#50 7/6/65

First Supplement to Memorandum 65-34

Subject: Study No. 50(L) - Rights of Lessor

Attached is another tentative recommendation and statute. This was prepared pursuant to the Commission's instruction at the last meeting that an alternative form of statute be prepared to provide merely that leases are to be viewed as contracts.

The Commission asked to have such a statute prepared because some members were fearful of the effect that a detailed statute would have on the variety of different leases that may exist.

This recommendation and statute is based on Cardozo's idea that legislation is sometimes sufficient if it merely gives the courts a new point of departure. It should not imprison the courts in particulars. A new set of shackles should not be substituted for the old, but the courts should be set free to develop the new principle established by the freedom-giving statute.

Respectfully submitted,

Joseph B. Harvey
Assistant Executive Secretary

TENTATIVE RECOMMENDATION OF THE CALIFORNIA LAW REVISION COMMISSION

relating to

THE RIGHTS AND DUTIES ATTENDANT UPON

ABANDONMENT OR TERMINATION OF A LEASE

Section 1925 of the Civil Code provides, in effect, that a lease is a contract. Historically, however, a lease was regarded as a conveyance of an interest in land. 2 POWELL, REAL PROPERTY ¶ 221 (1950). The California courts, unwilling to believe completely that the statement in Section 1925 really means what it says, have vacillated between the two concepts. The courts state that a lease is both a contract and a conveyance. Medico-Dental Bldg. Co. v. Horton & Converse, 21 Cal.2d 411, 132 P.2d 457 (1942); Beckett v. City of Paris Dry Goods Co., 14 Cal.2d 633, 96 P.2d 122 (1939). And while at times the courts apply principles of contract law in determining the rights and duties attendant upon abandonment or termination of a lease (see, e.g., Medico-Dental Bldg. Co. v. Horton & Converse, supra), the courts seem to be guided principally by common law property concepts in determining these rights and duties (see, e.g., Kulawitz v. Pacific etc. Paper Co., 25 Cal.2d 664, 155 P.2d 24 (1944); Welcome v. Hess, 90 Cal. 507, 25 Pac. 369 (1891)). See, generally, The California Lease--Contract or Conveyance? 4 STAN. L. REV. 244 (1952).

As a result, the law relating to leases has not kept abreast of the law relating to contracts generally. Developments in contract law that are designed to place a promisee in as good a position after breach by the promisor as performance would have done have not been made available to lessors. And the courts have permitted defaulting lessees to be subjected to forfeitures that would not be countenanced under the law relating to contracts generally. See 26 CAL. L. REV. 385 (1938).

For example, under the law applicable to most contracts, repudiation constitutes a total breach for which an action can be maintained even though the time for full performance has not yet elapsed. Gold Mining & Water Co. v. Swinerton, 23 Cal.2d 19, 142 P.2d 22 (1943); Remy v. Olds, 88 Cal. 537, 26 Pac. 255 (1891). And, under the law applicable to most contracts, a material breach by the promisor gives rise to a duty on the part of the promisee to mitigate damages, i.e., the promisee cannot recover damages for any detriment that is reasonably avoidable. See discussion in Bomberger v. McKelvey, 35 Cal.2d 607, 613-615, 220 P.2d 729 (1950). In contrast, when a lessee repudiates or breaches a lease, the courts frequently require a lessor to choose between forfeiting his right to damages for future injury and enhancing the damages by continuing performance.

Except where a mining lease is involved (see Gold Mining & Water Co. v. Swinerton, supra), the doctrine of anticipatory breach has not been applied to leases. Oliver v. Loydon, 163 Cal. 124, 124 Pac. 731 (1912); Welcome v. Hess, 90 Cal.507, 27 Pac. 369 (1891); In re Bell, 85 Cal. 119, 24 Pac. 633 (1890). Under existing law, when a lessee abandons the leased property and repudiates the remaining obligations of the lease, his actions constitute merely an offer to surrender the remainder of the term. Welcome v. Hess,

