First Supplement to Memorandum 90-50

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

We have received letters from Ronald P. Denitz of Tishman Companies (Exhibit 1) and from our consultant, Professor William G. Coskran (relevant portion of letter reproduced in Exhibit 2), commenting on the issues raised concerning the tentative recommendation on use restrictions in commercial real property leases.

General Comments

Mr. Denitz opposes the changes to the tentative recommendation suggested by the staff in Memorandum 90-50; he would submit the recommendation to the Legislature without change, or with compromise language discussed below.

Professor Coskran refutes the allegation that this tentative recommendation is biased in favor of landlords by pointing out that existing statutes make a use restriction absolutely enforceable against a tenant, whereas this tentative recommendation would temper the law with a reasonableness requirement where the parties have not specified standards for the landlord's consent. Professor Coskran also urges caution against automatic application of a reasonableness requirement to every use restriction that is a "bad deal" for the tenant--"if a bad deal is to be sufficient justification to allow a judicial modification of express contract terms, I believe it is essential that the Commission develop clear and consistent requirements for application of the new policy. It is also important to consider the ramifications of such a new policy on contracts generally."

§ 1997.040. Effect of use restriction on remedies for breach

Application of Civil Code § 1951.2

When a tenant breaches a lease the landlord is entitled to damages based in part on the amount of loss the landlord could reasonably have

avoided by reletting the property. Section 1997.040(a) of the tentative recommendation would provide that in determining what rental loss is reasonably avoidable, the landlord is entitled to take into account any use restrictions imposed by the lease on the tenant. After reviewing commentary received on this proposal, the staff concludes in Memorandum 90-50 that the landlord's damages should be based on any reasonable use of the property, not on restricted use of the property.

Professor Coskran believes there is a problem here, but that the Commission should be circumspect about ignoring the use restriction in assessing damages. After all, the policy of the law is to enforce the agreement of the parties. Why should the landlord be required to lose the benefit of the bargain made? Why should the tenant be allowed to ignore the use restriction by threatening to breach, free of liability, unless the landlord accedes to the change in use?

Mr. Denitz disagrees at length with the proposal to base damages on any reasonable use of the property. His basic point is that if the landlord's damages are based on any reasonable use, the landlord will not be made whole. The landlord had very good commercial reasons to begin with for needing to restrict use, such as tenant mix, structural impact, hazards, rental needs, etc., and these concerns will remain and will affect the landlord's ability to mitigate by finding a suitable replacement tenant. Mr. Denitz believes that the section should be left unchanged. As an alternative, he would revise it to provide, in effect:

> 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~~ . This subdivision does not apply to the extent the lease includes a restriction on use that is enforceable under this chapter, unless the tenant proves that, at the time of the termination of the lease, all of the facts and circumstances surrounding both the leased premises and any building or complex in which it is located no longer justify continued imposition of the restriction on use.

The staff believes this sort of approach may offer a useful middle ground on this issue.

Application of Civil Code § 1951.4

The tentative recommendation provides that if a landlord exercises the remedy of requiring a breaching tenant to continue paying rent, any assignment or sublease made by the tenant seeking to mitigate damages must remain subject to use restrictions in the main lease. In Memorandum 90-50 the staff suggests that the tenant be able to assign or sublet for any reasonable use, despite the restriction, since the existence of a highly restrictive clause in the main lease may as a practical matter make it impossible for the tenant to mitigate.

Professor Coskran and Mr. Denitz have the same concerns about this liberalization as with the preceding one. Professor Coskran sees some merit in continuing to subject the lease to the use restriction. Mr. Denitz suggests middle ground language. The staff believes a middle ground approach may be useful.

§ 1997.210. Right of any reasonable use absent a restriction

Mr. Denitz believes that the statute should state explicitly 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". Mr. Denitz believes the intent of the proposed legislation is to allow the parties by agreement to override these common law concepts.

