

Memorandum 67-32

Subject: Study 50 - Leases

In the first supplement to this memorandum, we forward a draft of a statute prepared by Joe Harvey designed to accomplish most of what we intended to accomplish by our recommendation on leases. However, because I believe that the draft statute attached to the first supplement goes beyond what is needed, will create problems if it is enacted, and is unlikely to be enacted, I have prepared the draft statute attached to this memorandum.

The draft statute attached to this memorandum is discussed below. The additional provisions included in the draft statute attached to the first supplement are also discussed.

Section 1951

This section requires that the lessor minimize his damages. It does not apply to long term leases or leases with a substantial rent.

Section 1951.5

This section permits the lessor to relet without the danger of his action in reletting being construed to be an acceptance of the surrender of the lease. This is an essential section if the lessor has the duty to mitigate damages.

Section 1952

This section frees the lessor from his obligations under the lease after he has regained possession of the property. The requirement that he regain possession of the property is included so that the lessor could not turn off the heat, for example, if the lessee fails to pay his rent on time. The section is intended, for example, to permit a lessor to relet the subject property, or other property, contrary to the provisions of the

lease after he has taken possession of the subject property.

Section 1952.5

This section makes liquidated damages provisions valid if they meet the general standards for valid liquidated damages provisions.

Section 1953

This section precludes forfeitures of advance payments that are in excess of actual damages.

Section 1953.5

This section limits application of the statute to leases executed after January 1, 1968.

Section 1954

This section is included out of an abundance of caution; it is designed to make it clear that nothing in the statute affects the validity of public agency lease-purchase arrangements.

General comment

This statute is designed to deal with the specific problems that exist in lease law. The statute makes no change in Civil Code Section 3308 (which permits the lease to include a provision giving the lessor a right to recover for the loss of the bargain as an alternative remedy or for the loss of the bargain for a period of less than the lease). Any lease of importance will have a Section 3308 provision. For leases that do not, the remedy is to recover rent when it becomes due or to wait until the end of the term to determine the lessor's damages. This is existing law and is not changed except for the requirement that damages be minimized. The statute attached to the first supplement proposes to make the rule stated in Section 3308 the general rule in all cases and would, for example,

preclude the lease from limiting the period during which damages are calculated.

Likewise, the draft attached to this memorandum makes no change in the unlawful detainer procedure. The draft attached to the first supplement would not permit the lessor to recover possession of the premises without terminating the lease. In view of the fact that damages must be minimized, I see no need to change the law on unlawful detainer actions.

I believe that the statute attached to this memorandum should be recommended for enactment this session. It is a simple statute, meets the problems that now exist, and should have a good chance of enactment. If a more complex statute is to be recommended, I believe that this matter should be referred to interim study.

If time permits, I will prepare comments to the sections in the attached draft.

Also attached to this memorandum is another letter objecting to the provisions of the bill as it now exists.

Respectfully submitted,

John H. DeMouly
Executive Secretary

1951. (a) Subject to subdivision (b), when the lessee under a lease of real property has abandoned the property before the end of the term, or when the lessee's right to possession of real property is terminated by the lessor by reason of the lessee's breach of the lease, the lessor may not recover for any detriment that the lessee proves could have been avoided through the exercise of reasonable diligence without undue risk of other substantial detriment.

(b) Unless the lease otherwise provides, subdivision (a) does not apply to any lease where:

(1) The rent and other charges equivalent to rent provided in the lease amount to more than \$500 a month; or

(2) The term stated in the lease is five years or longer.

(c) The right under this section may not be waived prior to the accrual of such right.

1951.5. Where the lessee under a lease of real property has abandoned the property before the end of the term of his lease, a reletting of the property by the lessor, or an attempt by the lessor to relet the premises, shall not be evidence of acceptance of a surrender of the lease. If the lessor in such a case relets the property without termination of the lease, amounts received by the lessor as a result of such reletting, less the reasonable expenses of the reletting, shall be credited to the lessee. If the reletting is for a term extending beyond the term of the abandoning lessee, the amounts received by the lessor as a result of such reletting, less the reasonable expenses of such reletting, shall be credited to the abandoning lessee to the extent that the amount thereof is equitably apportionable to the unexpired portion of his lease.

