Memorandum 90-50

Subject: Study H-112 - Use Restrictions in Commercial Leases of Real Property (Comments on Tentative Recommendation)

The Commission's tentative recommendation relating to use restrictions in commercial leases of real property was circulated for comment in January 1990. A copy is attached to this memorandum. We have received the seven comments attached to this memorandum as Exhibits. The staff has analyzed the comments in this memorandum. The Commission needs to review the comments and make any necessary revisions in the recommendation before submitting it to the Legislature.

General Comments

Arnold F. Williams of Fresno (Exhibit 4) supports the attempt to inject some clarity into this area; he also has a few specific comments, which are analyzed below. Larry M. Kaminsky of the California Land Title Association Forms & Practices Committee (Exhibit 5) supports the statutory specifications of standards and notes that if use restrictions appear in the official land records, they will be shown as exceptions from coverage. John C. Hoag of Ticor Title Insurance (Exhibit 2) likewise believes the recommendation is a good one. Allen J. Kent of San Francisco (Exhibit 1) approves the tentative recommendation without further comment.

Ernest E. Johnson of Los Angeles (Exhibit 7) feels the recommendation is heavily biased in the landlord's favor and does not sufficiently take into account the practical operation of a use restriction. As a general principle, he believes the landlord should be required to have a commercially reasonable justification for a refusal to consent to a change in use. He is concerned that a landlord may seize upon a minor and harmless change in use in order to demand a higher rent the landlord would not otherwise be entitled to.

> 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. ... 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.

Mr. Johnson is concerned that the tentative recommendation assumes parties of equal bargaining strength who are represented by counsel, whereas the practicalities are that most small business tenants do not use an attorney. The landlord deals with them on a take it or leave it basis, and many tenants do not examine the details or 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. ... 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." Accordingly, Mr. Johnson is of the opinion that the requirements of good faith and fair dealing, of commercial reasonableness, and banning unreasonable restraints on alienation, are of great importance; the adhesion contract and unconscionability doctrines are not sufficient protection for a small tenant.

§ 1997.040. Effect of use restriction on remedies for breach

Subdivision (a).

If a tenant breaches a lease, the landlord is entitled to recover the contract rent minus the amount of rental loss that the landlord could reasonably have avoided. Civil Code § 1951.2(a). Subdivision (a) of Section 1997.040(a) requires that, in determining the amount of rental loss that could reasonably be avoided, any reasonable use of the leased property must be taken into account except to the extent the lease includes an enforceable use restriction.

Michael P. Carbone of San Francisco (Exhibit 3) does not believe that damages should be based on a use restriction in the lease. He

gives an example of a shopping center store leased for retail sale of children's books. If the tenant goes into default, the landlord could allow damages to accumulate without making a real effort to mitigate. "At trial, tenant seeks to show that there were several prospective replacement tenants available to landlord, all of whom were engaged in businesses suitable for this particular shopping center. Landlord counters by arguing that no such replacement tenants were engaged in the business of selling children's books, and the court agrees with landlord. Result: the court finds that none of landlord's rental loss could have been 'reasonably avoided,' and landlord is relieved, in effect, of the duty to mitigate damages."

The staff believes Mr. Carbone's point is a good one, and in computing damages for breach, the landlord's duty to mitigate should be based not on a use restriction in the lease but on any reasonable use of the leased property. The staff would revise subdivision (a) of Section 1997.040 to read:

> For the purpose of subdivision (a) of Section 1951.2 (damages on termination for breach), the amount of rental loss that could be or could have been reasonably avoided is computed by taking into account any reasonable use of the leased property ~~except to the extent~~ even though the lease includes a restriction on use that is enforceable under this chapter.

Subdivision (b).

Subdivision (b) addresses the situation where, under the lease, the landlord is not required to mitigate damages, but the tenant in default is permitted to assign or sublet in mitigation. Under subdivision (b), the defaulting tenant must honor the use restriction in assigning or subletting the premises.

Martin I. Zankel of San Francisco (Exhibit 6) finds fault with this approach. He gives the example of a lease for use of the premises solely for the retail sale of T-shirts. The tenant whose T-shirt business has failed, perhaps because the site is not a good one for a retail T-shirt outlet, may have a very hard time indeed trying to find another retail T-shirt tenant to whom to assign or sublet the premises. "In effect, by limiting the use severely, the landlord has placed a quantum of restraint out of all proportion to the benefits to be derived by the landlord since it is clear, taking our example, that

if the lease were terminated, the landlord would lease to some use other than a T-shirt operation. For this reason, the highly restrictive use would seem clearly to constitute an unreasonable restraint on alienation."

