

Memorandum 68-13

Subject: Study 50 - Abandonment or Termination of Lease

BACKGROUND

Attached is a copy of the pamphlet containing the Commission's 1966 Recommendation and Study Relating to Abandonment or Termination of a Lease. Senate Bill No. 252 was introduced at the 1967 session to effectuate this recommendation. The bill was supported by the State Bar. The bill passed the Senate and was approved by the Assembly Judiciary Committee in amended form. However, the Commission withdrew its recommendation for further study because problems that had not been considered by the Commission were brought to its attention after the bill had been approved by the Assembly Judiciary Committee. Hence, the bill was not enacted.

It is suggested that you read the 1966 study prior to the meeting. The study is summarized below.

In general, the existing California law governing the lessor's remedies upon the lessee's default is "far from satisfactory" to the lessor and, at times, "harsh" to the lessee. The situation can be summarized as follows:

I. Lessor's Rights Upon Abandonment in the Absence of Lease Provisions

Where the lessee has abandoned the property, the lessor has three remedies in the absence of lease provisions:

(a) Recovery of rent as it accrues. As the owner of an estate in land, the lessee cannot abandon his title and the title continues in him until terminated in some mode recognized by law, such as forfeiture or surrender. Since the lessee's estate continues, his

liability for the rent under the lease also continues and is recoverable from time to time in an action brought for that purpose. It matters not that the lessee has repudiated the lease, has abandoned the premises, or has otherwise indicated he will not perform his obligations under the lease. The lease is, in effect, specifically enforceable by a series of actions for rent.

The difficulty with the remedy so far as the lessor is concerned is that the action must be limited to accrued rental installments; there can be no recovery for future installments because the lease is still in existence and no obligation to pay the rent arises until each installment falls due. Moreover, since the statute of limitations runs on each rental installment as it becomes due, repeated actions for the recovery of rent are necessary if the full amount of the rental is to be collected from a lease of more than two (oral) or four (written) years' duration. Consider the lessor's problem when the lessee under a 20-year lease abandons the property and ceases to pay the rent.

Another difficulty is that, inasmuch as the lease theoretically continues in existence, the lessor remains bound to perform his obligations under the lease even though no one receives any benefit from his performance. Consider, for example, the lessor's problem when the tenant abandons a store in a shopping center and ceases to pay rent and the lessor has an opportunity to lease another store in the same shopping center for a competing business. See the Kulawitz case discussed on page 745 of the study.

The remedy is also unfair to the lessee since it ignores a fundamental principle--mitigation of damages. The social utility

in not increasing the cost to one party without commensurate gain to the other is as present here as in any other field of the law. The operation of the principle in lease cases would require the landlord to make a reasonable effort to relet [or would require some other alternative procedure that would permit the lessee to minimize the damages--such as permitting the lessee to mitigate the damages by subleasing the premises].

(b) Termination of the lease. Upon abandonment of the property by the defaulting lessee, the landlord may terminate the lease. In such case, the lessor loses his right to damages for loss of future rent. The hardship to the lessor of this remedy results from its application in cases where the lessor has suffered serious detriment for which he seeks to recover damages. In such cases, the lessor's efforts to minimize his damages by seeking a new tenant have been held to result in his acceptance of a surrender of the lease and the loss of his right to recover his damages from the original tenant. Generally speaking, any act by the lessor suggesting an assertion of ownership over the property results in a surrender of the lessee's estate and in the loss of the lessor's right to damages, whether or not the lessor intends that result.

There are no sound policy reasons supporting the rule that a lessor's effort to mitigate the damages caused by a defaulting lessee terminates the lessor's right of recovery of damages. The only explanation for the continuation of the rule is "a matter of history that has not forgotten Lord Coke."

(c) Retaking of possession and suit for damages. Upon abandonment of the property by the defaulting lessee, the lessor may retake possession for the lessee's account and relet the premises, holding the lessee for the difference between the lease rentals and what the lessor is able in good faith to procure by reletting. It is essential that the lessor notify the lessee that he is retaking possession of the property on behalf of the tenant and that he intends to sublet to another on behalf of the tenant to mitigate damages.

The requirement of notice makes it difficult to utilize this remedy, and lessors have suffered loss because of defective attempts to use it. Since the lessee retains no ownership interest in the property, it should be no more necessary for the lessor to notify the lessee of his intention to mitigate damages than it is for a wrongfully discharged employee to notify his former employer before taking another job. Moreover, the lessor should not have to wait until the end of the term to sue for damages--as he does under existing law--since his right to recover them does not depend on the continued existence of an interest of the lessee in the leasehold estate. The difficulties in determining the lessor's damages for prospective losses are no different in kind or degree from those in determining prospective losses under any other kind of contract.

II. Lessor's Rights Upon Breach of the Lease in the Absence of Lease Provisions

Where the lessee has not abandoned the property, the lessor has the following remedies upon a breach of a lease for which the landlord could justifiably evict the tenant:¹

¹ Code of Civil Procedure Sections 1161-1174 (unlawful detainer) describe the conditions under which a lessor is permitted to evict a lessee before the normal expiration of the term of the lease. See Study at 758-759.

(a) He can treat the breach as a partial breach and recover the damages caused thereby, leaving the tenant in possession.

(b) He may terminate the lease and evict the lessee, waiving all rights to further rentals or to damages for their loss.

(c) He may evict the lessee and take possession of the property and relet it for the account of the lessee. In such a case, the lessor can recover damages from the original lessee for any resulting rental deficiencies. If the abandonment cases are followed, however, it seems likely that the cause of action for the damages will not accrue until the end of the original term. Moreover, there is nothing in any of the applicable statutes or cases indicating that the lessor is under any duty to relet the property after evicting the lessee. A lessor might be able to evict a lessee for breach of the lease, permit the property to remain vacant, and sue the lessee for the rental installments as they accrue. Because there have been no cases presenting the question, it is impossible to determine whether the courts would refuse to permit such recoveries on the ground that they would constitute forfeitures.

III. Landlord's Rights Under Provisions of Lease

(a) Liquidated damages. Lease provisions for liquidated damages are void on the ground that the actual damages would not be "extremely difficult to fix or impractical of estimation." This is true where-- as under existing law--the action for such damages cannot be brought until the end of the original term, a rule that is unsound.

(b) Acceleration of rental. A provision accelerating all of the rentals due under the lease upon default by the lessee was held void

in a case where the lessor had taken possession of the property. Enforcement of the acceleration provision under such circumstances would force the defendant lessee to pay for a benefit never received. An acceleration provision might be valid under existing law if the lessee were permitted to retain his estate in, and right to possession of, the lease property, but no case has considered the validity of such a provision under these circumstances.

