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The Contractual Nature of Real Property Leases

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I. INTRODUCTION AND SCOPE

The concept of a real property lease has been undergoing change throughout the life of Anglo-American jurisprudence; however, this change has been often so slow as to give the appearance of dormancy. In recent years real property leases have been encrusted with property law characteristics to the extent that other characteristics which they may possess have been largely hidden from view. Yet, there is an aspect of such leases that has been inherent in them for many years and is now beginning to break through to the surface and be recognized and used. This aspect—the contractual nature of real property leases—forms the subject matter of this paper.

There are two interrelated factors that have affected the concept of a leasehold interest in real property as it exists today. First, the historical setting of a lease has changed from that of rural England, where raw land, devoid of any but the most simple improvements, was leased for agricultural purposes to that of urban America, where space provided by valuable and extensive improvements on the land serves both residential and commercial needs in our society. The leased farm and pasturage of our English and American ancestors has largely given way to the multi-storied complex or office building or industrial plant of late-twentieth-century America.

Second, the property characteristic of a lease of real estate was the characteristic which best served the needs of our recent ancestors when they were concerned with the leasing of unimproved land for agricultural purposes or for pasturage. Although this characteristic of a lease was not the first it possessed, having gone through earlier evolutionary stages, it is the characteristic which has been carried into the twentieth century and with which our present society must cope. Although our society has changed dramatically from that known by our recent ancestors, the leasehold in real property, as a functional tool, has not kept pace.

More and more the judicial, educational and professional segments of the legal profession are calling for a redefinition of a real property lease to include a contractual aspect in order that this legal tool may better serve our present needs.

There have been three sources injecting contract principles into real property leases. The first source has been public policy, used by the judiciary to mold common law leasehold principles to fit modern day needs. The second source has been federal and state statutes. Some statutes have been directly aimed at real property leases; others, in particular the Uniform Commercial Code, which is enjoying wide adoption across the United States, have been indirectly affecting attitudes toward leases. And the third source has been local ordinances, such as housing codes, that have placed the rights and responsibilities of lessors and lessees in a new light. Each of these sources has been more useful than the others in dealing with certain aspects of leases; yet, all three have been needed for a full development of the contractual nature of real property leases.

The subject-matter covered in this paper includes both residential and commercial leases. Some of the principles discussed, such as unconscionable clauses, are applicable primarily to residential leases, but most are applicable to both types. The investigation of this subject has been limited to leases of real property. The following types of leases have not been included: leases of personality, leases of advertising space, crop leases, mining leases, mineral leases or oil and gas leases.

II. THE NATURE OF A REAL PROPERTY LEASE

A. *Origin and History*

In order to fully appreciate the nature of a modern lease of real property, it is necessary to understand the origin of this legal concept and the transformations it has undergone over the years. An appreciation of these transformations helps to explain the problem legal authorities have had in identifying and utilizing the various aspects of a lease. It is necessary to step back in history in order to set the stage for an analysis of the contractual nature of real property leases.

1. *Creation of Status in the Lessee*

The earliest interest that a lessee had in a lease was that of status. In order to understand this concept one must keep in mind the difference between free tenure and unfree tenure. The character of the services due the lord by his tenant formed the chief test for the differentiation between these two forms of landholding. If the services were definite and certain, and, consequently, worthy of a free man, the tenure was classified as free. However, if the services were uncertain or dependent on the will of the overlord as to quantity or manner of performance, the tenure was classified as unfree.¹ This test resulted in classifying the great mass of individuals in post Norman-Conquest England, the workers who performed agricultural and other manual services for their manorial lord, as villeins, holding their manor lands in unfree tenure.²

"Villeinage" was considered a status as well as a tenure.³ A villein was a serf, but not a slave. His position before the thirteenth century was quite precarious. He held his cottage and small strip of land at the will of the lord. His tenure was not protected in the king's courts. This view of the villein's status was more than a theoretical legal proposition; it no doubt became a stark reality to many such unfortunate persons:

It was the law then, that if the tenant in villeinage was ejected, either by his lord or by a third person, the king's court would not restore him to the land, nor would it give him damages against his lord in respect of the ejection. He held the land *nomine alieno*, on his lord's behalf; if a third person ejected him, the lord was disseised. Before the end of the thirteenth century, the king's courts were beginning to state their doctrine in a more positive shape—the tenant in villeinage is in our eyes a tenant at will of the lord.⁴

However, such persons were not without some measure of protection. This protection was provided by manorial courts. In theory, the protection was very slight—holding at the will of the lord, the villein tenant could not sue the lord in the manor court;

¹ F. Pollock and F. Maitland, *THE HISTORY OF ENGLISH LAW* 371-72 (2d ed. 1952).

²*Id.* at 372.

³*Id.* at 358.

⁴*Id.* at 360.

the tenant had no right to alienate and no right to pass the land on to his heirs.⁵ In practice, however, the villein tenant's rights were much greater—the lords felt themselves bound more or less conclusively by the terms of the customary unfree tenures, and such customs, rigidly enforced, became the "law" of the manor court; the villein tenant, though personally unfree, was not considered a mere tenant at will, but was considered to hold permanently, frequently heritably, and on somewhat definite terms.⁶

In the four centuries following the thirteenth, the status of the villein tenant continued to improve. Plucknett states that in the fifteenth century courts of equity and prerogative started protecting villeins, principally where intervention could be justified as sustaining a manorial custom, and that in the sixteenth century the common law courts followed this example, while in the seventeenth century the villein's rights were established at common law under the name of copyhold tenure.⁷

2. *Creation of Contractual Rights in the Lessee*

During the same period of time forces were at work that were ultimately to replace the villein tenant, who held at the will of his lord, with a tenant who held the land for a term of years. With this change comes an alteration in the lessee's position from that of a landholder having mere status, albeit protected, to that of a landholder having recognized contractual rights. Both capitalists and agricultural workers participated in this change.

Prior to the thirteenth century, leases for a term of years were principally given by great landowners to moneylenders as a way of circumventing the church's prohibition of usury.⁸ *A*, in consideration of a lump sum amount of money, would grant a term of years to *B* of sufficient duration to allow *B* to recoup both his consideration and a profit. It is obvious why Plucknett can say of this type of lessee: "The termor, therefore, is not unnaturally placed in popular literature in very bad company among usurers and other scoundrels who prey upon society."⁹ The law put such

⁵Lesar, *The Landlord-Tenant Relation in Perspective: From Status to Contract and Back in 900 Years?*, 9 KAN. L. REV. 369 (1961).

⁶1 F. Pollock and F. Maitland, *supra* note 1, at 361, 379-81.

⁷T. Plucknett, *A CONCISE HISTORY OF THE COMMON LAW*, 538 (5th ed. 1956).

⁸*Id.* at 571-73.

⁹*Id.* at 572-73.

a lessee in his "proper place" by giving him little protection in the enjoyment of his possession.¹⁰ Upon ouster the lessee's sole remedy was an action on the covenant against his lessor; he had no rights against third parties. The lessee's term was subject to the dower interests of the lessor's widow and the lessor could alienate free from the rights of the lessee. Not having an estate in land, the real actions were denied to the lessee.

Ultimately the mortgage arose as a more satisfactory method of rendering land as security for a debt and the term of years became disassociated with the unsavory aspects of moneylending and became associated with a more respected strata of English society, the agricultural tenant for years. Economics played a key role in replacing the villein tenant with the agricultural tenant for years. As a result of the Black Death (1348-49), and the resulting economic revolutions centering on a shortage of agricultural labor, more and more such laborers started holding agricultural lands under leases for terms of years.¹¹ The agriculture or husbandry lease, which has formed the basis for so much of the current law surrounding leases, became a common form of real property lease.

The rights of such a lessee were contractual in nature. Not having seisin in the land, the lessee did not have the benefit of the real actions. That great possessory remedy, the assize of *novel disseisin*, which was available to freeholders, was not available to a lessee for a term.¹² He was forced to content himself with the benefit derived from a covenant or warranty. Frequently, however, the termor had such a benefit.¹³ The lessee's right was one *in personam* against the lessor and his heirs. It would allow him specific enforcement of the covenant, recovering possession of the land. If the lessee were ejected by a third person, he could sue the lessor for an equivalent of the benefit taken from him, but he was remediless against third persons in general.

3. Creation of Property Rights in the Lessee

Beginning in the thirteenth century new causes of action were given to the lessee for years which were to ultimately result in

¹⁰1 AMERICAN LAW OF PROPERTY § 1.11 (A. J. Casner ed. 1952) [hereinafter cited as AMERICAN LAW OF PROPERTY].

¹¹T. Plucknett, *supra* note 7, at 573-74.

¹²2 F. Pollock and F. Maitland, *supra* note 1, at 36.

¹³*Id.* at 106.

giving him property rights in the land rather than mere contractual rights. In 1235 the lessee for years was given a new action, *quare ejecit infra terminum*, which would restore the ejected lessee to the land. Although Bracton later said this action would lie against any ejector, it was actually limited to apply to what was considered the most odious situations, ejectment by one who had purchased the land from the lessor.¹⁴ Later, the lessee was given the right to recover damages against any and all ejectors through the fashioning of a special form of trespass, *de ejectione firmæ*, which became the equivalent of the freeholder's *quare clausum fregit*.¹⁵ This remedy was expanded in 1499 to allow the lessee to recover possession of the land. Out of these changes the action of ejectment emerged, from its originally inferior position, to ultimately replace most of the old forms of real action. Consequently, the interest of a lessee for years came gradually to be regarded, not merely as a right of action resting on a covenant by the lessor, but as a right of property enforceable against any wrongdoer by a remedy analogous to that to which the owner of a freehold was entitled.¹⁶ The lessee was becoming recognized as the owner of an estate in land.

Because of the fact that the term of years gained popularity, for reasons previously mentioned, in an age when there were few urban centers and a majority of the population depended on the land for livelihood, it is not surprising that the term most often involved the agricultural use of land.¹⁷ The heart of the lease involved the possession of the land so that crops could be planted, cultivated and harvested. Rarely would there be any structural improvements placed on the land; those that were erected were simple and rather unimportant compared to the land itself and its use. Out of this situation arose the concept that the rent, the consideration for the lease, issued out of the land itself, and so long as the lessee had possession of the land, the consideration would not fail.¹⁸ The rules the common law developed to govern this type of lease were comparatively simple, reflecting the simplicity of the

¹⁴*Id.* at 107-08.

¹⁵T. Plucknett, *supra*, note 7, at 373.

¹⁶H. Tiffany, *THE LAW OF REAL PROPERTY* § 73 at 108-09 (3d ed. B. Jones 1939) [hereinafter cited as Tiffany].

¹⁷Lesar, *supra* note 5, at 371.

¹⁸R. Powell, *THE LAW OF REAL PROPERTY* § 221[1], at 177 (P. Rohan recomp. 1969) [hereinafter cited as Powell].

leases themselves.¹⁹ It is many of these rules, developed for leases of rural agricultural lands, that have presented problems in the twentieth century when applied to leases of urban residential and commercial land.

4. *Status of the Modern Lease*

In the last century and a half, there have been emerging factors in society which have exerted increasing influence on the law governing leases. There has been a shift in population from rural areas into urban areas.²⁰ Cities have replaced the farm as the place where a majority of our population resides and works. As more and more people have come to live in small geographical areas, the real property lease has become important for residential purposes. For many families individual homes have given way to apartments, which have in turn developed into high-rise living complexes. In such complexes the residents are not concerned merely with the right to possession of a plot of ground or a cubic area of airspace, but are concerned with being furnished with services such as heating, lighting, plumbing, garbage disposal, security and recreation.

In this same period of time, as more and more of men's affairs have been conducted in urban areas, the "business lease" has become more common and of greater social importance than the agrarian lease. This has caused an increased significance to be placed on the structures located on leased premises—their quality, condition, maintenance and terms of use.

These changes in the use of leased premises from agrarian uses to residential and commercial uses, and the increased relative importance of the structural improvements on the land as opposed to the land itself, have caused modern leases to evolve into a form far different from their agrarian ancestor. The parties to the modern real estate lease have recognized these changes by placing covenants of greater variety and detail in the lease, in an attempt to

¹⁹For a summary of the common law rules, see Lesar, *supra* note 5, at 371-72.

²⁰In 1800 there were approximately fifteen times as many Americans living in rural areas as in urban areas; in 1960 there were approximately two and one-half times as many Americans living in urban areas as in rural areas. See U. S. Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1957*, Washington, D.C., 1960; Continuation to 1962 and Revisions, Series A 195-209 (U.S. Gov't Printing Office, Washington, D.C., 1965).

protect their respective positions.²¹ This trend has in itself caused problems.²² The law, however, has been slower to adapt itself to this transformation in the real property leases. There is, however, now recognized to be an intertwining of property law (viewing a lease as a conveyance of a nonfreehold estate in real property) and contract law (viewing a lease as a bilateral contract) in a lease that together form its substance.

B. *Definition of a Real Property Lease*

How may the modern lease of real property be defined? Authorities have never been able to agree—some say that a lease is a conveyance;²³ others say that it is a contract;²⁴ while yet others argue that it is a conveyance with contractual obligations superimposed.²⁵ This disagreement points up the many-faceted aspects of a real property lease.²⁶ It also points up the need to be aware of how the property and contract aspects of a lease may affect a given situation:

In practice, the law today concerning estates for years consists of rules determining the construction and effect of lease covenants. Thus the background of a lease as a conveyance, built solidly by 1500, has a tremendous foreground, evolved largely since 1880, which is purely contractual in character. The modern law is the synthesis of these two historical factors. Sometimes the background peeks through and controls. Sometimes the foreground is alone considered as determina-

²¹Lesar, *Landlord and Tenant Reform*, 35 N.Y.U.L. REV. 1279 (1960).

²²See Sections V and VI, *infra*.

²³W. Blackstone, COMMENTARIES 316—"A lease is properly a conveyance of any lands or tenements, usually in consideration of rent or other annual recompense. . . ."

²⁴*Jackson v. Pepper Gasoline Co.*, 280 Ky. 226, 133 S.W.2d 91 (1939). The plaintiff-lessor leased land and a building to the defendant-lessee for use as a service station, reserving as rent an amount equal to one cent per gallon on each gallon of gasoline delivered to the station, payable monthly. The plaintiff sought to cancel the lease, claiming it was a unilateral contract and lacked mutuality. The Kentucky Supreme Court held the lease valid and not too indefinite to constitute a binding obligation, saying: "The lease from appellant [lessor] to appellee [lessee] is a bilateral contract, since there are mutual promises between the parties to the lease."

²⁵1 Tiffany § 74, at 110. This authority says that a lease is ". . . the legal act or acts by which various contractual obligations are created in connection with such conveyance, that is, it is applied to an aggregate of simultaneous legal acts, by one of which a lesser estate is transferred to another, and by another or others of which the transferor or transferee, or both, contract to do or leave undone certain things." This definition describes a lease as a conveyance *plus* the covenants of the lease.

²⁶1 AMERICAN LAW OF PROPERTY § 3.11, at 202-05.

tive. The lawyer's problem is to determine which of these two factors is to control in his specific controversy.²⁷

The sections which follow discuss one of the aspects of a real property lease—the contractual aspect—in its varied forms.

III. MUTUAL DEPENDENCY OF COVENANTS

One problem concerning the contractual nature of a real property lease centers around the mutual dependence of covenants found in a lease. Are such covenants handled the same way covenants in a contract are? One authority on the law of contracts has expressed the opinion that a real property lease is a bilateral contract as well as a conveyance of a property interest.²⁸ What, then, are the rules surrounding the mutual dependence of covenants in a bilateral contract and to what extent have these rules been applied to leases?

A. Contract Principles

A bilateral contract is one in which there are mutual promises between two parties to the contract, each party being both a promisor and a promisee.²⁹ In such a contract not only are the promises consideration for one another, but also the parties normally expect that the performances promised are to be exchanged for one another.³⁰ The promises and the promised performances are, then, dependent on one another. Just as a failure to give a promise on one side would cause invalidity of the counter-promise, so a failure to give performance on one side should deprive the party in default of a right to enforce performance on the other side.³¹

B. Real Property Leases

1. Mutual Independence of Covenants

The general rule governing real property leases is that covenants

²⁷ Powell § 221[1], at 179.

²⁸3A A. Corbin, *CONTRACTS* § 686, at 237 (1960) [hereinafter cited as Corbin]; see Section II-B *supra*.

²⁹RESTATEMENT OF CONTRACTS § 12 (1932).

³⁰6 S. Williston, *A TREATISE ON THE LAW OF CONTRACTS* § 813, at 6 (3d ed. W. Jaeger 1962) [hereinafter cited as Williston].

³¹*Id.*; for a discussion of the history of the mutual dependency of bilateral contracts, see 3A Corbin § 654.

are considered independent unless expressly³² or impliedly³³ made dependent. For example, a breach of the lessor's covenant to repair is no defense to an action to recover rent.³⁴ Likewise, a lessor may not forfeit the lease for failure to pay rent or other breach of covenant unless he has reserved that power.³⁵ The reason for this discrepancy between the rule applied to most bilateral contracts and the rule applied to leases seems to be rooted in history: the view that a lease is primarily a conveyance, to which the covenants are merely incidental, and the rules based thereon, were established before the development of mutual dependency in contracts.³⁶

2. Bargained-For Covenants Which Go to the "Whole Consideration" of a Lease

There are some situations, nevertheless, where courts often hold covenants in a lease to be mutually dependent. For example, when the covenants go to the "whole consideration" of a lease, *i.e.*, when they are vitally important terms of the lease, courts have treated them as mutually dependent.

A number of cases dealing with residential leases have reached this decision. In *Berman v. Shelby*³⁷ the lessor leased a house to the lessee under a lease whereby the lessee promised to pay rent and the lessor promised to repair the bathroom and leave certain furniture in the house. The lessee vacated the premises during the period of the lease, claiming the lessor did not comply with his covenants in the lease. The lessor relet the premises and sued the lessee for the difference between the old and new rents. The Arkansas Supreme Court held that the lessee was not liable for the rent, stating that the obligations of the lease were mutual and the failure of the lessor to comply with the terms of the lease relieved the lessee from a duty to perform his obligations under

³²*Wurdemann v. Hjilm*, 257 Minn. 450, 102 N.W.2d 811 (1960), *cert. denied*, 364 U.S. 894 (1960).

³³*Brady v. Brady*, 140 Md. 403, 117 A. 882 (1922).

³⁴*Arnold v. Krigbaum*, 169 Cal. 143, 146 P. 423 (1915); *Hosang v. Minor*, 205 Cal. App.2d 269, 22 Cal. Rptr. 794 (1962); *see generally* Annot., 28 A.L.R.2d 446 (1953).

³⁵*Brown v. Bragg*, 22 Ind. 122 (1864).

³⁶*Lesar, Landlord and Tenant Reform*, 35 N.Y.U. L. REV. 1279, at 1281 (1960).

³⁷93 Ark. 472, 125 S.W. 124 (1910).

the lease. Note that the covenants considered mutually dependent were express in the lease, evidencing the parties' estimation of their importance, and that the lessee vacated the premises. This latter fact is often important in these cases, as will be seen later.³⁸

In *Higgins v. Whiting*³⁹ the lessor leased premises to the lessee under a lease whereby the lessee promised to pay monthly rent and the lessor covenanted "to supply hot and cold water and to heat the said apartment during the winter and to supply the usual janitor services." On February 8, 1924, the lessee notified the lessor of a lack of heat and stated that he would move unless heat was supplied. Upon the lessor's failure to provide heat the lessee moved from the premises and the lessor sued for failure to pay the rent from that time until the termination of the lease. The New Jersey court held that the lessor could not recover the rent, stating that where the covenants are concurrent and to be performed at the same time, they are dependent and neither party can maintain an action against the other without averring and proving performance on his part.