90 Cal. 507, 513, 27 Pac. 369 (1891). Confronted with such an offer, the lessor has three courses of action among which he may choose. Kulawitz v. Pacific etc. Paper Co., 25 Cal.2d 664, 671, 155 P.2d 24 (1944). First, he may decline the lessee's offer to surrender and sue for the unpaid rent as it becomes due for the remainder of the term. If the lessor selects this course of action, he has no duty to mitigate damages by reletting the property; he can recover the full amount of the rent while permitting the property to remain vacant. See De Hart v. Allen, 26 Cal.2d 829, 832, 161 P.2d 453 (1945). Second, he may accept the lessee's offer to surrender and thus extinguish the lease. This course of action not only terminates the lessee's interest in the property, it also terminates the lessee's obligation to pay any further rent, and the lessor is not entitled to any damages for the loss of his bargain represented by the original lease. Welcome v. Hess, 90 Cal. 507, 27 Pac. 369 (1891). The cases make clear, too, that any action taken by the lessor that is inconsistent with the lessee's continued ownership of the property will be deemed an acceptance of the lessee's offer to surrender, whether the lessor intended such an acceptance or not. Dorcich v. Time Oil Co., 103 Cal. App.2d 677, 230 P.2d 10 (1951). Finally, if the lessor notifies the lessee of his intention to do so, the lessor may relet the property for the benefit of the lessee and recover damages in the amount of the excess of the rentals called for in the original lease over the rentals obtained by reletting. The lessor cannot sue immediately to recover these damages; the cause of action does not accrue until the end of the term, and the lessor must wait until that time and then sue for all of the rental deficiencies. Truff v. Gulko, 214 Cal. 591, 7 P.2d 697 (1932). The courts have held that prior notification

to the lessee is essential to this course of action and that without such notification the lessor's reletting of the property will terminate the original lease and the lessee's rental obligation. Dorcich v. Time Oil Co., 103 Cal. App.2d 677, 230 P.2d 10 (1951). Apparently, then, this third course of action is unavailable to a lessor who is unable to give proper notice to the defaulting lessee. Such a lessor must choose between permitting the property to remain vacant (thus preserving the lessee's rental obligation) and terminating the lessee's remaining obligation by resuming possession or by reletting the property.

A similar range of choices confronts the lessor whose lessee commits a sufficiently substantial breach of the lease to warrant termination thereof. He 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. The lessor may also 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). 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. In such a case, 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).

Bound by common law property concepts, the courts have considered the lessee's obligation to pay rent as dependent on the continued existence of the term. 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 dependent thereon also ends. Continued adherence to these property concepts thus forces a lessor to choose among several courses of action none of which provides an immediate remedy that will compensate him for all of the detriment caused by the lessee.

To take another example, under the law applicable to most contracts, "promises for an agreed exchange are concurrently conditional, unless a contrary intention is clearly manifested." RESTATEMENT, CONTRACTS § 267. This means that each party's duty to perform his promise is conditional upon the performance by the other party of the promises given in exchange therefor. The Restatement's comment to this rule states: "The treatment of promises as concurrently conditional is favored since each party is protected by the privilege of withholding his performance until he receives performance by the other party."

The rule was not always as stated in the Restatement. When contracts were first enforced by the courts, the courts tended to treat all promises as independent. Thus, even if a party failed to perform his promise, he could still obtain a judgment requiring the other party to perform his counter-promise. But resultant injustices in the cases eventually forced the courts to modify contract law to its present state where most promises are considered conditional. See 3A CORBIN, CONTRACTS § 654 (1960).

Property law is of a more ancient origin than contract law, and the rule that promises are independent, though long abandoned in contract law, is still the rule applied to leases in most jurisdictions. See RESTATEMENT, CONTRACTS § 290; 3A CORBIN, CONTRACTS § 686 (1960). In California, the courts have not been consistent. In Medico-Dental Bldg. Co. v. Horton & Converse, 21 Cal.2d 411, 132 P.2d 457 (1942), the court held that the lease should be construed as a contract. Viewing the lease as a contract, the court held that the lessee's promise to pay rent and the lessor's promise not to permit a competing business in the same building were concurrently conditional; hence, the lessor's permitting of a competing business to operate excused the lessee from his obligations under the lease. In Kulawitz v. Pacific etc. Paper Co., 25 Cal.2d 664, 155 P.2d 24 (1944), the court retreated to the ancient property doctrine that the covenants in a lease are independent unless expressly made dependent and held that promises of the same kind as were involved in the Medico-Dental case should be treated as independent when the first breach came from the lessee's side. Hence, the lessee's failure to pay rent and his abandonment of the leased property were held not to excuse the lessor from his obligation not to permit a competing business in the same building. See the criticism of the Kulawitz case in The California Lease--Contract or Conveyance? 4 STAN. L. REV. 244, 251-256 (1952).