(c) Prepayments. The case law relating to various prepayment devices has been summarized as follows:

"[T]he monies paid upon the execution of a lease . . . fall into four classes: (1) advance payment of rent; (2) as a bonus or consideration for the execution of the lease; (3) as liquidated damages; and (4) as a deposit to secure faithful performance of the terms of the lease." . . . [I]f the payment was made under the first two classes it may be retained by the landlord if the lease is terminated due to the fault of the tenant. Payments under class three are penalties, result in forfeitures, are invalid as such, and may be recovered by the tenant. Payments made under the fourth class are retainable by the landlord only to the extent of the amount of damage actually suffered. [Warming v. Shapiro, 118 Cal. App.2d 72, 75, 257 P.2d 74, 76 (1963).]

Although the labels differ, these various prepayment provisions are the same in substance. However, the name applied to the prepayment by the parties to the lease determines whether the sum may be forfeited to the lessor upon the lessee's default. Hence, if the correct nomenclature is used, the lessor may succeed in retaining a substantial penalty for the lessee's default in the performance of the lease. It should be noted that recent developments in the California law on forfeitures generally suggest that a change in the law relating to prepayments under leases is likely to be made by the courts.

(d) Acceleration of damages. Section 3308 of the Civil Code provides that the parties, by agreement, may grant the lessor the

right to terminate the lease and immediately recover from the lessee the difference between the value of the rentals provided for in the lease and the fair rental value of the property for the balance of the lease term. It is unfortunate that the right of the lessor to use this remedy must depend upon a provision in the lease and that the section permits the lessor to refuse to mitigate his damages by electing not to use this remedy. Moreover, the wording of Section 3308 is slightly defective.

(e) Agency to relet. A lease may contain a provision that, upon abandonment by the lessee, or after default by the lessee and eviction by the lessor, the lessor may reenter the property, relet it as "agent" for the defaulting lessee and hold the lessee responsible for any deficiencies resulting from the reletting. Such a provision is valid. This provision is based on the "fiction" that the lessor is an agent for the lessee. This fiction could create problems if the lessor relet the property for a profit or if he refused to relet the property at all. Whether in the first case the profit would belong to the lessor or the defaulting lessee, and whether in the second case the lessor could collect the full rental called for in the lease, will depend to a great extent upon how far the courts are willing to apply the "agency to relet" fiction. Moreover, as previously indicated, the requirement of notice to the lessee makes it risky for the lessor to use this remedy, especially in abandonment cases.

IV. Rights of Lessee Upon Breach by Lessor

The rights of a lessee upon breach by the lessor have been summarized by the California Supreme Court as follows:

In such a case the lessee has a choice of several remedies: he may rescind and become absolved from further payment of rentals; he may continue under the lease and sue for loss of profits [or other damages]; or he may treat the violation as putting an end to the lease for the purposes of performance and sue for damages. [Kulawitz v. Pacific Woodenware & Paper Co., 25 Cal.2d 664, 672, 155 P.2d 24, 28 (1944).]

Generally speaking, there is no need to alter these remedies. In one respect, however, modification of a lessee's remedies might alleviate unnecessary hardship to the lessor without diminishing the protection now provided the lessee. For example, assume that the lessor has the duty under the lease to restore the premises in case of partial destruction but fails to do so. It has been held that in such a case the lessee may treat a breach by the lessor as a partial breach and recover the damages that have accrued at the time of judgment and, in addition, a judgment for the loss in the future rental value of the property. The lessee must continue to pay the full rental stipulated in the lease. This is a poor solution to the problem. The lessor's principal security for the payment of the stipulated rent over the remainder of the term is the value of the leasehold itself: If the lessee fails to pay the rent, the lessor can relet the property to another for its reasonable rental value. But the courts have given the lessee an immediately enforceable judgment for the full amount of the decrease in value of the leasehold. This leaves the lessor with a security for the payment of the lessee's future obligations that the court had itself determined was no longer adequate. A better remedy in a case where

the value of a leasehold has been impaired is to permit the lessee, in lieu of terminating the lease, to obtain an abatement of the rent. The same problem exists in cases of partial takings by condemnation. The staff suggests that the Commission defer proposing any legislative solution to this problem until we have considered it in connection with our study of condemnation law and procedure. Legislation designed to solve the problem in condemnation cases was introduced in 1965 but was not enacted; it was opposed by the State Bar because of possible tax complications. After the Commission has considered the problem in the condemnation study, the Commission can then determine whether a general statute dealing with the problem in other types of cases should be recommended.

PROBLEMS RAISED BY 1967 BILL

The 1967 bill would, in effect, have made a lease the same as any other contract and the same remedies that are available in the case of other contracts would have been available in lease cases.

A number of attorneys whose practice involves the use of leases for financing the construction and operation of shopping centers and other major commercial enterprises were seriously concerned with the effect that the 1967 bill would have on the financing of these projects. They related a variety of examples where the standard remedies provided in our 1967 statute might seriously jeopardize the rights of the parties.

Some of the specific problems mentioned 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 should be able to preserve the original lessee's obligation at least to the extent of guaranteeing the payment of the original rental over the whole life of the lease. In effect, the lessor would be 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 would permit the lessee to offset his 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. It was pointed out that it does not 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. Bullock's 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 Penny'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. Under the 1967 bill, the lessor was in a much less favorable position.

The problems described above would be eliminated if the lessor were given the right to collect the rent as it became due under any lease involving a rental of \$500 or more a month or a term of five years or more.

The view was also expressed that the 1967 bill would have created a significant problem for lessors, even if the bill were revised to permit the lessor to collect the rent under leases providing for rent of \$500 or more a month or a term of five years or more. Some attorneys commenting on the 1967 bill feel a general duty to relet the property to mitigate damages would create a factual and troublesome defense that might prove both awkward and unfair to lessors, especially in that such a duty would require the lessor, in effect, to compromise his claim to future rentals. The lessor should, it was suggested, be in a position where he has no duty to relet the premises if he is willing to permit the tenant to minimize the damages by subleasing the premises. Some attorneys also advised the Commission that, despite the case law, they advise their clients that there is a duty to mitigate damages and that trial courts enforce such duty by a variety of means. The Commission was advised further that most lessors would, as a matter of self-interest, relet the property to mitigate damages because they would be reluctant to sacrifice assured receipts of rent to obtain the uncertain fruits of a lawsuit.

The Commission directed the staff to write to various organizations representing lessors and to persons representing lessees to determine their views on this general problem. We wrote to or discussed this problem with a number of individuals but either received no response or received a response indicating a willingness to examine any tentative proposals but an inability or unwillingness to comment on the problem generally. Accordingly, we have prepared a tentative recommendation that we believe will solve the problems that exist and will not create any additional problems. After this tentative

recommendation has been considered by the Commission, we suggest that a tentative recommendation be prepared and distributed for comments. The comments on the tentative recommendation will indicate whether it is possible to devise appropriate legislation in this field of law.