The significance of *Higgins* in this area was weakened by a later case, *Licker v. Rudd*,⁴⁰ where on facts similar to those in *Higgins*, the New Jersey Supreme Court held that the lessee must vacate the premises if he proposed to contest the lessor's claim for rent. The court interprets the problem presented by both *Higgins* and *Licker* as one of constructive eviction, necessitating the lessor's removal from the premises, rather than one of the mutuality of covenants in a lease.⁴¹

A third New Jersey case, *Steven Stanoyevich Fund v. Steinacher*,⁴² also deals with the problem of mutuality of important covenants in a residential lease. The lessor leased premises to the lessee under a lease containing a covenant in which the lessor promised that the heating system was in good working order and that if the premises were equipped with an oil burner the lessor would make any necessary repairs not due to the negligence of the lessee. When the furnace gave off noxious and offensive odors and heated the lessee's part of the building to 90 degrees without

³⁸See Section III-B-3 *infra*.

³⁹102 N.J.L. 279, 131 A. 879 (1926).

⁴⁰7 N.J.M. 575, 146 A. 588 (1929).

⁴¹See 39 HARV. L. REV. 1102 (1926) in conjunction with *Higgins v. Whiting* and Section III-B-3 *infra*.

⁴²125 N.J.L. 326, 15 A.2d 772 (1940).

the ability of the lessee to control the heat, the lessee vacated the premises, whereupon the lessor sued to recover rent unpaid for the balance of the term. Relying on *Higgins*, the court held that the lessor's failure to furnish a furnace in good condition, or repair it after notice of defect, was a breach of his covenant which would justify a breach of the lessee's covenant to pay rent.

Even more than residential leases, commercial leases have given rise to the problem of the mutuality of covenants vital to the lease. In *Tedstrom v. Puddephat*⁴³ the lessor leased commercial premises to the lessee by a lease which stated that if the premises were destroyed by fire either party had a right to cancel the lease. The premises were damaged by fire and the lessee sought to cancel the lease. The Arkansas Supreme Court held that the premises were not destroyed, only damaged; therefore, the lessee could not cancel the lease. But the court, in dicta, used the following language that was later to be applied to commercial leases in Arkansas, as had earlier been applied to residential leases:⁴⁴

. . . the covenants in a lease on the part of a lessor, and the agreement on the part of a lessee to pay the rent, are mutual undertakings, and the refusal by the one party to perform his part of the contract may justify the other party in treating the contract as rescinded. [Citations omitted.] So that the failure on the part of the lessor to perform his covenants in the lease may justify the abandonment of the premises by the lessee, and may work a cessation of the rent. *Berman v. Shelby*, 93 Ark. 472, 125 S.W. 124.⁴⁵

The Arkansas Supreme Court utilized both *Berman* and *Tedstrom* in *Felder v. Hall Bros. Co.*,⁴⁶ a case where the lessor leased farm lands to a business lessee by a lease which provided that (1) the lessee would pay a stipulated rent, (2) the lessee would have a right to renew the original eight-year term for an additional ten-year period, and (3) the lessee covenanted to keep the premises in good repair. At the end of the original term the lessor sued to eject the lessee, claiming that the lessee had no right to an extension of the lease because it failed to keep the premises in

⁴³99 Ark. 193, 137 S.W. 816 (1911); see also *Ashmore v. Hays*, 159 Ark. 234, 252 S.W. 11 (1923).

⁴⁴See note 37 *supra* and accompanying text.

⁴⁵99 Ark. at 197, 137 S.W. at 818.

⁴⁶151 Ark. 182, 235 S.W. 789 (1921).

good repair. The lessor was able to prove that the lessee had failed to keep the premises in good repair. The court held that the lease could not be automatically extended by the lessee, and that the lessee had forfeited its right to an extension because of its failure to keep the improvements on the land in good repair.

One of the most celebrated cases in this area is *University Club of Chicago v. Deakin*,⁴⁷ wherein the plaintiff-lessor leased premises to the defendant-lessee by a lease containing a covenant that, "Lessor hereby agrees during the term of this lease not to rent any other store in said University Club building to any tenant making a specialty of the sale of Japanese or Chinese goods or pearls." The lessor later leased to one, placing a clause in this lease prohibiting the lessee from using his premises for the specialty of selling pearls. However, this lessee did use the premises for this purpose, whereupon the defendant vacated his premises, sought to cancel his lease and refused to pay further rent. The plaintiff then sued to collect the unpaid rent. The court held that the lease in question was a bilateral contract, and that upon breach of an essential element by the lessor, the lessee had a right to refuse to be bound further by its terms and to surrender possession of the premises. The court was of the opinion that the lessor's default, his failure to enforce the covenant in the second lease, was in a matter vital to the lease in question, and that the defendant had a right to terminate his lease, surrender possession and refuse to further perform on his part the provisions of the lease.

A Texas Court of Civil Appeals, in *Ingram v. Fred*,⁴⁸ followed the lead of Arkansas in this area. The lessor rented business premises to the lessee by a lease which stated that in case the building should from any cause leak, the lessee should notify the lessor of this fact and the lessor would have a reasonable time to repair. When the roof leaked the lessee notified the lessor and waited for a reasonable time for him to repair, but when he failed to repair the lessee vacated the premises, refusing to pay rent further. Upon the lessor's suit to recover the unpaid rent, the court stated that the English (common law) rule is that if the lessor is bound by express contract to repair and by his failure to do so the premises become uninhabitable, or unfit for the purposes

⁴⁷265 Ill. 257, 106 N.E. 790 (1914).

⁴⁸210 S.W. 298 (Tex. Civ. App. 1918, *error ref'd*).

for which they were leased, the lessee has no right to vacate or to refuse to pay rent according to his covenant, but his only remedy is by action for damages. However, the court rejected that rule and, relying on *Berman v. Shelby*,⁴⁹ held that the covenants to pay rent and to repair were mutually dependent, and, consequently, the lessee was not liable for the unpaid rent.

An unusual case in this area is *Stifter v. Hartman*,⁵⁰ where the plaintiff had discussed with the defendant the rental of one-half of the former's office to the latter. They discussed sharing the expenses of stenographic service and telephone service. This agreement was not placed in the lease, but was proved by the defendant by parol evidence at the trial to which the plaintiff objected, claiming that parol evidence could not be admissible to alter or vary the terms of a written lease. After the lease was entered into the plaintiff refused to share the above named expenses; therefore, the defendant stopped paying rent. The Michigan Supreme Court upheld the decision of the trial court that the agreement as to sharing the named expenses was one of the inducements that led the defendant to enter into the lease, that the parol evidence was admissible to prove the inducement, and that when the plaintiff failed to share these expenses a part of the consideration for the lease failed and the defendant was not liable on the rent.

Hiatt Investment Co. v. Buehler,⁵¹ a case similar to *University Club of Chicago v. Deakin*,⁵² expands the remedies of a party to a lease who has been the victim of a breach of a mutually dependent covenant. Here the lessor leased premises to the lessee by a lease containing a covenant that the lessor would not lease to another for the purpose of operating a drugstore in the building. When the lessor breached this covenant the lessee attempted to rescind his lease and refused to pay further rent. The court, in upholding the lessee's right to take this course of action because the covenant went to the "entire consideration of the lease," said that the lessee had a choice of remedies: (1) rescind the lease, in which case he would owe no further rent; (2) continue under the lease and at the end of the term sure for any loss of profits

⁴⁹See note 37 *supra*.

⁵⁰225 Mich. 101, 195 N.W. 673 (1923).

⁵¹225 Mo. App. 151, 16 S.W.2d 219 (1929).

⁵²See note 47 *supra*.

caused by the lessor's breach of covenant; or (3) treat the breach of covenant as having ended the lease contract and sue for damages.

Medico-Dental Bldg. v. Horton & Converse,⁵³ factually similar to both *Hiatt Investment Co.* and *University Club of Chicago*, brings another jurisdiction into the camp of those holding that the breach of a vitally important covenant in a commercial lease affects other covenants in the lease. Here the lessor leased premises to the lessee by a lease in which the lessor promised not to lease to anyone who would engage in the prescription or pharmacy business. The lessee claimed that the lessor's renting to a doctor who compounded and dispensed drugs to his own patients was a breach of the covenant, allowing him to rescind the lease. The California Supreme Court said:

While it is true that a lease is primarily a conveyance . . . it also presents the aspect of a contract. . . . This dual character serves to create two distinct sets of rights and obligations—"one . . . based on 'privity of estate' and the other . . . based on 'privity of contract.'" . . . Those features of a lease which are strictly contractual in their nature should be construed according to the rules for the interpretation of contracts generally. . . .

. . . It is an established rule that those covenants which run to the entire consideration of a contract are mutual and dependent. . . . Undoubtedly the restrictive covenant in defendant's [lessee's] lease was of such a nature.⁵⁴

The court ruled that there was ample evidence to support the trial court's findings that the doctor was conducting a drugstore and that the lessor's acquiescence to this activity amounted to a breach of the covenant. Therefore, the lessee had a right to rescind the lease.

This rule concerning the mutual dependency of covenants which go to the "whole consideration" of a lease has been applied to defeat the action of a lessee as well as that of a lessor. In *Silken v. Farrell*⁵⁵ the lessee sued his lessor for breach of the covenant

⁵³21 Cal.2d 411, 132 P.2d 457, *aff'g* 124 P.2d 56 (Dist. Ct. App. 1942); *see also* *Kulawitz v. Pacific Woodenware & Paper Co.*, 25 Cal.2d 664, 155 P.2d 24 (1945).

⁵⁴132 P.2d at 462.

⁵⁵281 App. Div. 718, 118 N.Y.S.2d 16 (1952, *aff'd* 4 N.Y.2d 117, 172 N.Y.S.2d 808, 149 N.E.2d 328 (1958)).

of quiet enjoyment. The lessor was able to prove that the lessee was delinquent in paying taxes he was obligated to pay by the terms of the lease and that a tax foreclosure was imminent. The court held that the lessee could not recover unless as a condition precedent he proved performance on his part. Since it was undisputed that he was delinquent in paying taxes, he could not "cast the indulgent defendant in damages."

In *Dave Herstein Co. v. Columbia Pictures Corp.*⁵⁶ the lessee claimed that the lessor breached the covenant of quiet enjoyment by conducting extensive repairs and demolitions adjacent to the demised premises. During the time this activity was occurring the lessee was in arrears in rent. The court held that the payment of rent was a condition precedent to the enforcement of the covenant of quiet enjoyment, and, consequently, the lessee could not sue for damages occurring during the time he was in default in the rent.

Along the same line is *Osias v. 21st Borden Corp.*⁵⁷ where the lessor sued the lessee for possession based on non-payment of rent. At a time when the lessee was in default of the rent the temperature of the premises went above 90 degrees and the lessor refused to remedy this situation. The lessee defended against the suit on the theory that the overheated nature of the premises and the failure of the lessor to remedy the condition constituted a partial constructive eviction which was a breach of the covenant of quiet enjoyment. The court held this defense to be ineffective, stating that the lessee must pay rent as a condition precedent to asserting constructive eviction or breach of the covenant of quiet enjoyment as a defense to a summary proceeding based on non-payment of rent, or as a counterclaim, or as a separate action for damages.

3. *Constructive Eviction as a Substitute for Mutually Dependent Covenants*

The subject of constructive eviction is difficult to separate from the subject of the mutual dependence of covenants which go to the "whole consideration" of a lease. Both approaches share the same characteristics of being attempts on the part of our judicial system to give some remedy to one whose expectations in a lease have been frustrated because of the actions on the other party to

⁵⁶157 N.Y.S.2d 130 (Sup. Ct., Spec. Term 1956), *aff'd.*, 306 N.Y. 585, 115 N.E.2d 686 (1953).

⁵⁷29 Misc.2d 680, 211 N.Y.S.2d 463 (N.Y. City Mun. Ct. 1961).

the lease. Some of the cases presented earlier utilize both theories in protecting one party to a lease from the actions of the other party. There are, however, significant differences. First, the theory of constructive eviction is available only to the lessee in a lease situation, whereas, the theory of mutually dependent covenants is available to both lessor and lessee. Second, the theory of constructive eviction requires an overt act by the damaged lessee, vacation of the premises, whereas, the theory of mutually dependent covenants requires no such act.

There is no doubt, however, that the theory of constructive eviction is a much more established and utilized theory in landlord-tenant law than is the contractual theory of mutually dependent covenants. One can find ten constructive eviction cases for every one relying on the theory of mutually dependent covenants. History plays a large part in this. Historically, a lease has been regarded as a conveyance of an estate in land and the tenant has been regarded as primarily interested in the land from which the rents are said to issue.⁵⁸ For this reason in early common law only a physical eviction by the lessor of his lessee or a physical eviction of the lessee by a title paramount suspended the rent.⁵⁹ Such evictions were also regarded as a breach of the covenant of quiet enjoyment.⁶⁰ With the change in the character of leases, discussed earlier, wherein the principal thing of importance came to be not the land itself but the improvements on the land and the services furnished in connection with those improvements by the lessor, the rule that only physical eviction caused rent to be suspended became patently unsatisfactory. Where the lessor so seriously interferes with the lessee's use and enjoyment of the premises as to result in a frustration of the objectives of the lease, some recourse should be available to the lessee over and above money damages. Rather than adopting ordinary contract principles, our judicial system attempted to find a solution in the field of property law. The doctrine of constructive eviction is the result of that search.

Constructive eviction can be defined as any act of a grave and permanent character by the lessor or those acting under his author-

⁵⁸See 3 Tiffany § 876.

⁵⁹Rapacz, *Origin and Evolution of Constructive Eviction in the United States*, 1 DE PAUL L. REV. 69 (1951); 1 AMERICAN LAW OF PROPERTY § 3.50, at 278.

⁶⁰1 Tiffany § 92.

ity with intent and effect to deprive the lessee of the use, occupation and enjoyment of the premises or a part thereof, or the establishment or assertion against the lessee of a title paramount to that of the lessor, resulting in the lessee's abandonment of the premises.⁶¹ Such a serious interference by the lessor is construed to have the same legal effect as a physical eviction,⁶² hence the name "constructive eviction." In this way the element of physical expulsion is dispensed with, being regarded as a technical requirement that should not be applied.⁶³ The justification for this doctrine is that any serious interference with the lessee's use, occupation and enjoyment of the property amounts to a breach of the covenant of quiet enjoyment,⁶⁴ generally implied in leases.⁶⁵ The effects of constructive eviction are to terminate the duty of the lessee to pay rent and to give the lessee the right to sue the lessor for damages.⁶⁶ It is apparent that the former effect is identical to that arising from an application of the theory of mutually dependent covenants. To say that a serious interference with the use, occupation and enjoyment of property is a breach of the covenant of quiet enjoyment, justifying abandonment and a termination of rent liability, is only another way of saying that the covenant of quiet enjoyment (or some other covenant of the lessor) and the covenant to pay rent are mutually dependent so that the failure to perform one deprives the party in default of a right to enforce performance on the other side. Numerous authorities have pointed this out; one saying that, "The doctrine of 'constructive eviction' . . . has become a respectable property garb for the contract rule of 'mutuality';"⁶⁷ another saying that "When that [constructive eviction] doctrine is liberally applied, the result reached is not different than that which would be reached under the contract rule of mutually dependent covenants. . . ."⁶⁸

A recent New Jersey case, *Reste Realty Corp. v. Cooper*,⁶⁹

⁶¹Bloomberg v. Evans, 194 N.C. 113, 138 S.E. 593 (1927).

⁶²1 AMERICAN LAW OF PROPERTY § 350, at 280.

⁶³Rapacz, *supra* note 59, at 73.

⁶⁴Dyett v. Pendleton, 4 Cow. (N.Y.) 581 (1825), *on writ of error*, 8 Cow. (N.Y.) 727 (Court for Correction of Errors, 1826); *see generally* Rapacz, *supra* note 59, at 71-74.

⁶⁵See Section V-B-1 *infra*.

⁶⁶Rapacz, *supra* note 59, at 87-89.

⁶⁷2 Powell § 221[1], at 182 n. 11.

⁶⁸1 AMERICAN LAW OF PROPERTY § 3.51, at 282.

⁶⁹53 N.J. 444, 251 A.2d 268 (1968).

illustrates the closely connected nature of three concepts—(1) constructive eviction, (2) mutually dependent covenants, and (3) implied warranty of habitability—the first two of which are being presently discussed and the last of which will be discussed later.⁷⁰ In this case a lessor sued his lessee to recover unpaid rent. The lessor had leased the ground floor of a building to the lessee by a lease which stated that the lessee had inspected the premises, took them as is, and covenanted to keep them in repair. The lease included an express covenant of quiet enjoyment. At the trial the lessee proved that after every rain water flooded into the premises from an adjacent driveway, due to faulty grading and sealing of the foundation. Originally the lessor's manager would remove the water each time. The parties entered into another lease containing identical provisions, and when the problem was never remedied by the lessor, despite frequent promises by his manager to do so, the lessee vacated the premises. The plaintiff-lessor claimed that the lessee took the premises "as is," that the damage was not permanent, and that the lessee had waived any breach of the covenant of quiet enjoyment by remaining in possession. The lessee defended on the basis that the flooding constituted a breach of the covenant of quiet enjoyment which amounted to constructive eviction. The New Jersey Supreme Court ruled that the lessee was not liable for the unpaid rent on the following bases: (1) the lease contained an implied warranty that no latent defects existed on the premises or outside the premises, and that this warranty was breached by the lessor in this case; (2) the express warranty of quiet enjoyment was breached by the defect in the premises, resulting in the constructive eviction of the lessee, who vacated the premises within a reasonable time after the breach; and (3) under *Higgins v. Whiting*⁷¹ the covenant of quiet enjoyment and the covenant to pay rent were mutually dependent, the breach of one relieving the other party of the obligations of the other covenant. The court discussed the closely connected nature of these three concepts in the following way:

The inference to be drawn from the cases is that the remedy of constructive eviction probably evolved from a desire by the courts to relieve the tenant from the harsh burden im-

⁷⁰See Section V *infra*.

⁷¹See note 39 *supra* and accompanying text.

posed by common law rules which applied principles of *caveat emptor* to the letting, rejected an implied warranty of habitability, and ordinarily treated undertakings of the landlord in a lease as independent covenants. To alleviate the tenant's burden, the courts broadened the scope of the long-recognized implied covenant of quiet enjoyment (apparently designed originally to protect the tenant against ouster by a title superior to that of his lessor) to include the right of the tenant to have the beneficial enjoyment and use of the premises for the agreed term. It was but a short step then to the rule that when the landlord or someone acting for him or by virtue of a right acquired through him causes a substantial interference with that enjoyment and use, the tenant may claim a constructive eviction. In our view, therefore, at the present time whenever a tenant's right to vacate leased premises comes into existence because he is deprived of their beneficial enjoyment and use on account of acts chargeable to the landlord, it is immaterial whether the right is expressed in terms of breach of a covenant of quiet enjoyment, or material failure of consideration or material breach of an implied warranty against latent defects.⁷²

4. *Implied Mutually Dependent Covenants*

In almost all the cases discussed so far the covenants deemed to be mutually dependent were specifically bargained for and considered to be important provisions by the parties to the lease. It is not surprising that a majority of these cases revolve around commercial leases because it is in this type of lease that the parties most often stand at arm's length and bargain for the specific terms of the lease in an attempt to obtain the best possible position in the lease. It is in this type of lease that the view of holding only those express covenants deemed to be vital enough to go to the "whole consideration" of the lease to be mutually dependent has worked the most satisfactorily. In the area of residential leases, however, this approach has been highly criticized.⁷³ Limiting the doctrine of mutually dependent covenants to express covenants results in the doctrine being applied primarily to commercial leases because lessors' covenants are often not expressly bargained for in residential leases. And, yet, residential lessors' covenants—pertaining to: (1) services such as the furnishing of heat, hot water,

⁷²251 A.2d at 276.