1952. When a lessee's right to possession under a lease of real property is terminated because of the breach of the lease by the lessee and the lessor retakes possession of the property, the obligation of the lessor thereafter to continue to perform his obligations under the lease is excused.

1952.5. Upon breach of the provisions of a lease of real property, liquidated damages may be recovered if so provided in the lease and if they meet the requirements of Sections 1670 and 1671.

1953. (a) If a lessee's right of possession under a lease of real property is terminated because of the breach of the lease by the lessee, the lessee may recover from the lessor any amount paid to the lessor in consideration for such possession (whether designated rental, bonus, consideration for execution thereof, or by any other term) that is in excess of the sum of:

(1) The portion of the total amount required to be paid to or for the benefit of the lessor pursuant to the lease that is fairly allocable to the portion of the term prior to the termination of the lessee's right of possession; and

(2) Any damages, including liquidated damages as provided in Section 1952.5, to which the lessor is entitled by reason of such breach.

(b) The right of a lessee to recover under this section may not be waived prior to the accrual of such right.

1953.5. Sections 1951, 1951.5, 1952, 1952.5, and 1953 do not apply to:

(a) Any lease that was executed before January 1, 1968.

(b) Any lease executed on or after January 1, 1968, if the terms of such lease were fixed by a lease or other contract executed prior to January 1, 1968.

1954. Where an agreement for a lease of real property from or to any public entity or any nonprofit corporation whose title or interest in the property is subject to reversion to a public entity would be made invalid if any provision of Section 1951, 1951.5, 1952, 1952.5 or 1953 were applicable, such provision shall not be applicable to such lease.



BUCKEYE REALTY AND MANAGEMENT CORPORATION

THE BUCKEYE BUILDING

8500 WILSHIRE BOULEVARD • OL 2-1411 OL 5-7510 • BEVERLY HILLS, CALIFORNIA

April 26, 1967

Passed Senate 3/27

Senator Anthony C. Beilenson
State Capitol
Sacramento, California 95814

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later amended
Also, check copy to SOS 252,
pls.*

Dear Tony:

I have recently had the opportunity of examining the California Senate Bill #252. I am very concerned that our real estate holdings might be substantially affected if this bill were to be adopted by the legislature.

If you will assume a situation in which a financial institution has entered into a purchase-leaseback transaction with a company on the basis of the credit standing of the company to pay rental, or if you will assume a situation in which a mortgage loan is to be made in substantial reliance upon the rental promises of a tenant which is a company of major credit standing, I simply ask you to review this legislation to determine whether or not you would recommend such a loan or such a purchase-leaseback to the financial entity involved.

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Then, looking at the legislation, see how you can best answer these questions:

P. 1-Lines 5-7: What constitutes a "communication" by a tenant "by act" that he can not substantially perform?

P. 2-Lines 1-4: Can you tell, if your office is in New York City, when a tenant has engaged in a course of conduct which renders substantial performance apparently impossible?

P. 2-Line 5: If you re-enter possession for purpose of subletting to mitigate damages, have you terminated the liability of your tenant?

P. 2-Line 10: Same question.

P. 2-Lines 12-15: Suppose you merely ask the tenant to leave so that you can mitigate damages?

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P. 2-Lines 16-21: What happens to the liability of the tenant if you are entitled to an action for specific performance but you would rather have damages against the tenant?

P. 2-Lines 27-32: Would a financial institution like to play a game of cat and mouse?

P. 2-Lines 34-44: If you decide that you wish to continue to rely upon the financial responsibility of the tenant, and, therefore, you are not willing to rescind the lease, and specific or preventative relief is not available because the remedy at law is adequate, would the "lender" be satisfied with the sole remaining limited amount of damages described in this provision?

P. 2-Lines 48-51: Would a financial institution be willing to accept a situation in which the statute of limitations began to run as of the time when a course of conduct of the tenant rendered substantial performance apparently impossible?