TENTATIVE RECOMMENDATION

The attached tentative recommendation contains a series of sections designed to solve the lease problems. The sections are designed to meet the problems created by the 1967 bill and to eliminate the deficiencies in the existing law. We suggest that you study the tentative recommendation prior to the meeting and that we consider the statute sections contained in the tentative recommendation section by section at the meeting.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

#50

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PRELIMINARY DRAFT
of
TENTATIVE RECOMMENDATION
relating to

ABANDONMENT OR TERMINATION OF A LEASE

Note: This draft was prepared by the staff of the California Law Revision Commission. It does not represent or reflect the conclusions of the Commission since the Commission has not considered this draft.

LETTER OF TRANSMITTAL

The California Law Revision Commission was directed by Resolution Chapter 130 of the Statutes of 1965 to make a study to determine whether the law relating to the rights and duties attendant upon termination or abandonment of a lease should be revised.

The Commission published a recommendation and study on this subject in October 1966. See Recommendation and Study Relating to Abandonment or Termination of a Lease, 8 CAL. LAW REVISION COMM'N REPORTS 701 (1967). Senate Bill No. 252 was introduced at the 1967 session of the Legislature to effectuate this recommendation. The bill passed the Senate but was not enacted. Problems that had not been considered by the Commission were brought to its attention after the bill had passed the Senate and the Commission withdrew its recommendation for further study.

The Commission has prepared a revised tentative recommendation on this subject. In preparing this revised tentative recommendation, the Commission has taken into account the problems that caused it to withdraw its previous recommendation.

TENTATIVE

RECOMMENDATION OF THE CALIFORNIA

LAW REVISION COMMISSION

relating to

ABANDONMENT OR TERMINATION OF A LEASE

BACKGROUND

Section 1925 of the Civil Code provides that a lease is a contract. Historically, however, a lease of real property has been regarded as a conveyance of an interest in land. The influence of the common law of real property remains strong despite the trend of recent years to divorce the law of leases from its medieval setting of real property law and to adapt it to modern conditions by means of contract principles. The California courts state that a lease is both a contract and a conveyance and apply a blend of contract and conveyance law to lease cases. This blend, however, is frequently unsatisfactory and harsh, whether viewed from the standpoint of the lessor or the lessee.

RECOMMENDATIONS

Right of Lessor to Recover Damages Upon Lessee's Abandonment of
Leased Property

Under existing law, when a lessee abandons the leased property and refuses to perform his remaining obligations under the lease, his conduct does not--in the absence of a provision in the lease--give rise to an immediate action for damages as it would in the case of an ordinary contract. Such conduct merely amounts to an offer to surrender the remainder of the term. Welcome v. Hess, 90 Cal. 507, 27 Pac. 369 (1891). As stated in Kulawitz v. Pacific etc. Paper Co., 25 Cal.2d 664,

671, 155 P.2d 24, (1944), the lessor confronted with such an offer has three alternative courses of action:

(1) The lessor may refuse to accept the offered surrender and sue for the accruing rent as it becomes due for the remainder of the term. From the landlord's standpoint, this remedy is seldom satisfactory because he must rely on the continued availability and solvency of a lessee who has already demonstrated his unreliability. Moreover, he must let the property remain vacant, for it still belongs to the lessee for the duration of the lease. In addition, repeated actions may be necessary to recover all of the rent due under the lease. This remedy is also unsatisfactory from the lessee's standpoint, for it permits the lessor to refuse to make any effort to mitigate or minimize the injury caused by the lessee's default. See De Hart v. Allen, 25 Cal.2d 829, 832 161 P.2d 453, (1945).

(2) The lessor may accept the lessee's abandonment as a surrender of the remainder of the term and regard the lease as terminated. This amounts to a cancellation of the lease or a rescission of the unexecuted portion of the lease. Because in common law theory the lessee's rental obligation is dependent on the continuation of his estate in land, the termination of the lease in this manner has the effect of terminating the remaining rental obligation. The lessor can recover neither the unpaid rent nor damages for its loss. Welcome v. Hess, supra. Moreover, the courts construe any conduct by the lessor that is inconsistent with the lessee's continued ownership of an estate in the leased property as an acceptance of the lessee's offer of surrender, whether or not such an acceptance is intended. Dorcich v. Time Oil Co., 103 Cal. App.2d 677, 230 P.2d 10 (1951). Hence, efforts by a lessor to minimize his damages frequently result in the loss of all right to the

unpaid future rentals as well as of all right to any damages for the loss of future rentals.

(3) The lessor may notify the lessee that the leased property will be relet for the benefit of the lessee, take possession and relet the property, and sue for the damages caused by the lessee's default. This remedy, too, is unsatisfactory because the courts have held that the cause of action for damages does not accrue until the end of the original lease term. Treff v. Gulko, 214 Cal. 591, 7 P.2d 697 (1932). Hence, an action to recover any portion of the damages will be dismissed as premature if brought before the end of the original term. This may result in leaving the lessor without an effective remedy where the term of the lease is of such duration that waiting for it to end would be impractical, such as where the tenant under a 20-year lease abandons the property after only one year. In addition, any profit made on the reletting probably belongs to the lessee, not the lessor, inasmuch as the lessee's interest in the property theoretically continues. Moreover, the lessor must be careful in utilizing this remedy or he will find that he has forfeited his right to the remaining rentals from his original lessee despite his lack of intent to do so. See, e.g., Neuhaus v. Norgard, 140 Cal. App. 735, 35 P.2d 1039 (1934); A. H. Busch Co. v. Straus, 103 Cal. App. 647, 284 Pac. 966 (1930).

The Commission has concluded that when the tenant breaches the lease and abandons the property, the lessor should have an immediate right to resort to an action for damages. The lessor in such a case should be entitled to sue immediately for all damages--present and future--caused by the abandonment of the property or the termination

of the lease. He should not be required to defer a damage action --the present California practice--until the end of the term and run the risk that the defaulting lessee will be insolvent or unavailable at the end of the term. The availability of a suit for damages would not abrogate the present right to rescind the lease or to sue for specific or preventive relief if the lessor has no adequate remedy at law. Rather, an action for damages would present the lessor with a reasonable choice of remedies such as those available to a promisee when a promisor has breached a contract.

Right of Lessor to Recover Damages Upon Breach
by Lessee Justifying Termination of Lease

A similar choice of remedies confronts the lessor whose lessee commits a sufficiently material breach of the lease to warrant termination:

(1) The lessor may treat the breach as a partial breach, decline to terminate the lease, and sue for the damages caused by the particular breach. In such a case, the lessor must continue to deal with a lessee who has proven to be unsatisfactory.