Mr. Zankel believes that if the landlord wishes to retain its lock-in remedy under Civil Code Section 1951.4, it should be obligated to act in good faith with respect to enforcement of highly restrictive use clauses. The staff is persuaded by Mr. Zankel's argument, and would revise subdivision (b) of Section 1951.4 to read:

> The remedy described in Section 1951.4 (continuation of lease after breach and abandonment) is available notwithstanding the presence in the lease of a restriction on use of the leased property, ~~and the restriction on use applies under Section 1951.4 to the extent it is enforceable under this chapter~~ provided the lessor waives the restriction if the lessee sublets the property or assigns the lessee's interest in the lease for any reasonable use of the leased property.

§ 1997.210. Right of any reasonable use absent a restriction

This section states the basic freedom of contract rule that a lease may include a restriction on use. Mr. Johnson (Exhibit 7) would qualify this with a general statutory requirement of commercial reasonableness and of good faith and fair dealing. The fact that the assignment and sublease recommendation embraces freedom of contract is not a sufficient justification here; the assignment and sublease legislation is landlord oriented and itself should be reconsidered.

Mr. Williams (Exhibit 4) takes the opposite position. He suggests an explicit statement of purpose be added to the statute (perhaps at Section 1997.030) to the effect that, "This chapter modifies the law concerning unreasonable restraints on alienation, and the implied covenant of good faith and fair dealing governing restrictions on use." The staff notes that a statement of this sort appears in the Comments to Sections 1997.030 and 1997.210, and that this is the same structure the assignment and sublease statute has. However, in light of the conflicting opinions on this matter, the staff believes it is worth codifying whatever the Commission determines the rule should be.

§ 1997.230. Prohibition of change in use

This section permits a lease to absolutely prohibit a change in use. Mr. Johnson (Exhibit 7) fails to see why such an absolute prohibition should be allowed regardless of how trivial or inconsequential or reasonable the change of use may be. "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?" Mr. Johnson recognizes that the problem arises because the tenant has been careless about signing a lease with a harsh provision, "But as a practical matter many tenants simply do not make sufficient effort to negotiate changes in the printed form the landlord presents to him." Mr. Johnson believes the Commission should not be concerned exclusively with the landlord, but should give more weight to the tenant's needs. "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."

A similar view is expressed by Michael P. Carbone of San Francisco (Exhibit 3) who takes the position that even under an absolute prohibition on change of use, the landlord can always waive the prohibition in exchange for higher rent. "A lease provision which gives the landlord total control over the use of the premises, regardless of how it is couched, gives such a discretionary power to the landlord. There is no reason for the legislature to invite landlords to use such powers in bad faith." He would revise the Comment to state that "Whether the enforcement of such a restriction is a violation of the implied covenant of good faith and fair dealing should be decided on the facts of each case."

§ 1997.250. Express standards and conditions for landlord's consent

Subdivision (c).

For the same reasons expressed at length above, Mr. Johnson (Exhibit 7) believes landlords should not be allowed to exercise sole and absolute discretion but should always be required to be commercially reasonable, notwithstanding what the lease says. "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."

Mr. Williams (Exhibit 4) again has the opposite problem--he does not believe the statute adequately carries out the intent to allow a lease clause giving the landlord sole discretion to override the duty of good faith and fair dealing. He believes that despite the Comment, subdivision (c) does not authorize a violation of good faith and fair dealing without more explicit language to support such a construction.

The staff believes the Commission needs to review the policy. Whether the Commission adopts the Johnson position or the Williams position, the statute should be more clear on it. The matter should not be left to the Comment.

§ 1997.270. Limitation on retroactivity of Section 1997.260

Subdivision (a).

Subdivision (a) of Section 1997.270 limits application of the rule of good faith and fair dealing concerning use restrictions to cases where the lease was executed after the operative date of the new law. The reason for this rule is that this is new law and should not impair the agreement the parties had when the lease was made. Mr. Johnson (Exhibit 7) disagrees that this is new law and does not believe retroactivity should be limited. "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." In his opinion, public policy should be a statutory requirement of commercial reasonableness and of good faith and fair dealing, no matter when the lease was executed.

Subdivision (b).

Subdivision (b) applies the reasonableness requirement to use restrictions contained in an option if the option is executed after the operative date of the new law. Mr. Johnson (Exhibit 7) notes that reference to the time of "execution" of an option is ambiguous, since that could refer either to the time the option was signed or to the time it was exercised.

The reference is intended to mean the time the option was signed rather than the time it was exercised. The option was negotiated taking into account the law in effect at the time it was signed, and we should not rewrite the parties' deal. The reference to "execution" of an option is drawn from the Civil Code lease remedies provisions, which limit retroactivity of remedies for lease terms fixed by options executed before July 1, 1971. Section 1952.2(b).

