

Memorandum 89-81

Subject: Study H-111 - Assignment and Sublease (Remedies of Parties--
draft of tentative recommendation)

At the September 1, 1989, meeting the Commission made policy decisions concerning remedies of the parties to a commercial real property lease for violation of an assignment or sublease clause. Attached to this memorandum is a staff draft of a tentative recommendation to implement the Commission's decisions. If the Commission approves the draft, we will circulate it for comment.

Respectfully submitted,

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ns33f
9/26/89

Tentative Recommendation

relating to

COMMERCIAL REAL PROPERTY LEASES:

REMEDIES FOR BREACH OF ASSIGNMENT OR SUBLEASE COVENANT

REMEDIES FOR LANDLORD'S BREACH

If a lease requires the landlord's consent for an assignment or sublease and the landlord improperly withholds consent in violation of the standards prescribed in the lease or implied by law, the tenant has an array of possible remedies, some more effective than others. These may include declaratory relief, specific performance or mandatory injunction, termination of the lease, contract damages, tort damages, statutory remedies, and self-help. Of these remedies, contract damages and lease termination may be most useful to a tenant; however, both are in need of statutory clarification and improvement. Whether it would be helpful to codify the tenant's right to other remedies is problematical and the Law Revision Commission does not recommend it.

Breach of contract damages. The tenant may be able to obtain breach of contract damages if the requirement for the landlord to be reasonable in withholding consent is construed to be a "covenant" by the landlord. If the reasonableness requirement is construed to be a "condition", the tenant may be allowed to make the transfer without the landlord's consent, but may not be allowed breach of contract damages.¹

The tenant's remedies should not depend on whether the reasonableness requirement is construed to be a condition or covenant, depending on the happenstance of the particular phrasing used in the lease. A tenant who is precluded by the landlord's wrongful act from making a proper assignment or sublease may incur further expenses in

1. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 505-08 (1989).

attempting to assign or sublet and may lose the benefit of an advantageous business arrangement. Contract damages are appropriate in such a case.²

The covenant approach yields a more fair, practical, realistic, and consistent result, and should be codified. The tenant will thus be entitled to contract damages for the landlord's wrongful withholding of consent to an assignment or sublease.

Right to terminate lease. There is a conflict of opinion whether the tenant may terminate the lease if the landlord wrongfully withholds consent to the tenant's attempted assignment or sublease. As with contract damages, the right of a tenant to terminate depends on whether the provision violated by the landlord is construed to be a condition or a covenant. Contract law recognizes mutuality of covenants, so that substantial breach of a material covenant by the landlord excuses performance by the tenant and allows the tenant to terminate the lease.

There is no California case on point. However, California has adopted the contract doctrine of mutually dependent covenants for other aspects of real property tenancies, and there is no substantial reason to deny the tenant the right to terminate on establishing the landlord's breach of an assignment or sublease consent requirement. The right to assign or sublet is a key aspect of the lease and is an important protection for a tenant that may need to free itself from its obligations under the lease. If the tenant is wrongfully thwarted from exercising its right to assign or sublet, termination of the lease is an appropriate remedy for the tenant.

The Commission recommends that the matter be clarified by codifying the tenant's right to terminate the lease as a remedy for the landlord's wrongful refusal to consent to a proper assignment or sublease by the tenant. This would be consistent with the covenant

2. Civ. Code § 3300 ("For the breach of an obligation arising from contract, the measure of damages, except where otherwise expressly provided by this Code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.")

treatment generally applied to lease clauses in California and with the modern trend of the law to treat a lease as a contract.³

REMEDIES FOR TENANT'S BREACH

If a provision in a lease restricts transfer by the tenant but the tenant makes a transfer in violation of the restriction, the landlord has only one major remedy:⁴ The landlord may terminate the lease and recover possession of the property, together with any damages caused by the tenant's breach of the lease.⁵

The landlord may waive the termination remedy and allow the transfer to remain in effect, but whether the landlord may also recover damages for the breach is not clear. Nor is it clear whether the landlord may, instead of terminating the entire lease, terminate only the wrongful transfer, leaving the underlying lease in effect. These and other unresolved issues should be clarified by statute.

Breach of contract damages. Although the tenant's transfer in violation of a transfer restriction is a breach of contract, there is no case expressly dealing with the question of whether the landlord may waive the right to terminate the lease for breach and recover contract damages, and there is an implication in some cases that the landlord may not.⁶

It would be advantageous to both landlord and tenant for the law to state clearly that the landlord may waive the right to terminate for

3. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 510-12 (1989).