Professor Coskran notes that the policy against restraints on alienation does not apply to use restrictions, and enforcement of an express use restriction in accordance with its terms does not violate the covenant of good faith and fair dealing. He does not take a position on whether the statute should state this expressly.

§ 1997.230. Prohibition of change in use

Memorandum 90-50 discusses comments of persons who believe the landlord and tenant should not by agreement be able absolutely to prohibit a change in use--a change in use should always be subject to good faith and fair dealing and commercial reasonableness.

Mr. Denitz objects to this proposition. It would allow a tenant, once in possession, to change the use at will, notwithstanding the landlord's good and valid reasons for wanting to limit the uses for which the landlord will lease the property.

Professor Coskran also notes that it should require an amendment to the lease to avoid enforcement of the express terms of a use restriction. Extending the covenant of good faith and fair dealing to enforcement of the express terms of a use restriction would in effect authorize the tenant to renegotiate the lease every time the tenant felt that the lease had resulted in a bad deal.

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

In Memorandum 90-50, the staff suggests that the Commission make clear by statute whether or not the implied duty of good faith and fair dealing applies to a lease in which the landlord is given sole discretion to approve or reject a proposed change in use. At present, the Comment states that a sole discretion clause overrides the duty of good faith and fair dealing.

Mr. Denitz believes it is fundamental that the parties be able absolutely by contract to specify the standards that will govern use changes under their lease, subject only to the adhesion contract doctrine where applicable. He observes that this section parallels the assignment and sublease statute and should be the same for consistency. However, the staff notes that if we were to be consistent here we would delete from this draft the express authority for the parties to negotiate a clause that gives the landlord sole and absolute discretion to consent to a change in use. The assignment and sublease statute does not expressly provide that the parties may contract for the landlord to have sole and absolute discretion, no matter how unreasonable, to consent to an assignment or sublease. That feature of the Commission's recommendation was deleted from the legislation by the Assembly Judiciary Committee, which felt that the statute ought not expressly to condone unreasonable behavior.

Professor Coskran believes that the matter should be clarified by statute. "Does the mention of the possibility of consent lead the tenant to believe that the lessor will be reasonable in granting or refusing consent, or that the lessor will have to show some objectively legitimate reason for refusal? This concern arose with the assignment/sublease legislation and it continues to bother some people. It should be addressed."

§ 1997.270. Limitation on retroactivity of Section 1997.260

The tentative recommendation would require that the landlord be reasonable in exercising a lease term that calls for the landlord's consent to a change in use. This requirement would apply only to leases executed after the operative date of the legislation. Memorandum 90-50 notes that one comment on the tentative recommendation believes this rule should be fully retroactive, as a matter of both law and policy.

Professor Coskran does not believe existing law extends a reasonableness requirement to lease clauses requiring the landlord's consent for a change in use. "There is no doubt that one can speculate on the extension of the Kendall reasoning to a use clause, although there are many who believe that the current California Supreme Court will not make such an extension. However, I have looked in vain for cases imposing that implied standard of reasonableness to a use restriction."

A technical issue on Section 1997.270 relates to whether a lease option is "executed" when the option is signed or when the lease is signed. Professor Coskran agrees with the staff that the option is executed when the option is signed, since the option fixes the terms of the lease. The staff suggestion is that this be made clear in the Comment to Section 1997.270.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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May 11, 1990

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

Re: Tentative Recommendation Relating to Use Restrictions in Commercial Real Property Leases - (Study H-112) - Memorandum 90-50

Gentlemen:

Having continuously followed and having had the privilege of working with you on both your Study H-111 and the captioned Study H-112 as well as other Commercial Leasing problems over the last decade, I respectfully oppose the changes in the Tentative Recommendation (December, 1989) proposed by the Staff and urge that the Commission either (a) submit the Tentative Recommendation to the Legislature unchanged or (b) revise the Staff's suggested modification.

As it stands, Subdivision "(a)" of Section 1997.040 honors the use restriction negotiated by the parties; it does not require the landlord to mitigate damages by re-leasing to any reasonable-use-tenant. The Staff's suggested revision is that use-restrictions be disregarded in measuring the amount by which Landlord's rental-damages are to be reduced if landlord fails to re-lease to whatever reasonable-use tenant is out there.