It might be useful to make this clear in the Comment to Section 1997.270:

> Comment. Section 1997.270 limits the retroactive application of Section 1997.260 (implied standard for landlord's consent). The date of applicability of Section 1997.260 is January 1, 1992. If a lease is made on or after January 1, 1992, under an option signed before that date, the rights between the parties to the lease are governed by subdivision (a). If a sublease is made on or after January 1, 1992, under a lease executed before that date, the rights between the parties to the sublease are governed by Section 1997.260. See Section 1997.020(b) ("lease" means lease or sublease).

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

skent/ajk/pers/303

TICOR TITLE INSURANCE

Memo 90-50 EXHIBIT 2 Study H-112

CA LAW REV. COMM'N
FEB 23 1990
RECEIVED

John C. Hoag
Vice President and
Senior Asscciate Title Counsel

February 21, 1990

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

Re: Tentative Recommendation Relating to Commercial Real Property Leases: Use Restrictions

Dear Mr. DeMoully:

The tentative recommendation about use restriction will not affect the writing of leasehold title insurance for lessors, lessees and their lenders. Use restrictions will continue to be disclosed as exceptions to title insurance coverage. The recommendation is a good one.

Naturally, if commercial property has, at some future time, a common interest regime imposed on it - planned development or a condominium - existing restrictions must be analyzed to see if a common interest development is appropriate.

In addition to Kendall, I assume the tentative recommendation addresses Carma Developers (California), Inc. v. Marathon Development California, Inc., 259 Cal. Rptr. 908 (California Court of Appeal, 1989.)

Very truly yours,

John Hoag

JCH;j

cc: Larry M. Kaminsky

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March 1, 1990

CALIFORNIA LAW REVISION COMMISSION
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Re: Tentative Recommendations Relating to Commercial Real Property Leases: Use Restrictions

Gentlemen:

I would like to offer two comments regarding the tentative recommendation concerning use restrictions.

1. Proposed Civil Code Section 1997.230. This Section would be the counterpart, in the use restriction context, of Section 1995.240, which states that "A restriction on transfer of a tenant's interest in a lease may absolutely prohibit transfer." I have no quarrel with this principle as applied to either situation. However, I notice that the Comment to proposed Section 1997.230 states that "A lease term absolutely prohibiting change in use is not invalid as a restraint on alienation and is not a violation of the law governing good faith and fair dealing." (Emphasis added) The portion of the comment relating to good faith seems to be inapposite.

The apparent import of the statement is that it is not an act of bad faith to put such a provision in a lease. If that is the intent, the statement is erroneous because the implied covenant of good faith and fair dealing applies only to the performance of a contract and not to its formation. If the intent is to say that it is not an act of bad faith to enforce the provision, then I submit that the statement goes too far in that it attempts to settle as a matter of law an issue which is really one of fact and ought to be decided on a case-by-case basis.

Consider, for example, the case of a landlord who is quite willing to consent to a sublease involving a change of use, despite the absolute prohibition thereof in the lease, if the tenant will simply agree to double the rent for the balance of the term. Assume that in the particular case (unlike Hogan v. Kellogg, 187 Cal. App. 3d 589, 231 Cal.Rptr. 711 (1986)) there will be no

adverse economic impact on the landlord resulting from the proposed change of use. The Kendall case clearly says that it is objectionable for a landlord to use the occasion of a sublease as an opportunity to get a greater benefit than the landlord is otherwise entitled to under the lease. Kendall also states that where a contract confers on one party a discretionary power affecting the rights of the other party, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing. A lease provision which gives the landlord total control over the use of the premises, regardless of how it is couched, gives such a discretionary power to the landlord. There is no reason for the legislature to invite landlords to use such powers in bad faith. Where a landlord has a legitimate reason to prohibit a change of use, which is directly related to the protection of the landlord's interest in his ownership of the premises, then it is proper to uphold the landlord's exercise of absolute discretion in furtherance of that interest. See for example Pay 'N Pak Stores v. Superior Court, 258 Cal.Rptr. 816 (1989). It is perfectly feasible for the courts to afford such protection to landlords on a case by case basis without carving out a broad exception to the implied covenant of good faith and fair dealing.

I would delete that portion of the Comment which says "... and is not a violation of the law governing good faith and fair dealing." No such statement appears in the Comment to Section 1995.240. I would say instead that "Whether the enforcement of such a restriction is a violation of the implied covenant of good faith and fair dealing should be decided on the facts of each case."

2. Proposed Civil Code Section 1997.040(a). This Section would be unnecessarily harsh on a defaulting tenant and directly contrary to the terms of Civil Code Section 1951.2(a)(3) which allows the Lessor to recover "the worth at the time of the award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that the lessee proves could be reasonably avoided." (Emphasis added.)

