#H-111

ns83
05/08/90

Memorandum 90-49

Subject: Study H-111 - Remedies for Breach of Assignment or Sublease Covenant (Comments on Tentative Recommendation)

The Commission's tentative recommendation relating to remedies for breach of an assignment or sublease covenant was circulated for comment in January 1990. A copy is attached to this memorandum. We have received the five comments attached to this memorandum as Exhibits. Our objective is to review the comments and make any needed changes before approving the recommendation for submission to the Legislature.

General Comments

Larry W. Kaminsky of the California Land Title Association Forms & Practices Committee (Exhibit 4) supports the statutory specification of standards and remedies applicable in commercial real property leases and believes they will have no effect on the title industry. John C. Hoag of Ticor Title Insurance (Exhibit 2) likewise has no problem.

Ernest E. Johnson of Los Angeles (Exhibit 5) feels the recommendation is heavily biased in the landlord's favor and does not sufficiently take into account the practical operation of a restriction on assignment or subletting. The landlord should be required to have a commercially reasonable justification for refusal to consent to an assignment or sublease. Mr. Johnson points out that the statute applies even to nominal transfers such as to the family of a decedent, a successor corporation, a change in the form of business, a sale to employees, and the like. In addition many tenants are small businesspersons who do not have advice of counsel or bargaining strength; greater statutory protections for the right of a tenant to assign or sublet are needed. He believes the basic legislation on assignment and subleasing needs to be reconsidered.

> While I would personally advocate a requirement of commercial reasonability and good faith and fair dealing, at the very least I would urge that the definition of assignment be narrowed so as not to apply to technical changes not

substantially or adversely affecting landlord's property rights. Of course, this is consistent with my general view that there needs to be a balancing between the rights of tenants and the rights of landlords; that refusals to give consent to assignments and subleases or changes in use must be reasonable and in some manner relate to the protection of the landlord's legitimate interests in his property; they should be a shield to protect the landlord and not a sword with which to strike down the unwary tenant.

§ 1995.310. Tenant's Remedies for Landlord's Breach

Proposed Section 1995.310 makes clear that where the landlord has violated the tenant's right to assign or sublet, in addition to general remedies for breach of contract, the tenant may seek damages and terminate the lease.

Arnold F. Williams of Fresno (Exhibit 3) suggests that specific performance and mandatory injunction should also be included in the range of remedies available to the tenant. The staff believes it is already clear that these remedies are included. The statute states that the tenant has "all the remedies provided for breach of contract", and the Comment notes specifically that "The remedies available for breach of contract include declaratory relief, specific performance or mandatory injunction, termination of the lease, and contract damages." The staff believes nothing further is necessary or desirable.

Mr. Johnson (Exhibit 5) suggests that punitive damages be allowed in the event of a wrongful withholding of consent. As we note in the Comment, the wrongful withholding of consent may be a tortious act; in such a case punitive damages could be awarded, if the necessary elements (tortious act, malice) were shown. The staff has no problem with noting this in the Comment, thus:

> The landlord's wrongful conduct may, in addition to a breach of contract, involve a tort (e.g., interference with contract or prospective economic advantage, or trespass) <u>and warrant tort damages, including punitive or exemplary damages where appropriate</u>. Other remedies for breach of a lease may include statutory remedies. The tenant may also transfer without the landlord's wrongfully withheld consent.

Allen J. Kent of San Francisco (Exhibit 1) questions the remedy of lease termination. He notes that many times whether the landlord agrees to a particular assignee or subtenant is a question of judgment

based on factors important to the landlord; even though the landlord's refusal to consent may be found to be "unreasonable", termination of the lease should not be allowed automatically. "Whether or not the right to terminate the lease exists should be a matter that is subject to negotiation between the parties and not created by legislative fiat."

The staff disagrees. The right to assign or sublet is a fundamental aspect of the lease, and the law favors that right. If a landlord is concerned that the refusal to consent to a transfer will be found to be unreasonable and will trigger a termination, the landlord has a simple solution--consent to the transfer.

But should the law permit the tenant to bargain away the right to terminate (i.e., the reciprocal of Mr. Kent's suggestion)? Why not allow the statutory remedies to be waived by negotiation? This would be consistent with the general laissez faire approach of the basic assignment and sublease statute--anything goes that the parties freely agree to, including (1) absolute prohibition of assignment and sublease, (2) unrestricted right of assignment and sublease, and (3) any remedies the parties believe to be appropriate.