As a commercial real estate lawyer engaged at Tishman for more than 22 years in the actual day to day draftsmanship and negotiation of commercial lease documents (which day to day activities often resembles the "trenches" in the light of most good-sized tenants [who are represented by informed and often aggressive legal counsel]), I have found that use-restrictions in office building commercial leases are essential, and must not be vaguely limited to that which is "reasonable", in order (for example) for a medical office building to remain a medical office building or a non-medical office building to remain free of medical-arts tenants or for the Ground Floor commercial tenancies to remain commercial (rather than office-oriented in nature. The barest minimum such restrictions are as follows:

(a) The proposed use by tenant must be compatible with the other uses in the building or in the Complex within which the building is located;

(b) The proposed use by tenant must not negatively impact or "surcharge" any service elements in the building such as air-conditioning (e.g.,

assignment by drugstore to a commercial baker), elevators, increased foot or elevator traffic nor may the proposed tenant use demised premises for any of the diverse purposes contained in Exhibit "A" hereto [which Exhibit "A" contents constantly have been used by us as our well-accepted "Rule and Regulation No. 14"];

(c) Uses must not be made which would increase the insurance rates or create a fire safety hazard;

(d) Any use is forbidden which would provide any noise or "shake, rattle and roll" (e.g., a record company using its administrative office premises or other facilities for rehearsal or auditioning of bands and rock and roll groups); or

(e) In shopping centers or other store-type buildings and parking structure leases, where uses are directly related to and consistently and commercially determine what percentage rent (if any) should be imposed and the level of that percentage rent, the reasonableness of landlord's consent should not be negatively affected by the language of the Comment that "...denial [may not be imposed by landlord]...in order that the landlord may charge a higher rent that originally contracted for".

Similarly, in office buildings where ground floor space can readily be adapted to either office or bank uses (no percentage rent) or retail stores or shops (which do customarily pay percentage rent), landlord needs to reserve the right to impose a percentage rent for the first time or modify any preceding percentage rent clause (see Exhibit "B" hereto).

As a result of the foregoing, our company as Manager of more than 50 office buildings (and one shopping center) in California, urges that the proposed Staff changes be either rejected or modified to read as follows:

(i) Section 1997.040 (Remedies for Breach): [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 that the tenant proves that, at the time of the termination of the lease, all of the facts and circumstances surrounding both the leased premises and any building or complex in which it is located no

longer justify continued imposition of otherwise-enforceable use restrictions contained in the lease";

Section 195.14 ("Lock-in Remedy"): The modification proposed by me as a possible modification of Section 1997.040 are logically compatible with the existing provisions of Section 1951.4 that the Landlord cannot employ the "lock-in" remedy where lease-restrictions have become unreasonable.

(ii) Section 1997.210: (Right of Any Reasonable Use Absent a Restriction): We concur with Mr. Williams (Exhibit 4) that an explicit statement be made in the section that "this chapter modifies the law concerning unreasonable restraints and alienation, in the implied covenant of good faith and fair dealing governing restrictions on use". Although "good faith and fair dealing" and "commercial reasonableness" are treatments to which an existing tenant is entitled to the extent provided by law, the commission determined that freedom of contract and its concomitant opportunity for bilateral bargaining does not require a Landlord to treat a prospective tenant with the kind of quasi-fiduciary consideration that the courts developed as the Kendall extension of Wellenkamp; in the negotiations stage each of the prospective tenant and Landlord has a free and fair opportunity to retain counsel and the right to "just say no": It would play havoc with commerce generally if every potential buyer (and, in the context of our commercial leasing business, a potential tenant is, in fact, a "buyer") be treated with commercial reasonableness and good faith and fair dealing by every proposed "seller".