The tentative recommendation as drafted by the staff would require that the court, in determining the amount of rental loss that could be reasonably avoided, take into account any enforceable use restriction, including a restriction on a use that is absolute or subject to the landlord's consent in the landlord's sole and absolute discretion. Under this legislation what is reasonable for the landlord to avoid is only what the landlord in his sole and absolute discretion determines to avoid. This would be a very significant change in the law.

On page 3 in paragraph (6) of the tentative recommendation, the staff discusses the reasons why a provision that the landlord has sole and absolute discretion to give or withhold consent to a change in use should be enforceable. The staff points out 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 agree with that statement, and, in fact, this is a concern which landlords raise in lease negotiation on a daily basis. However, I have yet to hear the point raised in the context of a defaulting tenant, and I doubt that the point has much relevance in that setting.

My point can best be illustrated with an example. Suppose that in 1990 a landlord leases space of approximately 2,000 square feet in a regional shopping center to a tenant for the purpose of retail sale of children's books. The use clause states that "Tenant shall use the premises for the retail sale of children's books and for no other purpose without Landlord's prior written consent, which Landlord may withhold in Landlord's sole and absolute discretion." The lease is for a term of 15 years, and it contains a default clause which complies with the terms of Civil Code Section 1951.2(c)(1). Landlord informs tenant during the lease negotiation that the use clause must be written in the foregoing language (rather than with a reasonable consent standard) so that landlord may maintain control over the tenant mix in the shopping center and so that in the event of a request for permission to assign or sublet, landlord will not be exposed to potential litigation in the event that tenant's proposed change of use is not considered "reasonable" by landlord. Tenant accepts landlord's argument. After two years of operation, tenant goes into default, and landlord terminates the lease pursuant to Civil Code Section 1951.2. In the meantime, proposed Section 1997.040 has been enacted.

Litigation ensues and comes to trial in approximately four years. In the meantime, landlord makes minimal efforts to mitigate his damages by reletting the premises. At trial, tenant seeks to show that there were several prospective replacement tenants available to landlord, all of whom were engaged in businesses suitable for this particular shopping center. Landlord counters by arguing that no such replacement tenants were engaged in the business of selling children's books, and the court agrees with landlord. Result: the court finds that none of landlord's rental loss could have been "reasonably avoided," and landlord is relieved, in effect, of the duty to mitigate damages.

In my opinion, proposed Civil Code Section 1997.040(a) would be an unwarranted change in law. If the change is to be made at all, it should certainly not be made retroactively, as proposed Section 1997.050 would do, thereby imposing on tenants much greater obligations than they or their attorneys would have anticipated.

Very truly yours,

Michael P. Carbone

MPC:dr

CC: Real Property Law Section Executive Committee Members,
Advisors, CID and Landlord/Tenant Subsection Chairs
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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: Commercial Real Property Leases - Use Restrictions

Gentlemen:

With regard to the above-referenced tentative recommendation, I would suggest the addition to Section 1997.030 an explicit statement of purpose to guide the juduciary in the interpretation of it. Something along these lines would be sufficient: "This chapter modifies the law concerning unreasonable restraints on alienation, and the implied covenant of good faith and fair dealing governing restrictions on use."

With respect to 1997.050, I believe subdivision (c) does not authorize a violation of the law governing good faith and fair dealing, despite your comment, paragraph 4 without some more explicit language to support such a construction.

I support your attempt to inject some clairity into this area after the case of Kendall v. Ernest Pestana, Inc., 220 Cal Rptr. 818.

Very truly yours,

DOWLING, MAGARIAN,
PHILLIPS & AARON

Arnold F. Williams

AFW:ped

Fidelity National Title
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Larry M. Kaminsky
Vice President
Assistant General Counsel

March 21, 1990

John M. DeMoully, Esq.
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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

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March 30, 1990

California Law Revision Commission
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Re: Proposed Civil Code §§1997.010 - 1997.270
Use Restrictions

Gentlemen:

The proposed statutes codify the landlord's right to cause an absolute prohibition on assignment and subletting for a use which differs from that stated in the lease while at the same time not jeopardizing its rights under §1951.4.

While §1995 permits an absolute prohibition on assignment and subletting, doing so deprives the landlord of its remedies under §1951.4. By the enactment of the proposed §1997.230 and §1997.040, the Commission is proposing to substantially abrogate the provisions of §1951.4 which were drafted to provide the tenant a means for mitigating its damage of its breach of lease by assignment or subleasing. However, the newly proposed provisions of §1997.040 and 1997.230 allow the landlord to draft a highly restrictive use clause which has the effect of limiting the universe of potential assignees or sublessees to such a small field as to have the effect of preventing an assignment or subletting.

