

Memorandum 90-110

Subject: Study H-112 - Commercial Real Property Leases: Use
Restrictions (Revision of Comment)

At the September 1990 meeting the Commission decided, in response to a request from Ron Denitz of Tishman West, to consider revision of the Comment to proposed Section 1997.040 (effect of use restriction on remedies for breach) in the Commission's recommendation on use restrictions. The Comment would be revised to add a paragraph that elaborates types of circumstances that may be considered in determining whether enforcement of a use restriction would be reasonable.

The proposed section and Comment, with the added language shown in underscore, are set out below. The staff believes the added language is consistent with the Commission's intent, and would be helpful. The proposed revision is also approved by the Commission's consultant--Professor Coskran--as well as by Howard Lind and by Mr. Denitz. The staff recommends that the Commission print its recommendation in this revised form.

§ 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. However, if the lease contains a restriction on use that is enforceable under this chapter, the computation shall take into account the restricted use of the property except to the extent the tenant proves that under all the circumstances enforcement of the restriction would be unreasonable. The circumstances include, but are not limited to, those involving both the leased property and any building or complex in which it is located.

(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. The restriction on use applies under Section 1951.4 if it is enforceable under this chapter except to the extent the tenant proves that under all the circumstances enforcement of the restriction would be

unreasonable. The circumstances include, but are not limited to, those involving both the leased property and any building or complex in which it is located.

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, the landlord is not required to give up the bargained-for benefit in order to reduce the damages to the breaching tenant. However, the use restriction is not taken into account in computing mitigation damages to the extent the tenant satisfies the burden of showing that enforcement of the use restriction would be unreasonable. And, 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 regardless of whether enforcement of the use restriction would have been reasonable.

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, except to the extent enforcement of the use restriction would be unreasonable. 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, both the tenant and transferee have to conform to that restraint. However, the landlord's use of the Section 1951.4 remedy precludes the landlord's enforcement of a use restriction to the extent the tenant satisfies the burden of showing that enforcement of the use restriction would be unreasonable.

The circumstances that may be considered in determining the reasonableness of enforcement of a use restriction for purposes of this section include the following and all other relevant circumstances whether of a similar or dissimilar character:

(1) The landlord's desire to preserve or encourage a so-called "tenant mix" in a shopping center.

(2) The landlord's intent to preclude residential uses in a commercial building or complex.

(3) The landlord's intent to preclude medical arts uses in an almost exclusively business-use office building (or vice versa).

(4) The fact that a proposed use by a prospective new tenant would require an "exclusive" or contravene a pre-existing "exclusive" already possessed by, or promised to, another party.

(5) The fact that a proposed use is already prohibited by an outside party (e.g. a mortgagee or ground lessor or landlord) to whom the landlord is obligated.

Respectfully submitted,

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