(iii) Section 1997.230 (Changes in Use): Mr. Johnson's concerns should be met by reference to the same type of arguments as the undersigned writer made with respect to the reasons for restrictions on use applicable to Section 1997.040 and 1951.4. Mr. Johnson, in arguing for freedom of change of use where commercially reasonable, attempts a "back door" circumvention of the aforementioned right of the Landlord to, initially, restrict tenants' use. If a tenant, once in possession, were given permission by the Commission and the Legislature to change its use at will, it would entirely abridge the right of a Landlord to make any of the use-restrictions which I have stated above as well as the limitation to a specific (e.g., "accounting offices") use. The Commission's attention is, further, invited to the problem of tenant mix in shopping centers where the shopping

center needs a "shoe store" but does not need two bakeries to which a shoe store tenant in question might wish to switch.

(iv) Section 1997.250: The question of "express standards and conditions for Landlord's consent" is the keystone of the Commission's policy decision that a party to a lease should be entitled to contract for express restrictions, subject to the adhesion contract doctrine where applicable. Then, too, the rights of restrictions on use changes set forth in Section 1997.250 closely parallel the language already enacted by the Legislature in Section 1995.250 with respect to restrictions on assignment or sublease. Any departure from those standards and language would create a legislative inconsistency and play havoc with the ability of Landlords and tenants to rely on a lease, once executed, as a statement of the rights of each and, more important, the further right of the Landlord to grant exclusive-use-rights to other tenants in the same building or complex. Once again, the Commission should review Exhibits A and B hereto and sub-paragraphs "(a)" through "(e)" at the beginning of this letter: the same reasons that motivate Landlord to preclude the tenant (through use of use-restrictions) from certain forbidden activities likewise must give the tenant from unilaterally changing to any of those prohibited uses once the lease itself has been executed.

My separate-letter comments, with respect to each of Memoranda 90-49 (Remedies for Breach, etc.) and 90-68 (Reconsideration Kendall Legislation) accompany this letter.

With many thanks for your kind indulgence, I am

Sincerely,

RONALD P. DENITZ
Vice President and
General Counsel
TISHMAN WEST COMPANIES

RPD:hm

cc: W. Coskran, Esq.

RULES AND REGULATIONS

14. Tenant shall not occupy or permit any portion of demised premises to be occupied as an office that is not generally consistent with the character and nature of all other tenancies in the Building, or is (a) for an employment agency, a public stenographer or typist, a labor union office, a physician's or dentist's office, a dance or music studio, a school, a beauty salon or barber shop, the business of photographic or multilith or multigraph reproductions or offset printing (not precluding using any part of demised premises for photographic, multilith or multigraph reproductions solely in connection with Tenant's own business and/or activities), a restaurant or bar, an establishement for the sale of confectionary or soda or beverages or sandwiches or ice cream or baked goods, an establishment for the preparation or dispensing or consumption of food or beverages (of any kind) in any manner whatsoever, or as a news or cigar stand, or as a radio or television or recording studio, theater or exhibition-hall, for manufacturing, for the storage of merchandise or for the sale of merchandise, goods or property of any kind at auction, or for lodging, sleeping or for any immoral purpose, or for any business which would tend to generate a large amount of foot traffic in or about the Building or the land upon which it is located, or any of the areas used in the operation of the Building, including but not limited to any use (i) for a banking, trust company, depository, guarantee, or safe deposit business, (ii) as a savings bank, or as savings and loan association, or as a loan company, (iii) for the sale of travelers checks, money orders, drafts, foreign exchange or letters of credit or for the receipt of money for transmission, (iv) as a stock broker's or dealer's office or for the underwriting of securities, or (v) a government office or foreign embassy or consulate, or (vi) tourist or travel bureau, or (b) a use which conflicts with any so-called "exclusive" then in favor of, or is for any use the same as that stated in any percentage lease to, another tenant of the Building or any of Landlord's then buildings which are in the same complex as the Building, or (c) a use which would be prohibited by any other portion of this lease (including but not limited to any Rules and Regulations then in effect) or in violation of law. Tenant shall not engage or pay any employees on demised premises, except those actually working for Tenant on demised premises nor shall Tenant advertise for laborers giving an address at demised premises.