⁷³Note, *Contract Principles and Leases of Realty*, 50 B. U. L. REV. 24, at 28-29 (1970).

sanitation services; (2) freedom from rodent and insect infestation; and (3) the condition and maintenance of structural improvements on the land—can be essential to the lessee's use and enjoyment of the premises. A few jurisdictions are beginning to recognize the problems inherent in this approach and are holding that some covenants are so essential to a lease that they will be implied in lease agreements and that the mutual dependency doctrine will be applied to these implied covenants. The subject of implied warranties or covenants in leases generally is discussed later;⁷⁴ therefore, the present discussion will revolve around the application of the doctrine of mutual dependency to such covenants and not around these covenants themselves.

The impetus behind the application of the mutual dependency doctrine to implied covenants in leases stems from three sources: (1) public policy in general; (2) housing codes; and (3) state statutes. The source resorted to first was public policy. In *Pines v. Persson*⁷⁵ several law students leased a furnished house for the school year from the owner. The premises leased turned out to be in filthy and uninhabitable condition. After a brief attempt to make the house habitable the lessees moved out and sued the lessor for return of the rent deposit made on the house. The lessor defended on the basis that there was no covenant in the lease that the premises were suitable for habitation. The Supreme Court of Wisconsin held that the lessees were absolved from any liability for rent under the lease, their liability being limited to the reasonable rental value of the premises during the time of actual occupancy, and that they could recover their deposit on the basis that public policy demanded the implication of a covenant of habitability in this type of lease. The court went on to say: "Respondent's [lessee's] covenant to pay rent and appellant's [lessor's] covenant to provide a habitable house were mutually dependent, and thus a breach of the latter by appellant relieved respondents of any liability under the former."⁷⁶ It should be noted that although the correct source of the implied covenant has been the subject of some debate, *i.e.*, whether it stems from public policy or a well recognized exception to the general rule of *caveat*

⁷⁴See Section V *infra*.

⁷⁵14 Wis.2d 590, 111 N.W.2d 409 (1961).

⁷⁶*Id.* 111 N.W.2d at 413.

emptor,⁷⁷ there is no doubt that the court intended to apply the mutual dependency doctrine to this covenant.

The New Jersey Supreme Court reached the same conclusion recently in *Marini v. Ireland*.⁷⁸ In this case the lessor leased an apartment limited in use to dwelling purposes to the lessee who soon discovered that the toilet had a crack and leaked. After unsuccessful efforts to have the lessor repair, the lessee had the toilet repaired himself, paid the bill and deducted the amount of the bill from the rent he paid to the lessor. The lessor contested the assertion that the repair bill should be deducted from the rent and finally sued to dispossess the lessee for failure to pay rent due. The lessee raised the defense that the failure of the lessor to repair the defect constituted a breach of either the covenant of habitability or the covenant of quiet enjoyment, giving him the right to self-help. The court, in ruling that the lessee did have the right to exercise this form of self-help, said that they need not consider the question of a breach of the covenant of quiet enjoyment, but, rather, the question of breach of an implied covenant of habitability. Because the purpose of the lease was to furnish a dwelling suitable for living purposes, public policy demands that the lease should, by implication, contain a covenant that there were no latent defects at the commencement of the lease and that the premises would remain defect-free throughout the life of the lease. Citing *Higgins v. Whiting*,⁷⁹ the court stated that because the covenant to pay rent should be considered dependent on the implied covenant of habitability, a breach of the latter gives the lessee the right either to repair the defect and deduct the amount of the repair bill from the rent, or to vacate the premises and end his obligations under the lease.

Marini was soon followed by *Academy Spires, Inc. v. Brown*,⁸⁰ which sheds light on how damages may be determined, assuming the breach of a mutually dependent covenant. The lessor had leased an apartment to the lessee in a multistoried apartment building. The lessee refused to pay the rent because of a lack of heat, garbage disposal, and elevator service, along with defects in venetian blinds, water leaks, wall cracks, and a lack of painting. The

⁷⁷See Section V *infra*.

⁷⁸56 N.J. 130, 265 A.2d 526 (1970).

⁷⁹See note 39 *supra*.

⁸⁰111 N.J. Super. 477, 268 A.2d 556 (1970).

lessor sued to dispossess the lessee for failure to pay the rent, and the lessee defended on the basis that the rent should be diminished twenty-five per cent (25%) because of the defects. The court agreed with the lessee, relying on *Marini* and stating that the following principles of that case would be applicable to the present case: (1) in a dispossession proceeding a lessee can raise the issue of diminution in the amount of rent due by reason of the lessor's failure to supply services; (2) a covenant that the premises "were habitable and fit for living" would be implied in the lease because indispensable in order to carry into effect the purpose of the lease; and (3) the lessee's covenant to pay rent and the lessor's covenant of habitability would be construed to be mutually dependent. The court reached the conclusion that a failure to provide hot water, garbage disposal or elevator service, being basic living requirements, would be deemed to be a breach of the implied covenant of habitability; whereas, a malfunction of the venetian blinds, water leaks and a lack of painting would be deemed to be a deprivation of "amenities" and would not constitute such a breach. On the question of the amount of rent abatement allowable in such a situation, the court admitted the difficulty of it because of the lack of authority dealing with it, but relied on the *Model Residential Landlord-Tenant Code*⁸¹ which provides for a twenty-five per cent (25%) reduction in rent for failure to furnish hot water. This approach has been commended as a practical and reasonable way of determining the extent of rent abatement allowable without resort to the expensive process of hiring an expert appraiser to testify as to the amount of damages resulting from a given kind and quantity of breach of the covenant of habitability.⁸²

One later New Jersey case interprets both *Marini* and *Academy Spires*; it is *Kruvant v. Sunrise Market, Inc.*⁸³ In this case a lessor had leased commercial premises to the lessee by a lease containing a provision that any controversy as to the amount of rent owed should be settled by arbitration, and that, during arbitration, the stated rent was to be paid. The lessee repaved a parking lot which it claimed it was the lessor's obligation to do

⁸¹§ 2-207(1)(b) Amer. Bar Found. Tent. Draft 1969).

⁸²Bross, *Law Reform Man Meets the Slumlord: Interactions of New Remedies and Old Buildings in Housing Code Enforcement*, 3 THE URBAN LAWYER 609, at 617 (1971).

⁸³112 N.J. Super. 509, 271 A.2d 741 (1970).

and, thereafter, refused to pay the full rent, claiming an offset of the amount expended for repaving against the rent. The court upheld the lessor's suit to dispossess the lessee for failure to pay rent for two reasons. First, since the lease obligated the lessee to pay rent during the arbitration of any dispute, it was obligated to pay full rent during the present dispute. Second, the court stated that the "doctrine" laid down in *Marini* and extended in *Academy Spires* is not applicable to commercial leases, but only residential leases. Two observations can be made of this decision: (1) because of the specific obligations on the lessee in this commercial lease, the decision should be limited to the specific facts; and (2) if the court uses the term "doctrine" to refer to the rent abatement technique found in both *Marini* and *Academy Spires*, although it is true that they both dealt with residential leases, an earlier New Jersey Supreme Court case, *Reste Realty Corp. v. Cooper*,⁸⁴ held the concept of mutual dependency applicable to a covenant of habitability implied in a commercial lease. And the technique of rent abatement, based on the *Model Residential Landlord-Tenant Code*, or some other device, is merely an application of the concept of the mutual dependence of the lessor's covenant of habitability and the lessee's covenant to pay rent.

A second source of the application of the mutual dependency doctrine to implied covenants in leases is that of housing codes. They are becoming recognized as objective criteria for a determination of whether or not premises are habitable. One leading case adopting this approach is *Javins v. First National Realty Corp.*⁸⁵ A lessor was suing his residential lessee for possession of the premises for nonpayment of rent. As a defense the lessee offered evidence of numerous violations of the *Housing Regulations* of the District of Columbia. The lower court ruled this evidence inadmissible and ruled for the lessor. The circuit court reversed, holding that a warranty of habitability, measured by the standards set out in the *Housing Regulations*, is implied by law into leases of urban dwelling units covered by the *Regulations*. The court concluded by saying: "Under contract principles . . . the tenant's obligation to pay rent is dependent upon the landlord's

⁸⁴See note 69, *supra*.

⁸⁵428 F.2d 1071 (D.C. Cir. 1970), *cert. denied* 400 U.S. 925 (1970).

performance of his obligations, including his warranty to maintain the premises in habitable condition.⁸⁶

A second case reaching the same decision is *Amanuensis, Ltd. v. Brown*.⁸⁷ Here the lessor sought to evict a lessee for nonpayment of rent. The lessor had purchased the building wherein the lessee had his apartment on April 15, 1969, the building then having violations of the New York City *Housing Maintenance Code* assessed against it. The lessor took no steps to remove the violations, but, rather, refused to repair pursuant to what the court concluded was a scheme to force the remaining lessees to move. The lessee defended the suit on the basis that the lessor had breached warranties of fitness for use and quiet enjoyment. The court held that the requirements of the *Code* and the New York State *Multiple Dwelling Law* have created an implied warranty of habitability which was breached by the lessor due to his failure to exert a good-faith effort to remove substantial violations of the *Code* in order to force his lessees to move. The court went on to hold that "under accepted contract principles" the presence of substantial violations wholly defeated a claim for rent.

A third source of the application of the mutual dependency doctrine to implied covenants in leases is that of state statutes. The chief example of this source is New York's so-called *Spiegel Law*,⁸⁸ whereby welfare authorities may withhold an indigent lessee's rent from the lessor when there are conditions in the building wherein the lessee's apartment is located that are dangerous to life or health. The *Law* provides that the welfare lessee has a statutory defense in an action of eviction brought by the lessor for nonpayment of rent, if at the time the action is commenced there exist such conditions in the building. In *Schaeffer v. Montes*⁸⁹ the lessor sued to evict the lessee for nonpayment of rent due to the application of the *Spiegel Law*. The lessor claimed the *Law* was unconstitutional; however, the court upheld its constitutionality, concluding it does not violate the Fourteenth Amendment to the United States Constitution. The New York Court of Appeals upheld the constitutionality of the *Law*.⁹⁰

⁸⁶*Id.* at 1082.

⁸⁷65 Misc.2d 15, 318 N.Y.S.2d 11 (N.Y. City Civ. Ct. 1971).

⁸⁸N.Y. Soc. Services Law § 143-6 (McKinney 1966).

⁸⁹37 Misc.2d 722, 233 N.Y.S.2d 444 (N.Y. City Civ. Ct. 1962).

⁹⁰*Farrell v. Drew*, 19 N.Y.2d 486, 281 N.Y.S.2d 1, 227 N.E.2d 824 (1967).

IV. ILLEGALITY OF CONTRACT DOCTRINE

One contract principle which has been historically applied to real property leases falling into certain well-defined categories and which has recently been revived to deal with urban residential leases is that of illegality.⁹¹ An examination of the history and the present use of this doctrine reveals how courts can utilize a contractual principle in handling property leases.

A. *Contract Principles*

Illegality arises in the area of contracts when the bargain is in violation of existing law, whether its source is (1) legislation, (2) common law, or (3) prevailing *mores* of the community, *i.e.*, public policy.⁹² As a general rule of contract law, a party to an illegal bargain can neither recover damages for breach of the bargain, nor recover the performance that he has rendered or its value by rescinding the bargain.⁹³ There are, however, certain circumstances that justify recovery on such a contract; (1) recovery is allowed to a party who is justifiably ignorant of all facts making the bargain illegal;⁹⁴ (2) recovery is allowed to a party not as equally guilty as the other party;⁹⁵ and, (3) recovery is allowed to a party for whose benefit the statute making the bargain illegal was intended.⁹⁶

A bargain may be illegal because it is in violation of law existing at the time of its inception, or it may become illegal after its inception because of a change of fact or of law.⁹⁷ The latter alternative is known as "supervening illegality" and results in further performance of the bargain becoming illegal. In the area of real property leases the illegality of contract principle has been limited to cases of the first type, *i.e.*, where the law affecting the lease is in

⁹¹Although the designation "illegal contract" is often applied to this principle, the broader designation of "illegal bargain" is more accurate because the former term is contradictory except where performance is in some way recognized as a duty. Since many illegal bargains create no change in legal relations, they are void; however, some illegal bargains are enforceable by at least one party, and, consequently, cannot be said to be void. See RESTATEMENT OF CONTRACTS § 512, comment *c* (1932).

⁹²6A CORBIN § 1374.

⁹³RESTATEMENT OF CONTRACTS § 598 (1932).

⁹⁴*Id.* § 599; 6A CORBIN § 1538.

⁹⁵RESTATEMENT OF CONTRACTS § 604 (1932).

⁹⁶*Id.* § 601; 6A CORBIN § 1540.

⁹⁷RESTATEMENT OF CONTRACTS § 608 (1932).

existence at the time the lease is entered into. Cases wherein the law affecting the lease comes into existence after entry into the lease are decided on different principles.⁹⁸

B. Real Property Leases

1. Leases for Illegal or Immoral Purposes

It has long been the rule that where real property is leased with the knowledge and intent of both parties that it is to be used for illegal or immoral purposes, the lease is illegal, void and unenforceable.⁹⁹ This rule has frequently been applied to leases where in the purpose was the unlawful sale of liquor. *Dunn v. Stegemann*¹⁰⁰ is a typical example. In this case the plaintiff-lessor leased premises to the defendant-lessee by a lease containing a provision limiting the lessee's use of the premises to that of a saloon and cigar stand. At the time the lease was made San Francisco, by ordinance, prohibited the operation of a saloon without a license and prohibited the granting of a license where the premises were located within 150 feet of a church. The premises involved were located within 150 feet of a church. The lessor sued the lessee for unpaid rent. The California Court of Appeals reversed the trial court's judgment for the lessor, holding that no recovery can be had by either party to a "contract" having for its object the violation of law. The court reasoned that the lease was not enforceable because it was invalid.

The conduct of illegal gambling operations has been the basis for holding a real property lease illegal, void and unenforceable. In *Ryan v. Potwin*¹⁰¹ the lessor leased premises to the lessee, knowing that they were to be used for gambling purposes. A state statute made it a penal offense to so lease premises. When the lessor sued the lessee for unpaid rent, the court held that the lessor could not recover on such a lease.

A third illegal or immoral purpose which has caused a lease to

⁹⁸See Sections V and VIII *infra*.

⁹⁹1 AMERICAN LAW OF PROPERTY § 3.43.

¹⁰⁰10 Cal. App. 38, 101 P. 25 (1909); *accord*, *Musco v. Torello*, 102 Conn. 346, 128 A. 645 (1925); *Koepke v. Peper*, 155 Iowa 687, 136 N.W. 902 (1912); *Bank of Commerce & Trust Co. v. Burke*, 135 Tenn. 19, 185 S.W. 704 (1916).

¹⁰¹62 Ill. App. 134 (1896); *accord*, *Simpson v. Wood*, 105 Mass. 263 (1870).

be declared illegal is that of prostitution. In *Dougherty v. Seymour*¹⁰² the lessor leased premises to the lessee for the purpose of operating a bawdyhouse. When the lessor sued the lessee to collect unpaid rent the Colorado Supreme Court, upholding a trial court determination in the lessee's favor, said: ". . . we have a case in which both parties to the lease are shown to have entered into the same with the understanding that the leased premises were to be used for the purpose of prostitution. Such contracts, being *contra bonos mores*, cannot be enforced."¹⁰³

2. Leases Which Violate Zoning Ordinances

A second general category of leases which have consistently been held to be illegal and, consequently, unenforceable is composed of those which violate zoning ordinances.¹⁰⁴ The rule governing this type of case has been stated in the following way: "If the parties knowingly enter into a lease pursuant to which the sole use permitted by the landlord and intended to be pursued by the tenant is a use prohibited by the zoning ordinances the contract is for an illegal purpose and neither party may recover thereon."¹⁰⁵

Several cases well illustrate the application of this rule. In *Howell v. City of Hamburg Co.*,¹⁰⁶ the plaintiff-lessor leased to the defendant-lessee a one-story wooden building to be built on a lot for a period of two years with the right to extend the lease for three more years. At the time this lease was entered into San Francisco, where the premises were located, had a fire ordinance prohibiting the erection of wooden buildings within an area encompassing the premises covered by the lease. Upon the lessee's failure to pay the rent stipulated in the lease, the lessor sued to recover the rent. The California Supreme Court reversed the trial court's judgment in the lessor's favor, saying that ". . . the contract of lease was founded upon an unlawful consideration, and

¹⁰²16 Colo. 289, 26 P. 823 (1891); *accord*, *Campbell v. Gullo*, 142 La. 1082, 78 So. 124 (1918); *Rosenblath v. Sanders*, 150 La. 882, 91 So. 252 (1922); *Berni v. Boyer*, 90 Minn. 469, 97 N.W. 121 (1903); *Mitchell v. Campbell*, 111 Miss. 806, 72 So. 231 (1916); *Ashbrook v. Dale*, 27 Mo. App. 649 (1887); *Ernst v. Crosby*, 140 N.Y. 364, 35 N.E. 603 (1893); *Hunstock v. Palmer*, 4 Tex. Civ. App. 459, 23 S.W. 294 (1893).

¹⁰³26 P. at 823.

¹⁰⁴*See generally* Annot., 37 A.L.R.3d 1018 (1971).

¹⁰⁵3 A. Rathkopf, *THE LAW OF ZONING AND PLANNING* 73-1 (3d ed. 1970).

¹⁰⁶165 Cal. 172, 131 P. 130 (1913).

. . . the entire contract was therefore void and unenforceable."¹⁰⁷

In contrast to the last case, where the lessor was prevented from enforcing the lease because of its illegality, in *Ober v. Metropolitan Life Insurance Co.*¹⁰⁸ the lessee was prevented from enforcing the lease for the same reason. The defendant-lessor had leased the premises to the plaintiff-lessee for the sole purpose of operating a valet shop. Since the zoning ordinances which were in existence when the lease was executed prohibited such use in the area where the property was located, the lessee vacated and sued the lessor for breach of the covenant of quiet enjoyment contained in the lease. The court ruled in favor of the lessor, relying on the contract principle that a contract in violation of existing law cannot be enforced.

A recent case dealing with this problem is *Walker v. Southern Trucking Corp.*,¹⁰⁹ where the lessor leased premises to the lessee by a lease which provided that the property would be used as an "office and warehouse and Trucking Terminal and for no other different object or purpose." The lessee expended \$3,000 in preparing the property for the contemplated use, not knowing the property was zoned as a multiple-dwelling area. The city ordered the lessee to discontinue its use in violation of the ordinance. Both the lessor and lessee, who were ignorant of the zoning of the property at the time the lease was executed, sought unsuccessfully to have the zoning changed. The lessee vacated, whereupon the lessor sued for unpaid rent and the lessee filed for recoupment for \$3,000 spent in preparation of the property. The Alabama Supreme Court upheld a judgment in favor of the lessee and allowed recoupment in this case. The court, citing *Ober*, held that where a lease permits the lessee to use premises for a single purpose, a prohibition of law against such use annuls or terminates the "contract" and relieves the lessee of any obligation thereunder.