Adherence to ancient 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, 125 Cal. 563, 58 Pac. 130 (1899). 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 an advance payment to the lessor as an advance payment of rental 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).

In 1937, Civil Code Section 3308 was enacted in an effort to ameliorate

the deficiencies in the law relating to leases. The effort, however, was only partially successful. Under Section 3308, if a lease so provides, the lessor may bring an action for damages immediately upon termination of the lease by reason of the lessee's abandonment or breach of the lease. The lessor's damages in such an action amount to the excess of the value of the remainder of the term over the then reasonable rental value of the remainder of the term. Section 3308, however, does not apply unless it is made applicable by a provision in the lease, it does not require the lessor to resort to the remedy provided (and thus require mitigation of damages), and it does not relieve a lessee from forfeiture.

Code of Civil Procedure Section 1174 has also been amended in an effort to alleviate the problems faced by a lessor when his lessee refuses to pay rent or otherwise breaches the lease. 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 hold the lessee liable for any deficiency in the rentals. But again, the statutory remedy falls short of providing full protection to the rights of both parties. It does not permit the lessor to recover damages for future losses; it does not require the lessor to mitigate damages; and it does not protect the lessee from forfeiture.

The Law Revision Commission has concluded that the rules applicable to contracts generally would be fairer to both lessors and lessees than are the rules now applied when a lease is abandoned or otherwise terminated by reason of the lessee's breach. Accordingly, the Commission recommends the enactment

of legislation providing that leases are contracts and are to be construed as such. They are contracts providing for continuing performances by both lessors and lessees. It is the lessor's continuing obligation to permit the lessee to use the leased property, and it is the lessee's continuing obligation to pay the rent specified in the lease. The parties have other continuing obligations imposed either by law (see, e.g., CIVIL CODE §§ 1925-1935) or by the lease itself. Upon breach of these obligations, the rights, duties, remedies, and measure of damages applicable to contracts generally should be applicable.

Under such a legislative direction, the courts would be free to apply the developing concepts of contract law to leases. Courts and lawyers would no longer be required to construe a lease in a manner different from the way any other contractual document is construed. Upon repudiation of a lease by a lessee, an immediate right of action for damages would arise. The lessor would be entitled to recover all of his damages, past, present, and future. But he would not be permitted to enhance the liability of the lessee by permitting the property to remain idle. Payments by a lessee to a lessor in excess of the actual contractual liability of the lessee would be recoverable just as such payments made under any other contract are recoverable. And no longer would a lessor or lessee be able to seek enforcement of a lease or release from his further duties under a lease when he has not substantially performed his obligations under the lease.

PROPOSED LEGISLATION

The Commission's recommendations would be effectuated by enactment of the following measure:

SECTION 1. Section 1936 is added to the Civil Code, to read:

1936. A lease is a contract for continuing performance by the lessor and lessee during the life of the lease. The lessor has the continuing duty to refrain from interfering with the lessee's temporary possession and use of the leased property and such other duties as may be imposed by law or by the lease. The lessee has the continuing duty to care for and to refrain from abandoning the leased property, to pay for its possession and use, and to perform such other duties as may be imposed by law or by the lease. An abandonment by the lessee of the leased property is a breach of the lease and a repudiation of the remaining obligations of the lease. A lease shall be construed as contracts generally are construed; and the rights, duties, and remedies of the parties, and the measure of damages for the breach of a lease, shall be determined as are the rights, duties, remedies, and measure of damages, under any other contract calling for continuing performances.