For example, let us assume that a use provision of a lease states that the lessee may use the premises solely for the retail sale of T-shirts. The lessee fails at the enterprise. It may have been that the lessee failed because it was not a good operator. It may also be that the location is not suitable for the sale of T-shirts. Because of the highly restrictive use clause, the universe of potential sublessees is limited to T-shirt sellers. However, this universe, small as it was to begin with, is now made even smaller in that only T-shirt operators who are willing to invest in a location which has already failed for that use, would be possibilities. For all intents and purposes, there are no potential sublessees for this location. Nonetheless, the landlord would have all of the remedies of §1951.4 still available to it since once a T-shirt operator is found, the landlord must (we will

assume for sake of this discussion) be reasonable in granting or withholding consent.

In effect, by limiting the use severely, the landlord has placed a quantum of restraint all out of proportion to the benefits to be derived by the landlord since it is clear, taking our example, that if the lease were terminated, the landlord would lease to some use other than a T-shirt operation. For this reason, the highly restrictive use would seem clearly to constitute an unreasonable restraint on alienation.

The landlord's interest is in protecting its merchandise mix (assuming it owns a shopping center consisting of a number of stores). However, should the landlord wish to retain its §1951.4 remedies, it should be obligated to act in good faith with respect to enforcement of highly restrictive use clauses.

Incidentally, the statement in the comment that an absolute prohibition on change of use would not constitute a violation of the law governing good faith and fair dealing is a non sequitur since good faith and fair dealing is not an issue in drafting contract language, but rather in enforcing contract language. If it is agreed that a landlord can absolutely restrict changes in use which are at variance with the narrow use provision in the lease, then the landlord cannot possibly be acting in bad faith were it to refuse to alter that provision without consideration. If it were otherwise, a tenant signing a lease which, after a few years, turned out to be above market because of a change in market rate for rents in the area, couldn't the tenant, with this reasoning, complain that the landlord is being unreasonable for not agreeing to amend his lease to reduce the rent! Thus, once having agreed that restrictive use provisions are legal, one cannot command that the landlord <u>amend</u> its lease by changing the provision.

I suggest that the use provisions as drafted in the example lease section are enforceable. However, the landlord must be subjected to a rule of good faith with respect to amendments to restrictive use provisions should the landlord wish to avail itself of the remedies of §1951.4.

Alternatively, restrictive use provisions interpreted and enforced out of proportion to the true harm which the landlord may suffer in the operation of its business complex, should be interpreted as unreasonable restraints upon alienation. By

comparison to the Wellenkamp language, unless a landlord could show the equivalent of the impairment of its security, i.e., impairment of its business operation of the shopping center, it ought not to be able to strictly enforce a restrictive use provision and still benefit from §1951.4.

I would further suggest that the provisions of §1997.040(a) and (b) be altered to provide for good faith enforcement by landlord of its rights under the restrictive use provision.

Very truly yours,

Martin I. Zankel

MIZ:spm
cc: Real Property Law Section Executive Committee
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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

Use Restrictions

January 1990

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

Use Restrictions

The California Supreme Court case of *Kendall v. Ernest Pestana, Inc.*[1] held that if a clause in a lease of commercial real property requires the landlord's consent for an assignment or sublease but fails to express a standard for giving or withholding consent, the clause must be construed to include an implied standard that the landlord's consent will not unreasonably be withheld. This holding has now been codified on recommendation of the Law Revision Commission[2] for leases executed on or after September 23, 1983, and overruled for leases executed before that date.[3]

The reasoning in the Supreme Court's opinion raises the question whether other lease clauses that require the landlord's consent but that fail to express a standard for giving or withholding consent will also be held to require reasonableness. Of the other consent clauses typically found in commercial leases, those restricting change of use of the leased property without the landlord's consent are the most closely related to assignment and sublease clauses and are probably the most common. An assignment or sublease restriction may be used as a means to control a change in use; a use restriction may be used to void an undesired assignment or sublease.

The dual bases of the Supreme Court's *Kendall* ruling—the rule against unreasonable restraints on alienation and the implied covenant of good faith and fair dealing—apply somewhat differently to use restrictions than they do to assignment and sublease restrictions.[4] A use restriction is not

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1. 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P. 2d 837 (1985).
2. *Recommendation Relating to Commercial Real Property Leases: Assignment and Sublease*, 20 Cal. L. Revision Comm'n Reports 251 (1989).
3. Civil Code §§ 1995.260-1995.270.
4. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 532-48 (1989).

a direct restraint on alienation, although it clearly affects the ability of the tenant to make a transfer of the tenant's interest. A use restriction requiring the landlord's consent directly involves the implied covenant of good faith and fair dealing. Whether these varying considerations would yield the same result in the courts for use restrictions as for assignment and sublease restrictions is not clear.