4. Other remedies available to the landlord include declaratory relief, injunctive relief, and (if needed) unlawful detainer.

5. The damages include any loss measured by the difference between the contract rent and what the landlord is able to get on reletting the property. Civ. Code § 1951.2.

6. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 495-98 (1989).

breach and recover damages caused by the breach. For the landlord, it might be perfectly satisfactory to allow the assignment or sublease to remain in effect, provided the landlord is made whole for any loss caused by the assignment or sublease, such as a loss of percentage rentals, a change in use causing increased insurance premiums, or hazardous substance liability. For the tenant, it may be advantageous to allow the assignment or sublease to stand and only to be liable for damages. If the damage remedy is not available, the landlord may be forced to terminate the entire lease in order to recover damages--possibly a worse outcome for the tenant.

The added flexibility in the law that results from the landlord's ability to waive the termination remedy and recover damages for breach is desirable, and the remedy should be codified so that the law is clear that it is available. This is a specific application of the general rule that a landlord may leave a lease in effect and recover damages for breach of a covenant.

Right to terminate assignment or sublease. Existing law precludes the landlord from invalidating a wrongful assignment or sublease while leaving the underlying lease in effect.⁷ The landlord's only option is to terminate the entire lease or to let the wrongful assignment or sublease stand.

This choice of remedies may be inadequate in some situations. It may be important for the landlord to preserve favorable terms in the lease while preventing the wrongful assignment or sublease. This is particularly true where the parties have negotiated the right of the landlord to maintain the lease in effect under Civil Code Section 1951.4 in the event of the tenant's breach and abandonment. In this situation the landlord needs to be able to terminate a wrongful assignment or sublease in order to maintain the Section 1951.4 remedy.

For these reasons the Commission recommends that the remedies available to the landlord for the tenant's breach be expanded to

7. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 499-501 (1989).

provide that the landlord may terminate a wrongful assignment or sublease without terminating the underlying lease.⁸

Liability of assignee or subtenant. If the tenant makes an assignment or sublease, an assignee is liable to the landlord for subsequent breaches of the lease, but not a subtenant. This rule is founded on the privity between landlord and assignee and lack of privity between landlord and subtenant.⁹

Although the law is clear that an assignee is liable for subsequent breaches, it is not clear that the assignee is liable for damages caused by the wrongful assignment itself. Liability of the assignee for damages could benefit both the landlord and the assignee. For the landlord, the tenant may be insolvent and the assignee may be the only solvent party able to respond for the harm caused by the wrongful assignment. For the assignee, it may be more desirable to have the assignment stand and respond in damages, if there are any, than to force the landlord to a termination of the assignment. This option could also help avoid precipitous litigation by ensuring the landlord an adequate remedy short of termination if the assignment proves ultimately to harm the landlord's interest.

The Commission recommends that the law make clear that an assignee, but not a subtenant, is jointly and severally liable with the tenant for damages caused by a wrongful assignment. This principle would apply to the parties to a wrongful reassignment as well.

EFFECT OF LANDLORD'S CONSENT OR WAIVER (RULE IN DUMPOR'S CASE)

The rule in Dumpor's case is a common law principle dating from 16th century England. The rule states that notwithstanding a lease

8. The right to terminate the wrongful assignment or sublease requires adaptation of the unlawful detainer procedures in order to regain possession from the assignee or subtenant.

9. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 498-99 (1989).

provision requiring the landlord's consent to an assignment of the tenant's interest, if the landlord consents to an assignment (as opposed to a sublease), the initial consent effectively operates as a waiver of all future right the landlord may have to object to subsequent assignments by subsequent tenants.

The rule in *Dumpor's case* has been severely criticized judicially, and has been statutorily overruled in many jurisdictions. The situation in California has been summarized as follows:¹⁰

[T]here is language in early cases indicating, but not directly holding, that California follows *Dumpor's Case* with respect to successive assignments. There is language in later California cases criticizing, and at least one holding by a court of appeal rejecting, the rule. There is no California Supreme Court decision expressly involving the issue and either adopting or rejecting the rule. The decisions distinguish between a restriction that is expressly made binding on assignees, and one that is not express. The former has been treated as a continuing covenant that binds successors. The latter has been treated as a single and personal covenant that binds only the original tenant. California appears to follow the consensus that *Dumpor's Case* does not apply to subleases.

The rule is illogical and serves no useful purpose; it is only a trap for the unwary. Efforts to draft around the rule in the lease are generally ineffective since the rule has been held to apply notwithstanding the most clear and precise lease clauses to the contrary. Statutory modification of the rule is necessary.