PERCENTAGE RENTALS

49. Further supplementing Subdivision A of Article 3, Tenant acknowledges that Landlord normally requires that ground floor shop or store tenants (as opposed to normal office tenants) pay percentage rentals and consequently Tenant agrees that if the proposed assignee is to operate a shop or store in demised premises it shall be reasonable for Landlord to withhold Landlord's consent to any assignment of this lease unless the proposed assignee consents to an amendment of this lease adding thereto Landlord's then standard Rent Rider and providing for Tenant to pay, in addition to the base annual rent reserved on the first page of this lease, additional rent in the sum of a reasonable percentage of Tenant's gross sales at or from or on behalf of the demised premises; said percentage rent shall be payable upon the terms and at the times set forth in said Rent Rider.

Landlord acknowledges that Tenant, in its operation of a * office, is a normal "office" tenant and therefore an assignment of this lease for the same use would not entitle Landlord to require percentage rent as a condition of Landlord consenting to such an assignment.

OR

PERCENTAGE RENTALS

* The percentage rental set forth in the Rent Rider attached to this lease was a material and major inducement to Landlord to enter into this lease, the percentage of Gross Income to be paid as percentage rent and the amount of Gross Income in excess of which percentage rent is payable each being related directly to the type of business conducted or to be conducted by Tenant within demised premises and the amount which Tenant has represented to Landlord as Tenant's probable minimum annual dollar-volume of business. Accordingly, Landlord shall have the further reasonable right to withhold its consent to such proposed assignment unless Tenant and said proposed assignee agree to a proposal by Landlord to:

(i) increase the level of fixed minimum rent,

(ii) increase the percentage of Gross Income to be paid as percentage rent, and

(iii) decrease the amount of Gross Income in excess of which percentage rent is payable,

to reflect the proposed change in [a] the type of business or [b] the reasonably estimated minimum annual dollar-volume of business to be done in demised premises or [c] the financial strength of the occupant of demised premises or [d] any combination of the foregoing. Such adjustment shall be contained in an amendment of lease to be executed by Landlord, Tenant, and the proposed assignee concurrently with the execution of the Assignment, Assumption and Consent.

MAY 16 1990
RECEIVED

LOYOLA LAW SCHOOL

TO Nathaniel Sterling
California Law Revision Commission
FM Bill Coskran
5731 Marshall Dr., Huntington Beach, CA 92649
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DT 5/14/90

RE RECONSIDERATION OF ASSIGNMENT/SUBLEASE RESTRICTION LEGIS.; REMEDIES FOR BREACH OF ASSIGNMENT/SUBLEASE CLAUSE; USE RESTRICTIONS.

Thank you for copies of the correspondence concerning the above matters.

If the Commission is going to address reconsideration of the Assignment/Sublease Restriction legislation that went into effect January 1st, I think that issue should be resolved before going into the proposals on Remedies and Use Restrictions. The existing legislation is the product of a considerable amount of review, discussion and compromise. If there are going to be proposals to change the it, it seems the process begins anew. The issues of Remedies and Use Restrictions are closely related to the existing legislation. If the Commission reopens the existing legislation and makes changes, the changes will most likely have an effect on the recommendations regarding Remedies and Use Restrictions.

A summary of my comments is attached.
(Note: Citations to principal cases and treatises referred to in this memo are in the background study and not repeated here; page references to the study refer to the published version.)

Respectfully submitted,

W. C. COSKRAN

1

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USE RESTRICTIONS

1. CHARGE OF LANDLORD BIAS.

Mr. Johnson's charges of landlord bias have been raised and discussed on the other issues, so I will not repeat my comments here. However, there is an additional factor to consider with respect to use restrictions. What is the tenant's present position, absent the Commission's proposals?