3. Leases Which Violate Housing Codes

The illegality of contract principle has recently been taken out of the traditional areas of application, in so far as leases are concerned, and has been applied to urban residential leases which

¹⁰⁷*Id.* at 176, 131 P. at 132.

¹⁰⁸157 Misc. 869, 872, 284 N.Y.S. 966 (N.Y. City Ct. 1935).

¹⁰⁹283 Ala. 551, 219 So.2d 379 (1965).

substantially violate municipal housing codes. Courts in the District of Columbia have begun to utilize this principle as a means of compensating residential lessees for the damages suffered from substandard housing.¹¹⁰ The application of this principle has allowed complete or partial rent abatement and other relief to be given to lessees.

The first case to adopt the illegality rule in this context was *Adams v. Lancaster*.¹¹¹ The lessee sued her lessor to recover \$80 paid as a rent advance under an oral contract to lease the premises. The lessee never went into possession but found more suitable housing and asked the lessor to return the \$80. Upon the lessor's refusal to return the money, the lessee sued for its return, claiming that the lease was void because of the existence of housing code violations at the time the lease was executed and because the certificate of occupancy would not permit a family as large as hers to occupy the premises. The court ruled in favor of the lessee, holding that the lease was illegal and void and that the lessee could recover the \$80 paid to her lessor at the time the lease was executed. Although the court did not state the reasons for allowing the \$80 recovery, exceptions to the general rule of nonrecoverability on an illegal contract could be applied.¹¹²

A short time later *Brown v. Southall Realty Co.*¹¹³ was decided. The lessor sued the lessee for possession for nonpayment of rent. The trial court awarded judgment to the lessor. The lessee appealed to the District of Columbia Court of Appeals, although she had previously moved from the premises, on the basis that the judgment of the trial court would render certain facts res judicata in any subsequent action for rent; the Court of Appeals agreed. At the time the lease was entered into the lessor knew that certain housing code violations existed—obstructed commode, broken railing, insufficient ceiling height in basement—which prevented it from being used as a dwelling place. The lessee defended on the basis that no rent was due under the lease because it was an illegal contract, being in contravention of the District

¹¹⁰See Daniels, *Judicial and Legislative Remedies for Substandard Housing: Landlord-Tenant Reform in the District of Columbia*, 59 GEO. L.J. 909 (1971).

¹¹¹Small Claims No. C-12912-67 (D.C. Ct. Gen. Sess., Oct. 25, 1967), reprinted in *LAW IN ACTION*, Nov. 1967, at 14.

¹¹²See notes 94, 95 and 96 *supra* and accompanying text.

¹¹³237 A.2d 834 (D.C. Ct. App. 1968), *cert. denied*, 393 U.S. 1018 (1969).

of Columbia *Housing Regulations*, the pertinent parts of which are as follows:

§ 2304 — No person shall rent or offer to rent any habitation, or the furnishings thereof, unless such habitation and its furnishings are in a clean, safe and sanitary condition, in repair, and free from rodents or vermin.

§ 2501 — Every premises accommodating one or more habitations shall be maintained and kept in repair so as to provide decent living accommodations for the occupants. This part of the Code contemplates more than mere basic repairs and maintenance to keep out the elements; its purpose is to include repairs and maintenance to make a premises or neighborhood healthy and safe.

The Court of Appeals reversed the trial court's judgment for the lessor. The court concluded that because the violations were such as to make the habitation unsafe and unsanitary (§ 2304) and because the premises had not been maintained to the degree necessary to keep them healthy and safe (§ 2501), the lease was in violation of the *Housing Regulations*. The court stated that the general rule governing contracts is that ". . . an illegal contract, made in violation of the statutory prohibition designed for police or regulatory purposes, is void and confers no right upon the wrongdoer," and that there was no reason to treat a lease differently from any other contract in this regard.

Although not stressing the point, the court in *Brown* did find that the violations of the housing code were substantial. Housing codes themselves should be consulted to determine what type of violation will make a lease illegal. Courts need to exercise discretion and find illegality only where the violations are substantial enough to thwart the purpose of the housing code to maintain a healthy and safe dwelling.¹¹⁴ *Reese v. Diamond Housing Corp.*¹¹⁵ illustrates this approach. The lessee defended a suit brought by the lessor for possession of the premises for nonpayment of rent on the basis that the lease was void and unenforceable because violations of the District of Columbia *Housing Regulations* exist-

¹¹⁴See Note, *Leases and the Illegal Contract Theory—Judicial Reinforcement of the Housing Code*, 56 Geo. L.J. 920, 929-30 (1968); U. Prrr. L. Rev. 134, 126-37 (1968).

¹¹⁵259 A.2d 112 (D.C. Ct. App. 1969).

ing when the lease was executed made it an illegal agreement. The trial court found that the violations were not of the quality and kind sufficient to render the premises unsafe and unsanitary. The District of Columbia Court of Appeals upheld this determination on the basis that the evidence supported the decision that any housing code violations which existed at the inception of the lease did not substantially affect habitability, and, consequently, relieve the lessee of his obligation to pay the rent.

*Diamond Housing Corp. v. Robinson*¹¹⁶ deals with the problem of the lessor's knowledge of the existence of housing code violations on the premises when he leases them and also with the problem of the effect of substantial violations on the lease. The lessor sued the lessee for possession of the premises for nonpayment of rent. The lessee defended on the basis that the lease was void and unenforceable because it was illegal due to violations of the *Housing Regulations* in existence at the time the lease was executed. The lessor argued that *Brown* was not applicable because at the time the lease was signed he had not received official notice of the existence of the violations from the city's housing inspectors. The District of Columbia Court of Appeals held that violations of the *Housing Regulations* may exist even though city inspectors have not inspected the premises and cited the defective conditions, and, therefore, *Brown* was applicable. The court also held that when it is established that a lease is void and unenforceable under *Brown*, the lessee becomes a tenant at sufferance and the tenancy may be terminated on thirty days notice.

The lessee's victory in *Robinson* is a Pyrrhic one if the lessor can immediately terminate the lease pursuant to thirty days notice because the illegality of the lease transforms the lessee into a tenant at sufferance. The lessor can accomplish by one method what he cannot accomplish by another. The lessee may have some defense in such a situation, but only if he can prove that the eviction by the lessor was in retaliation for some act of the lessee such as reporting housing code violations, making complaints to the lessor, joining a tenant union, or withholding rent. Although the subject of retaliatory eviction is beyond the scope of this paper¹¹⁷ it should be pointed out that the District of Columbia

¹¹⁶257 A.2d 492 (D.C. Ct. App. 1969).

¹¹⁷See generally 21 SYRACUSE L. REV. 986 (1970); 54 MARQ. L. REV. 239 (1971).

Landlord-Tenant Regulations now protect a lessee who is withholding rent because of housing code violations against a retaliatory eviction by the lessor.¹¹⁸ But this is far from complete protection to the lessee because the lessor can still terminate the lease for any legitimate reason or for no reason at all.¹¹⁹ There is the additional factor of the lessor increasing the lessee's rent within this context for either legitimate or illegitimate reasons.¹²⁰ Thus, the illegality principle that is beginning to be applied to leases may prove to be a boon to the lessee more in the form of protection against past-due rent than in allowing him to maintain possession of the property.

*William J. Davis, Inc. v. Slade*¹²¹ deals with the question of what compensation, if any, the lessor is entitled to receive from his lessee for the use and occupancy of the premises when the lease is declared to be void and illegal because of the existence of housing code violations. The defendant-lessor had leased premises to the plaintiff-lessee at a time when the lessor knew of substantial code violations. The lessor had sued the lessee for possession of the premises for nonpayment of rent, but the suit failed because the lease was void under the ruling in *Brown*. The lessee then sued the lessor in the present action to recover the amount of rent (\$690) paid to the lessor under the void lease. The lessor argued that it was entitled to keep the rent because it and the lessee were in *pari delicto*, and, consequently, the court should leave the parties where it finds them, *i.e.*, with the lessor having the \$690. The District of Columbia Court of Appeals declined to follow this view, and, instead, held that the lessor was entitled only to the reasonable value of the premises in the condition they were in when occupied by the lessee. The court reasoned that the parties were not in *pari delicto* because the existing housing shortage in the District of Columbia, which the parties stipulated to and the court took judicial notice of, prevented there being any true bargaining power by the lessee to bargain for premises free from code violations. Since the lease was void *ab initio*, the lessee was a tenant at sufferance in the District of Columbia; therefore, the general rule denying quasi-contractual relief should not be

¹¹⁸See Daniels, *supra* note 110, at 940.

¹¹⁹See Dickhut v. Norton, 45 Wisc.2d 389, 173 N.W.2d 297 (1970).

¹²⁰See 54 MARQ. L. REV. 239, at 243.

¹²¹271 A.2d 412 (D.C. Ct. App. 1970).

followed but, rather, the lessor should receive from the lessee what a tenant at sufferance owes—the reasonable value of the premises in the condition they were in when occupied.

*Cooks v. Fowler*¹²² presents some of the procedural problems surrounding the application of the illegality principle to leases. The lessor sued the lessee for possession of the premises for non-payment of rent; the lessee defended on the basis that the lease was void under *Brown* because of the existence of known code violations when the lease was executed. The lessor then brought a second action for possession based on proper notice to quit, *i.e.*, the lessor treated the lessee as a tenant at sufferance and gave thirty days notice to quit; the lessee defended on the basis that the notice to quit was retaliatory. The jury found substantial code violations, but no retaliatory motive. Judgment was rendered for the lessor, but the court granted a stay of execution of the judgment, pending the lessee's appeal of the judgment that the notice to quit was not retaliatory, conditioned, however, on the lessee's depositing into court sums equal to the monthly rental under the lease. The District of Columbia Court of Appeals denied the lessee's appeal for reversal of this condition. However, the United States Court of Appeals for the District of Columbia Circuit held that the condition ignored the jury's finding that there were substantial code violations and also held that it required standard rent for substandard housing. Therefore, the condition was modified to require the lessee to deposit in court the reasonable occupancy value of the premises in the "as is" condition.

*Watson v. Kotler*¹²³ points up the fact that the lessor who promptly repairs housing code violations has nothing to fear from the illegality principle. The lessor sued the lessee for possession of the premises for nonpayment of rent; the lessee defended on the basis that there were housing code violations cited on the premises at the time the lease was executed. The violations were cited on June 23, 1967; on reinspection in September, 1967, the housing inspector found that the violations had been abated. During the period between these two inspections the lessor had leased the premises to the lessee. The court ruled that the fact that there had been violations, which were being corrected, on the premises

¹²²437 F.2d 669 (D.C. Cir. 1971).

¹²³264 A.2d 141 (D.C. Ct. App. 1970).

at the time the lease was executed did not render the lease void because the purpose of the *Housing Regulations* was not solely to penalize lessors, but to stimulate them into keeping the premises safe and habitable for lessees.

*Saunders v. First National Realty Corp.*¹²⁴ deals with the effect of housing code violations arising after entry into the lease. When the lessor sued the lessee for possession of the premises for non-payment of rent, the lessee defended on the basis that numerous housing code violations arose during the lease that ended the lessee's obligation to pay rent. The District of Columbia Court of Appeals upheld the trial court's judgment in the lessor's favor, refusing to hold that violations occurring after the tenancy is created void the lease. This decision was reversed by the United States Court of Appeals for the District of Columbia Circuit, who shifted the basis of decision from that of illegality to that of implied warranty of habitability.

There are two Illinois appellate court decisions which indicate that Illinois will apply the illegality of contract doctrine to leases. In *Heineck v. Grosse*¹²⁵ the lessor leased to the lessee a portion of land under a sidewalk and a portion of the sidewalk directly above for a term of five years. The lessee occupied these premises for four and one-half years and then vacated, whereupon the lessor sued to collect rent for the last six months of the term. A City of Chicago ordinance prohibited the occupancy of part of a sidewalk for private purposes. The appellate court reversed the trial court's judgment for the lessor, holding ". . . the lease is in direct violation, so far as it provides for the occupancy of a portion of the sidewalk, of the municipal ordinances above set out, and is therefore invalid. Being invalid as to part of the lease, because of its violation of the city ordinances, it cannot be the basis of a recovery in this suit."¹²⁶

*Longenecker v. Hardin*¹²⁷ relied on both *Heineck* and *Brown v. Southall Realty Co.*¹²⁸ in reaching a decision based on the illegality of contract doctrine. The lessor sued the lessee for unpaid rent

¹²⁴245 A.2d 836 (D.C. Ct. App. 1968), *rev'd sub. nom.*; *Javins v. First National Realty Corp.* 428 F.2d 1071 (D.C. Cir. 1970), *cert. denied* 400 U.S. 925 (1970).

¹²⁵99 Ill. App. 441 (1902).

¹²⁶*Id.* at 444.

¹²⁷264 N.E.2d 878 (Ill. App. Ct. 1970).

¹²⁸See note 113 *supra*.

and the lessee raised the defense that the lease was invalid and unenforceable under the following provisions of the *Municipal Code* of the City of Chicago:

§ 78-13. No person shall occupy as owner-occupant, nor shall any person let or hold out to another for occupancy, any dwelling or family dwelling unit which does not comply with the requirements of sections 78-13.1 through 78-13.12 of this chapter.

§ 78-17. No person shall occupy as owner-occupant or shall let or hold out to another for occupancy any dwelling or family unit, for the purpose of living therein, which is not safe, clean, sanitary and fit for human occupancy, and which does not comply with the particular requirements of sections 78-17.1 through 78.17.8 of this chapter.

The lessee alleged numerous violations of these sections. The trial court struck this affirmative defense; the appellate court held this to be reversible error. The lessor argued that the lessee's affirmative defense should be stricken for two reasons: (1) the lessee was precluded by a provision in the lease from asserting violations of the *Code*; and (2) such alleged violations would not relieve a lessee from the obligation to pay rent so long as he remained in possession. The appellate court refused to adopt this view, first, because the lease provision relied on by the lessor ". . . cannot preclude the interposition of the doctrine of illegality of the lease;" and second, because the lessee's defense was not based on constructive eviction, which the lessor's argument was directed toward, but was based on the illegality of the lease under the *Code*.

The Wisconsin Supreme Court has recently refused to extend the illegality of contract doctrine to leases. In *Posnanski v. Hood*¹²⁹ the lessor sued the lessee to recover unpaid rent and the lessee defended on the basis that serious violations of the Milwaukee *Housing Code* existed before and after the lease was executed which rendered the lease illegal and void. The trial court rejected the lessee's evidence of such violations, and the Supreme Court upheld this action, stating that the lessee did not have an affirmative defense based on violations of the *Code*, and, consequently, the trial court did not commit error in refusing to admit evidence

¹²⁹46 Wisc.2d 172, 174 N.W.2d 528 (1970).

based on that contention. The court reasoned that the intent of the legislation creating the *Code* was to make the commissioner of health the enforcing agency of the *Code* and not an individual lessee, and, also, that holding a lease void for violating the *Code* would circumvent the existing enforcement procedures.

V. IMPLIED WARRANTY OF QUALITY

The issue that is receiving perhaps the most attention today in the area of real property leases is whether a warranty of quality—that the premises are habitable and fit for the purpose intended by the parties—should be implied in such leases. To imply such a warranty would alter the common law concept of the nature and functions of a lease.

A. General Rule — *Caveat Emptor*

It has long been the rule that there is no covenant or warranty implied in a lease that the premises are tenantable, habitable or fit for the purpose for which they are leased.¹³⁰ The basis of this rule is one already discussed:¹³¹ A lease is a conveyance of realty for a term and subject to the same rule applied to freehold interests—that a conveyance does not carry with it an implied warranty of fitness and habitability.¹³² This doctrine is predicated on the theory that all the parties to the transaction have an equal opportunity to acquire information and knowledge of the condition of the premises, and, consequently, no affirmative duty to inform regarding defects exists.¹³³ The parties, under this doctrine, can protect themselves by prior inspection and express warranties. It is apparent why, under this doctrine, the chief exception concerns defects which the lessor knows about or should know about which he fails to disclose to the lessee and which are not discoverable by a reasonable inspection.¹³⁴

As is true with so many of the common law rules surrounding leases, the doctrine of *caveat emptor* arose when many leases were of an agricultural nature, and the land itself was the most impor-

¹³⁰1 Tiffany § 99; 1 AMERICAN LAW OF PROPERTY § 3.45.

¹³¹ See Section II-A-3 *supra*.

¹³²1 Tiffany § 81.

¹³³ See 2 ST. MARY'S L.J. 106 (1970).

¹³⁴1 AMERICAN LAW OF PROPERTY § 3.45, at 269.

tant element and there were few, if any, structures on the land, making it a relatively simple task for the lessee to determine for himself the condition of the premises and their suitability for his purpose.

B. *Presently Recognized Exceptions to the General Rule*

However, the law did not refuse to imply a warranty of quality or another type of warranty when the need for such warranty was evident. For example, there are two situations in which courts have consistently implied a warranty that the premises are habitable and fit for the purpose intended. First, where there is the leasing of furnished premises for a short term, such a warranty is implied.¹³⁵ The reason for this exception is that the parties contemplate an immediate possession of the premises without time for the lessee to inspect or put them in a tenantable condition. Second, where there is the leasing of premises within a building not yet completed when the lease is made, such a warranty is implied.¹³⁶ The reason here is that since the premises are not yet completed, the lessee cannot inspect and determine for himself if they are suitable.

The concept of implied warranty, then, is not completely foreign to leases. And there are other warranties that are implied in leases. First, a warranty of quiet enjoyment—that the lessee's possession will not be disturbed by an act of the lessor or by one acting under the lessor's authority or under paramount title—is implied in the lease because of the relationship of the parties.¹³⁷ This implied covenant points up the common law's concern over the physical possession of the premises by the lessee. The use of the doctrine of constructive eviction together with the covenant of quiet enjoyment demonstrate the law's attempt to deal with the problem of enjoyment of, rather than mere possession of, the premises on a property basis, rather than a contractual basis.¹³⁸ Second, from a use of the words "demise" or "grant" or the equivalent in a

¹³⁵*Id.* at 267-68; *Smith v. Marrable*, 11 M. & W. 6, 152 Eng. Rep. 693 (Ex. 1843).

¹³⁶*Young Corp. v. McClintic*, 26 S.W.2d 460 (Tex. Civ. App. 1933), *rev'd on other grounds*, 66 S.W.2d 676 (Tex. Comm. App. 1933); Skillern, *Implied Warranties in Leases: The Need for Change*, 44 DENVER L.J. 387, 392-93 (1967).

¹³⁷1 AMERICAN LAW OF PROPERTY § 3.47.