The Law Revision Commission believes that the uncertainty in the law governing use restrictions caused by the *Kendall* decision, together with the high frequency of use restrictions and their interrelation with assignment and sublease restrictions, makes further codification of this area of the law important. The Commission believes public policy mandates that use restrictions be treated statutorily the same as assignment and sublease restrictions.[5] Specifically, the Commission makes the following recommendations with respect to use restrictions in commercial real property leases:

(1) Absent a use restriction in the lease, the tenant should be able to make any reasonable use of the leased property.[6]

(2) The parties to a lease should be able to include an enforceable use restriction, subject to the overriding public policies that the use restriction not be discriminatory or otherwise illegal and that the contract not be unconscionable or a contract of adhesion.[7]

(3) A use restriction should be strictly construed in favor of unrestricted use.[8]

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5. Civil Code §§ 1995.010-1995.270.

6. This would codify the common law. See Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 535-36 (1989).

7. See, e.g., Civil Code § 53(a) ("every restriction or prohibition as to the use or occupation or real property because of the user's or occupier's sex, race, color, religion, ancestry, national origin, or blindness or other physical disability is void").

8. This would codify the common law. See Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A.L. Rev. 405, 535-36 (1989).

(4) The parties to a lease should be able to absolutely prohibit a change in use, or to require that there be no change in use without the landlord's consent, with or without express standards for giving or withholding consent.

(5) If the lease requires the landlord's consent without providing express standards for giving or withholding consent, the landlord should be subject to an implied requirement of reasonableness, consistent with the rule governing assignment and sublease restrictions.[9] Because this would represent a change in the law on which parties to leases have relied, the new rule should apply only to leases executed after the operative date of the new law.

(6) If the lease requires the landlord's consent and provides express standards for giving or withholding consent, the express standards should be enforceable by their terms, including a provision that the landlord has sole and absolute discretion to give or withhold consent. Such a provision should be exempt from any implied standard of commercial reasonableness since it does not create an implication that the landlord will not be arbitrary. 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.

(7) In case of termination of a lease for the tenant's breach, the tenant should be able to require mitigation of the landlord's damages[10] based on any reasonable use of the premises if the lease contains no use restriction, and based on restricted use of the premises if the lease contains a use restriction.

(8) In case the landlord continues a lease in effect notwithstanding the tenant's breach,[11] the tenant should have the right to assign or sublet for any reasonable use of the

9. Civil Code § 1995.260.
10. See Civil Code § 1951.2.
11. See Civil Code § 1951.4.

premises if the lease contains no use restriction, and to assign or sublet for restricted use of the premises if the lease contains a use restriction.

PROPOSED LEGISLATION

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

Civil Code §§ 1997.010-1997.270 (added). Use restrictions

Chapter 7 (commencing with Section 1997.010) is added to Title 5 of Part 4 of Division 3 of the Civil Code, to read:

CHAPTER 7. USE RESTRICTIONS

Article 1. General Provisions

§ 1997.010. Scope of chapter

1997.010. This chapter applies to a restriction on use of leased property by a tenant under a lease of real property for other than residential purposes.

Comment. Section 1997.010 limits the scope of this chapter to commercial real property leases. Use restriction issues concerning personal property leases and residential real property leases may involve different public policies than commercial real property leases, and therefore are governed by the common law and not by this chapter.

§ 1997.020. Definitions

1997.020. As used in this chapter:

(a) "Landlord" includes a tenant who is a sublandlord under a sublease.

(b) "Lease" means a lease or sublease of real property for other than residential purposes, and includes modifications and other agreements affecting a lease.

(c) "Restriction on use" means a provision in a lease that restricts the use of leased property by a tenant, whether by limiting use to a specified purpose, mandating use for a specified purpose, prohibiting use for a specified purpose, limiting or prohibiting a change in use, or otherwise.

(d) "Tenant" includes a subtenant or assignee.

Comment. Section 1997.020 provides definitions for drafting convenience.

Subdivision (b) is consistent with Section 1997.010 (scope of chapter). A restriction separately agreed to by the parties that affects a lease is part of the lease for purposes of this chapter. The provisions of this chapter apply between parties to a sublease and between parties to an assigned lease, as well as between original parties to a lease.

Under subdivision (c), this chapter does not apply to a restriction on use unless the restriction is expressly provided in the lease (as defined in this section).

§ 1997.030. Use restriction for illegal purpose not authorized

1997.030. Nothing in this chapter authorizes a restriction on use that is otherwise prohibited by law.

Comment. Section 1997.030 makes clear that this chapter is not intended to validate a restriction on use that serves an illegal purpose. See, e.g., Civil Code § 53(a) ("every restriction or prohibition as to the use or occupation of real property because of the user's or occupier's sex, race, color, religion, ancestry, national origin, or blindness or other physical disability is void"). However, the chapter is intended to govern a restriction on use notwithstanding any contrary implication in the law governing unreasonable restraints on alienation or the implied covenant of good faith and fair dealing. See Section 1997.210 and its Comment.