Existing statutes provide for the enforcement of a use restriction according to its terms. If property is leased for a "particular purpose" the tenant must not use it for "any other purpose," and if the tenant does so, the tenant is liable to the lessor for all damages resulting from such use, or the lessor may treat the lease as rescinded (C.C. 1930). The lessor may terminate the lease and recover possession when the tenant uses or permits use of the property "in a manner contrary to the agreement of the parties."

Existing California case law does not inhibit the lessor's ability to restrict changes in use. Even in the Kendall type situation, where a clause requires the lessor's consent to change but does not express the applicable standard, the tenant is not assured of the protection of an implied reasonableness standard. Although I personally favor application of the Kendall result to such a silent consent clause, an opinion that the present Cali-

fornia Supreme Court would do so is quite speculative. I have heard experienced real property lawyers express the view that the tenant would not receive such judicial protection. The proposed legislation extends this protection to tenants.

Even if the Kendall result is judicially extended to a use restriction clause, this would not prevent use of an express "absolute prohibition of change" clause or other express restrictions. The Kendall holding only applies to clauses which require consent but fail to express a standard.

2. BASIC PRINCIPLES.

Mr. Johnson again argues for a mandatory reasonableness standard. My comments on basic principles contained in the discussion of reopening the assignment/sublease legislation also apply here, and there is no need to repeat them. I am not against providing relief to parties who have made a bad deal. There are certain base level protections in existing doctrines, e.g. adhesion. I agree with Mr. Johnson that such doctrines do not provide complete relief from a bad deal. However, further relief requires a change in existing doctrines, or the development of a new one. In either event, if a bad deal is to be sufficient justification to allow a judicial modification of express contract terms, I believe it is essential that the Commission develop clear and consistent requirements for application of the new policy. It is also important to consider the ramifications of such a new policy on contracts generally.

3. DAMAGES UPON TENANT BREACH & LEASE TERMINATION; C.C. 1997.040(a).

Existing law provides that if the tenant breaches the lease and abandons the premises, or the lessor terminates the lease based on the tenant's breach, certain damages are recoverable (C.C. 1951.2). The major component of recoverable damages is the excess of the agreed rent over the reasonably avoidable rent loss.

Suppose in a particular case there will be a deficiency and damages if the lessor relets for the use specified in the lease. Suppose further that the lessor could get more rent by leasing for a different use and thus reduce or eliminate the deficiency. How does a use restriction in the breached lease affect the tenant's offset for reasonably avoidable rent loss?

First, assume that under the terms of the breached lease, the tenant could have changed the use without the lessor's consent, or limited only by a requirement for the lessor's reasonable consent. It seems clear that the tenant should be entitled to have a reasonable change in use considered in avoiding damages. Subsection (a) of proposed C.C. 1997.040 provides for this result.

Second, assume that under the terms of the breached lease the tenant could not have changed the use because the terminated lease contained an express absolute restriction or a sole discretion standard for consent. Can the tenant avoid the express

restriction by having a reasonable change in use considered in avoiding damages? The present wording of subsection (a) would prevent that change from being considered.

Mr. Carbone raises an important objection to the result in this second situation. His letter argues persuasively that once the lease is terminated and the issue is damages, a reasonable change in use should be considered for purposes of mitigation. This position has considerable merit. It should be weighed against the factors that were discussed in leading to the present wording of subsection (a).

As I recall, the main reason in support of the present wording was that the lessor should not be required to give up a bargained benefit expressed in the lease in order to reduce damages to a breaching tenant. Also, if a tenant is allowed to base offsets on a modification of the terms of the use clause, why should the modifications be limited to the use clause?

If the legislation is changed in accordance with Mr. Carbone's proposal, there is another possible consideration. Would there be a potential for the tenant to indulge in tactical avoidance of the express terms of the lease? Suppose the following sequence:

1. Execution of a lease containing an express clause specifying the use and absolutely prohibiting a change.

2. Tenant proposes a change in use and the lessor refuses to amend the lease.

3. Tenant breaches the lease and abandons the premises, triggering a termination of the lease pursuant to C.C. 1951.2.

4. Lessor sues the tenant for damages and the tenant offsets based on the rental value for a different use of the premises.

