basic purpose of the controlled rentals.

One type of ordinance allows the lessor to raise the rent to the market rent when the tenancy terminates and the unit is relet. If a lessor could not restrict transfer, it seems that a tenant could transfer the unexpired tenancy and receive consideration in the amount of the bonus value from the third party. The former tenant who no longer occupies the unit would get the profit. The new transferee occupant would pay more than the controlled rental. The owner of the property would still be receiv-

ing less than free market rent. This does not serve the purpose of rent control, and it supports the freedom of the lessor to restrict transfers.

Under another type of ordinance, the rent remains controlled even when the tenancy terminates and the unit is relet. The lessor cannot require a higher rent from the new occupant whether the former tenancy is terminated or transferred. In theory, the new occupant does not have to "buy" the bonus value from the present tenant because the new occupant will be protected by the rent ceiling under a new tenancy. In practice, if there is a shortage of rent controlled units available, an existing tenant may be able to "sell" his position if the lessor cannot restrict transfers. This type of ordinance would also seem to support the freedom of the lessor to restrict transfers.

In sum, I do not see anything in the concept of rent control that would militate against applying the same basic conclusions of freedom to contract for express strict restrictions that the Commission has reached concerning commercial leases. If a rent control jurisdiction wishes to further restrict the tenant from receiving a profit from a third party assignee or subtenant, that is a policy matter best left to the rent control ordinance.

CONTINUING LIABILITY. A tenant who assigns or sublets to a third party remains liable to the lessor for breaches of the tenancy obligations. If the tenant can terminate the tenancy without breach, the typical residential tenant is better off

terminating the tenancy rather than risking continuing exposure of liability related to premises no longer controlled by the tenant. Thus, a "freedom to transfer" may be an illusory benefit for most tenants, and a trap for some who transfer to a flake.

TYPE OF PROPERTY. The degree of tolerable control may depend upon the type of residential property subject to the tenancy. The following distinction is mentioned in the study at pages 106-107.

One's attitude toward transfer restrictions in a residential lease can shift dramatically depending on the nature of the transaction. Suppose you have a nice single family residence which has served as your family nest since you personally designed and built it. It is filled with unique furnishings collected over the years. You have been temporarily transferred or you are planning an extended trip and need to rent your home, furnished, to provide income for loan payments, taxes, insurance and maintenance. You select your tenant according to your own personal standards, preferences and instincts. Should you be required to have a "commercially reasonable objection" to prevent a transfer by this tenant? On the other hand, suppose that a major apartment development and management company owns hundreds of virtually identical apartment units throughout the state, with professional on-site management and security. Do you mind imposing a reasonableness standard on that lessor?

The Restatement recognizes the distinction between these two situations when applying a reasonableness standard. It points out

that "(a) reason may be reasonable in relation to residential property that is the personal home of the landlord that would not be reasonable as to other residential property (endnote omitted)." Perhaps more flexibility in discretion than that provided by the reasonableness standard is needed in some residential situations. In some situations the lessor, as well as the tenant, may be considered to be in need of consumer protection. There are a variety of situations where legislation has made a distinction between one to four unit residential transactions and other residential transactions (endnote omitted). If a distinction is to be made based upon the type of residential property, this might be a reasonable compromise distinction.

MOBILEHOMES. The expense and difficulty of moving a mobilehome put mobilehome site tenancies in a distinct category. The lessor's ability to restrict transfer of the tenancy is strictly limited when title to the mobilehome is transferred. The limitations are contained in a separate article of the comprehensive "Mobilehome Residency Law", particularly in C.C. sections 798.73-798.74 (sale of mobilehome), 798.78 (death transfer and later sale), and 798.79 (foreclosure transfer and later sale). I think these limitations should be preserved due to the unique nature of the mobilehome tenancies.

CONCLUSIONS & ISSUES.

The Commission has adopted the position that a reasonableness standard should be imposed on a "Silent Consent Standard" type of clause in a commercial lease. I think the same thing should be done for residential tenancies. This would conform to the likely expectations of residential tenants. Also, it would require an express agreement disclosing a different standard in the rental agreement if the lessor wants greater control.

The Commission has adopted various conclusions which implement the general proposition that express agreements in commercial leases should be enforced in accordance with their terms. Here there is policy issue with respect to residential tenancies. Should the lessor be able to contract away the reasonableness standard in a residential tenancy? On the one hand, residential tenants are more likely to need "consumer protection" than commercial tenants. On the other hand, assignment and sublease of a residential tenancy is not likely to be of major significance to most residential tenants and litigation over a reasonableness standard is impractical. An exception would be the case where a tenant with a fixed term lease breaches and abandons and the lessor elects to use the "lock-in" remedy under C.C. 1951.4. In this case, the tenant is already protected by the reasonableness requirements of that section.

A mobilehome tenancy presents a unique situation and the existing statutory limitations on transfer restrictions should be left undisturbed.

The Commission's basic approach toward commercial leases requires disclosure by express agreement, and allows expressly agreed strict restrictions on transfer.

1. Is there a compelling reason to depart from this approach when a residential tenancy is involved?

2. If a different approach is adopted (e.g. mandatory reasonableness standard):

A. Should there be a distinction based on the duration of the tenancy? Does a month-to-month tenant or short term tenant need the same freedom to transfer as a long term tenant?

B. Should there be a distinction based on the type of property involved (e.g. single family residence vs. unit in an apartment building)?

We can discuss this further at the next Commission meeting if you wish. In the meantime, if you have any questions or comments, please give me a call either at the law school {(213) 736-1087} or at home {(714) 846-5920}.

Best regards,

A handwritten signature in cursive script, appearing to be 'J. J. ...', written in dark ink.