Although the right of the parties to limit or waive remedies is probably the law, the staff believes it would be useful to codify it because of the general pattern of the lease law to heavily control statutory remedies. We could add to the statute a provision that:

> <u>§ 1995.300. Remedies subject to express provision in lease</u>
>
> 1995.300. A remedy provided by law for violation of the rights of the tenant or of the landlord concerning transfer of a tenant's interest in a lease, including a remedy provided in this article, is subject to an express provision in the lease that affects the remedy.
>
> <u>Comment.</u> This section codifies the general rule that the parties to a contract may negotiate the remedies to be applied in case of a breach of the contract. This rule is of course subject to general principles limiting freedom of contract. See, e.g., 1 B. Witkin, Summary of California Law <u>Contracts</u> §§ 23-36 (9th ed. 1987) (adhesion and unconscionable contract doctrines).

§ 1995.330. Application of remedies to assignee or subtenant

Subdivisions (a) and (b).

Subdivision (a) of Section 1995.330 provides that a restriction on assignment or subletting continues to apply to an assignee but not to a subtenant. Subdivision (b) provides that an assignee of a wrongful assignment, but not a subtenant of a wrongful subletting, is jointly and severally liable with the tenant for damages. The reason for this distinction is that there is privity between the landlord and assignee but not between the landlord and subtenant.

Mr. Williams (Exhibit 3) is dismayed at this distinction; he suggests that in the law generally there has been a move away from privity defenses and property law should follow suit. "I believe that the landlord should be considered in law to be an intended beneficiary of both the contract of assignment and of the contract of sub-tenancy."

The staff agrees with Mr. Williams that, theoretically, a lease clause restricting assignment or sublease should also restrict the subtenant's assignment or sublease of the subtenancy. However, the staff is concerned that this will require the subtenant to be aware of the terms of the master lease, even though the subtenant is not a party to the lease. Can the subtenant rely on the tenant's representation of the terms of the master lease? Would the subtenant need to get a release from the landlord in order to be safe? While it may not seem unreasonable to require the subtenant to be aware of the terms of the master lease in a commercial real property context, in fact there will be many small cases where this expectation is unrealistic, and even in large cases it will cause practical problems. The staff recommends against Mr. Williams' proposal; privity has its reasons.

Subdivision (c).

Subdivision (c) permits the landlord to terminate a wrongful transfer by the tenant without terminating the underlying lease. Mr. Johnson (Exhibit 5) is concerned that this gives the landlord too much power in a situation where the wrongful transfer is an insubstantial change, such as a merger, reorganization, incorporation, or sale of a business. "For example, consider the acquisition of a small

manufacturing business by a larger corporation which contemplates continuing operations as in the past; technically, the landlord could refuse consent to the assignment and demand that the seller (who may be elderly or in poor health or even deceased) continue to pay the rent under the original lease."

By this example Mr. Johnson poses a case where the landlord is acting unreasonably, and asks whether the law should condone this even though technically agreed to by the parties. He is most concerned, of course, with the situation where the "agreement" is not real, due either to lack of counsel or bargaining position. As indicated above, he does not believe the general rules of adhesion and unconscionability adequately cover the matter.

Assuming the Commission believes its original recommendation is sound to allow freedom of contract between the parties, the issue now is whether the proposed remedy is appropriate in the situation described by Mr. Johnson. To eliminate the landlord's remedy of terminating the wrongful transfer while letting the underlying lease stand is to force the landlord to an election--the landlord can terminate the underlying lease and seek damages from a failing tenant, or the landlord can allow the lease to stand and seek damages from a solvent assignee. Query whether, if the landlord elects to terminate, the would-be assignee is also liable for damages under subdivision (b)? And query what, if the landlord allows the lease to stand, the measure of damages would be in the case posed by Mr. Johnson?

An alternative approach to Mr. Johnson's problem would be to provide the landlord the remedy of terminating the transfer without terminating the underlying lease in situations where the landlord has a commercially reasonable objection, as opposed to a technically legal objection under the lease, to the transfer.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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January 29, 1990

California Law Revision Commission
4000 Middlefield Road, Suite D-2
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Re: Tentative Recommendations Relating to:
1. Commercial Real Property Leases (Remedies for Breach of Assignment or Sublease Covenant)
2. Commercial Real Property Leases (Use Restrictions)
3. Right of Surviving Spouse To Dispose of Community Property
4. Deposit of Estate Planning Documents With Attorney

Greetings:

Please be advised that I approve of the tentative recommendations relating to the Right of Surviving Spouse To Dispose of Community Property, the Deposit of Estate Planning Documents With Attorney and Commercial Real Property Leases (Use Restrictions).

