Commissioner Primarily Responsible: Arnebergh

#50 7/12/68

Memorandum 68-73

Subject: Study 50 - Leases

Attached are two copies of a tentative recommendation that reflects the decisions made at the last meeting. We hope to distribute this for comment after the July meeting. Hence, please mark your editorial changes on one copy and turn it in to the staff at the meeting so that they can be taken into account when the tentative recommendation is revised after the meeting before distribution for comment.

Respectfully submitted

John H. DeMoully
Executive Secretary

#50 7/12/68

STATE OF CALIFORNIA

C A L I F O R N I A L A W

R E V I S I O N C O M M I S S I O N

TENTATIVE RECOMMENDATION

relating to

LEASES

CALIFORNIA LAW REVISION COMMISSION
School of Law
Stanford University
Stanford, California 94305

WARNING: This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be considered when the Commission determines what recommendation it will make to the California Legislature.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

NOTE

This recommendation includes an explanatory Comment to each section of the recommended legislation. The Comments are written as if the legislation were enacted. They are cast in this form because their primary purpose is to undertake to explain the law as it would exist (if enacted) to those who will have occasion to use it after it is in effect.

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

LEASES

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 Woodenware & Paper Co., 25 Cal.2d 664,

671, 155 P.2d 24, 28 (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, 26 Cal.2d 829, 832, 161 P.2d 453, 455(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 as, for example, 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: (1) 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 (2) 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 Woodenware & 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 reasonably avoided. 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 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 terminate the lessee's right to 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.

The need to provide the lessor with this remedy arises primarily as a result of the advent of 'net lease financing,' a practice which 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]

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[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 recommended remedy will permit the parties to retain this effect of the existing law.

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. Where an advance payment is designated as a deposit to secure faithful performance of the terms of the lease, the lessor may retain the deposit only to the extent of the amount of damage actually suffered. 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. See Warming v. Shapiro, 118 Cal. App.2d 72, 75, 257 P.2d 74, 76 (1953).

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 a consideration for the execution of the lease, and security for the lessee's performance 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.

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, 1971. 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, 1971. This is necessary because the parties did not take the recommended legislation into account in drafting leases now in existence.

SECTIONS ADDED TO CIVIL CODE

§ 1951. "Rent" defined

1951. As used in Sections 1951.2 to 1951.8, inclusive, "rent" includes charges equivalent to rent.

Comment. The phrase, "includes 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 Section 1951.2. The same would be true where the lease imposes on the lessee the obligation to provide fire, earthquake, or liability insurance.

§ 1951.2. Termination of real property lease; damages recoverable

1951.2. (a) Except as otherwise provided in Section 1951.4, if a lessee of real property breaches the lease and abandons the property before the end of the term or if his right to possession is terminated by the lessor because of a breach of the lease, the lease terminates and the lessor may recover from the lessee:

(1) The amount of the unpaid rent which had been earned but had not been paid at the time the lease terminated;

(2) The worth at the time of judgment of the amount by which the unpaid rent which had not been earned at the time the lease terminated exceeds the amount of rental loss that the lessee proves could have been or could be reasonably avoided; and

(3) Any other damages necessary to compensate the lessor for all the detriment proximately caused by the lessee's failure to perform his obligations under the lease or which in the ordinary course of things would be likely to result therefrom.

(b) Efforts by the lessor to mitigate the damages caused by the lessee's breach of the lease do not waive the lessor's right to recover damages under this section. Unless the parties otherwise agree, if the lessor relets the property after the lease terminates under this section, he is not accountable to the lessee for any rent received from the reletting; but such rent, less the reasonable expenses of reletting, shall be offset against any amount sought to be recovered under this section.

(c) Nothing in this section affects the right of the lessor under a lease of real property to indemnification for liability arising prior to the termination of the lease for personal injuries or property damage where the lease provides for such indemnification.

(d) Nothing in this section affects the right of the lessor under a lease of real property to equitable relief in any case where such relief is appropriate.

Comment. Section 1951.2 states the measure of damages where the lessee breaches the lease and abandons the property or when his right to possession is terminated by the lessor.

"Rent" includes "charges equivalent to rent." See Section 1951.

The lessor is entitled to recover the amount of the unpaid rent which had been earned but had not been paid at the time the lease terminated. To this should, of course, be added interest at the legal rate to the date of judgment in accord with the general rule that a liquidated debt bears interest. See Civil Code Section 3287.