§ 1997.040. Effect of use restriction on remedies for breach

1997.040. (a) For the purpose of subdivision (a) of Section 1951.2 (damages on termination for breach), the amount of rental loss that could be or could have been reasonably avoided is computed by taking into account any reasonable use of the leased property except to the extent the lease includes a restriction on use that is enforceable under this chapter.

(b) The remedy described in Section 1951.4 (continuation of lease after breach and abandonment) is available notwithstanding the presence in the lease of a restriction on use of the leased property, and the restriction on use applies under Section 1951.4 to the extent it is enforceable under this chapter.

Comment. Subdivision (a) of Section 1997.040 makes clear that absent an enforceable use restriction the tenant is entitled to the benefit of mitigation under Section 1951.2 that would be achieved by devoting the leased property to any reasonable use. Thus if the tenant could have changed the use without the landlord's consent, or is limited only by a requirement for the landlord's reasonable consent, the tenant is entitled to have a possible reasonable change in use considered as one of the factors in determining the reasonably avoidable rental loss.

Subdivision (a) also makes clear that an enforceable use restriction may not be ignored in determining the extent of the landlord's obligation to mitigate following termination of the lease for the tenant's breach. Thus, if the tenant could not have changed the use because the terminated lease contained a restriction on use that was absolute or subject to the landlord's consent in the landlord's sole and absolute discretion, the landlord is not required to give up the bargained-for benefit in order to reduce the damages to the breaching tenant. However, if the landlord in fact relets for a purpose that would have violated the use restriction, the reletting is in effect a waiver of the use restriction for that purpose and the tenant is entitled to have that purpose taken into account in the computation of damages.

Subdivision (b) makes clear that the landlord's use of the remedy provided in Section 1951.4 does not limit enforceability of a use restriction that is otherwise enforceable. Thus if the lease allows the tenant to change the use without restriction or with the landlord's reasonable consent, the transferee would have the same freedom and limitations. If a use restriction absolutely prohibits change, or gives the landlord sole and absolute discretion to prevent change, both the tenant and transferee have to conform to those restraints.

§ 1997.050. Transitional provision

1997.050. Except as provided in Section 1997.270, this chapter applies to a lease executed before, on, or after January 1, 1992.

Comment. Section 1997.050 makes clear that this chapter is intended to be applied to existing leases as well as to leases executed after its operative date. An exception is made in the case of the rule of Section 1997.260 (implied standard for landlord's consent), which only applies to leases executed on or after January 1, 1992. See Section 1997.270 (limitation on retroactivity of Section 1997.260).

Article 2. Use Restrictions

§ 1997.210. Right of any reasonable use absent a restriction

1997.210. (a) Subject to the limitations in this chapter, a lease may include a restriction on use of leased property by a tenant.

(b) Unless the lease includes a restriction on use, a tenant's rights under a lease include any reasonable use of leased property.

Comment. Subdivision (a) of Section 1997.210 is a specific application of general principles of freedom of contract. Subdivision (a) is limited by the other provisions of this chapter. See, e.g., Sections 1997.030 (use restriction for illegal purpose not authorized), 1997.260 (implied standard for landlord's consent). Neither the law governing unreasonable restraints on alienation nor the law governing the implied covenant of good faith and fair dealing prevents the enforcement of a restriction on use in accordance with the express terms of the restriction. It should be noted, however, that subdivision (a) remains subject to general principles limiting freedom of contract. See, e.g., 1 B. Witkin, Summary of California Law *Contracts* §§23-36 (9th ed. 1987) (adhesion and unconscionable contract doctrines).

Subdivision (b) codifies the common law rule that a tenant may make any reasonable use of the leased property unless the right is expressly restricted by the parties.

§ 1997.220. Use restriction strictly construed

1997.220. An ambiguity in a restriction on use of leased property by a tenant shall be construed in favor of unrestricted use.

Comment. Section 1997.220 codifies the common law.

§ 1997.230. Prohibition of change in use

1997.230. A restriction on use of leased property by a tenant may absolutely prohibit a change in use.

Comment. Section 1997.230 settles the question of the validity of a clause absolutely prohibiting change in use of the leased property by the tenant. A lease term absolutely prohibiting change in use is not invalid as a restraint on alienation and is not a violation of the law governing good faith and fair dealing. Such a term is valid subject to general

principles governing freedom of contract, including the adhesion contract doctrine, where applicable. See Section 1997.210 and its Comment (right of any reasonable use absent a restriction).

§ 1997.240. Use restriction subject to standards and conditions

1997.240. A restriction on use of leased property by a tenant may provide that a change in use is subject to any express standard or condition.