¹³⁸*See* Section III-B-3 *supra*.

lease, the law implies a covenant of power to demise, with some cases indicating that the covenant will be implied without reference to any particular language.¹³⁹ This covenant also demonstrates the law's concern over possession of the demised property. Third, the implied covenant to deliver possession, whereby the entry into the lease implies a promise by the lessor to deliver legal and, in some jurisdictions, actual possession to the lessee at the commencement of the term, demonstrates the law's concern over possession of the premises.¹⁴⁰ Fourth, on the lessee's part, the entry into a lease whereby the rental is reserved in terms of a percentage of gross sales or net profits, usually with a flat minimum rental below the present rental value, implies a covenant by the lessee to occupy and use the property, to use reasonable diligence to operate the business in such a manner as to produce profits, and not to assign or sublease the leasehold without the lessor's consent.¹⁴¹

C. *Departure from Caveat Emptor in Other Areas*

1. *Sales of Personalty*

There has been a trend away from the rule of *caveat emptor* in other types of transactions which has had an impact on the law of real property leases. The most noteworthy example of this trend is in the area of chattel sales. One avenue of approach that the judiciary has taken to the problem of defective goods is that of implying a warranty of quality.¹⁴² A warranty, in this context, is a statement or representation made by the seller of goods contemporaneously with, and as a part of, the contract of sale, having reference to the quality of the goods, whereby he promises that certain facts are as he represents them.¹⁴³ The warranty will be express when it is imposed by the parties to the contract; it is

¹³⁹1 AMERICAN LAW OF PROPERTY § 3.46; 1 Tiffany § 90.

¹⁴⁰1 AMERICAN LAW OF PROPERTY § 3.37; 1 Tiffany § 95.

¹⁴¹1 AMERICAN LAW OF PROPERTY § 3.66.

¹⁴²See James, *Products Liability*, 34 TEX. L. REV. 192 (1955); Kessler, *The Protection of the Consumer Under Modern Sales Law* (pt. 1), 74 YALE L.J. 262 (1964); Comment, *The Application of the Doctrine of Unconscionability to Warranties: A Move Toward Strict Liability Within the U.C.C.*, 38 FORD. L. REV. 73 (1969).

¹⁴³Jaeger, *Products Liability: The Constructive Warranty*, 39 NOTRE DAME LAW. 501, 506 (1964).

implied when it is imposed by law. The implied warranty is a curious mixture:

A more notable example of legal miscegenation could hardly be cited than that which produced the modern action for breach of warranty. Originally sounding in tort, yet arising out of the warrantor's consent to be bound, it later ceased necessarily to be consensual, and at the same time came to lie mainly in contract.¹⁴⁴

Today, the implied warranty of fitness or merchantability in chattel sales is imposed by law independent of any contractual agreement.¹⁴⁵ The contractual warranty faced a number of problems at the outset: (1) necessity of giving notice of a breach within a reasonable time; (2) disclaimer of warranty by the seller, and (3) privity between the plaintiff and defendant.¹⁴⁶ This "contract mask" has led to unsatisfactory results and caused many courts to turn to the alternative of strict liability.¹⁴⁷ Under this theory the prime question is whether the goods are defective, rather than whether they fail to conform to the warranty the law imputes to the seller. This theory remedies the major limitations of the warranty theory by dispensing with the requirement of privity and precludes the possibility of disclaimer of liability.¹⁴⁸ However, there are restrictions in the application of the strict liability doctrine limiting its usefulness.¹⁴⁹

The utilization of the warranties of merchantable quality and fitness for a particular purpose in the *Uniform Commercial Code*¹⁵⁰ has had a large impact on the law of sales. However the *Code* makes express provision for the limitation of damages for breach of warranty,¹⁵¹ for the limitation and exclusion of remedies,¹⁵² and for the exclusion of warranties entirely.¹⁵³ These limitations direct the *Code* toward a contractual form of warranty with its

¹⁴⁴42 HARV. L. REV. at 414 (1929).

¹⁴⁵PROSSER, *The Assault Upon the Citadel (Strict Liability to the Consumer)*, 69 YALE L.J. 1099, 1126-27 (1960).

¹⁴⁶*Id.* at 1127-33.

¹⁴⁷*Id.* at 1134.

¹⁴⁸NOTE, *Contract Principles and Leases of Realty*, 50 B.U. LAW REV. 24, 36 (1970).

¹⁴⁹*Id.*

¹⁵⁰§ 2-314, 2-315.

¹⁵¹§ 2-719(3).

¹⁵²§ 2-719(1)(a).

¹⁵³§ 2-316.

accompanying limitations. But it has been suggested that the doctrine of unconscionability¹⁵⁴ prevents the *Code* from being entirely contract-oriented in its approach and gives it the capacity for moving in the direction of strict liability.¹⁵⁵

2. Policy Considerations

The policy considerations behind the imposition of an implied warranty of quality in chattel-sales cases have been argued to be just as applicable to the leasing of real property because of the fact that a modern lease is a "sale" of space and services analogous to the "sale" of a "product."¹⁵⁶ First, the risk of loss due to defects in the product should be shifted to the seller because he is best able to disperse the loss by adding his risk to the cost of doing business and adjusting his prices accordingly. This process works better when applied to a mass-producer than to a small-scale lessor because of the problems of profit margins and rent control.¹⁵⁷ But, whether the lessor is engaged in a large-scale or small-scale enterprise, he is generally more able to absorb the loss arising from defects in the premises than is the lessee.¹⁵⁸ Second, a manufacturer, by placing his product on the market and advertising it, represents its quality and should bear responsibility for its defects. Likewise, a lessor, in placing premises in the rental housing market, represents that they are habitable and will continue to be so during the tenancy and should bear responsibility for their non-habitability.¹⁵⁹ Third, a buyer cannot judge for himself whether a product conforms to representations impliedly made by the seller, but, rather, relies on the seller's superior skill and knowledge. Likewise, the urban, residential lessee cannot judge for himself the quality of the premises (electricity, plumbing, structural soundness, services provided, etc.), but must rely on the lessor's superior knowledge concerning these factors.¹⁶⁰ Fourth, a war-

¹⁵⁴§ 2-302, 2-719.

¹⁵⁵See Comment, *supra* note 103.

¹⁵⁶See Note, *supra* note 109, at 36-39.

¹⁵⁷See Gribetz & Grad, *Housing Code Enforcement: Sanctions and Remedies*, 66 COLUM. L. REV. 1254, 1271-72 (1966); Sax & Hiestand, *Slumlordism as a Tort*, 65 MICH. L. REV. 869 (1967); Comment, *A Contract Remedy for the Slum Dweller*, 1970 WASH. U.L.Q. 499, 509-510.

¹⁵⁸See *Javins v. First National Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970), *cert. denied*, 400 U.S. 925 (1970).

¹⁵⁹*Id.*

¹⁶⁰*Id.*

ranty of quality should be implied because the unequal bargaining position between buyer and seller makes it virtually impossible for a buyer to bargain for the inclusion of warranties in the contract of sale. Likewise, today, in many urban areas, there is a housing shortage, especially in low-income housing, that creates a "landlord's market," forcing the lessee to enter into a form lease on the lessor's terms.¹⁶¹

3. *Leases of Personalty*

Although the concept of implied warranty has been applied mainly to chattel sales, there are indications that it may expand to chattel leases as well. Where the same policy considerations justifying the imposition of this standard on the seller are present, the implied warranties found at common law and in the *Uniform Commercial Code* should be applied to nonsales cases.¹⁶² Courts have taken two approaches to this problem: (1) treating the lease transaction essentially as a sale so as to apply the sales warranty directly, and (2) applying the law of sales warranties by analogy to lease transactions.¹⁶³ The *Code* recognizes the possibility of applying implied warranty to nonsales cases:

[T]he warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract.¹⁶⁴

The leading case in this regard is *Cintrone v. Hertz Truck Leasing*¹⁶⁵ where the defendant-lessor had leased several trucks to the

¹⁶¹In the District of Columbia, low vacancy rates force low-income lessees to occupy the same premises, regardless of their condition. In 1968, the vacancy rate for apartments was 28%, compared to the 1966 rate of 3.3%. See FEDERAL HOUSING ADMINISTRATION ANALYSIS OF WASHINGTON, D.C.-MARYLAND-VIRGINIA HOUSING MARKET 18 (1969). In Colorado, "[t]he lack of available low-income housing is reflected in the low vacancy rate in the Denver Housing Authority's units. The vacancy rate is only 0.05%..." Comment, *Housing the Poor: A Study of the Landlord-Tenant Relationship*, 41 U. COLO. L. REV. at 542 n.6 (1969).

¹⁶²See Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653 (1957).

¹⁶³See Comment, *Implied Warranties of Quality: Protection in Chattel Leases*, 1969 U. ILL. L.F. 115.

¹⁶⁴§ 2-313, Comment 2.

¹⁶⁵45 N.J. 434, 212 A.2d 769 (1965); accord, *Dore v. Hartford Accident & Indemnity Co.*, 180 S.2d 434 (La. Ct. App. 1965); *Hoffman v. Misericordia Hospital of Philadelphia*, 439 Pa. 501, 267 A.2d 867 (1970).

plaintiff's employer under a long-term contract whereby the defendant was to repair and maintain the trucks. The plaintiff was injured while riding in one of the trucks when the brakes failed. The plaintiff sued the defendant on the basis of breach of an implied warranty that the vehicle was fit and safe to use. The New Jersey Supreme Court reversed the trial court's decision to dismiss this warranty claim, holding that the contract for the leasing and use of the truck gave rise to an implied warranty that it is fit for the use contemplated by the plaintiff's employer. The court said:

There is no good reason for restricting such warranties [of fitness for use] to sales. Warranties of fitness are regarded by law as an incident of a transaction because one party to the relationship is in a better position than the other to know and control the condition of the chattel transferred and to distribute the losses which may occur because of a dangerous condition the chattel possesses.¹⁶⁶

What is said in this case concerning the position of the seller to know of and control defects in the product is as applicable to leases of realty as to leases of personalty.

4. Sales of Realty

Although *caveat emptor* has been the rule consistently applied to the sale of real property,¹⁶⁷ there are cases which evidence a trend away from this rule in this area in recent years. There are three periods of time connected with the sale of realty which are important in this regard: (1) Period I: contract of sale executed before commencement of improvements on the property; (2) Period II: contract of sale executed between the time of commencement of improvements on the property and the time of completion of the improvements; and (3) Period III: contract of sale executed after completion of improvements on the property.¹⁶⁸ *Hoye v. Century Builders, Inc.*¹⁶⁹ is a prominent example of a Period I, or custom-built house, case in which the theory of implied war-

¹⁶⁶212 A.2d at 775.

¹⁶⁷3 AMERICAN LAW OF PROPERTY § 11.20.

¹⁶⁸See Young & Harper, *Quaere: Caveat Emptor or Caveat Venditory?*, 24 ARK. L. REV. 245 (1970).

¹⁶⁹52 Wash.2d 830, 329 P.2d 474 (1958).

ranty of habitability was utilized. The plaintiff-vendee made an on-site visit to a subdivision, and, accompanied by a salesman of the defendant-builder-vendor, selected a lot, chose a set of plans and contracted to buy the lot upon which the defendant was to build the house before commencement of construction. When the plaintiff sued the defendant on an implied warranty of habitability, the Washington Supreme Court upheld the trial court's determination that in such a case, the doctrine of *caveat emptor* does not apply, but, rather, there was in the contract an implied warranty that the completed house would be fit for habitation.

Much of the reported litigation in this area has fallen into the Period II category and *Müller v. Cannon Hill Estates, Ltd.*¹⁷⁰ was the spawner of this litigation. In that case the plaintiff-vendee visited a subdivision, viewed a model home and signed a contract to purchase a house still in the process of construction. When the house later proved to be uninhabitable due to dampness, the plaintiff sued the defendant-vendor for breach of contract, claiming a breach of an implied warranty that the defendant would complete the house in a good and workmanlike manner with materials of good quality. The court, drawing a careful distinction between the contract to purchase a finished house and the contract to purchase an unfinished house, said that in the latter situation ". . . there is an implication of law that the house shall be reasonably fit for the purpose for which it is required, that is, for human dwelling."¹⁷¹ American cases have adopted this "unfinished house" doctrine on the basic policy ground that it is impossible for the buyer to inspect the premises for defects before construction is complete.¹⁷² Notice the similarity in reasoning in this approach and the approach taken in a situation involving the leasing of space within a building not yet completed, discussed earlier.¹⁷³

Recently there have been several cases falling into Period III wherein the court has implied a warranty of habitability into the

¹⁷⁰[1931] 2 K.B. 113.

¹⁷¹*Id.* at 121.

¹⁷²*Glisan v. Smolenske*, 153 Colo. 274, 387 P.2d 260 (1963); *Belhlahmy v. Bechtel*, 91 Idaho 55, 415 P.2d 698 (1968); *Weck v. A:M Sunrise Construction Co.*, 36 Ill. App.2d 383, 184 N.E.2d 728 (1962); *Vanderschrier v. Aaron*, 103 Ohio App. 340, 140 N.E.2d 819 (1957); *Jones v. Gatewood*, 381 P.2d 158 (Okla. 1963).

¹⁷³See note 97, *supra*, and accompanying text.

contract of sale between a builder-vendor and the first vendee.¹⁷⁴ *Schipper v. Levitt & Sons*¹⁷⁵ expresses best the policy behind this departure from the general rule:

Caveat emptor developed when the buyer and seller were in an equal bargaining position and they could readily be expected to protect themselves in the deed. Buyers of mass produced development homes are not on an equal footing with the builder-vendors and are no more able to protect themselves in the deed than are automobile purchasers in a position to protect themselves in the bill of sale.¹⁷⁶

This type of language is echoed in recent cases involving the lease of realty wherein the argument has been raised that a warranty of quality should be implied, so let us now turn our attention to the movement away from the doctrine of *caveat emptor* in the leasehold field.

D. *Implied Warranty of Quality in Real Property Leases*

Three different sources have caused some departure from the doctrine of *caveat emptor* and given rise to an implied warranty of quality in real property leases. These sources are: (1) public policy, whether derived from state or local legislation or from contemporary conditions in the community; (2) state statutes which impose a warranty of quality, either directly or indirectly, in leases; and (3) municipal housing codes which impose a warranty of quality, either directly or indirectly, in leases.

1. *Effect of Public Policy*

Several cases have relied on public policy, rather than specific legislation, to imply a warranty of quality in leases. This aspect of a number of cases discussed earlier¹⁷⁷ played a prominent part in the courts' decisions. In *Pines v. Perssion*¹⁷⁸ the Wisconsin

¹⁷⁴*Wawak v. Stewart*, 247 Ark. 1093, 449 S.W.2d 922 (1971); *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964); *Schipper v. Levitt & Sons*, 44 N.J. 70, 207 A.2d 314 (1965); *Waggoner v. Midwestern Development Co.*, 83 S.D. 57, 154 N.W.2d 803 (1967); *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968); *House v. Thornton*, 76 Wash.2d 398, 457 P.2d 199 (1969).

¹⁷⁵44 N.J. 70, 207 A.2d 314 (1965).

¹⁷⁶*Id.*, 207 A.2d at 326.

¹⁷⁷See Section III *supra*.

¹⁷⁸14 Wisc.2d 590, 111 N.W.2d 409 (1961); see Section III, note 75 *supra*.

Supreme Court used the following language in departing from the doctrine of *caveat emptor* and implying a warranty of habitability in a one-year residential lease of furnished premises:

Legislation and administrative rules, such as the safeplace statute, building codes and health regulations, all impose certain duties on a property owner with respect to the condition of his premises. Thus, the legislature has made a policy judgment—that it is socially (and politically) desirable to impose these duties on a property owner—which has rendered the old common law rule obsolete. To follow the old rule of no implied warranty of habitability in leases would, in our opinion, be inconsistent with the current legislative policy concerning housing standards. The need and social desirability of adequate housing for people in this era of rapid population increases is too important to be rebuffed by that obnoxious legal cliché, *caveat emptor*.¹⁷⁹

The court also discussed the well-recognized exception to the *caveat emptor* doctrine pertaining to the leasing of furnished premises for a short term, into which this case could fall. The importance of the case in the present context is weakened by the failure of the court to clearly state whether the basis of their decision was one or both of these principles. The remedies to which the lessees were entitled were rescission of the lease and a reduction of the rent for the time of their actual occupancy to the reasonable rental value of the premises.

There is no such doubt, however, surrounding *Reste Realty Corp. v. Cooper*,¹⁸⁰ where the use and enjoyment of the premises by the lessee was interfered with by a defect in them. The New Jersey Supreme Court held that the lessee, who had vacated the premises, was not liable for the unpaid rent because there was a breach of a warranty implied in the lease that no latent defects existed on the premises or outside the premises. The court gave the following reasons for not applying the *caveat emptor* doctrine: (1) there is an inequality of bargaining power between the lessor and lessee in many cases today, and (2) the lessee does not ordinarily have as much knowledge of the condition of the premises as the lessor. The court pointed out that building code require-

¹⁷⁹111 N.W.2d at 412-13.

¹⁸⁰53 N.J. 444, 251 A.2d 268 (1969); see Section III, note 69 *supra*.

ments and violations are made known to the lessor, not the lessee, and that the lessor is in a better position to know of the existence of latent defects, structural or otherwise, than the lessee who rarely has the knowledge or expertise to see or discover them.

The affirmative remedy of terminating the cause of constructive eviction, rather than the right to vacate pursuant to a rescission of the lease, was given to the lessee in *Marini v. Ireland*.¹⁸¹ When the lessor failed to repair a defective toilet, the lessee had it repaired and deducted the cost from her rent, whereupon the lessor sued for possession for nonpayment of rent. The New Jersey Supreme Court held that the lessee had a right to have the repair made under the circumstances of the case and deduct the cost from future rents on the basis that, ". . . the landlord should, in residential letting, be held to an implied covenant against latent defects, which is another way of saying, habitability and livability fitness."¹⁸² The court referred to "these present days of housing shortage" as a reason for allowing the lessee to exercise an affirmative remedy instead of the remedy of rescission of the lease and vacation of the premises.

In *Academy Spires, Inc. v. Brown*¹⁸³ the court allowed a rent abatement to the lessee according to a schedule set up in the *Model Residential Landlord-Tenant Code*¹⁸⁴ because of the lessor's failure to provide heat, hot water, garbage disposal service and elevator service. The court relied on the theory that a covenant of habitability was implied in the lease, a breach of which allowed a percentage reduction in the rent. The court took judicial notice of the housing shortage in the area where the premises were located in reaching its decision to allow a percentage rent reduction, rather than require vacation of the premises in order to work a rescission of the lease.

2. Effect of State Statutes

A number of state legislatures have recognized the problems surrounding the habitability of leased residential premises and have attempted, with varying success, to alleviate them in a va-

¹⁸¹56 N.J. 130, 265 A.2d 526 (1970); see Section III, note 78 *supra*.

¹⁸²*Id.* 265 A.2d at 534.

¹⁸³111 N.J. Super. 477, 268 A.2d 556; see Section II, note 80 *supra*.

¹⁸⁴§ 2-207(1)(b) (Amer. Bar Found. Tent. Draft 1969).

riety of ways. The most popular approach has been the so-called "repair and deduct" statutes adopted in five states.¹⁸⁵ Generally, these statutes provide that the lessor of a building intended for human occupation must put it into a condition fit for such use and repair all subsequent dilapidations not occasioned by the lessee's own negligence. If the lessor fails to repair within a reasonable time after notice of dilapidations is given to him by the lessee, the lessee has a choice of remedies: (1) he may repair the dilapidations himself and deduct the cost from the rent, or (2) he may vacate the premises and be discharged from any further obligation under the lease. However, these statutes have been of limited effectiveness because: (1) some limit the cost of repairs deductible to one month's rent,¹⁸⁶ which may not cover the cost of major defects which cause the premises to be uninhabitable; and (2) they all expressly permit the lessor to contract away his statutory obligation, a fact that could render the statute useless in an area where housing shortages force lessees to lease on the lessors' terms. Also, the statutes have been interpreted to limit the lessee to the statutory remedies,¹⁸⁷ rather than allowing the more flexible contract remedies of rescission, reformation and specific performance.