P. 3-Lines 5-9: Would a financial institution be willing to rescind a purchase-leaseback?

P. 3-Lines 10-12: Would a financial institution be willing to settle for the complex damage formula described in this statute?

P. 3-Lines 13-16: What would constitute a "detriment" under the provisions of this clause.

P. 3-Lines 17-20: Is this remedy available where a money judgement could cure the default?

P. 3-Lines 22-27: Are you prepared to advise lending institutions that contracting parties are no longer free to establish their own contracts in California regarding real property?

P. 3-Lines 34-35: Does this statute apply to existing lease agreement in which there are options in the tenant to renew and, to that extent, are you prepared to advise lending institutions as to this modification of their existing option contracts in leases they now hold?

P. 4-Lines 22-25: Is it possible to compute "present worth" without having an interest rate available?

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If you have a 25 year lease at \$1,000.00 per month with a corporation rated "AAA" by Moody and after 5 years this tenant is in default, but I could relet the premises on a month to month basis to a tenant, having a net worth of ten cents, for \$800.00 per month, tell me the amount of my damages under this provision.

P. 4-Lines 38-41: Do you believe it would be possible to establish a dollar amount for "any other damages" without going to court or arbitration?

P. 4-Lines 42-46: What constitutes "the exercise of reasonable diligence" or the lack thereof in an absolutely net purchase-leaseback on California property between an institution with its office in New York and a corporation with its office in Illinois where it has sublet the premises to an operating entity with its head office in Carson City, Nevada?

Try and answer this same question if part of the premises are occupied by concessionaires.

P. 4-Lines 47-51: If you proceeded to get a so-called "present worth judgement" against your original tenant and you relet the property for a rental which is \$100.00 per month more than the original rental but on a month to month basis, try to advise a lender on what the deductions are from the judgement and when they may expect the judgement to be paid.

P. 5- Lines 5-21: If the purchase-leaseback is a substitute for a mortgage loan, would the lender be willing to pay attorneys' fees in a suit brought by the tenant?

P. 5- Lines 22-37: Can you visualize a financing transaction in which the financial institution would be willing to return any money?

P. 5-Lines 38-39: How do you advise a lender in an existing lease where there are options to renew for which the tenant has already paid?

P. 6- Lines 5-11: Have you ever heard of a specific performance suit for the payment of money?

Is a statute necessary to provide for specific performance of a lease where the remedy at law is not adequate and are you prepared to decide whether or not the Legislature intends, by this language, to make specific performance the sole and exclusive remedy and, if not, why is this statute necessary?

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P. 6-Lines 17-25: If the financial institution brings a suit for rental payments (if it really can under this legislation) are you prepared to advise a lender that "restitution of the premises" is involved; and can you accurately describe what that means?

If a suit is brought under unlawful detainer after failure to pay rent, are you prepared to accept a mandatory judgement that the lease is not terminated?

P. 6-Lines 36-52: Is a mortgage lender to a landlord of a tenant having a major credit standing willing to permit the landlord to exercise remedies against the tenant which may involve the complete destruction of the lease and which, at best, would give the lender 5 days after entry of judgement to protect the lease on which it really made the loan?

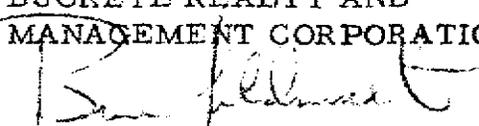
P. 7- Lines 5-8: Are you prepared to tell a lender or a landlord that every lease in his portfolio is now subject to litigation on the issue of the unconstitutional impairment of contracts?

I believe that after you have reviewed the above points you will be as disturbed as I was to realize that if the Legislature would adopt Senate Bill # 252 there could possibly result an economic disaster to the State of California. At best, the adoption would result in substantial litigation in an attempt to interpret this statute and would result in many lenders staying totally away from considering loans in real estate in California.

Need I say more.

Very truly yours,

BUCKEYE REALTY AND
MANAGEMENT CORPORATION


Bram Goldsmith
President

BG:bm