It is probable that most lease transfer restrictions are intended to apply continuously to any transfer and are not personal to the original tenant. The rule in *Dumpor's case* should be reversed by statute, which should create a presumption that a restriction on assignment applies not only to the original tenant but also to subsequent assignees. This rule should be subject to an express provision in the lease to the contrary.

10. Coskran, Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers, 22 Loy. L.A.L. Rev. 405, 564 (1989).

The Commission's recommendations would be implemented by enactment of the following measure.

An act to amend Section 1951.4 of, and to add Article 3 (commencing with Section 1995.310) to Chapter 6 of Title 5 of Part 4 of Division 3 of, the Civil Code.

The people of the State of California do enact as follows:

Civil Code §1951.4 (amended). Continuation of lease after breach and abandonment

SECTION 1. Section 1951.4 of the Civil Code is amended to read:

1951.4. (a) The remedy described in this section is available only if the lease provides for this remedy. In addition to any other type of provision used in a lease to provide for the remedy described in this section, a provision in a lease in substantially the following form satisfies this subdivision:

"The lessor has the remedy described in California Civil Code Section 1951.4 (lessor may continue lease in effect after lessee's breach and abandonment and recover rent as it becomes due, if lessee has right to sublet or assign subject only to reasonable limitations)."

(b) Even though a lessee of real property has breached the lease and abandoned the property, the lease continues in effect for so long as the lessor does not terminate the lessee's right to possession, and the lessor may enforce all the lessor's rights and remedies under the lease, including the right to recover the rent as it becomes due under the lease, if any of the following conditions is satisfied:

(1) The lease permits the lessee, or does not prohibit or otherwise restrict the right of the lessee, to sublet the property, assign the lessee's interest in the lease, or both.

(2) The lease permits the lessee to sublet the property, assign the lessee's interest in the lease, or both, subject to express standards or conditions, provided the standards and conditions are reasonable at the time the lease is executed and the lessor does not require compliance with any standard or condition that has become unreasonable at the time the lessee seeks to sublet or assign. For

purposes of this paragraph, an express standard or condition is presumed to be reasonable; this presumption is a presumption affecting the burden of proof.

(3) The lease permits the lessee to sublet the property, assign the lessee's interest in the lease, or both, with the consent of the lessor, and the lease provides that such consent shall not be unreasonably withheld or the lease includes a standard implied by law that consent shall not be unreasonably withheld.

(c) For the purposes of subdivision (b), the following do not constitute a termination of the lessee's right to possession:

(1) Acts of maintenance or preservation or efforts to relet the property.

(2) The appointment of a receiver upon initiative of the lessor to protect the lessor's interest under the lease.

(3) Withholding consent to a subletting or assignment, or terminating a subletting or assignment, if the withholding or termination does not violate the rights of the lessee under subdivision (b).

Comment. Paragraph (3) is added to Section 1951.4(c) to make clear that the landlord's efforts to preclude or terminate an assignment or sublease that is neither reasonable nor otherwise permitted by the lease are not held to impair the landlord's rights under this section. This clarifies a matter that was unclear under prior law.

Civil Code § 1995.310-1995.340 (added). Breach and remedies

SEC. 2. Article 3 (commencing with Section 1995.310) is added to Chapter 6 of Title 5 of Part 4 of Division 3 of the Civil Code, to read:

Article 3. Breach and Remedies

§ 1995.310. Tenant's remedies for landlord's breach

1995.310. If a restriction on transfer of a tenant's interest in a lease requires the landlord's consent for transfer subject to an express or implied standard that the landlord's consent may not be unreasonably withheld, and the landlord unreasonably withholds consent to a transfer in violation of the tenant's rights under the lease, in

addition to any other remedies provided by law for breach of a lease, the tenant has all the remedies provided for breach of contract, including but not limited to either or both of the following:

- (a) Contract damages caused by the landlord's breach.
- (b) The right to terminate the lease.

Comment. Section 1995.310 treats a requirement for the landlord to be reasonable in withholding consent as a covenant rather than a condition, violation of which is a breach of the lease. This clarifies California law and is consistent with the majority view in the United States. See Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 505-7 (1989). Section 1995.310 does not distinguish between breach of an express reasonable consent requirement under Section 1995.250 and an implied reasonable consent requirement under Section 1995.260; a breach of either an express or implied covenant entitles the tenant to the normal remedies for breach of contract.