Comment. Section 1936 is designed to bring the law relating to leases within the law relating to contracts generally. By adhering to the concept that a lease is more of a conveyance than it is a contract, the California courts have permitted both lessors and lessees to suffer hardship and injustice. The doctrine of anticipatory breach has not been applied to leases generally, and as a result the lessor whose lessee has abandoned the property has the unpleasant choice of either terminating the lease and losing the bargain contracted for or continuing to recognize the lessee's interest in the property. The notion that a contract may be ended for purposes of performance without affecting the parties' rights to damages has not been applied to leases. The contractual rule that the promisee must minimize his damages, too, has not

been applied to leases, so a lessor whose lessee has abandoned the property has not been required to seek a new tenant to reduce the amount owed by the original lessee. In fact, some cases have held that a lessor is prohibited from so minimizing his damages. The contractual rule that covenants should be construed to be dependent has been applied to leases only irregularly. Advance payments by lessees, when properly designated in the lease, have been forfeited to lessors regardless of the actual damages suffered.

Section 1936 gives the courts a new point of departure in construing leases. It frees them from the ancient property concepts that have prevented the development of landlord and tenant law. But it does not imprison them in a mass of particulars. It permits the courts to keep the law relating to leases in harmony with the continuing developments in the law of contracts.

Under this section, an abandonment of a leasehold by a lessee will give rise to an immediate right to recover damages, just as repudiation of a contract does. The lessor will have the right to treat the lease at an end for the purposes of performance without forfeiting his right to recover the damages caused by the lessee's default. But, the lessor will not have the right to permit the property to remain idle and to exact from the lessee the payment of the full rental due under the lease. As under the law applicable to contracts generally, the lessor will be unable to recover damages for any reasonably avoidable consequences of the lessee's breach.

Under this section, a lessee will have the right to recover advance payments in excess of the damages suffered by the lessor just as a defaulting buyer under a land sales contract has such a right. See Caplan v. Schroeder, 56 Cal.2d 515, 15 Cal. Rptr. 145, 364 P.2d 321 (1961).

Because damages for abandonment of a lease may include some damages for prospective injury, it will be proper to provide for liquidated damages in accordance with Civil Code Sections 1670 and 1671 in any case where such prospective damages may be difficult to ascertain, just as it is under the law of contracts generally.

Thus, no longer will there be a separate body of rules for the construction of leases. A lawyer or judge may apply the rules for the construction of contracts to a lease without fear that some ancient concept of real property law will defeat the just expectations of the parties.

SEC. 2. Section 3308 of the Civil Code is repealed.

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

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

Comment. Section 3308 is repealed because Section 1936 makes it unnecessary. The remedy that Section 3308 states may be provided in a lease is the general rule, whether or not provided in the lease, under the contract law made applicable by Section 1936.

SEC. 3. Section 1174 of the Code of Civil Procedure is amended to read:

1174. If upon the trial, the verdict of the jury, or, if the case be tried without a jury, the findings of the court be in favor of the plaintiff and against the defendant, judgment shall be entered for the restitution of the premises; and if the proceedings be for an unlawful detainer after neglect, or failure to perform the conditions or covenants of the lease or agreement under which the property is held, or after default in the payment of rent, the judgment shall also declare the forfeiture of such lease or agreement ~~if the notice required by Section 1161 of the code states the election of the landlord to declare the forfeiture thereof, but if such notice does not so state such election, the lease or agreement shall not be forfeited~~.

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

When the proceeding is for an unlawful detainer after default in the payment of rent, and the lease or agreement under which the rent is payable has not by its terms expired, and the notice required by Section 1161 has not stated the election of the landlord to declare the forfeiture thereof, the court may, and, if the lease or agreement is in

writing, is for a term of more than one year, and does not contain a forfeiture clause, shall order that execution upon the judgment shall not be issued until the expiration of five days after the entry of the judgment, within which time the tenant, or any subtenant, or any mortgagee of the term, or any other party interested in its continuance, may pay into the court, for the landlord, the amount found due as rent, with interest thereon, and the amount of the damages found by the jury or the court for the unlawful detainer, and the costs of the proceedings, and thereupon the judgment shall be satisfied and the tenant be restored to his estate.

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

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

Inasmuch as Civil Code Section 1936 permits a lessor to terminate a lease without forfeiting his right to damages for the loss of the future rentals due under the lease, the deleted language is no longer necessary.