(2) The lessor may terminate the lease and force the lessee to relinquish the property, resorting to an action for unlawful detainer to recover the possession of the property if necessary. In such a case, the lessor's right to the remaining rentals due under the lease ceases upon the termination of the lease. Costello v. Martin Bros., 74 Cal. App. 782, 241 Pac. 588 (1925).

(3) Under some circumstances, the lessor may decline to terminate the lease but still evict the lessee and relet the property for

the account of the lessee. Lawrence Barker, Inc. v. Briggs, 39 Cal.2d 654, 248 P.2d 897 (1952); Burke v. Norton, 42 Cal. App. 705, 184 Pac. 45 (1919). See CODE CIV. PROC. § 1174. As previously stated this remedy is unsatisfactory.

The courts have considered the lessee's obligation to pay rent as dependent on the continued existence of the term under common law property concepts. When the term is ended, whether voluntarily by abandonment and repossession by the lessor or involuntarily under the compulsion of an unlawful detainer proceeding, the rental obligation also ends. In the usual case where the lessor has no reason to expect the lessee to remain available and solvent until the end of the term, continued adherence to this rule denies the lessor any effective remedy for the loss caused by a defaulting lessee.

The Commission has concluded that the lessor should be able to bring an action for the loss of present and future rentals at the time that the lease is terminated because of a substantial breach by the lessee. Under existing law, the action may not be brought until after the end of the term of the lease. This new remedy would be an alternative to existing remedies that would continue to be available --the right to treat the breach as a partial breach, regard the lease as continuing in force, and recover damages for the detriment caused by the breach and the right to rescind or cancel the lease.

Duty of Lessor to Mitigate Damages

Existing Law

Under existing law, when the lessee breaches the lease and abandons the property, the lessor may refuse to accept the lessee's

offer to surrender his leasehold interest and may (1) sue for the accruing rent as it becomes due for the remainder of the term or (2) notify the lessee that the property will be relet for the benefit of the lessee, retake possession and relet the property, and sue for the damages caused by the lessee's default. Kulawitz v. Pacific etc. Paper Co., supra. Thus, although the lessor may mitigate damages--by reletting for the benefit of the lessee--he is not required to do so. Moreover, if the lessor does attempt to mitigate the damages, he may lose his right to the future rent if the court finds he has accepted the lessee's offer to surrender his leasehold interest when he did not mean to do so as, for example, when his notice to the lessee is found to be insufficient. Dorcich v. Time Motor Co., supra. The result is that the existing law tends to discourage the lessor from attempting to mitigate the damages.

Recommendations

General duty to mitigate damages. Absent a provision in the lease to the contrary, when the lessee has breached the lease and abandoned the property or has been evicted by the lessor, the lessor should not be permitted to let the property remain vacant and still recover the rent as it accrues if the damages could be mitigated by reletting the property to a suitable tenant. Instead, the lessor should be required to make a reasonable effort to mitigate the damages by reletting the property.

To achieve this objective the basic measure of the lessor's damages should be made the loss of the bargain represented by the

lease--i.e., the amount by which the remaining rentals provided in the lease exceeds the amount of rental loss that the lessee proves could have been or could be avoided through the exercise of reasonable diligence without undue risk of other substantial detriment. In other words, the lessor should be entitled to recover the unpaid future rents less such amount as the lessee proves could have been obtained by reletting the property to a tenant reasonably acceptable to the lessor. This burden of proof rule is similar to the one applied in actions for breach of employment contracts. See Erler v. Five Points Motors, 249 A.C.A. 644, 57 Cal. Rptr. 516 (1967). The recommended measure of damages is essentially the same as that now provided in Civil Code Section 3308, but the measure of damages provided by that section applies only when the lease so specifies and the section is silent as to burden of proof.

In addition, the lessor should be entitled to recover any other damages necessary to compensate him for all the detriment caused by the lessee's breach or which in the ordinary course of things would be likely to result therefrom. This is the rule applicable in contract cases under Civil Code Section 3300 and would permit the lessor to recover his expenses in retaking possession of the property, making repairs that the lessee was obligated to make, and in reletting the property.

The requirement of existing law that the lessor notify the lessee before reletting the property to mitigate the damages should be eliminated. This requirement has discouraged lessors from attempting to mitigate damages and serves no useful purpose in view of the recommended requirement that the lessor be required to relet the

property to mitigate damages in any case where he seeks to recover damages for loss of future rent from the lessee.

Lease provisions relieving lessor of burden of mitigating damages.

The parties should be permitted to include provisions in the lease that will guarantee to the lessor that the lessee will remain obligated to pay the rent provided in the lease for the entire term of the lease unless the lessor retakes possession of the property.

1. Provision allowing lessee to relet or assign. In any lease, the parties should be permitted to include a provision in the lease that obligates the lessee to pay the rent for the entire lease term if the lease also includes a provision giving the lessee the right to assign the lease or to sublet the property to any person reasonably acceptable as a tenant to the lessor. If the lease contains such provisions, the lessor would be permitted to collect the rent as it accrues so long as he does not retake possession of the property. These lease provisions would allow the lessor to guard against the loss of the rentals provided in the lease and at the same time would allow the lessee to protect his interests by obtaining a new tenant.

2. Long term leases and leases for a substantial rental. Where the term of the lease is five years or more or the rent is \$500 a month or more, the parties should be permitted to include a provision in the lease that obligates the lessee to pay the rent provided in the lease for the entire term of the lease so long as the lessor does not retake possession of the property. It is essential that the parties be permitted to impose this obligation on the lessee in cases where a long term lease is used as a commercial financing device.

The advent of "net lease financing" has turned the lease into an important instrument for investment and for the financing of land acquisition and building.