The remedies available for breach of contract include declaratory relief, specific performance or mandatory injunction, termination of the lease, and contract damages. Under Section 1995.310, the tenant may seek contract damages or exercise the right to terminate the lease or both. See Civ. Code § 3300 (measure of contract damages). Other remedies for breach of a lease may include statutory remedies, tort remedies, and self help.

§ 1995.320. Landlord's remedies for tenant's breach

1995.320. If a tenant transfers the tenant's interest in a lease in violation of a restriction on transfer of the tenant's interest in the lease, in addition to any other remedies provided by law for breach of a lease, the landlord has all the remedies provided for breach of contract, including but not limited to either or both of the following:

- (a) The right to contract damages caused by the tenant's breach.
- (b) The right to terminate the lease.

Comment. Section 1995.320 treats a restriction on transfer as a covenant, violation of which is a breach of the lease. A transfer in violation of the restriction is voidable not void, and the landlord may waive the landlord's remedies for breach either expressly or by conduct. This principle applies to a sublease as well as an assignment. Section 1995.020(e) ("transfer" defined).

Section 1995.320 makes clear the landlord may seek contract damages caused by the wrongful transfer in addition to termination of the lease. This is a specific application of Section 1951.2 (damages in connection with lease termination).

Section 1995.320 also permits the landlord to waive the termination remedy and still collect contract damages for wrongful transfer. This resolves a matter that was unclear under prior law, consistent with the general principle that a landlord may leave a lease

in effect and recover damages for breach of a covenant. See Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 495-98 (1989).

Other remedies available to the landlord for the tenant's breach include unlawful detainer, declaratory relief, and injunctive relief. For remedies against the assignee or subtenant under a wrongful transfer, see Section 1995.330 (application of remedies to assignee or subtenant).

§ 1995.330. Application of remedies to assignee or subtenant

1995.330. (a) Except as provided in Section 1995.340, a restriction on transfer of a tenant's interest in a lease applies to an assignee or subtenant to the same extent as to the tenant.

(b) An assignee is jointly and severally liable with the tenant for contract damages under Section 1995.320. For this purpose the provisions of Section 1951.2 applicable to a lessee apply as well to an assignee.

(c) The landlord's right to terminate a lease under Section 1995.320 includes the right to terminate a transfer without terminating the lease. If the landlord terminates a transfer without terminating the lease, the assignee or subtenant in possession is guilty of unlawful detainer and the landlord may obtain possession from the assignee or subtenant without terminating the right to possession of the tenant. For this purpose the landlord may use the procedure provided in Chapter 4 (commencing with Section 1159) of Title 3 of Part 3 of the Code of Civil Procedure, with the changes necessary to make the procedure applicable to this subdivision.

Comment. Subdivision (a) of Section 1995.330 is an express application of Section 1995.020(d) ("tenant" defined). It states the general rule that an assignee or subtenant is in the same position as an original tenant with respect to enforcement of a transfer restriction in the lease. Thus, if the landlord wrongfully refuses to consent to an assignment or sublease by an assignee or subtenant, the landlord's refusal is a breach of the lease that entitles the assignee or sublessee to the remedies provided by law. Conversely, a transfer restriction binds the assignee or subtenant, and breach by the assignee or subtenant entitles the landlord to the remedies provided by law. The extent to which a consent or waiver of a transfer restriction by the landlord applies also to a transfer by the assignee or subtenant is governed by Section 1995.340 (rule in *Dumpor's* case abolished).

On the basis of privity of estate an assignee but not a nonassuming subtenant is liable to the landlord for breaches occurring after transfer. Subdivision (b) makes clear that these principles

apply to the wrongful transfer itself. An assignee that makes a subsequent transfer in violation of a transfer restriction is liable to the same extent as a tenant would be.

Subdivision (c) makes clear that the landlord's remedies for breach of a transfer restriction include the right to terminate the transfer without terminating the underlying lease. This right is new in California. See Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 487-93 (1989).

§ 1995.340. Rule in Dumpor's case abolished

1995.340. (a) Subject to subdivision (b), a restriction on transfer of a tenant's interest in a lease applies to a subsequent transfer by an assignee or subtenant notwithstanding the landlord's consent to a prior transfer or the landlord's waiver of a standard or condition for a prior transfer.

(b) Subdivision (a) does not apply if either of the following conditions is satisfied:

(1) The lease provides expressly that the restriction on transfer is limited to the original tenant.

(2) The landlord states expressly that the consent or waiver applies to a subsequent transfer.

Comment. Section 1995.340 makes clear that the rule in Dumpor's case is not the law in California. This probably codifies existing law. Cf. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 551-64 (1989).