However, I believe some more thought should be given to the tentative recommendation relating to Commercial Real Property Leases (Remedies For Breach of Assignment or Sublease Covenant).

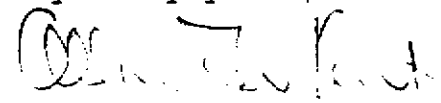
I do not believe that the tenant should have the right to terminate a lease if a landlord unreasonably withholds consent to a transfer in violation of the tenant's rights under the lease. Property owners often wish to have specific types of tenants in particular locations in a multi-tenant situation. Indeed, even in a single tenant situation, the landlord may wish to have a particular type of tenant. There are

also other considerations that a landlord utilizes in deciding what type of tenant it wishes to have in its leased premises.

For these reasons, I believe the right to terminate the lease by the tenant should not be made a part of this proposed legislation. I realize in saying so that the hypothesis stated is that the landlord has unreasonably withheld consent to a transfer. However, in my opinion, whether or not the right to terminate the lease exists should be a matter that is subject to negotiation between the parties and not created by legislative fiat.

Thank you for giving me the opportunity to review these very interesting tentative recommendations.

Very truly yours,



Allen J. Kent

AJK:eyr

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TICOR TITLE INSURANCE

CA LAW REV. COMM'N
FEB 15 1990
RECEIVED

John C. Hoag
Vice President and
Senior Associate Title Counsel

February 13, 1990

John H. DeMoully, Esq.
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Tentative Recommendation: Commercial Real Properties Leases: Remedies For Breach of Assignment or Sublease Covenant

Dear Mr. DeMoully

Since title insures insure leases and lenders (who loan on the strength of a particular leasehold interest) subject to the terms and provisions of the lease itself, the aforementioned recommendation would not create a need for me to revise the California Land Title Association Manual of Title Practices nor to revise the Title Handbook (which I also write).

The remedies set out in the recommendation (for both parties to the lease), are, of course, not required by the recommended statutes to be exercised by recordation of some piece of paper in the public records. Naturally, the judgment eventually rendered may be recorded and from that point on, generally speaking, title insurers could rely upon lease termination to omit reference to the terminated leasehold from future reports and policies of title insurance.

In a sense my statement here is a broad comment on the relationship between statutory remedies, marketability of title to real property and the public records.

Very truly yours,

John C Hoag

JCH:j

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OUR FILE NO._____

March 13, 1990

The California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, CA 94303-4739

Re: Tentative Recommendation Concerning Commercial Real Property Leases, Remedies for Breach of Assignment or Sublease Covenants

Gentlemen:

I am dismayed to note that you continue the distinction between an assignee and a sub-tenant in your draft of this law. I would suggest that in law generally, there has been a move away from "privity defenses", and that property law should, absent some overriding public policy consideration, move in the same direction. I believe that the landlord should be considered in law to be an intended beneficiary of both the contract of assignment and of the contract of sub-tenancy.

Second, let us take the situation in which the tenant has leased part of an industrial park only to discover that it is failing with industrial park rent. It wishes to assign to a "little bitty subdivision of IBM". The tenant has no basis for this scenario for contract damages, nor does termination appear to be terribly effective, especially if the tenant expects that this will become a more valuable lease further into the lease term. Such expectations are notoriously difficult to prove, and I would suggest that specific performance or mandatory injunction should also be included in the range of remedies available to the tenant in the situation.

I await with interest your next draft of this recommendation.

Very truly yours,

DOWLING, MAGARIAN, PHILLIPS & AARON

Arnold F. Williams

Arnold F. Williams

AFW:ped

Fidelity National Title

INSURANCE COMPANY

Larry M. Kaminsky
Vice President
Assistant General Counsel

March 21, 1990

John M. DeMoully, Esq.
Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303

RE: Tentative Recommendation On Commercial Real Property Leases:
A. Use Restrictions
B. Remedies for Breach of Assignment or Sublease Covenant

Dear Mr. DeMoully,

On behalf of the California Land Title Association Forms & Practices Committee, the following comments are offered on the above referenced tentative recommendations.

We support the statutory specification of standards and remedies applicable in such leases, and we believe that they will have no affect on our industry.