An essential requirement in net lease financing is that there be no termination except for a taking of the whole property by eminent domain, rejection of the lease by the tenant's trustee in bankruptcy, or a complete destruction of the land and building by a flood which does not recede. Williams, The Role of the Commercial Lease in Corporate Financing, 22 BUS. LAW. 751, 752-53 (1967). Thus, it is necessary that any change in the law of leases in California preserve the ability of the lessor under such a financing agreement to hold the lessee unconditionally to the payment of the rent.¹

¹ Such agreements are often complex. One example of such an arrangement is described in Williams, The Role of the Commercial Lease in Corporate Finance, 22 BUS. LAW. 751, 762, (1967): A Co. needs a new building to expand its operations. It arranges for X to purchase the land for the building. X purchases the land and leases it to A Co. on a short term lease. A Co. builds the improvement and sells it to X. X makes payment by means of an unsecured promissory note. X then sells the land at cost to Investment Co., but retains the fee in the improvement. Investment Co. leases the land to X on a long term lease with a net term basis which will return a fair rate of interest on the investment of Investment Co. X leases the improvement back to A Co. on a net lease basis, and subleases the land to A Co. on the same basis. X then mortgages the ground lease and the improvement to Investment Co. for an amount equal to the cost of the building. X uses the proceeds of the mortgage transaction to pay the promissory note given by X to A Co. for the purchase of the improvement. Thus, A Co. has possession of the land and the improvement and has paid out no cash which has not been returned; the only obligation of A Co. is to pay the periodic rentals. X has spent no money which has not been returned, is the mortgagor of the improvement and the sublease and is primarily liable on the ground lease. X has security for the performance of A Co. in his ownership of the equity in the improvement. Investment Co., the investor, owns the land and has it and the improvement as security for the payment of rent by A Co. Investment Co. also has the obligation of X, as sublessor, as security. Investment Co. has an investment which is now paying interest equivalent to a mortgage in the form of rent.

Where the lease is used as a financing arrangement, the "rent" is in substance interest and the rate of the rent depends on the credit rating of the lessee. Ordinarily, 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 may not have the credit rating of the prior lessee and, if the lease had been made with the new lessee originally, a higher rent would have been charged to reflect the increased risk in loaning the money secured by the lease. In this type of case, a mitigation of damages requirement would result in the lessor's losing the benefit of the transaction since the credit rating of the lessee involved in the transaction determines the rent. Even where the lease is not part of a financing arrangement, the same consideration applies because a lessee with a prime credit rating will often be required to pay less rent than a tenant whose ability to pay the rent is suspect. In addition, where a financing arrangement is not involved, the desirability of a particular tenant may be a factor that significantly influences the amount of the rental. For example, a lessor of a shopping center may desire that a particular tenant of outstanding quality be located in the shopping center to attract customers for the entire center. In order to attract this tenant, the rent may be very favorable to the tenant. If the tenant later wishes to leave the location, there may be no equivalent store willing to come in. A store which caters to a different type of clientele may be willing to come in, but the lessor may not want that store 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 the original tenant live up to its bargain. The recommendation concerning long term leases will permit the parties to retain this effect of the existing law.

Liquidated Damages

The California Supreme Court held a provision for liquidated damages in a lease void because "it does not occur to us that upon the failure of a tenant to pay rent, and upon his eviction after notice and demand, the actual damage would be extremely difficult to fix or impracticable of estimation." Jack v. Sinsheimer, 125 Cal. 563, 566, 58 Pac. 130, 131 (1899). No objection to this holding can be made if the law is that no action for damages--even liquidated damages--can be brought until the end of the original term. However, in view of the recommendation that the lessor be permitted to bring an action for damages for loss of future rents as soon as he retakes possession of the property, there is no reason why a liquidated damages provision in a lease should be treated any differently than a similar provision in any other contract. When the amount of the prospective damage caused by the lessee cannot be readily ascertained, a fair liquidated damages provision should be enforceable to the same extent as in any other contract.

Forfeiture of Advance Payments

Adherence to common law property concepts in the interpretation of leases has caused hardship to lessees as well as to lessors. Under the existing law, lessees may be subjected to forfeitures that would not be permitted under any other kind of contract. The courts have been

quick to hold that provisions in leases for liquidated damages are void. Jack v. Sinsheimer, supra. Similarly, provisions for the acceleration of the unpaid rental installments have been held invalid. Ricker v. Rombough, 120 Cal. App.2d Supp. 912, 261 P.2d 328 (1953). But if the lessee makes a payment to the lessor as an "advance payment of rent" or "in consideration for the execution of the lease," the lessor is entitled to keep the payment regardless of his actual damages when the lease is terminated by reason of the lessee's breach. A-1 Garage v. Lange Investment Co., 6 Cal. App.2d 593, 44 P.2d 681 (1935); Curtis v. Arnold, 43 Cal. App. 97, 184 Pac. 510 (1919); Ramish v. Workman, 33 Cal. App. 19, 164 Pac. 26 (1917). See 26 CAL. L. REV. 385, 388 (1938).

In contrast, where the buyer repudiates a contract for the sale of real property, any advance payments made to the seller in excess of his actual damages are recoverable by the buyer. Freedman v. The Rector, 37 Cal.2d 16, 230 P.2d 629 (1951). Moreover, even though a contract for the sale of property recites that an initial payment is in "consideration for entering into the agreement," the courts permit the buyer to recover so much of the payment as exceeds the seller's damages if, in the light of the entire transaction, there was in fact no separate consideration supporting the payment. Caplan v. Schroeder, 56 Cal.2d 515, 15 Cal. Rptr. 145, 364 P.2d 321 (1961).

The distinction between a payment made as an advance payment of rent or as consideration for the execution of the lease, and security for the lessee's performance or liquidated damages is artificial and ought to be eliminated. A defaulting lessee should be entitled to

relief from the forfeiture of an advance payment that exceeds the damages caused by his default, regardless of the label attached to the payment by the provisions of the lease. A lessor should not have the right to exact forfeitures by the artful use of language in a lease.

Effect on Unlawful Detainer

Code of Civil Procedure Section 1174 provides that the lessor may notify the lessee to quit the premises, and that such a notice does not terminate the leasehold interest unless the notice so specifies. This permits a lessor to evict the lessee, relet the property to another, and recover from the lessee at the end of the term for a any deficiency in the rentals. The statutory remedy falls short of providing full protection to the rights of both parties. It does not permit the lessor to recover damages immediately for future losses; it does not require the lessor to mitigate damages; and it does not protect the lessee from forfeiture.

An eviction under Section 1174 should terminate the lessee's rights under the lease and the lessor should be required to relet the property to minimize the damages. At the same time, the eviction should not affect the lessor's right to enforce covenants in the lease, such as a covenant not to compete.

The lessor's right to recover damages for loss of the benefits of the lease should be independent of his right to bring an action for unlawful detainer to recover the possession of the property. The damages should be recoverable in a separate action in addition to any damages recovered as part of the unlawful detainer action. Of course, the lessor should not be entitled to recover twice for the same items of damages.

In case of a long term lease or a lease for a substantial rent, the landlord should be required to elect between (1) allowing the lessee to retain the premises and suing for rent as it accrues, and (2) evicting the lessee and suing for all damages, including future rents. The lessor should not be able to evict the lessee and refuse to mitigate damages, thereby holding the lessee for all future rent while at the same time depriving him of the property and the ability to mitigate damages.