In addition, the lessor is entitled to recover the worth at the time of judgment of the amount by which the unpaid rent which had not been earned at the time the lease terminated exceeds the amount of rental loss that was or could be reasonably avoided. In determining the worth at the time of judgment of a rental payment that was due but not paid prior to the time of judgment, there should be added to the amount by which the rental payment exceeds the amount of avoidable rental loss, interest at the legal rate from the time the payment was due to the date of judgment. Where a rental payment is not due at the time of judgment, the amount by which the rental payment exceeds the

amount of avoidable rental loss must be discounted to reflect the fact that it is being prepaid at a rate that takes into account the risk and other factors that bear on the value of receiving the prepayment under the circumstances of the particular case.

Under Section 1951.2(a)(2) 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 by acting reasonably in reletting the property.

Paragraph (3) of subdivision (a) of Section 1951.2 makes it clear that the measure of the lessor's recoverable damages is not limited to damages for the loss of past and future rentals. This paragraph adopts language used in Civil Code Section 3300 and provides, in substance, 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. For example, 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 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--for example, a promise to maintain the premises or secure adequate fire, earthquake, or liability insurance. Reasonable attorney's fees may be recovered if the lease so provides. See Section 1951.6.

The statute of limitations for an action under Section 1951.2 is four years in the case of a written lease and two years in the case of a lease not in writing. See Code of Civil Procedure Sections 337.5 and 339.5.

The basic measure of damages provided in Section 1951.2 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 1951.4, the measure of damages under Section 1951.2 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, Section 1951.2 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 Point Motors, 249 Cal. App.2d 560, 57 Cal. Rptr. 516 (1967).

One result of the enactment of Section 1951.2 is that the lessor is no longer required to act after the lease terminates under Section 1951.2 as if the lessee's right to have the lessor perform his obligations continued in existence; unless the parties

otherwise agree, the lessor is excused from further performance of his obligations after the lease terminates. In this respect, Section 1951.2 would change the result in Kulawitz v. Pacific Woodenware & Paper Co., 25 Cal.2d 664, 155 P.2d 24 (1944).

Section 1951.2 is not a comprehensive statement of the lessor's remedies. 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 1951.2. 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. Section 1951.2 makes no change in these remedies. See 30 Cal. Jur.2d Landlord and Tenant § 344 (1956).

The damage remedy provided in Section 1951.2 ordinarily is the exclusive remedy when the lessee breaches the lease and abandons the property or when his right to possession is terminated by the lessor. Nevertheless, in rare 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. See Section 1951.2(d). For example, the lessor's recovery of damages under Section 1951.2 would not necessarily preclude him from obtaining preventive relief to enforce the lessee's covenant not to compete.

Section 1951.4 permits the parties to provide an alternative remedy in the lease--recovery of rent as it becomes due. See also Section 1951.8 (retention of deposit or advance payment as damages).

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 1951.2, 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, the prior decisions holding liquidated damages provisions in leases to be void are no longer authoritative and, if the parties wish, they may in an appropriate case provide for liquidated damages which will be in lieu of the damages provided in the other sections of the statute. Such a liquidated damage provision will be valid only if it meets the requirements of Civil Code Sections 1670 and 1671.

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 1951.2 changes this rule.

§ 1951.4. Continuance of lease in effect after breach and abandonment

1951.4. (a) A lease of real property continues in effect after the lessee has breached the lease and abandoned the property and the lessor may enforce all his rights and remedies under the lease, including the right to recover the rent as it becomes due under the lease, if the lease so provides and includes one or more of the following provisions:

(1) The lease permits the lessee either to sublet the property or to assign his interest in the lease, or both, 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 or for such subletting or assignment.

(2) The lease permits the lessee either to sublet the property or to assign his interest in the lease, or both, if the consent of the lessor is obtained and provides that such consent shall not unreasonably be withheld.

(b) A lease described in subdivision (a) terminates when the lessor terminates the lessee's right to possession.

(c) For the purposes of this section:

(1) Efforts by the lessor to maintain and preserve the property after the lessee has vacated the property do not constitute a termination of the lessee's right to possession.

(2) The appointment of a receiver upon initiative of the lessor to protect the lessor's interest under the lease does not constitute a termination of the lessee's right to possession.