A second approach taken has been in the form of "rent abatement" statutes found in three states.¹⁸⁸ The Pennsylvania statute serves as a good example of the operation of this type of statute.¹⁸⁹ In Pennsylvania for a dwelling to qualify under the statute it must be certified as "unfit for human habitation" by an inspector who has examined the building. Once such a determination of unfitness has been made, the duty of the lessee to pay rent is suspended and the lessor is given six months to correct the violations. The rent due during this period is placed in an escrow account. If, at any time within the six-month period the dwelling is found to

¹⁸⁵CAL. CIV. CODE §§ 1941-42 (West 1954); MONT. REV. CODES ANN. § 42-201 to -202 (1947); N.D. CENT. CODE §§ 47-16-12 to -13 (1960); OKLA. STATE. tit. 41, §§ 31-32 (1971); S.D. CODE §§ 38.0409-.0410 (1939).

¹⁸⁶CAL. CIV. CODE §§ 1941-42 (West 1954); MONT. REV. CODES ANN. § 42-202 (1947).

¹⁸⁷*e.g.*, *Staples v. Baty*, 206 Okla. 288, 242 P.2d 705 (1952).

¹⁸⁸MASS. GEN. LAWS ANN. ch. 111 §§ 127F, 127H (1971); ch. 239, § 8A (Supp. 1972); MICH. COMP. LAWS §§ 125.530, 125.534, 125.536 (Supp. 1971); N.Y. MULT. DWELL. LAW § 302-A, REAL PROP. ACTIONS § 755 (McKinney Supp. 1971); PA. STAT. ANN. tit. 35, § 1700-1 (Supp. 1970).

¹⁸⁹*See Note, Rent Withholding in Pennsylvania*, 30 U. PITT. L. REV. 148 (1968).

be habitable, the rent in escrow is paid to the lessor; if, after six months, the dwelling is not found to be habitable, the rent in escrow is returned to the lessee, except for funds used in making the dwelling habitable and for payment of utility services. The weakness of this procedure is that although the funds in escrow can be used by the lessor to make the needed repairs, they seldom are.¹⁹⁰ This points up a fundamental problem in this area that has yet to be solved—it may be economically unfeasible for lessors to place a badly dilapidated building in habitable condition. For example, in New York City in 1969, lessors left 30,000 buildings abandoned and without services, generally for economic reasons.¹⁹¹ One alternative, the one being turned to more and more today, it seems, is federal assistance:

Consideration of the problem of housing the poor must begin with acknowledgment that it is not profitable to provide decent housing at rents poor people can afford:

There is no way for private owners to make a profit by housing the poor in decent standard housing except through some form of aid or by demanding excessive payments from the poor. This fact must be faced.

Substantial subsidies are essential and the federal government is the only likely source for such funding.¹⁹²

A third approach has been to enact statutes which authorize the institution of receiverships for the management and repair of offending buildings.¹⁹³ Where there has been a long history of continuing violations of building codes on the property, it becomes apparent that the owner cannot or will not make the necessary repairs; therefore, the appointment of a receiver is one way to break the inertia of the situation. Statutes of this type have been upheld in Illinois¹⁹⁴ and New York.¹⁹⁵

¹⁹⁰*Id.* at 150-52.

¹⁹¹N.Y. Times, Oct. 4, 1970, at 42, col. 4; see Comment *Landlord and Tenant Law—Warranty of Habitability Implied by Law in Leases of Urban Dwellings*, 24 VAND. L. REV. 425 (1971).

¹⁹²Roisman, *The Right to Public Housing*, 39 GEO. WASH. L. REV. at 692 (1971) (footnotes omitted).

¹⁹³CONN. GEN. STAT. ANN. § 19-347(b) (1969); ILL. REV. STAT. ch. 24, § 11-31-2 (Supp. 1972); N.J. STAT. ANN. § 40:48-2.12h (1967); N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1971).

¹⁹⁴*Community Renewal Foundation v. Chicago Title & Trust Co.*, 44 Ill.2d 284, 255 N.E.2d 908 (1970).

¹⁹⁵*In re Department of Buildings (Philo Realty)*, 14 N.Y.2d 291, 200 N.E.2d 432 (1964).

A fourth approach has been to expressly provide for an implied warranty of quality in the lease of real property. Connecticut has recently adopted a statute¹⁹⁶ which provides that each parol lease of real property intended for human habitation shall be deemed to contain a covenant on the part of the lessor that such property is fit for such habitation. This direct approach is the most recent one tried and has not been widely adopted at the present time. Whether such a statute is surrounded by limitations similar to those surrounding "repair and deduct" statutes or is construed along different lines remains to be seen.

The State of New York has as wide ranging a set of statutes dealing with untenability of leasehold premises as any state at the present time. In addition to the remedy of rent abatement given to the lessee which allows rent to be placed in escrow while designated "rent impairing" conditions continue to exist on the premises,¹⁹⁷ when one third of the lessees in a building join in a petition alleging the existence of conditions dangerous to health or safety, the lessees may request that an administrator be appointed to collect the rents and make repairs.¹⁹⁸ As was discussed earlier,¹⁹⁹ the *Spiegel Law* allows welfare authorities to withhold an indigent lessee's rent from the lessor when there are conditions in the building wherein the lessee's apartment is located that are dangerous to life or health. Under these circumstances the lessee is given a statutory defense to an action of eviction brought by the lessor for nonpayment of rent. Two other types of statutes should be mentioned because they are commonly found in states other than New York. The first provides for criminal prosecution of the owner-lessor of substandard housing.²⁰⁰ This approach has been criticized as establishing a system of licensing rather than constituting an effective deterrent to substandard housing.²⁰¹ The second approach is unsatisfactory in any area suffering from a housing shortage because it may result in evicting lessees

¹⁹⁶CONN. GEN. STAT. ANN. § 47-24(b) (Supp. 1971).

¹⁹⁷See note 59 *supra*.

¹⁹⁸N.Y. REAL. PROP. ACTIONS § 770 (McKinney Supp. 1971).

¹⁹⁹See Section III-B-4, note 88 *supra*; see ILL. REV. STAT. ch. 23, § 11-23 (Supp. 1972); MICH. COMP. LAWS § 400.14c (Supp. 1971).

²⁰⁰N.Y. MULT. DWELL. LAW § 304 (McKinney Supp. 1971).

²⁰¹Note, *Judicial Expansion of Tenants' Private Law Rights: Implied Warranties of Habitability and Safety in Residential Urban Leases*, 56 CORNELL L. REV. 489 (1971). In 1965, the average fine in New York City was \$13.96. N.Y. Times, April 15, 1966, at 36, col. 5.

who have no other place to go.²⁰² Most people will agree that even a substandard home is better than no home at all.

3. *Effect of Housing Codes*

Recently, courts have started to turn to the most prolific source²⁰³ of housing standards in the United States—municipal housing codes—in an effort to adjust the rights of lessor and lessee in today's urban setting. For several years it has been recognized that such codes could be used to imply a warranty of quality in leases:

These codes are seemingly an appropriate basis for a continuing implied warranty since they generally require that essentials such as heating, lighting, ventilation and plumbing facilities with adequate sewage disposal be installed and properly maintained. Furthermore, most codes have established maintenance and cleanliness standards for buildings, including elimination of vermin, rodents, and other unsanitary conditions.²⁰⁴

The judiciary is beginning to pick up this theme. In *Lemle v. Breeden*²⁰⁵ the plaintiff-lessee rented a furnished house from the defendant-lessor for two separate, short periods of time. Soon after moving in the lessee detected large numbers of rats in the house and informed the lessor's agent, who exterminated the house with only partially successful results. Three days after first occupying the house the lessee vacated and demanded a return of his deposit and rent payments already made, claiming constructive eviction and breach of an implied warranty of habitability and fitness for use. The Hawaii Supreme Court upheld a judgment for the lessee on the latter theory. The court said that the doctrine of *caveat emptor* has historically been applied to leases because a lease has always been considered the sale of an estate in

²⁰²N.Y. MULT. DWELL. LAW § 309 (McKinney Supp. 1971).

²⁰³As of 1968, over 4,900 municipalities had enacted housing codes that set minimum standards of sanitation and safety which the lessor was obligated to maintain in leased dwellings. F. Grad. LEGAL REMEDIES FOR HOUSING CODE VIOLATIONS 112 (National Comm'n on Urban Problems Research Rep. No. 14, 1968).

²⁰⁴Note, *Municipal Housing Codes*, 69 HARV. L. REV. at 1116 nn. 12 & 13 (1956).

²⁰⁵51 Haw. 426, 478, 462 P.2d 470 (1969).

land, but that this doctrine has outlived its historical justification. At a time when a lease embodied all the agreements of the parties, there was equal knowledge of the land by both lessor and lessee, and the land itself was the most important element, *caveat emptor* may have been justified. But, today, in an urban society where the main benefit of a lease is the amenities provided by the lessor and standardized clauses are used, *caveat emptor* should not be applicable. The court rejected the application of the constructive eviction doctrine, saying this was an artificial solution to the problem. Relying on the reasons why implied warranties of fitness and merchantability have been applied in the chattel-sales field, the court stated that a lease is a contractual relationship, and, consequently, a warranty of habitability is a just and necessary implication. The court held that the implied warranty of habitability had been breached in this case, giving rise to the ordinary contract remedies of damages, reformation and rescission. Here the lessee was entitled to rescind the lease and vacate the premises.

The court in *Lemle* does not explicitly rely on a housing code in implying a warranty of habitability in the lease in that case, but a case following soon after and relying heavily on *Lemle* does explicitly rely on a housing code. In *Lund v. MacArthur*²⁰⁶ the plaintiff-lessor leased an unfinished apartment to the defendant-lessee for a term of one year. The lessee notified the lessor of wiring defects, and, soon after, the city building department notified the lessor that violations of the city electrical code existed on the premises and ordered the lessor to repair. The lessee vacated soon thereafter and the lessor brought suit for unpaid rent. The lessee defended on the basis that the violations of the electrical code constituted a breach of an implied warranty of habitability, entitling him to recover the difference between the amount of rent paid as stipulated in the lease and the fair rental value of the premises in the "as is" condition. The Hawaii Supreme Court reversed and remanded the trial court's judgment in the lessor's favor, holding that under *Lemle* an implied warranty of habitability exists in unfurnished as well as furnished dwellings. The court instructed the trial court to determine if the violations of the electrical code constituted a breach of the implied warranty of habitability, treating the code as the measure of the warranty.

²⁰⁶51 Haw. 473 462 P.2d 482 (1969).

In *Javins v. First National Realty Corp.*,²⁰⁷ previously discussed,²⁰⁸ a lessor sued his lessee for possession of the premises for nonpayment of rent. As a defense the lessee offered evidence of numerous violations of the *Housing Regulations* of the District of Columbia. The lower court ruled that evidence inadmissible, but the United States Court of Appeals for the District of Columbia Circuit reversed this decision, saying:

In our judgment, the old no-repair rule cannot coexist with the obligations imposed by a typical modern housing code, and must be abandoned in favor of an implied warranty of habitability. In the District of Columbia, the standards of this warranty are set out in the *Housing Regulations*.

* * *

We believe . . . that the District's housing code requires that a warranty of habitability be implied in the leases of all housing that it covers.²⁰⁹

The court went on to hold that the duties imposed by the *Housing Regulations* could not be waived or shifted by agreement of the parties. This approach protects the lessee much more than do the "repair and deduct" statutes discussed earlier.²¹⁰ In addition to this protection, the court's holding extends to the lessee all of the existing remedies for breach of contract.²¹¹ Therefore, the lessee is not limited to a defensive use of the warranty, but can affirmatively use the remedies of specific performance and set-off.

Amanuensis, Ltd. v. Brown,²¹² also previously discussed,²¹³ followed *Javins* in a situation where there were violations of the New York City *Housing Code* in existence on the premises when the lessor leased them to the lessee. When the lessor sued to evict the lessee for nonpayment of rent, the court sustained the lessee's defense of breach of an implied warranty of habitability because: (1) the lessor had made no good faith effort to comply with the *Code*; (2) there were substantial violations on the premises and code enforcement remedies had been pursued and found to be ineffective; and (3) the lessor continued the violations

²⁰⁷428 F.2d 1071 (D.C. Cir. 1970), cert. denied, 400 U.S. 925 (1970).

²⁰⁸See Section III-B-4, note 85 *supra*.

²⁰⁹428 F.2d at 1076-77, 1080.

²¹⁰See note 56, *supra*, and accompanying text.

²¹¹16 VILL. L. REV. at 393-94 (1970).

²¹²65 Misc.2d 15, 318, N.Y.S.2d 11 (N.Y. City Civ. Ct. 1971).

²¹³See Section III-B-4, note 87 *supra*.

pursuant to a scheme to force this lessee and others to vacate the premises.

In *Kline v. Burns*²¹⁴ the plaintiff-lessee leased premises from the defendant-lessor under an oral tenancy at will. Later, the lessee sued to recover all rent paid under the lease on the basis that the lease was in violation of the city housing code. The lessor then sued to recover possession and unpaid rent. The city building inspector conducted an inspection and found code violations, some of which had existed for a long period of time. The trial court dismissed the lessee's action for rent already paid and granted judgment to the lessor for possession and for unpaid rent. In reversing this judgment, the New Hampshire Supreme Court pointed out that the conditions under which the common law rule of *caveat emptor* was formulated have changed and that such a rule is no longer just. The court listed these factors for consideration in determining the principles to be applied to modern urban leases: (1) the legislature, by passing enabling legislation for municipal housing codes, has recognized that public welfare requires that dwellings be habitable and safe at the outset and throughout the life of the lease; (2) the lessor has better knowledge of the condition of the premises than the lessee; (3) it is more appropriate for the lessor, who retains ownership of the premises together with all improvements, to bear the cost of repairs necessary to make the premises habitable and safe, and (4) in today's housing market the lessor is in a better bargaining position than the lessee. These considerations led the court to conclude that there should be implied in a lease, written or oral, for a specific time or at will, a warranty of habitability that the premises are habitable and fit for living at the inception of the lease and throughout its life. Under this view the lessee has the basic contractual remedies of damages, reformation or rescission. In the present case the lessee's damages were the difference between the agreed rent and the fair rental value of the premises in their condition while occupied by the lessee.

VI. UNCONSCIONABLE CLAUSES

One contractual principle that has been molded into many forms

²¹⁴276 A.2d 248 (N.H. 1971).

and applied to real property leases is that of unconscionability. As with the illegality principle, although used in the past in the leasehold area, the doctrine of unconscionability has recently taken on new shapes to deal with present leasehold problems.

A. *Contract Principles*

The common law adopted a *laissez faire* attitude in the law of contracts that expressed itself in two generally accepted theories:²¹⁵ (1) freedom of contract, and (2) stability of contract. Under the concept of freedom of contract, the parties to a private agreement are allowed to reach any terms they so desire so long as the terms do not violate some legislative policy or other public policy. The parties are given the freedom to negotiate the best terms possible for each, based on their relative positions, even though these positions may not be perfectly equal. Under the concept of stability of contract, the law has been loath to step into a contract and alter its terms on the basis that the terms are "unconscionable," *i.e.*, harsh, oppressive or unfair to one party. The reason for this reluctance is that to do so would be to make a new contract for the parties, creating uncertainty in the law of contracts since the parties to a contract could never be sure that terms negotiated into a contract would be left intact and not altered.

Both of these theories are justified to some degree on the fact that parties to a private agreement can and do negotiate over the terms of the agreement. If the ability to negotiate is absent, for one reason or another, then there is no true "freedom" to contract in the particular situation and the "stability" becomes a straight jacket used to enclose one party to the agreement.²¹⁶ This type of "agreement" is known as a standard form contract or contract of adhesion which gives rise to the problem of unconscionability. "Unconscionability" is not a label or a specific defense, but a generic term covering a wide variety of situations. It has been used most often in equity to prevent the specific performance of a contract so harsh and oppressive as to be associated with fraud, mistake, incapacity or inadequacy of consideration.²¹⁷ Originally, unconscionability was not available as a defense at law,²¹⁸ but it has gradually become recognized as a defense where there is gross

²¹⁵20 ARK. L. REV. 165 (1966); Note, *Unconscionable Contracts: The Uniform Commercial Code*, 45 IOWA L. REV. 843 (1960).

inequality of bargaining positions between the parties.²¹⁹ More often, however, law courts have reached the result that an unconscionable contract clause will not be enforceable by use of technical bases such as construing a contract strictly against the maker, lack of mutuality and limitation on disclaimer of warranties.²²⁰

In contrast to the often indirect approach taken by the common law in dealing with unconscionable clauses in contracts, the *Uniform Commercial Code* takes a very direct approach to the problem in sales contracts:

If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.²²¹

The term "unconscionability" is not defined in the *Code*, but it has been argued to be equivalent to "grossly unfair."²²² However, the comments following the section quoted above do shed light on the intention of the draftsmen of the *Code* to give courts the authority to deal directly with the problem of unconscionable contract clauses:

1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability.

* * *

2. Under this section the court, in its discretion, may refuse

²¹⁶See Llewellyn, *Whate Price Contract?—An Essay in Perspective*, 40 *YALE L.J.* 704 (1931).

²¹⁷*e.g.*, *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3d Cir. 1948); see 1 *CORBIN* § 128.

²¹⁸1 *CORBIN* § 128.

²¹⁹*Henningsen v. Bloomfield Motors Co.*, 32 N.J. 358, 161 A.2d 69 (1960).

²²⁰20 *ARK. L. REV.*, *supra* note 215, at 166.

²²¹§ 2-302.

²²²45 *IOWA L. REV.*, *supra* note 215, at 849.

to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike out any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.²²³

B. *Real Property Leases*

1. *Clauses Favoring the Lessor*

There are types of clauses favorable to the lessor in real property leases, especially those entered into by the indigent lessee of urban residential premises, that give rise to the problem of unconscionability.²²⁴ Six types are found most commonly: (1) clauses whereby the lessee waives notice to quit and which state that non-payment of rent operates as notice to quit; (2) clauses whereby the lessee is prohibited from using premises for disorderly or unlawful purposes, is prohibited from creating noise or annoyance detrimental to premises or other inhabitants, and is prohibited from engaging in any acts which constitute annoyance, damage or disturbance to the lessor, of which the lessor shall be the sole judge; (3) clauses in term leases providing for acceleration of rent for the entire term upon the lessee's failure to pay any periodic installment and providing for termination of the lease at the lessor's option in event of default; (4) clauses whereby the lessee undertakes to pay attorney's fees and other costs and expenses of the lessor by reason of the lessee's default; (5) clauses imposing a duty of repair on the lessee; and (6) clauses exculpating the lessor from liability for damages to the lessee for failure to repair or other act of nonfeasance. This last type of clause is the one found perhaps most often in leases and the one which has generated the most litigation; consequently, it will be used to demonstrate how the law deals with a lease clause deemed to be unconscionable. This type of clause can either be an exculpatory clause or an indemnity clause. An exculpatory clause is one which acts to release the exculpatee from liability from any future acts

²²³§2-302, Comments 1 and 2; see Comment, *Bargaining Power and Unconscionability: A Suggested Approach to U.C.C. Section 2-302*, 114 U. PA. L. REV. 998 (1966); Comment, *The Uniform Commercial Code's Solution for Unconscionable Contracts*, 48 ORE. L. REV. 209 (1969).