Civil Code Section 3308

Section 3308 of the Civil Code should be revised to limit its application to personal property. Section 3308 provides, in effect, that a lessor of real or personal property may recover the measure of damages recommended above if the lease so provides and the lessor chooses to pursue that remedy. Enactment of legislation effectuating the other recommendations of the Commission would make Section 3308 superfluous insofar as real property is concerned. Section 3308 should also be revised to eliminate the implication that arises from its terms that a lessor of personal property cannot sue for all of his prospective damages unless the lease so provides.

Effective Date: Application to Existing Leases

The recommended legislation should take effect on July 1, 1970. This will permit interested persons to become familiar with the new legislation before it becomes effective.

The legislation should not apply to any leases executed before July 1, 1970. This is necessary because the parties did not take the recommended legislation into account in drafting leases now in existence.

RECOMMENDED LEGISLATION

CIVIL CODE

§ 1951. Damages recoverable by lessor upon abandonment of property or termination of lease

1951. (a) Subject to subdivision (b), when the lessee under a lease of real property has breached the lease and abandoned the property before the end of the term of the lease, or when the lessee's right of possession under a lease of real property is terminated by the lessor by reason of the breach thereof by the lessee, the lessor is entitled to recover from the lessee the sum of the following:

(1) The amount by which the present worth of the unpaid rent and charges equivalent to rent provided in the lease exceeds the amount of rental loss that the lessee proves could have been or could be avoided through the exercise of reasonable diligence without undue risk of other substantial detriment as, for example, by reletting the property to a person reasonably acceptable as a tenant to the lessor. For the purpose of this paragraph, unless the lease otherwise provides, the present worth of an unpaid rental installment that is not yet due is that amount which, together with four percent simple interest thereon from the time of computation to the due date of the rental installment, is equal to the amount of the rental installment.

(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, including reasonable attorney's fees if such fees are recoverable under Section 1954, less such amount of such damages as the lessee proves could have been or could be avoided through the exercise of reasonable diligence without undue risk of other substantial detriment.

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(b) When the lessee has breached the lease and abandoned the property prior to the end of the term of the lease, or when the lessee's right to possession is terminated by the lessor by reason of the breach of the lease by the lessee, the lessor is entitled to recover liquidated damages if the lease so provides and such damages meet the requirements of Sections 1670 and 1671.

(c) An action to recover under this section must be commenced within four years after the breach in the case of a written lease and within two years after the breach in the case of an oral lease.

Comment. Section 1951 states the measure of damages when the lessee has breached the lease and abandoned the property or when the lessee's right to possession is terminated by the lessor. It is not a comprehensive statement of the lessor's remedies. For example, when the lessee breaches the lease and abandons the property or the lessor terminates the lessee's right to possession because of the lessee's breach, the lessor may simply rescind or cancel the lease without seeking affirmative relief under Section 1951. Where the lessee is still in possession but has breached the lease, the lessor may regard the lease as continuing in force and seek damages for the detriment caused by the breach, resorting to a subsequent action if a further breach occurs. In appropriate cases, the lessor may seek specific performance of the lessee's obligations under the lease, or he may seek injunctive relief to prevent the lessee from interfering with his rights under the lease. Section 1951 makes no change in these remedies. See 30 CAL. JUR.2d Landlord and Tenant § 344 (1956). The lessor may enforce other covenants in the lease such as the lessee's covenant to continue in business or not to compete

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with the lessor (Section 1953), and, if the lease so provides, the lessor is entitled to reasonable attorney's fees (Section 1954).

Section 1951.5 provides an alternative remedy, at the lessor's election, if the lease contains one of the provisions described in subdivision (a) of Section 1951.5 and provides for the remedy specified in Section 1951.5.

Subdivision (a) -- paragraph (1). Under paragraph (1) of subdivision (a), 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 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 this section. Under paragraph (1), the 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 the lessee can prove the lessor could obtain upon reletting through the exercise of reasonable diligence without undue risk of other substantial detriment.

The measure of damages described in paragraph (1) 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. Except as provided in Section 1951.5, the measure of damages under Section 1951 is applicable to all cases in which a lessor seeks damages upon breach and abandonment by the lessee or upon termination of the lease because of the lessee's breach of the lease. Moreover, paragraph (1) makes clear that the 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. In this respect, the rule stated is similar to that now applied in actions for breach of employment contracts. See discussion in Erler v. Five Points Motors, 249 A.C.A. 644, 57 Cal. Rptr. 516 (1967).

The second sentence of paragraph (1) is designed to provide a certain discount rate for discounting all future rental installments in order that the appropriate discount rate will not be a matter that must be proved in each case. Where the statutory discount rate would not be appropriate in a particular case, the parties may provide a different rate in the lease and such rate, if reasonable, will be used instead of the rate prescribed by statute.

Subdivision (a)--paragraph (2). Paragraph (2) of subdivision (a) is included to make clear that the measure of the lessor's recoverable damages is not limited to damages for the loss of future rentals..

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Paragraph (2), 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.

It will usually be necessary for the lessor to take possession for a time to prepare the property for reletting and to secure a new tenant. The lessor is entitled to recover for the expenses incurred for this purpose that he would not have had if the lessee had not abandoned the property or breached the lease.

In some cases, a lessor may wish to give a lessee a reasonable opportunity to 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 is entitled to recover not only the full amount of the rentals due under the lease for this period of negotiations but also his expenses in caring for the property during this period.

In addition, the lessor is entitled to recover his expenses in retaking possession of the property, making repairs that the lessee was obligated to make, and in reletting the property. If there are other damages necessary to compensate the lessor for all of the detriment proximately caused by the lessee, the lessor is entitled to recover them also. These would include, of course, damages for the lessee's breach of specific covenants of the lease. See Section 1953 and the Comment to that section.

Subdivision (b). Subdivision (b) does not create a right to recover liquidated damages; it merely recognizes that such a right

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may exist if the conditions specified in Civil Code Sections 1670 and 1671 are met. Under prior law, provisions in leases for liquidated damages upon repudiation of the lease by the lessee were held to be void on the ground that there could be little prospective uncertainty over the amount of the lessor's damages. Jack v. Sinsheimer, 125 Cal. 563, 58 Pac. 130 (1899). Such holdings were proper as long as the lessor's cause of action upon breach of the lease and abandonment of the property or upon termination of the lessee's right to possession was either for the rent as it became due or for the rental deficiencies as of the end of the lease term. Under Section 1951, however, the lessor's right to damages accrues at the time of the breach and abandonment or when the lease is terminated by the lessor, and the amount of the damages may be difficult to determine 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, subdivision (b) 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, such provisions were upheld under the preexisting law if reasonable. See Seid Pak Sing v. Barker, 197 Cal. 321, 240 Pac. 765 (1925). Nothing in Section 1951 changes this rule.

Subdivision (c). This subdivision prescribes the statute of limitations for recovery under Section 1951. Although the prior law was not clear, it appears that, if the lessor terminated a lease because

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of the 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 Section 1951, 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.