(d) Nothing in this section affects the right of the lessor to recover damages under Section 1951.2 after the lessor has has terminated the lessee's right to possession.

Comment. Even though the lessee has breached the lease and abandoned the property, Section 1951.4 permits the lessor to continue to collect the rent as it becomes due under the lease rather than to recover damages based primarily on the loss of future rent under Section 1951.2. This remedy is available only if the lease so provides and contains a provision permitting the lessee to mitigate the damages by subletting or assigning his interest in the property. The right to continue to collect the rent terminates when the lessor evicts the lessee; in such case, the damages are computed under Section 1951.2. The availability of a remedy under Section 1951.4 does not preclude the lessor from terminating the right of a defaulting lessee to possession of the property and then utilizing the remedy provided by Section 1951.2.

Where the lease gives the lessor the Section 1951.4 remedy and also permits the lessee to sublet or assign his interest in the property, the lessor may recover the rent as it becomes due under the terms of the lease and at the same time has no obligation to retake possession and relet the property in the event the lessee abandons the property. This allocation of the burden of minimizing the loss will be most useful where the lessor does not have the desire, facilities, or ability to manage the property and to supervise the location of a suitable tenant and for this reason desires to avoid the burden that Section 1951.2 places on the lessor to mitigate the damages by reletting the property.

The allocation of the duty to minimize damages feature of Section 1951.4 is important. However, the primary reason that this form of relief has been provided is that systems for financing the purchase or improvement of real property would be seriously jeopardized if the lessor's only right upon breach of the lease and abandonment of the property were the right to recover damages under Section 1951.2. For example, because the lessee's obligation to pay rent under a lease can be enforced under existing law, leases have been utilized by public entities to finance the construction of public improvements. The lessor constructs the improvement to the specifications of the public entity-lessee, leases the property as improved to the public entity, and at the end of the term of the lease all interest in the property and the improvement vests in the public entity. See, e.g., Dean v. Kuchel, 35 Cal.2d 444, 218 P.2d 521 (1950); County of Los Angeles v. Nesvig, 231 Cal. App.2d 603, 41 Cal. Rptr. 918 (1965). Similarly, a lessor may, in reliance on the lessee's rental obligation under a long term lease, construct an improvement to the specifications of the lessee for the use of the lessee during the lease term. The remedy available under Section 1951.4 gives the lessor, in effect, security for the repayment of the cost of the improvement in these cases.

Section 1951.4 also 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. The Section 1951.4 remedy makes the right to receive the rental payments an attractive investment since the assignee is assured that the rent will be paid if the tenant is financially responsible.

Under this section, in contrast to Section 1951.2, the lessor, so long as he does not terminate the lease, is obliged to continue to perform his obligations under the lease.

§ 1951.6. Attorney's fees

1951.6. Section 1717 of the Civil Code, relating to attorney's fees, applies to leases of real property and the attorney's fees described in Section 1717 shall be recoverable in addition to any other relief or amount to which the lessor or lessee may be entitled.

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 1951.6 makes it clear that nothing in the other sections of the statute impairs a party's rights under such a provision and that Civil Code Section 1717 (enacted by Cal. Stats. 1968, Ch. 266) applies to leases.

§ 1951.8. Advance payments and deposits

1951.8. (a) As used in this section, "advance payment or deposit" means moneys paid to the lessor of real property (1) as advance payment of rent, (2) as a bonus or consideration for the execution of the lease, (3) as a deposit to secure faithful performance of the terms of the lease, or (4) as the substantial equivalent of any of these.

(b) An advance payment or deposit shall be applied toward any amount recoverable by the lessor. If the lessee establishes that the advance payment or deposit exceeds the amount recoverable by the lessor, the lessee is entitled to recover the excess.

Comment. Section 1951.8 changes the California law so that--regardless of label--any advance payment or deposit shall be treated the same, i.e., shall be applied toward any amount recoverable by the lessor. If the prepayment exceeds the amount recoverable by the lessor, the lessee is entitled to the excess.

Section 1951.8 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 1951.8 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 1951.8 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 1951.8.

Section 1951.8 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), 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 Warning v. Shapiro, 118 Cal. App.2d 78, 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 1951.8 will eliminate this uncertainty, for it makes the principle of Freedman and Caplan clearly applicable to leases.