B. *Real Property Leases*

²²⁴Schoshinski, *Remedies for the Indigent Tenant: Proposal for Change*, 54 GEO. L.J. 519, 552-53 (1966).

of negligence by the exculpatee which might result in harm to the exculpator; an indemnity clause is one which covers the risk of harm sustained by third persons that might be caused by either the indemnitor or the indemnitee and acts to effect a shift of the financial burden for the ultimate payment of damages from the indemnitee to the indemnitor.²²⁵

The general common law rule is that exculpatory clauses releasing a lessor from liability in tort for injuries traceable to the condition of the leased premises are upheld as within the proper scope of the freedom to contract, or as a reasonable substitute for the lessor's carrying of insurance, or for some other reason.²²⁶ This rule has been applied to absolve a lessor from liability for personal injuries sustained by a residential lessee caused by the lessor's negligence,²²⁷ to absolve a lessor from liability for property damage sustained by a residential lessee caused by the lessor's negligence,²²⁸ and to absolve a lessor from liability for property damage sustained by a commercial lessee caused by the lessor's negligence.²²⁹

However, from this rule there have been traditional and more recent departures that demonstrate the fact that the unconscionability doctrine has played a role and will continue to play an expanding role in the construction and determination of validity of lease clauses. The traditional departure from the common law rule has been based on a strict interpretation of the exculpatory clause against the draftsman, who is ordinarily the lessor. Certain standards have been devised to circumscribe the use of exculpatory clauses.²³⁰ These standards are: (1) an exculpatory clause must be construed strictly because they are not favored; (2) an exculpatory clause must set forth the intention of the parties with the greatest particularity; (3) an exculpatory clause must be construed against the party seeking exculpation; and (4) the burden of establishing immunity from liability is on the party seeking immunity.

²²⁵Weaver v. American Oil Co., 261 N.E.2d 99 (Ind. App. Ct. 1970), modified, 262 N.E.2d 663 (Ind. App. Ct. 1970).

²²⁶2 POWELL § 234[4]; 6 WILLISTON § 1751C, at 4969-70.

²²⁷Mackenzie v. Ryan, 230 Minn. 378, 41 N.W.2d 878 (1950).

²²⁸King v. Smith, 47 Ga. App. 360, 170 S.E. 546 (1933).

²²⁹Plaza Hotel Co. v. Fine Products Corp., 87 Ga. App. 460, 74 S.E.2d 372 (1953); Manaster v. Gopin, 330 Mass. 569, 116 N.E.2d 134 (1953).

²³⁰See Employers Liability Assurance Corp. v. Greenville Business Men's Ass'n, 423 Pa. 288, 224 A.2d 620 (1966).

An illustration of the general application of these standards is found in *Galligan v. Arovitch*,²³¹ where the plaintiff-lessee entered into a lease with the defendant-lessor whereby the lessee agreed to relieve the lessor of all liability by reason of any injury to the lessee arising from the lessee's use of elevators, hatches, openings, stairways, fire escapes, hallways, and sidewalks. The lessee was injured when she tripped on the lawn area in front of the lessor's apartment building. When the lessee sued the lessor in a tort action based on negligence, the lessor relied on the exculpatory clause. The trial court upheld this defense, but the Pennsylvania Supreme Court reversed, stating that an exculpatory clause should be strictly construed against the maker (lessor), and, applying that rule of construction to the case, the exculpatory clause would not be a valid defense because the injury did not occur in any one of the seven places listed in the clause. The same approach has been taken in cases involving property damage sustained by a lessee due to the lessor's negligence.²³²

The standards of strict construction discussed above cause exculpatory clauses to be inapplicable in certain types of situations. An exculpatory clause may not be applicable where the tort is committed by a lessor in some capacity other than that of lessor. In *W. F. Zimmerman, Inc. v. Daggett & Ramsdell, Inc.*²³³ the plaintiff-lessee subleased commercial premises from the defendant-lessor by a lease which incorporated into the sublease all terms of the lessor's main lease with his lessor. The main lease contained a clause stating that the lessor would not be liable for any damage to property on the premises because of any defect and the lessor would not be liable for loss of property due to explosion. The defendant operated a tank of volatile fluid in conjunction with its business which exploded, causing injury to the plaintiff's premises. When the plaintiff sued for the damage caused by the defendant's negligence, the defendant relied on the exculpatory clause incorporated into the sublease. The court, relying on the strict construction doctrine, held the clause inapplicable, saying: "The boun-

²³¹421 Pa. 301, 219 A.2d 463 (1966).

²³²*Butt v. Bertola*, 110 Cal. App.2d 128, 242 P.2d 32 (1952); *Sun Copper & Wire Co. v. White Lamp, Inc.*, 12 N.J. Super. 87, 79 A.2d 93 (1951); *Sacher v. Murray Lenox Land Co.*, 171 N.Y.S. 216 (Sup. Ct. App. Term 1917).

²³³34 N.J. Super. 81, 111 A.2d 448 (1955); *accord*, *Smith v. Faxon*, 156 Mass. 589, 31 N.E. 687 (1892).

daries of the field of exempted liability are staked out by the legal relationship which the parties mutually assumed, namely, that of landlord and tenant."²³⁴ Here the damage was caused by the defendant's negligence in pursuit of its independent business venture which was unconnected with its function as a lessor.

An exculpatory clause will not serve as a defense to a tort occurring before entry into the lease. In *Employers' Liability Assurance Corp. v. Greenville*²³⁵ the plaintiff's insured was in possession of premises without benefit of the lease in question at a time when the defendant-lessor's negligence caused an automatic sprinkler system to activate, causing flooding and damage to the insured's property. The parties later executed a lease containing a clause exculpating the lessor from liability for any damage occurring to the lessee's property. The plaintiff-subrogee of the lessee's rights brought an action against the lessor for its negligence and the lessor relied on the exculpatory clause. Applying the strict construction doctrine, the Pennsylvania Supreme Court held that the clause did not grant immunity for negligence occurring prior to entry into the lease because, first, the lease did not specifically grant immunity for acts of negligence occurring prior to the lease, and, second, the parties contemplated future conduct only, and, consequently, the clause was intended to operate prospectively, not retrospectively.

*Freddi-Gail, Inc. v. Royal Holding Corp.*²³⁶ deals with the problem of misfeasance, *i.e.*, affirmative negligence, as opposed to non-feasance. The lessee leased premises from the lessor by a lease containing a clause relieving the lessor of liability for any damage due to water leakage. The lessee sued the lessor for property damage claimed to have been caused by water leakage due to faulty repairs made by the lessor. The lessor's defense based on the exculpatory clause was not upheld, the court adopting the rule that an exculpatory clause exempting a lessor from liability for damage by water, without clearly referring to the matter of negligence on the lessor's part, does not absolve him from his own

²³⁴34 N.J. Super. at 84, 111 A.2d at 450.

²³⁵423 Pa. 288, 224 A.2d 620 (1966); *accord*, *Kotwasinski v. Rasner*, 436 Pa. 32, 258 A.2d 865 (1969).

²³⁶34 N.J. Super. 142, 111 A.2d 636 (App. Div. 1955); *accord*, *Sears, Roebuck & Co. v. Poling*, 248 Iowa 582, N.W.2d 462 (1957); *Carbone v. Cortlandt Realty Corp.*, 58 N.J. 366, 277 A.2d 542 (1971); *Anno.*, 175 A.L.R. 8, 89 (1948).

affirmative negligence. The court adopted this rule pursuant to a strict construction given to the clause in controversy.

The strict construction doctrine has frequently been applied in cases where the tort involved is committed by the lessor on premises remaining under his control. In *Daltex, Inc. v. Western Oil & Fuel Co.*²³⁷ the lessee leased commercial premises from the lessor by a lease which included an exculpatory clause. The lessee's property was damaged by a fire started due to the lessor's negligence in allowing a furnace under the lessor's control and located on premises occupied by the lessor to overheat and set fire to combustible materials nearby. The Minnesota Supreme Court rejected the lessor's defense based on the exculpatory clause, holding that, under the strict construction doctrine utilized because the lease was drawn by the lessor, the clause would not be construed to relieve the lessor of liability for damage caused by its negligence committed upon its own premises.

Finally, the doctrine of strict construction has been utilized to limit the effectiveness of an exculpatory clause where the tort involved is committed off the leased premises. In *Wilmington Housing Authority v. Williamson*²³⁸ the parents of the plaintiffs, minor children, leased residential premises from the lessor by a lease containing a clause releasing the lessor from liability for any injury to the lessee or members of his household resulting from any cause whatsoever. The plaintiffs were injured off the apartment premises when they played on a path leading from the grounds to a steep and rough descent to railroad tracks adjacent to the premises. The plaintiffs sued the lessor, claiming it was negligent in allowing the path to remain unfenced when it knew of the existence of the path. The Delaware Supreme Court refused to uphold the lessor's defense based on the exculpatory clause, stating that, under the doctrine of strict construction, the effect of the clause "must be confined to the physical premises actually leased to the adult plaintiff."

A second departure from the common law rule recognizing exculpatory clauses stems from the view that such clauses violate public policy. The freedom of contract and stability of contract

²³⁷275 Minn. 509, 148 N.W.2d 377 (1967); accord, *Batwin v. Rathkopf*, 128 Misc. 15, 217 N.Y.S. 192 (Sup. Ct., App. Term 1926); *LeVette v. Hardman's Estate*, 77 Wash. 320, 137 P. 454 (1914).

²³⁸228 A.2d 782 (Del. 1967); accord, *Buckner v. Azulai*, 251 Cal. App.2d 1013, 50 Cal. Rep. 806 (1967).

theories are partially based on the assumption that parties have a right to make any type of agreement concerning their private affairs.²³⁹ But once the agreement breaks over into some area of public concern, expressed in some public policy, then limitations on the agreement come into play. *Papakalos v. Shaka*²⁴⁰ deals with this point in a situation where the lessee orally leased residential premises from the lessor by an agreement whereby one rental would be charged if the lessor repaired the premises, but a lesser rental would be charged if the lessor did not repair the premises. The lessee was injured on a common stairway and sued the lessor, claiming the injury was caused by the lessor's negligent failure to maintain the stairway. The lessor argued that the agreement providing for a different rental based on the presence or absence of repairs was tantamount to an exculpatory clause. The New Hampshire Supreme Court doubted that such construction could be given to the agreement and held: "But however this [the construction of the agreement] may be, the whole answer to this contention of the defendant is to be found in our rule that one may not by contract relieve himself from the consequences of the future nonperformance of his common-law duty to exercise ordinary care."²⁴¹ In a later New Hampshire case the court relied on *Papakalos* in making this statement: "Defendant's counsel concede that in this jurisdiction the ordinary contract exempting a person from liability for the consequences of his negligence is held to be void as against public policy."²⁴²

This same view of an exculpatory clause has been adopted recently in the District of Columbia. In *Tenants' Council of Tiber Island-Carrollsbury Square v. DeFranceaux*²⁴³ the plaintiff-lessees leased apartments from the lessor in a complex that included a swimming pool operated by the lessor and financed through rents paid by all lessees. The form supplied by the lessor used for applying for membership rights to use the pool contained a clause relieving the lessor of all liability for any injuries sustained by

²³⁹See *Employers Liability Assurance Corp. v. Greenville Business Men's Ass'n*, 423 Pa. 288, 224 A.2d 620 (1966).

²⁴⁰91 N.H. 265, 18 A.2d 377 (1941).

²⁴¹*Id.* 18 A.2d 379 (1941).

²⁴²*Nashua Gummed & Coated Paper Co. v. Noyes Buick Co.*, 41 A.2d 920, 922 (1945); *accord*, *Shaer Shoe Corp. v. Granite State Alarm, Inc.*, 110 N.H. 132, 262 A.2d 285 (1970).

²⁴³305 F. Supp. 560 (D.D.C. 1969).

the lessees. The lessees objected to this clause, and, when the lessor refused to admit them to pool-club membership without signing the liability-waiver application card, they brought this action seeking to restrain the lessor from requiring them to agree to the clause to obtain use of the pool. The court granted judgment for the lessees, stating that "[t]he challenged clause is invalid as against public policy," both under the common law and the District of Columbia *Building Code*.

The public policy basis for refusing to recognize exculpatory clauses is discussed in *McCutcheon v. United Homes Corp.*²⁴⁴ In this case the lessee entered into a residential lease which contained a clause relieving the lessor of all liability for injury to the lessee on the premises. The lessee was injured when she fell down unlighted stairs and sued the lessor for the damage caused by its alleged negligent failure to keep the common area in a safe condition. The Washington Supreme Court reversed the lower court judgments upholding the validity of the exculpatory clause, stating that the clause did not relate to the "personal and private affairs of two parties on an equal footing," because residential leasing has grown to such high proportions (citing statistics) that there is a public interest involved today that prevents the recognition of exculpatory clauses. In the court's language: "Under these circumstances [referring to cited statistics] it cannot be said that such exculpatory clauses are 'purely a private affair' or that they are 'not a matter of public interest.'"²⁴⁵

McCutcheon raises a consideration that serves as a third point of departure from the common law rule—the relative equality or inequality of the bargaining positions of the parties to a lease. Do the parties occupy positions that allow each to bargain over the terms of the agreement, or, are their positions so unequal that one dictates the terms which the weaker party must simply adhere to if he wishes to enter into the agreement? This latter situation is one that has arisen in a number of areas, notably the insurance industry, and has given birth to the standardized contract or contract of adhesion.²⁴⁶ The problems surrounding this type of agree-

²⁴⁴79 Wash.2d 443, 486 P.2d 1093 (1971).

²⁴⁵*Id.* 486 P.2d at 1097.

²⁴⁶See Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943). The term "contract of adhesion" was first applied to insurance contracts; see Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919).

ment are present in the leasehold field. Two approaches have been taken to the real property lease that is determined to be a contract of adhesion because of inequality of bargaining power between the lessor and lessee. The first approach is to make use of evidentiary presumptions concerning knowledge of the exculpatory clause in determining whether the clause is valid. The approach is suited to commercial leases more than residential leases because the degree of inequality of bargaining power is usually not as critical as is knowledge of the lease terms and their importance. This first approach is illustrated in *Weaver v. American Oil Co.*,²⁴⁷ where the lessee entered into a commercial lease with the lessor which included an exculpatory and indemnity clause relieving the lessor of liability for acts of negligence toward the lessee. When the lessee was injured by the lessor's negligence, the lessor brought suit for declaratory judgment, relying on the exculpatory and indemnity clause. The court held that the clause was not void as contrary to public policy, but was void under "freedom of contract principles. The court stated:

[because of] the unusual and considerable burden imposed by the exculpatory clause . . . it is not enforceable unless it appears that the party who assumes the burden under the clause was aware of its existence and understood its far-reaching implications. Where there is approximate equality of bargaining positions, it is rebuttably presumed that the assuming party had such knowledge and understanding. However, where there is a patent disparity of bargaining positions, it is rebuttably presumed that there was not the requisite notice or understanding. In the case at bar there existed between the parties a patent disparity of bargaining positions and because there is nothing to indicate that [defendant] was aware of the clause or its implications the presumption that there was no notice or understanding remains unrebutted and the exculpatory clause is not enforceable.²⁴⁸

The second approach, referred to in dicta in *Kay v. Cain*,²⁴⁹ involves the outright holding of the exculpatory clause void due to an inequality of bargaining power between the parties. This approach is more suited to residential leases because the question

²⁴⁷261 N.E.2d 99 (Ind. App. Ct. 1970), *modified*, 262 N.E.2d 663 (Ind. App. Ct. 1970).

²⁴⁸*Id.* at 104.

²⁴⁹154 F.2d 305 D.C. Cir. 1946).

is not as much the knowledge of such clauses as the ability to negotiate concerning them.²⁵⁰ In *Kay* the lessee leased residential premises from the lessor by a lease that contained an exculpatory lease. The lessee fell and injured himself in an unlighted hallway and sued the lessor for negligence in maintaining this common area. The court refused to sustain the lessor's defense based on the exculpatory clause on the basis that, under the principle of *ejusdem generis*, the clause did not refer to negligence in failing to light a common area.²⁵¹ The court went on to say that it was doubtful whether a clause which did purport to exempt a lessor from liability for negligence would be valid in light of the acute housing shortage in and near the District of Columbia which gave the lessor so great a bargaining advantage that the clause should be held violative of public policy.

This position was taken in *Kuzmiak v. Brookchester, Inc.*,²⁵² a case where the lease contained an exculpatory clause which was relied on by the lessor when it was sued by the lessee for negligently failing to maintain a common stairway. The court reversed a summary judgment for the lessor on the following grounds:

Another basis for declaring invalid a bargain, otherwise valid, which exempts one from future liability, is where a relationship exists in which the parties have not equal bargaining power, and one of them must accept what is offered or be deprived of the advantages of the relation.

* * *

We also take judicial note that under present housing conditions the bargaining positions of landlord and tenant in an apartment building are decidedly unequal.

* * *

Under present conditions, the comparative bargaining positions of landlords and tenants in housing accommodations within many areas of the state are so unequal that tenants are in no position to bargain; and an exculpatory clause which purports to immunize the landlord from all liability would be contrary to public policy.²⁵³

Although New Jersey continues to take this position relative to

²⁵⁰See Section V-C-2, note 246 *supra*.

²⁵¹See note 231 *supra* and accompanying text.

²⁵²33 N.J. Super. 575, 111 A.2d 425 (App. Div. 1955).

²⁵³*Id.* at 430, 431, 432.

residential leases, it has refused to apply it to commercial leases.²⁵⁴

There is one type of lessor whose nature prevents it from utilizing exculpatory clauses—the public housing authority. In *Housing Authority of Birmingham v. Morris*²⁵⁵ the lessee leased residential premises from the lessor, a public body created by statute to erect, operate and maintain public housing, by a lease relieving the lessor of liability for damage to the person or property of the lessee from any cause whatsoever. The lessee was injured because of a malfunction of the water system and hot water heater caused by the lessor's negligence. The Alabama Supreme Court, in upholding a judgment in favor of the lessee in a suit brought against the lessor, stated that an agreement exempting persons from liability for their negligence induces a lack of due care on their part; therefore, “. . . public policy forbids that [public service corporations] contract for immunity for their negligence or the negligence of their servants or agents committed in the prosecution of their major business.”²⁵⁶

A different reason for reaching the same result was utilized recently by the Washington Supreme Court in *Thomas v. Housing Authority of the City of Bremerton*.²⁵⁷ In this case, on facts similar to those found in *Morris*, the court held the exculpatory clause contained in the lease to be void as violative of public policy for the following reason:

Public housing such as that provided by the defendant is only available to “persons of low income,” in other words, those who the legislature has determined are unable to obtain safe and sanitary housing elsewhere. The situation presents a classic example of unequal bargaining power. . . . We think that the instant matter, in which the [parents of the injured plaintiff] had to sign the defendant's standard lease form in order to acquire housing in West Park, is an example of an obvious disadvantage in bargaining power which would have the effect, if the exculpatory provision were upheld, of putting the tenants at the mercy of the defendant housing authority's negligence. This would be contrary to the public policy inherent in the basic legislation and authorization relative to low rent public housing.²⁵⁸

²⁵⁴*Midland Carpet Corp. v. Franklin Associated Properties*, 90 N.J. Super. 42, 216 A.2d 231 (N.J. App. Div. 1966).