If such matters as use restrictions appear in the official land records, they will be shown as exceptions from coverage.

Thank you for your consideration.

Sincerely,
FIDELITY NATIONAL TITLE INSURANCE COMPANY

Larry M. Kaminsky

Larry M. Kaminsky
Vice President
Assistant General Counsel

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April 9, 1990

Mr. Nathaniel Sterling
Assistant Executive Secretary
California Law Revision Commission
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

Re: Assignment and Sublease/
Use Restrictions Tentative Recommendations

Dear Mr. Sterling:

Thank you for your letter of March 30th; I did in fact receive the material from Professor Coskran with his letter of March 29th and please consider this letter to be my comments.

1. As with the recommendation relating to Commercial Real Property Leases, dated February 19, 1989, I feel the tentative recommendations concerning remedies and concerning use restrictions are heavily biased in the landlord's favor and do not sufficiently take into account the practical operation of such provisions.

Philosophically, I believe that a lease constitutes a conveyance of an interest in property and that the tenant is accordingly the owner of a large bundle of those rights, privileges, powers and immunities we call property. While the landlord is certainly entitled to all reasonable protection for his rights, privileges, powers and immunities, so too the tenant is deserving of protection.

Clearly if circumstances change adversely and particularly if a leasehold declines in value, the landlord will insist upon his full rent as provided in the lease; but if the circumstances change positively or if the value of the leasehold increases substantially, I have difficulty seeing why the landlord is entitled to extract more from the tenant than he contracted for in his lease. To me, the landlord should be required to have some commercially reasonable justification for a refusal to consent to a change in use or an assignment or a subleasing. Any broker, agent or employee will seek to maximize the return and will rationalize a demand for a tribute or increased rent on the ground that he is only asking for current market.

2. Application. It is critical to emphasize that these recommendations concerning assignment, sublease and use apply to a broad range of circumstances, many of which have no material or adverse consequences to the landlord's rights. As I read the statutes the application is determined by the definition of "transfer" contained in Section 1995.020 without any qualification or clarification. Thus an assignment or transfer and the consequent right of the landlord to extract increased rent, etc. would occur where (for example)

a. The tenant dies and his widow, children or heirs take over the business and continue to operate the business as before.

b. The tenant merges with or is acquired by a second corporation and operations continue on the premises substantially as before.

c. An individual or partnership determines to incorporate and accordingly the lease is technically assigned.

d. A change in the composition of a partnership through the death, withdrawal or admission of a partner without any substantial change in the continuing business being transacted on the premises.

e. An owner decides to retire and sell to his employees.

To me such things as the foregoing do not constitute a substantial change and do not adversely impact upon the landlord, particularly where the assignor remains liable. Through application of a requirement of reasonableness, of good faith and fair dealing and a ban on unreasonable restraints on alienation, this problem can be resolved.

In other situations, a business expands or contracts or requires different premises. To limit assignment rights in such a situation constitutes in my judgment, a restraint on alienation and reasonableness should be required.

Similar considerations apply with respect to a change of use. The operation of a men's clothing store may become unprofitable and the owner determined to operate a women's clothing store, or a jewelry shop may convert to a stationery shop. If the use descriptions in the lease are specific such a change could constitute a breach of the lease giving the landlord the right to

demand extra rent or a payment for consent, though there has been no adverse or substantial impact upon the landlord. Of course this is something that must be analyzed in each individual case as there may already be a women's clothing store or a stationery shop in the shopping center. But here too, the requirement of commercial reasonableness and the application of the covenant of good faith and fair dealing would seem appropriate, rather than allowing the landlord the absolute unfettered right to enforce his will. And as a practical matter the broker, agent or employee would feel it was his DUTY to demand payment if permitted.