It might be noted that this section is concerned solely with "advance payments, or deposits." Liquidated damages provisions in leases fixing in advance the amount of damages recoverable by the lessor will in appropriate circumstances now be enforceable. See Comment to Section 1951.2.

§ 1952. Effect on unlawful detainer, forcible entry, and forcible detainer actions

1952. (a) Except as provided in subdivision (c), nothing in Sections 1951 to 1951.8, 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 lessor's right to bring a separate action to recover damages under Section 1951.2, but no damages shall be recovered 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) Whether or not the judgment referred to in Section 1174 of the Code of Civil Procedure declares the forfeiture of the lease, the lessor's right to damages after the lessor evicts the lessee is limited to the remedy that the lessor is provided under Section 1951.2.

Comment. Section 1952 is designed to clarify the relationship between Sections 1951-1951.8 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 chapter 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.

Subdivision (b) of Section 1952 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 Sections 1951, 1951.2, 1951.6, and 1951.8. 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 Sections 1951, 1951.2, 1951.6, and 1951.8. Under Section 1952, 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 Sections 1951, 1951.2, 1951.6, and 1951.8 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, such as a covenant not to compete. However, when the lessor has evicted the lessee under the unlawful detainer provisions, he cannot proceed under the provisions of Section 1951.4; a lessor cannot evict the tenant and refuse to mitigate damages. In effect, the lessor is put to an election of remedy in such a case.

§ 1952.2. Leases executed before January 1, 1971

1952.2. Sections 1951 to 1952, inclusive, do not apply to:

(a) Any lease executed before January 1, 1971.

(b) Any lease executed on or after January 1, 1971, if the terms of the lease were fixed by a lease or other contract executed before January 1, 1971.

Comment. Section 1952.2 is included to preclude the application of the new statute to existing leases.

§ 1952.4. Natural resources agreements

1952.4. 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 1952.2, 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 (3rd ed. 1914).

Sections 1951-1952.2 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 1952.4 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 1952.4 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.

§ 1952.6. Lease-purchase agreements of public entities

1952.6. 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 Sections 1951 to 1952.2, inclusive, were applicable, such provision shall not be applicable to such a 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 1952.6 is included to prevent the application of any provision of Sections 1951 to 1952.2 to lease-purchase agreements by public entities if such application would make the agreement invalid.

CONFORMING AMENDMENT OF CIVIL CODE

SECTION 3308

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 :

(1) The amount of the unpaid rent, including charges equivalent to rent, which had been earned but had not been paid at the time the lease terminated;

(2) The ~~the~~ worth at the time of ~~such termination,~~ judgment of the ~~excess, if any, of the~~ amount ~~of~~ by which the unpaid rent , ~~and~~ including 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~~ which had not been earned at the time the lease terminated exceeds the amount of rental loss that the lessee proves could have been or could be reasonably avoided; and

(3) Any other damages necessary to compensate the lessor for all the detriment proximately caused by the lessee's failure to perform his obligations under the lease 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 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 has been revised to exclude reference to leases of real property because, insofar as the section related to real property, it has been superseded by Sections 1951-1952.6.

The section has been further amended to conform substantially to Section 1951.2 and the Comment to that section should be referred to for further discussion.

The revision also eliminates 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).

SECTIONS TO BE ADDED TO CODE OF CIVIL PROCEDURE

§ 337.5. Damages recoverable upon abandonment or termination of written lease of real property

337.5. Where a lease of real property is in writing, no action shall be brought under Civil Code Section 1951.2 more than four years after the breach of the lease and abandonment of the property, or after the termination of the right of the lessee to possession of the property, whichever is the earlier time.

Comment. The four-year period provided in Section 337.5 is consistent with the normal statute of limitations applicable to written contracts. See Code of Civil Procedure Section 337. Although the prior law was not clear, it appears that, if the lessor terminated a lease because 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 Civil Code Section 1951.2, 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.

§ 339.5. Damages recoverable upon abandonment or termination of oral lease of real property

339.5. Where a lease of real property is not in writing, no action shall be brought under Civil Code Section 1951.2 more than two years after the breach of the lease and abandonment of the property, or after the termination of the right of the lessee to possession of the property, whichever is the earlier time.

Comment. The two-year period provided in Section 339.5 is consistent with the normal statute of limitations applicable to contracts not in writing. See Code of Civil Procedure Section 339. See also the Comment to Code of Civil Procedure Section 337.5.