Comment. Section 1997.240 is a specific application of subdivision (a) of Section 1997.210 (lease may include use restriction). This section does not apply, and Section 1997.250 does apply, to a restriction on use of the leased property by a tenant that requires the landlord's consent for a change in use. Section 1997.240 is subject to general principles limiting freedom of contract. See Section 1997.210 and its Comment.

§ 1997.250. Express standards and conditions for landlord's consent

1997.250. A restriction on use of leased property by a tenant may require the landlord's consent for a change in use subject to any express standard or condition for giving or withholding consent, including, but not limited to, any of the following:

(a) The landlord's consent may not be unreasonably withheld.

(b) The landlord's consent may be withheld subject to express standards or conditions.

(c) The landlord has sole and absolute discretion to give or withhold consent.

Comment. Section 1997.250 is a specific application of the broad latitude provided in this chapter for the parties to a lease to contract for express restrictions on use of the leased property by the tenant. Such restrictions on change in use are valid subject to general principles governing freedom of contract, including the adhesion contract doctrine, where applicable. See Section 1997.210 and its Comment (right of any reasonable use absent a restriction).

The meaning of "unreasonably withheld" under subdivision (a) is a question of fact that must determined under the circumstances of the particular case, applying an objective standard of commercial reasonableness as developed by case law.

Subdivision (b) makes clear that the lease may condition the landlord's consent in any manner.

Subdivision (c) settles the question of the validity of a clause granting sole and absolute discretion over change in use to the landlord. A lease clause of the type described in subdivision (c) is not invalid as a restraint on alienation, and its exercise by the landlord is not a violation of the law governing good faith and fair dealing.

§ 1997.260. Implied standard for landlord's consent

1997.260. If a restriction on use of leased property by a tenant requires the landlord's consent for a change in use but provides no standard for giving or withholding consent, the restriction shall be construed to include an implied standard that the landlord's consent may not be unreasonably withheld. Whether the landlord's consent has been unreasonably withheld in a particular case is a question of fact on which the tenant has the burden of proof. The tenant may satisfy the burden of proof by showing that, in response to the tenant's written request for a statement of reasons for withholding consent, the landlord has failed, within a reasonable time, to state in writing a reasonable objection to the change in use.

Comment. Section 1997.260 is new. For an analogous provision, see Section 1995.260 (assignment and sublease). The retroactive application of Section 1997.260 is limited by Section 1997.270.

Under Section 1997.260, whether a landlord's consent has been unreasonably withheld may be a question of procedure or substance or both. A landlord may act unreasonably in responding to a request of the tenant for consent to a change in use (for example by delaying or failing to respond or by requiring excessive investigation charges), or the landlord may not have a reasonable objection to the change in use. Either of these circumstances may give rise to a determination that the landlord has unreasonably withheld consent to the change in use within the meaning of this section.

This section provides the tenant a means of satisfying the burden of proof on this matter by making a written request for a statement of reasons. However, this is not the exclusive means of satisfying the burden of proof that the landlord's consent has been unreasonably withheld in a particular case, and proof of unreasonableness may be made by other means.

Section 1997.260 rejects an absolute approach to the question of commercial reasonableness. Whether a particular objection is reasonable within the meaning of this section is a question of fact that must be determined under the circumstances of the particular case, applying an objective standard of commercial reasonableness as developed by case law.

§ 1997.270. Limitation on retroactivity of Section 1997.260

1997.270. (a) Section 1997.260 applies to a restriction on use executed on or after January 1, 1992. If a restriction on use executed before January 1, 1992, requires the landlord's consent for a change in use of leased premises by a tenant but provides no standard for giving or withholding consent, the landlord has sole and absolute discretion to give or withhold consent.

(b) For purposes of this section, if the terms of a restriction on change in use are fixed by an option or other agreement, the restriction on change in use is deemed to be executed on the date of execution of the option or other agreement.

Comment. Section 1997.270 limits the retroactive application of Section 1997.260 (implied standard for landlord's consent). The date of applicability of Section 1997.260 is January 1, 1992. If a sublease is made on or after January 1, 1992, under a lease executed before that date, the rights between the parties to the sublease are governed by Section 1997.260. See Section 1997.020(b) ("lease" means lease or sublease).

Limitation of retroactive operation of Section 1997.260 is supported by the public policies of foreseeability, reliance, and fairness.

Nothing in this section is intended to limit the law governing modification or waiver of a lease provision by subsequent conduct or agreement of the parties, including modification or waiver of a restriction on use that expressly or impliedly permits the landlord's consent to be unreasonably withheld, whether the lease was executed before or after January 1, 1992. See also Section 1995.020(b) ("lease" includes modifications and other agreements affecting lease). Thus, a tenant may show that the landlord's sole and absolute discretion to give or withhold consent pursuant to an express or implied lease restriction executed before January 1, 1992, has been modified or waived.