3. Leases in Practice. Many of the problems discussed in the recommendations and in the literature on the subject deal with theoretical situations and not what in fact happens in the real world of the small business. The very large tenants would have attorneys specializing in the field and in fact would be experienced in negotiating leases. There would in fact be an arm's length negotiation between substantially equal parties in connection with the lease. But the practicalities are that most small business tenants do not use a special attorney if indeed they use any attorney at all. The landlord has a tendency to deal with them on a take it or leave it basis and I am afraid that many of these tenants buy the sizzle rather than examining the details because they frankly do not think in terms of the future possibilities. Sometimes the use provisions in a lease will describe "general business office" but other times it is more specific such as "insurance agency" which is where the change of use problems arise. Some small business clients are sufficiently sophisticated to provide for changes in a partnership composition or death, but I have run into very few who provide for incorporation or merger or the sale of a business, etc. It may be that a large part of the problem I see is the fault of the small business tenant and his failure to adequately protect himself, but the fact remains that in many situations the small business tenant is at a distinct disadvantage in negotiating with the large experienced and well represented landlord. And accordingly, in my opinion the requirement of good faith and fair dealing, of commercial reasonableness and of bans on unreasonable restraints on alienation such as the case of Kendall v. Pestana sought to impose are of great importance. The bans on contracts of adhesion, etc. is not sufficient protection in my opinion.

4. Specifically with respect to the tentative recommendation on remedies, I suggest that the language might specifically allow punitive damages in the event of a wrongful withholding of consent. I would read recommended Section 1995.310 as allowing for any contractual damages and, as the note indicates,

under certain circumstances this could be a tort. But it seems likely to me that a landlord would bluff and delay where this was to his advantage and that accordingly additional protection should be given to the tenant in the event of an unreasonable withholding of consent in a timely manner. It should be emphasized that a landlord's refusal to consent to an assignment could destroy a sale or transfer of the business or a merger or other corporate reorganization and that a recourse to the courts could only lead to a damage recovery several years down the line long after the proposed merger or sale or reorganization had fallen through.

Somewhat similarly I am concerned about Section 1995.330 when applied to these nonsubstantial changes or assignments. Consider the application of Section 1995.330(c) in the case of a merger, or a reorganization, or a debt, or an incorporation or the sale of a business. In my judgment you are giving the landlord too much power to demand tribute when his rights would not be adversely nor materially affected. For example, consider the acquisition of a small manufacturing business by a larger corporation which contemplates continuing operations as in the past; technically, the landlord could refuse consent to the assignment and demand that the seller (who may be elderly or in poor health or even deceased) continued to pay the rent under the original lease.

5. My comments on the recommendation on use restrictions are similar to the comments I had on the earlier recommendation concerning assignment and sublease. In my opinion, the usage of the date of September 23, 1983 is inappropriate. The rise in the concept of requiring good faith and fair dealing and requiring commercial reasonableness was apparent even before but was made emphatic by the Wellenkamp case in 1978.

While there is much to be said for having an identical public policy relating to use and to assignment restrictions, in my opinion that public policy should be a statutory requirement of commercial reasonableness and of good faith and fair dealing. The statute dealing with assignment restrictions has been criticized as "landlord oriented" and I do not believe that same mistake should be made with respect to use. Indeed I would urge the Commission to reconsider its recommendation concerning assignments and subleasing.

6. Frankly I fail to see why there should be permission for an absolute prohibition in the change of use regardless of how trivial, or inconsequential or reasonable that change of use may be. Similarly, I am concerned by the statement that "the parties might negotiate such a provision because the landlord needs to be

able to exercise the landlord's best business judgment without being subject to second guessing by the tenant and the courts"; I suggest that the Law Revision Commission should be concerned with both with the landlord's needs and the tenant's needs which with all due respect seem to be given rather little weight. What of the tenant who winds up with a use restriction providing for the manufacture of a product that becomes obsolescent or uneconomic? Why should he be prohibited from changing to a similar type of business where the change in use does not adversely or unreasonably affect the landlord? Why should the tenant be forced to continue in the same type of business described in the lease?

Again to a large extent this problem relates to the definition of use contained in the lease and, here also, the tenant may be largely responsible because he failed to incur the expense of a skilled attorney or of extended negotiations. But as a practical matter many tenants simply to not make sufficient effort to negotiate changes in the printed form the landlord presents to him. Accordingly in my judgment it would be appropriate for the law to require that any restriction on the use of leased property or any refusal to approve a change in use must be commercially reasonable (Section 1997.230) and that the landlord is not entitled to "sole and absolute discretion" (Section 1997.250). Landlords have not shown themselves deserving of such divine authority and I would urge the Law Revision Commission to balance the respective rights and obligations of the parties.

7. A minor comment on Section 1997.270. As with the earlier restriction on assignment and sublease, I do not understand the reference to "execution of the option" as contained in Section 1997.270(b). Is this intended to refer to the "exercise" or is it intended to refer to the date of execution of the document containing the option which will normally be the same as the original lease. Logically it would seem to me that it should refer to the date upon which the option rights are exercised and that in effect a new lease, etc. would date from that time.