§ 1951.5. Alternative method of computing damages

1951.5. (a) This section applies only to a lease of real property which meets one or more of the following requirements:

(1) The rent or other charges equivalent to rent provided in the lease amount to \$500 or more a month.

(2) The term stated in the lease is five years or longer.

(3) The lease provides that the lessee may sublet or sublease the property to any person reasonably acceptable as a tenant to the lessor and does not set any unreasonable standards for the determination of whether a person is reasonably acceptable as a tenant to the lessor or for such subletting or subleasing.

(4) The lease provides that the lessee may assign his interest in the lease to any person reasonably acceptable as a tenant to the lessor and does not set any unreasonable standards for the determination of whether a person is reasonably acceptable as a tenant to the lessor or for such assignment.

(b) Subject to subdivision (d), when the lessee under a lease described in subdivision (a) has breached the lease and abandoned the property before the end of the term, the lessor may elect to recover from the lessee, in lieu of the damages provided in Section 1951, the amount of the rent and charges equivalent to rent as they become due under the terms of the lease if the lease so provides.

(c) If the lease is one described in subdivision (a) and provides for the remedy described in subdivision (b), a reletting of the premises by the lessor, or an attempt by the lessor to

relet the premises, after breach of the lease and abandonment of the property by the lessee before the end of the term does not constitute a waiver of the lessor's rights under this section.

(d) If the lessor relets the property during the term of the original lease, he is not accountable to the lessee for any rent or charges equivalent to rent received on the reletting, but any such rent and charges, less the reasonable expenses of reletting, shall be set off against any amount to which the lessor is otherwise entitled under subdivision (b).

Comment. Even though the lessee has breached the lease and abandoned the property, Section 1951.5 permits the lessor to elect to recover the rent as it becomes due under the terms of the lease if the lease contains one of the provisions described in subdivision (a) and provides for this remedy. Unlike Section 1951, Section 1951.5 imposes no obligation on the lessor to retake possession of the property and relet it to minimize damages. The lessor may permit the property to remain vacant and nevertheless recover the rent provided in the lease as it becomes due. Section 1951.5 does not affect any right the lessor may have to obtain specific performance of a covenant by the lessee to engage in business on the leased premises if the lessor elects to resort to that remedy rather than to the remedy provided in Section 1951.5.

Section 1951.5 also permits the lessor to retake possession of the property after it has been abandoned by the defaulting lessee and to relet the property to a new tenant. In such case, the lessor is entitled to recover the rent as it becomes due and the original lessee is entitled to have the rent received on the reletting, less the reasonable expenses

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of reletting, set off against the amount of the rent payable under the original lease. The reletting of the premises by the lessor does not waive his rights under Section 1951.5.

The remedy provided by Section 1951.5 will be available only if the lease so provides. Moreover, the remedy is available only if the lease is for a substantial rent (\$500 or more a month) or a substantial term (five years or more) or if the lease permits the lessee to mitigate the damages by subletting or subleasing the property, or by assigning his interest in the lease, to a person reasonably acceptable as a tenant to the lessor. Section 1951.5 is not applicable in any case where the lessor evicts the lessee. In that case, the damages are computed under Section 1951.

No notice to the lessee is required if the lessor elects to relet the property. Under prior law, before the lessor was permitted to relet the property for the account of the lessee, the lessor was required to notify the lessee that he was retaking possession of the property on behalf of the lessee and that he intended to sublet on behalf of the lessee to mitigate damages. Frequently, the lessor's attempt to use this remedy was ineffective because notice to the lessee was not properly given and the retaking was, accordingly, held to constitute an acceptance of the surrender of the property and terminated the lessor's right to damages. Since the lessee retains no ownership interest in the property under Section 1951.5, when the lessor retakes possession after the lessee's breach and abandonment of the property, it is no longer necessary for the lessor to notify the lessee of his intention to mitigate damages. This is consistent with the law concerning a wrongfully discharged employee; a wrongfully discharged employee does not have to notify his former

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employer before taking another job. 1 WITKIN, SUMMARY OF CALIFORNIA LAW, Agency, § 96 at 471 (1960)(by implication).

Under prior California law, a lessor could decline to terminate the lease and retake possession of the leased property after it had been abandoned by the defaulting 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). The substance of this remedy is retained by Section 1951.5. Thus, Section 1951.5 permits the lessor under a long term lease to assign the right to receive the rent under the lease in return for the discounted value of the future rent. It also permits the parties to a short term lease to place on the lessee the burden of minimizing the loss by finding a new tenant reasonably acceptable to the lessor. The parties can accomplish this by including a provision in the lease permitting the lessee to sublet or assign his interest under the lease to a tenant reasonably acceptable to the lessor and providing in the lease that the remedies provided by Section 1951.5 are available to the lessor in the event the lessee breaches the leases and abandons the property.

Also, under prior law, the lessor could relet the property after the original lessee had breached the lease and abandoned the property. The lessor could relet the property for his own account (in which case the lessee's rental obligation was terminated) or for the account of the lessee (in which case he could recover any deficiency from 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,

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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. 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, 1156-1166 (1966), reprinted with permission in 8 CAL. LAW REVISION COMM'N REPORTS 701, 731 (1967). The substance of the right to relet the property for the account of the lessee is retained in a modified form in Section 1951.5, but the fiction of an "agency to relet" is abolished.

§ 1953. Lessor relieved of obligations under lease after he retakes possession

1953. When the lessee under a lease of real property has breached the lease and abandoned the property before the end of the term of the lease, or when the lessee's right of possession under a lease of real property is terminated by the lessor by reason of the lessee's breach, and the lessor retakes possession of the property, the obligation of the lessor thereafter to perform his obligations under the lease is excused, but without prejudice to the right of the lessor to seek relief for the default in performance or to enforce any other provisions of the lease. Nothing in Section 1951 or 1951.5 affects the right of the lessor to obtain specific or preventive relief in any case where such relief is appropriate.

Comment. Section 1953 changes the prior California law. Under the prior law, breach of the lease and abandonment of the property by the lessee did not terminate the lease and the lessor remained obligated to perform all his obligations under the lease. If the lessor 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 abandonment. 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 1953 makes it clear that the lessor is no longer required to act after a breach and abandonment or after termination of the lease as if the lessee's right to have the lessor perform his obligations continued in existence.

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Section 1953 is also designed to make clear that the obtaining of relief under Section 1951 or 1951.5 does not necessarily preclude obtaining another form of relief in appropriate cases. For example, a lessor of property in a shopping center 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 the original 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.