It seems that the tenant has imposed an amendment of the lease terms by breaching the lease and abandoning the premises. If this is going to be the result, could the tenant then threaten the lessor with this result when proposing an amendment to the lease? I am going to ask Mr. Carbone if he considers this to be a problem.

Since the basic issue here is one of mitigation of damages, it seems the Commission has a great deal of flexibility in determining policy, and I think Mr. Carbone's point deserves careful consideration.

4. LOCK-IN REMEDY UPON TENANT BREACH & ABANDONMENT; C.C. 1997.040(b).

Existing law provides that if the tenant breaches the lease and abandons the premises, the lessor can elect to keep the lease in effect and enforce the lease terms against the breaching tenant. The remedy is available only is the tenant is permitted to assign or sublet, subject only to reasonable restrictions.

Suppose in a particular case the tenant wants to transfer to a third party who will use the property for a different use. How does a use restriction in the breached lease affect the tenant's ability to transfer for a different use?

First, assume that, under the terms of the breached lease, the tenant could have changed the use without the lessor's consent, or limited only by a requirement for the lessor's reasonable consent. It seems clear that the tenant should be entitled to transfer to a third party who will be making a reasonable change in use. Subsection (b) of proposed C.C. 1997.040 allows this result.

Second, assume that under the terms of the breached lease the tenant could not have changed the use because the lease contains an express absolute restriction or a sole discretion standard for consent. Can the tenant avoid the express restriction by making a transfer to a third party? The present wording of subsection (b) would prevent such a change in use even if the change would not be unreasonable.

Mr. Zankel raises an important objection to the result in this second situation. His letter argues persuasively that once the lessor chooses this remedy, the reasonableness standard should govern the use of the premises as well. This position has considerable merit. The tenant must be allowed a reasonable right to transfer, and the type of use is closely related to the practical ability to find a transferee. Thus, strict adherence to the existing use could make it quite difficult or impossible for the tenant to get a transferee. This is particularly true, as Mr. Zankel points out, if the tenant has already failed at the business specified in the lease.

Mr. Zankel's position should be weighed against the factors discussed in leading to the present wording of subsection (b). As I recall, the main reason in support of the present wording of subsection (b) was that the use clause is an integral part of the continuing lease which remains enforceable according to its terms against the tenant and third party. The present wording of C.C. 1951.4 provides that "the lease continues in effect" and "the lessor may enforce all the lessor's rights and remedies under the lease." Also, if a tenant who breaches and abandons is entitled to a modification of the use clause, what other clauses could be modified to make it easier for the tenant to transfer? For example, suppose the tenant wants an extension of the lease term to make it more attractive to a third party. Perhaps these factors in support of subsection (b) can be eliminated by treating the use clause as uniquely related to the right to transfer.

If the legislation is changed in accordance with Mr. Zankel's proposal, there is another possible consideration. Would there be a potential for the tenant to engage in tactical avoidance of the express terms of the lease? Suppose the following sequence:

1. Execution of a lease containing an express clause specifying the use and absolutely prohibiting a change.

2. Tenant proposes an assignment to a third party who will change the use, and the lessor refuses to amend the lease.

3. Tenant breaches the lease and abandons the premises.

4. Lessor elects to use the lock-in remedy and keep the lease in effect despite the tenant's breach and abandonment. (Assume the lease is properly drafted to allow the 1951.4 remedy.)

5. Tenant assigns to the third party who will change the use of the premises.

It seems that the tenant has imposed an amendment of the lease terms by breaching the lease and abandoning the premises. If this is going to be the result, could the tenant then threaten the lessor with this result when proposing an amendment to the lease? I am going to ask Mr. Zankel if he considers this to be a problem.