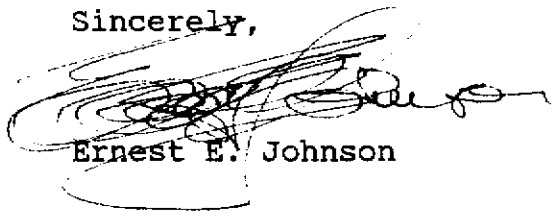
I apologize for the length and nature of these comments, but I have not had sufficient time in my practice to do the thorough job this subject really requires, but I did want to express my opinion, which may constitute another view and is based upon my some 35 years of practice, during the course of which questions and problems with respect to assignment and subleasing and change of use have arisen only when some unforeseen event occurred and the landlord sought to use this event to extract a payment or an increase to the then current market rate. In fact the situation was analogous to the due-on-sale clauses ultimately

resolved in Wellenkamp where the financial institutions sought to use a sale or transfer as a method of increasing their interest payment without regard to their security.

I wish I could identify a tenant organization or small business tenants who would be willing to devote the time and expense necessary to appropriately respond to your request; but unfortunately I am not aware of any and can only suggest that it might be appropriate to retain an expert to present the landlord's side and a second expert to present the tenant's side. I am afraid that is the only way I can see for a full presentation of conflicting views to be adequately presented.

Because they have a bearing upon the subjects discussed in the two new tentative recommendations, I am enclosing copies of my earlier letters relating to the legislation concerning assignment and sublease based upon the Commission's recommendation of February 1989 which unfortunately, I had not heard of until November 1989 after the legislation was adopted. I would still urge that that matter be reconsidered. While I would personally advocate a requirement of commercial reasonability and good faith and fair dealing, at the very least I would urge that the definition of assignment be narrowed so as not to apply to technical changes not substantially or adversely affecting landlord's property rights. Of course, this is consistent with my general view that there needs to be a balancing between the rights of tenants and the rights of landlords; that refusals to give consent to assignments or subleases or changes in use must be reasonable and in some manner relate to the protection of the landlord's legitimate interests in his property; they should be a shield to protect the landlord and not a sword with which to strike down the unwary tenant.

Sincerely,



Ernest E. Johnson

EEJ:kla

cc: Arthur K. Marshall
William G. Coskran

STATE OF CALIFORNIA

CALIFORNIA LAW REVISION COMMISSION

TENTATIVE RECOMMENDATION

relating to

Commercial Real Property Leases

Remedies for Breach of Assignment or Sublease Covenant

December 1989

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 a part of the public record and will be considered at a public meeting when the Commission determines the provisions it will include in legislation the Commission plans to recommend to the Legislature. It is just as important to advise the Commission that you approve the tentative recommendation as it is to advise the Commission that you believe revisions should be made in the tentative recommendation.

COMMENTS ON THIS TENTATIVE RECOMMENDATION SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN **MARCH 31, 1990.**

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.

CALIFORNIA LAW REVISION COMMISSION
4000 Middlefield Road, Suite D-2
Palo Alto, California 94303-4739

TENTATIVE RECOMMENDATION

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 attempting to assign or sublet and may lose the benefit of an advantageous business

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

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.

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2. Civil 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.")

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 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]

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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. Civil Code § 1951.2.

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

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 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

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

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 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

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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).

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 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.

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

The rule is illogical and serves no useful purpose. It is a trap for the unwary. And for the wary, it may cause a refusal to consent to an otherwise reasonable transfer for fear that a single waiver will be converted into a permanent waiver. 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.

PROPOSED LEGISLATION

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) The right to 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, 505-07

(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 Section § 3300 (measure of contract damages).

The landlord's wrongful conduct may, in addition to a breach of contract, involve a tort (e.g., interference with contract or prospective economic advantage, or trespass). Other remedies for breach of a lease may include statutory remedies. The tenant may also transfer without the landlord's wrongfully withheld consent.

§ 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 to the same extent as to the tenant.

(b) An assignee who receives or makes a transfer in violation of a restriction on transfer of a tenant's interest in a lease 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 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 application of the general rule that the landlord and assignee are in privity of estate. The landlord is directly obligated to the assignee for performance of the lease provision. Conversely, the assignee is directly obligated to the landlord for performance of the lease provision.

On the basis of privity of estate an assignee 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 a tenant, an assignee, or a 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 in writing 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).