Under prior law there were no cases considering specific enforcement of the covenant to pay rent because the lessor could allow the property to remain vacant and sue for the rent as it accrued. Thus, the remedy at law was equivalent to specific performance. In addition, the suit was for money damages and the remedy at law was deemed adequate. Under Section 1951, however, the lessor must sue for damages within four years of the breach of a written lease and within two years of the breach of an oral lease. Under such circumstances, a situation might arise where the court would consider rendering a judgment of specific performance of a covenant to pay rent or remain in business on the premises because of the impossibility of computing money damages or because the lease called for payment

in something other than money. Such a situation might occur under a lease calling for the rental to be paid from a specific percentage of the gross or net receipts. The last sentence in Section 1953 is designed to make it clear that that remedy will be available if proper under the circumstances; Sections 1951 and 1951.5 do not preclude an action for specific performance of a lease if that remedy is appropriate.

§ 1952. Recovery by lessee of advance payments

1952. 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, or if the lessee has breached the lease and abandoned the property prior to the end of the term of the lease, the lessee may recover from the lessor any amount paid to the lessor in consideration for the possession of the property (whether designated rental, bonus, consideration for the execution thereof, or by any other term) that is in excess of the sum of:

(a) 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 abandonment or termination of the lessee's right of possession.

(b) Any sum which the lessor is entitled to recover under Sections 1951 and 1951.5.

Comment. Section 1952 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 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 1952 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 1952 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 1952. However, a reasonable cleaning deposit paid at the inception of the lease should not be considered as within these provisions.

Section 1952 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); Note, 26 CAL. L. REV. 385 (1938). Although the California courts have not yet considered whether the doctrine developed in Freedman and Caplan can or should be applied to leases, commentators have suggested that the cases involving prepaid rent and bonuses are now of doubtful authority. 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, 1173-1174 (1966); Smith, Contractual Controls of Damages, 12 HASTINGS L.J. 122, 139-140 (1960); Note, 43 CAL. L. REV. 344, 349 n.32 (1955). Section 1952 will eliminate this uncertainty, for it makes the principle of Freedman and Caplan clearly applicable to leases.

§ 1952.5. Waiver of lessee's rights under Sections 1951 and 1952

1952.5. Except as provided in Section 1951.5, the rights of a lessee provided in Sections 1951 and 1952 may not be waived prior to the accrual of such rights.

Comment. Section 1952.5 makes clear that the lessee's rights under Sections 1951 and 1952 may not be avoided by the addition to leases of provisions waiving the lessee's rights under those sections.

§ 1953.2. Effect on unlawful detainer, forcible entry, and forcible
detainer actions

1953.2. (a) Except as provided in subdivision (c), nothing in Sections 1951 to 1953, inclusive, 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 Section 1951; 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.

(c) Notwithstanding the fact that the judgment referred to in Section 1174 of the Code of Civil Procedure does not declare the forfeiture of the lease, the lessor's right to damages after breach of the lease by the lessee and repossession of the property by the lessor is limited to the damages specified in Section 1951. Nothing in this subdivision affects the right of the lessor to obtain specific or preventive relief in any case where that relief is appropriate.

Comment. Section 1953.2 is designed to clarify the relationship between Sections 1951-1953 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 1953.2, in subdivision (b), 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 Section 1951. 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 Section 1951. Under Section 1953.2, 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.

Subdivision (c) does not preclude the lessor from recovering damages under Section 1951 or obtaining specific relief to enforce a covenant not to compete. If the lease is not terminated, it continues in force for purposes of a covenant from the lessee to the lessor, other than the covenant to pay rent. However, when the lessor has evicted the lessee under the unlawful detainer provisions he cannot proceed under the provisions of Section 1951.5; a lessor cannot evict the tenant and refuse to mitigate damages. Thus, where a lessee who is holding under a lease for more than a five-year term is evicted for failure to pay rent, the lessor cannot hold him to a promise to guarantee the rent made pursuant to Section 1951.5. In effect, the lessor is put to an election of remedy in such a case.

§ 1953.5. Leases executed before January 1, 1970

1953.5. Sections 1951, 1951.5, 1952, 1952.5, 1953, and 1953.2 do not apply to:

- (a) Any lease that was executed before January 1, 1970.
- (b) Any lease executed on or after January 1, 1970, if the terms of such lease were fixed by a lease or other contract executed prior to January 1, 1970.

Comment. Section 1953.5 is included to preclude the application of Sections 1951 to 1953 to existing leases.

§ 1954. Attorney's fees

1954. 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 1954 makes clear that nothing in Sections 1951 to 1953 impairs a party's rights under such a provision.

§ 1954.2. Natural resources agreements

1954.2. An agreement for the exploration for or the removal of natural resources is not a lease of real property within the meaning of Sections 1951 to 1953, inclusive.

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).

Sections 1951-1953 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 1954.2 limits these sections to their intended purpose. Of course, some of the principles expressed in these sections may be applicable to natural resources agreements. Section 1954.2 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.

§ 1954.5. Public entity lease purchase agreements

1954.5. Where an agreement for a lease of real property from or to any public entity or any nonprofit corporation whose title or interest in the property is subject to reversion to a public entity would be made invalid if any provision of Section 1951, 1951.5, 1952, 1952.5 or 1953 were applicable, such provision shall not be applicable to such lease. As used in this section, "public entity" includes the state, a county, city and county, city, district, public authority, public agency, or any other political subdivision or public corporation.

Comment. Section 1954.5 is included to prevent the application of any provision of Sections 1951 to 1953 to lease-purchase agreements by public entities if such application would make the agreement invalid.

RIGHTS UPON TERMINATION OF LEASE OF
PERSONAL PROPERTY

§ 3308 (Amended)

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

3308. (a) ~~The parties to any lease of real or personal property may agree therein that if such~~ Unless the lease otherwise provides, if a lease shall be 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 at the time of such termination, of the excess, if any, of the amount of rent and charges equivalent to rent reserved in the lease for the balance of the stated term or any shorter period of time specified in the lease over the then reasonable rental value of the premises property for the same period.

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

~~The rights of the lessor under such agreement shall be cumulative to all~~

(b) Nothing in this section precludes the lessor from resorting to any other rights or remedies now or hereafter given to the lessor him by law or by the terms of the lease . ; provided, however, that the election of the lessor to exercise the remedy hereinabove permitted shall be binding upon him and exclude recourse thereafter to any other remedy for rental or charges equivalent to rental or

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~~damages for breach of the covenant to pay such rent or charges accruing subsequent to the time of such termination. The parties to such lease may further agree therein that unless the remedy provided by this section is exercised by the lesser within a specified time the right thereto shall be barred.~~

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.

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 REPORTS at 731 (1967).

Paragraph (2) of subdivision (a) is substantially the same as Civil Code Section 3300 which specifies the measure of damages for breach of contract.