5. APPLICATION OF POLICY AGAINST RESTRAINTS ON ALIENATION AND COVENANT OF GOOD FAITH AND FAIR DEALING; C.C. 1997.210.

An express restriction on use does not violate the policy against restraints on alienation. This is discussed at length in the background study, and summarized above in the discussion regarding reopening the assignment/sublease legislation. In addition, the policy against restraints on alienation has not even been considered to apply to a use restriction.

Enforcement of an express restriction on use in accordance with the terms of that restriction does not violate the covenant of good faith and fair dealing. This is discussed at length in the background study, and summarized above in the discussion regarding reopening the assignment/sublease legislation.

The present proposal reflects the validity and enforceability of express restrictions according to their terms. As discussed above, if the Commission is going to expand the concept of good faith and fair dealing, there are several factors that must be considered and expressed.

6. ABSOLUTE PROHIBITION AGAINST CHANGE; C.C. 1997.230.

I agree with Mr. Carbone's view that the statement in the comment about good faith and fair dealing should apply to enforcement rather than the mere existence of the absolute prohibition clause. That part of the comment could be corrected by changing the statement to "The covenant of good faith and fair dealing does not prevent enforcement of an express lease provision absolutely prohibiting use, in accordance with its express terms."

Mr. Johnson again argues for a mandatory reasonableness standard. This has been addressed above.

Mr. Carbone would revise the comment to provide that enforcement of the restriction would be subject to the implied covenant of good faith and fair dealing, to be decided on the facts of each case. I lean towards Mr. Zankel's view that it requires an amendment to the lease to avoid enforcement of the express terms of a clause. The question of extending the covenant of good faith and fair dealing is discussed above in the comments on reopening the assignment/sublease legislation. If the Commission adopts the comment, just what does it mean in this context

to say that the express contract provision is subject to the covenant of good faith and fair dealing?

7. SOLE DISCRETION CONSENT STANDARD; C.C. 1997.250(c).

Mr. Johnson again argues for a mandatory reasonableness standard. This has been addressed above.

Mr. Williams raises an issue of clarity. Is a clause clear when it states that the lessor's consent is required to change, and that the consent is governed by the sole and absolute discretion of the lessor clear? Does the mention of the possibility of consent lead the tenant to believe that the lessor will be reasonable in granting or refusing consent, or that the lessor will have to show some objectively legitimate reason for refusal? This concern arose with the assignment/sublease legislation and it continues to bother some people. It should be addressed.

The matter was made moot in the assignment/sublease legislation by eliminating the section providing for sole discretion consent.

8. EFFECTIVE DATE; C.C. 1997.270.

The proposed legislation imposes an implied reasonableness standard on the lessor where the restriction requires consent but fails to state an express standard. Subsection (a) of C.C. 1997.270 limits this rule to leases executed after the effective date of the legislation.

Mr. Johnson believes that this should receive full retroactivity. The question of retroactivity is discussed above in connection with the comments on reopening the assignment/sublease legislation. The application of the principles in the cases discussed to a use restriction is speculative even after the Kendall case. Existing statutes provide for the enforcement of a use restriction according to its terms. If property is leased for a "particular purpose" the tenant must not use it for "any other purpose," and if the tenant does so, the tenant is liable to the lessor for all damages resulting from such use, or the lessor may treat the lease as rescinded (C.C. 1930). The lessor may terminate the lease and recover possession when the tenant uses or permits use of the property "in a manner contrary to the agreement of the parties." There is no doubt that one can speculate on the extension of the Kendall reasoning to a use clause, although there are many who believe that the current California Supreme Court will not make such an extension. However, I have looked in vain for cases imposing that implied standard of reasonableness to a use restriction.

Mr. Johnson questions the language of subsection (b) of 1997.270. He refers to the language dealing with execution of an option. I believe it is intended to apply to the situation where a binding option to lease is entered into. The option fixes the terms of the lease which will go into effect when the option is exercised. Since the parties are bound by the lease terms fixed by the option, that date controls rather than the later date of

exercise of the option. This parallels the approach taken by C.C. 1952.2 when the basic remedies legislation became effective in 1970.