²⁵⁵244 Ala. 557, 14 So.2d 527 (1943).

²⁵⁶*Id.* at 531.

²⁵⁷71 Wash.2d 69, 426 P.2d 836 (1967).

²⁵⁸*Id.* at 842.

There are two types of legislation which are playing expanded roles in the area under discussion—municipal codes and state statutes. Such municipal codes as housing and fire codes are widely adopted across the United States²⁵⁹ and can often be utilized in determining the effectiveness of exculpatory lease clauses. In *Gilpin v. Abraham*²⁶⁰ the lessee sued his lessor for injuries sustained in a fall resulting from the collapse of a platform caused by the lessor's negligence. The lessor relied on a clause in the lease relieving him of liability for injury to the lessee or his guests caused by the lessor's negligence. The court rendered judgment in favor of the lessee, holding that the clause was void under the Philadelphia *Housing Code* because the *Code's* purpose is to protect the public health, safety and welfare and the lessee is entitled to this protection unaffected by any private agreement.

A fire code was relied on in *Hanna v. Lederman*.²⁶¹ In this case a fire sprinkler system on the leased premises activated and operated for a substantial period of time, causing damage to the lessee's property. The sprinkler system did not have an alarm device which would operate when the sprinkler activated, as was required by the Los Angeles *Municipal Code*. The lease contained a clause relieving the lessor of liability for damages to personal property on the premises. The court held that the exculpatory clause could not be a defense to a cause of action based on a violation of the *Code*.

Courts in several jurisdictions have reached the conclusion that state statutes affect the validity of exculpatory clauses. In *Boyd v. Smith*²⁶² the lessee leased residential premises from the lessor by a lease containing a clause relieving the lessor of liability for injury to the lessee due to the lessor's negligence. A state statute required an apartment building such as the one the lessee lived in to have a fire escape; however, this building did not have one and the lessee was injured in trying to escape from a fire by jumping from the third floor of the building. The lessee sued the lessor, who relied on the exculpatory clause. The court upheld the lower court's judgment in the lessee's favor, stating that since the law in question was a police power measure intended to protect human

²⁵⁹See Section V-D-3, note 203 *supra*.

²⁶⁰218 F. Supp. 414 (E.D. Pa. 1963), *appeal dismissed*, 328 F.2d 884 (3d Cir. 1964).

²⁶¹223 Cal. App.2d 786, 36 Cal. Rep. 150 (1963).

²⁶²372 Pa. 306, 94 A.2d 44 (1953).

life, public policy would not allow a person to waive the protection afforded by the statute; therefore, the clause was void.

In *American States Ins. Co. v. Hannan Construction Co.*,²⁶³ the plaintiff-insurance company, subrogated to the rights of the lessee, sued the lessor for negligence in causing a fire that damaged the lessee's property. The commercial lease involved contained a clause relieving the lessor of liability for damage to any goods maintained on the premises or any damage to property whatsoever. The court rendered judgment for the plaintiff, holding that the clause could not exculpate the lessor from liability because to do so would thwart the public purposes of an Ohio statute designed to make buildings "free from danger or hazard to life, safety, health or welfare of persons occupying or frequenting it or of the public," and of the related Ohio *Building Code*.

A Michigan housing law, placing a duty on the lessor to keep the premises clean, was relied on by the court in *Feldman v. Stein Building & Lumber Co.*²⁶⁴ when a lessor raised an exculpatory clause as a defense to a cause of action brought by the lessee who was injured when he fell in a parking lot adjacent to the apartment because of an accumulation of ice and snow on the lot. The court construed the statute to require a lessor to remove ice and snow from the premises and concluded that the exculpatory clause, being violative of the statute, was against public policy and void.

Three states have dealt directly with the problem of exculpatory clauses in real property leases.²⁶⁵ The New York statute, the first to be enacted, is illustrative of the others. It provides:

Every covenant, agreement or understanding in or in connection with or collateral to any lease of real property exempting the lessor from liability for damages for injuries to person or property caused by or resulting from the negligence of the lessor, his agents, servants or employees, in the operation or maintenance of the demised premises shall be deemed to be void as against public policy and wholly unenforceable.

This statute has been upheld as constitutional against the attack that it violates the due process clauses and the equal protection

²⁶³283 F. Supp. 988 (N.D. Ohio 1966).

²⁶⁴6 Mich. App. 180, 148 N.W.2d 544 (1967).

²⁶⁵MD. ANN. CODE art. 53, § 40 (1968); MASS. GEN. LAWS ANN. ch. 186, § 15 (1958); N.Y. REAL PROP. LAW § 234.

clauses of the United States and New York Constitutions.²⁶⁶ A fourth state, Illinois, enacted similar legislation,²⁶⁷ but it was held unconstitutional as making a discriminatory classification without reasonable basis by exempting municipal corporations, governmental units, and corporations regulated by a state or federal commission or agency, from its operation.²⁶⁸ The Illinois legislature subsequently enacted a statute voiding exculpatory clauses that is identical to the New York statute quoted above.²⁶⁹

2. *Clauses Favoring the Lessee*

There is one type of clause favorable to the lessee that has generated some controversy over whether it is unconscionable or not. This clause, generally found in commercial leases, states: (1) that the lessee agrees to make all necessary repairs to the leased premises excepting damage or destruction by fire or other casualty, in which case the lessor agrees to insure and restore the premises; or (2) if found in the surrender covenant, that the lessee will surrender the premises in as good condition as when received, "loss by fire and ordinary wear and decay excepted."²⁷⁰ The question is whether or not such a clause exempts the lessee from liability for loss due to fire or other casualty caused by his negligence.

*Cerney-Pickas & Co. v. C. R. Jahn Co.*²⁷¹ reached the conclusion that such a clause has the effect of exempting the lessee from liability for loss due to fire or other casualty caused by his negligence. The lessee leased commercial premises from the lessor by a lease stating, first, that the lessee would keep the premises in good repair and return them in good condition (loss by fire excepted), and, second, that the lessor would pay for fire insurance. When the premises were damaged by fire caused by the lessee's

²⁶⁶*Billie Knitwear v. New York Life Ins. Co.*, 174 Misc. 978, 22 N.Y.S.2d 324 (Sup. Ct. 1940), *aff'd*, 262 App. Div. 714, 27 N.Y.S.2d 328, 329 (1941), *aff'd*, 288 N.Y. 682, 43 N.E.2d 80 (1942).

²⁶⁷ILL. REV. STAT. ch. 80, § 15a (1966).

²⁶⁸*Sweeney Gasoline & Oil Co. v. Toledo, P. & W. R.R.*, 42 Ill.2d 265, 247 N.E.2d 603 (1969).

²⁶⁹ILL. REV. STAT. ch. 80, § 91 (Supp. 1972).

²⁷⁰*See* 7 DUKE L.J. 59 (1957).

²⁷¹Ill.2d 393, 131 N.E.2d 100 (1955); *accord*, *General Accidental, Fire & Life Assur. Corp. v. Traders Furniture Co.*, 401 P.2d 157 (Ariz. Ct. App. 1965); *Stein v. Yarnell-Todd Chevrolet, Inc.*, 41 Ill.2d 32, 241 N.E.2d 439 (1968); *Fry v. Jordan Auto Co.*, 224 Miss. 445, 80 So.2d 53 (1955); *Rock Springs Realty, Inc. v. Waid*, 392 S.W.2d 270 (Mo. 1965); *United States Fire Ins. Co. v. Phil-Mar Corp.*, 166 Ohio St. 85, 139 N.E.2d 330 (1950).

negligence and the lessor sued to recover damages, the lessee claimed that the lease exonerated it from liability for loss due to fire, whether or not the fire was caused by the lessee's negligence. The court agreed with the lessee for two reasons: (1) unless the clause included negligently-caused fire, it would not change the common law rule and would be useless since, at common law, the lessee would not be liable for any loss unless caused by its negligence; and (2) under the lessor's construction of the lease (lessee liable for negligently caused fire, but not liable for nonnegligently caused fire), both the lessor and lessee would necessarily have to carry fire insurance to be protected, which is repugnant to the intent of the clause.

A different position is taken by *Winkler v. Appalachian Amusement Co.*,²⁷² where the lessee entered into a commercial lease with the lessor containing the following clauses: (1) lessee would make all repairs necessary inside the demised building, except in case of destruction or damage by fire or other casualty; (2) lessor agreed to keep the premises insured; and (3) lessee would at the expiration of the lease return possession of the premises in as good repair as at the time of leasing, ordinary wear and tear excepted and damage by fire excepted. When the premises were destroyed by fire due to the lessee's negligence, the lessee defended against a suit brought by the lessor on the basis that the three clauses exculpated him from liability for damage due to his negligence. The court, in reversing a lower court judgment in favor of the lessee, held that a contract for exemption from liability for negligence is not favored and should be strictly construed against the party asserting it. In the present lease there were no explicit words exempting the lessee from liability for his own negligence; therefore, the three clauses in the lease would not be construed to have that effect.

VII. MITIGATION OF DAMAGES AND ANTICIPATORY BREACH DOCTRINES

Two related principles of contract law about which there has

²⁷²238 N.C. 589, 79 S.E.2d 185 (1953); accord, *Stone Mountain Industries, Inc. v. Bennett*, 112 Ga. App. 466, 145 S.E.2d 591 (1965); *Sears, Roebuck & Co. v. Poling*, 248 Iowa 582, 81 N.W.2d 462 (1957); *Dixie Fire & Casualty Co. v. Esso Standard Oil Co.*, 265 N.C. 121, 143 S.E.2d 279 (1965); *Dilks v. Flohr Chevrolet, Inc.*, 411 Pa. 425, 192 A.2d 682 (1963).

been some dispute concerning their applicability to real property leases are those of "mitigation of damages" and "anticipatory breach." These two doctrines are well entrenched in the law of contracts, but the dual nature of a lease, with the property aspect historically having been given preference, has created confusion and a divergence of opinion in this corner of the leasehold field.

A. *Breach of Contract Principles*

1. *Rule of Avoidable Damages (Mitigation of Damages)*

In the contracts field, since the purpose of the rule concerning damages is to put the injured party in as good a position as he would have been put by full performance of the contract at the least necessary cost to the defendant, the injured party is never given judgment for damages for losses that he could have avoided by reasonable effort without risk of other substantial loss or injury.²⁷³ This rule is often expressed by the statement that the injured party has a "duty" to mitigate his damages to the extent possible. But because there is no judicial penalty for his failure to make this effort (his recovery will be the same whether he mitigates his loss or not), it is more accurate to say that he cannot recover avoidable damages or the increased damages caused by his failure to mitigate.²⁷⁴ The law does not penalize his inaction; it merely refuses to compensate him for the loss that he helped to cause by not avoiding it.

2. *Rule of Breach of Contract by Anticipatory Repudiation (Anticipatory Breach)*

The rule of avoidable damages is applicable to the "anticipatory breach" of a contract by one of the parties.²⁷⁵ Under this doctrine, more correctly called breach of contract by anticipatory repudiation,²⁷⁶ when a party bound by an executory contract repudiates his obligations or disables himself from performing them before the time for performance arrives, the promisee has the option to treat the contract as ended so far as further performance is con-

²⁷³Corbin § 1039.

²⁷⁴11 Williston § 1353; RESTATEMENT OF CONTRACTS § 336 (1932).

²⁷⁵Corbin § 1053.

²⁷⁶*Id.*

cerned and maintain an action at once for damages occasioned by the breach.²⁷⁷

B. *Remedies Available to Lessor Upon Lessee's Abandonment of Premises and Refusal to Pay Rent*

When the lessee under a real property lease abandons the premises and refuses to pay rent, what remedies are available to the lessor? The answer to this question involves a determination of whether or not the principles of "mitigation of damages" and "anticipatory breach" are a part of the law governing leases.

1. *Continued Recognition of Lease With No Reletting (Applicability of Mitigation of Damages Doctrine)*

One traditional remedy is for the lessor to continue to recognize the lease (refuse to accept any surrender) and allow the premises to remain vacant, suing the lessee to collect rent as it falls due.²⁷⁸ This remedy points out the property nature of a lease—in the conveyance of land for a term, the lessor need not concern himself with what use, indeed, if any, is made of the premises.²⁷⁹ A majority of jurisdictions²⁸⁰ adopt this remedy and hold that a lessor need not, for the purpose of mitigating the damages recoverable from a lessee who abandons or fails to occupy the premises, accept or procure a new lessee during the remainder of the unexpired term of the lease.

A number of reasons have been given for following this rule. First, it is often argued that the lessee becomes the owner of the premises for a term and the lessor need not concern himself with the lessee's abandonment of his own property.²⁸¹ Second, the lessee, by breaching the covenants in his lease, is acting wrong-

²⁷⁷RESTATEMENT OF CONTRACTS § 318 (1932).

²⁷⁸1 AMERICAN LAW OF PROPERTY § 3.99, at 392; 3 Tiffany §902, at 560. For the proposition that the lessor has no right of action on the rent until it falls due, see *Grayson v. Mixon*, 176 Ark. 1123, 5 S.W.2d 312 (1928); *Bradbury v. Higginson*, 162 Cal. 602, 123 P. 797 (1912).

²⁷⁹See 1 AMERICAN LAW OF PROPERTY § 3.41, at 256.

²⁸⁰Alabama, California, Connecticut, Delaware, District of Columbia, Georgia, Indiana, Kentucky, Maine, Maryland, Minnesota, Mississippi, Missouri, Oklahoma, and Pennsylvania. Other jurisdictions are probably in accord although the rule is somewhat less certain: Arkansas, Florida, Louisiana, Massachusetts, Nebraska, New Jersey, New York, and Texas. See *Annot.*, 21 A.L.R.3d 534 (1968).

²⁸¹*Wright v. Bauman*, 239 Or. 410, 398 P.2d 119 (1965).

fully, and, by so doing, he should not be allowed to impose a duty on the lessor to relet.²⁸² Connected with this reason is the fear that the lessor would be required to seek out new lessees continually.²⁸³ Third, if the lessor were to accept the property and relet it, a rescission of the lease by operation of law would occur, releasing the lessee from his obligations.²⁸⁴ This reason expresses a fear that the lessor's actions might be construed to constitute an unwilling acceptance of a surrender. Fourth, since the parties to the lease could have placed a duty to mitigate on the lessor, the absence of such a covenant indicates a lack of desire to do so. And, fifth, some courts feel obligated to follow this rule as a matter of *stare decisis* because many leases presently in effect covering a substantial amount of real property were prepared in reliance on this rule.²⁸⁵

There are several recognized exceptions to this rule, however. First, where the lessor re-enters the premises abandoned by the lessee, there will be imposed on the lessor a duty of accepting or procuring a new lessee for the purposes of mitigating damages. In this situation the lessor's claim for general damages is measured by the difference between the rental stipulated to be paid and what, in good faith, the lessor is able to recover from a reletting.²⁸⁶ Although the lessee's term does not come to an end and he remains liable on his covenant to pay rent, he is liable only for the amount of unavoidable loss the lessor sustains, which is the general contract measure of damages.²⁸⁷ Note the difference between this situation, where the lessee remains liable under the lease, and the situation where, because of the lessor's resumption of possession under such circumstances as to evidence an acceptance of the lessee's surrender, the lease comes to an end, extinguishing the lessee's liability for rent.²⁸⁸ Second, some courts have held that if the lease gives the lessor the right to re-enter

²⁸²*Browne v. Dugan*, 189 Ark. 551, 74 S.W.2d 640 (1934).

²⁸³*Wohl v. Yelen*, 22 Ill. App.2d 455, 161 N.E.2d 339 (1959).

²⁸⁴*Haycock v. Johnston*, 81 Minn. 49, 83 N.W. 494 (1900).

²⁸⁵*Gruman v. Investors Diversified Services*, 247 Minn. 502, 78 N.W.2d 377 (1956).

²⁸⁶*Kanter v. Safran*, 99 So.2d 706 (Fla. 1958); Annot., 21 A.L.R.3d at 556-61 (1968).

²⁸⁷This exception is an extension of the second remedy available to a lessor upon the lessee's abandonment of the premises, discussed in Section VII-B-2 *infra*.

²⁸⁸See Section VII-B-3 *infra*.

upon the lessee's abandonment of the premises, the lessor is held to a duty of mitigating his damages.²⁸⁹ This has the effect of converting a license given in the lease ("may re-enter and relet") into a duty imposed by law ("must re-enter and relet"). This exception should be distinguished from the first one in that here the mere presence of the right of re-entry gives rise to the duty to mitigate damages; whereas, in the first exception it is the right of re-entry coupled with an actual re-entry pursuant thereto that gives rise to the duty. And, third, where the lessor agrees to mitigate his damages in the lease, or independently thereof, there exists a duty on his part to do so.²⁹⁰

There are a number of jurisdictions, however, which follow the rule that the lessor cannot recover damages caused by his refusal to accept or procure a new lessee for the purpose of mitigating his damages upon the original lessee's abandonment of the premises.²⁹¹ This rule points out the contractual nature of a lease. If the lease is viewed as a contract for the purpose of determining damages upon the lessee's default, the obligation placed on the lessor to mitigate would seem to be no greater than that imposed on a party under a contract not relating to the occupancy of land.²⁹²

Several reasons have been advanced for utilizing this contractual rule in the leasehold area. First, it is important that the rules for awarding damages should be such as to discourage even persons against whom wrongs have been committed from passively suffering economic loss which could be averted by reasonable efforts.²⁹³ Second, if mitigation is not required, the lessor is encouraged to allow his property to remain idle and unproductive. This may very well be economically undesirable, both from the standpoint of a reduction of available land for use and also from the stand-

²⁸⁹Annot., 21 A.L.R.3d at 561-63 (1968).

²⁹⁰*Id.* at 563-69.

²⁹¹Iowa, Kansas, Michigan, New Hampshire, North Carolina, Oregon, South Carolina, Utah, and Wisconsin. Illinois and Washington appear to follow this view although the rule is somewhat less certain. See Annot., 21 A.L.R.3d 534 (1968). See generally, Harvey, *A Study to Determine Whether the Rights and Duties Attendant Upon the Termination of a Lease Should Be Revised*, 54 CALIF. L. REV. 1141, 1183-86 (1966).

²⁹²See *Wright v. Bauman*, 239 Or. 410, 398 P.2d 119 (1965); 1960 U. ILL. L.F. 332.

²⁹³C. McCormick, *HANDBOOK ON THE LAW OF DAMAGES* § 33, at 127 (1935); McCormick, *The Rights of the Landlord Upon Abandonment of the Premises by the Tenant*, 23 MICH. L. REV. 211, 222 (1925).

point of the possible damage done to the land from vandalism, accidental fire and undetected waste.²⁹⁴ Third, many of the possible disadvantages of requiring a lessor to mitigate his loss have not been persuasive, in the light of experience:

. . . [T]he tenant will be liable for the difference between the rent he had contracted to pay and other rentals obtained by the landlord. The landlord may also expect to recover costs which he suffers in order to secure new occupants, whether he is successful or not. Also, holdings in various jurisdictions belie the contention that a duty to mitigate might require the lessor to enter into an undesirable business relationship. The landlord has not been required to accept tenants who were financial risks, or who conducted a type of business precluded by the original lease. Neither have the landlords been required to shift present tenants into new quarters, nor to alter their premises.²⁹⁵

In those jurisdictions which hold that a lessor is under a duty to mitigate the damages caused by the lessee's breach of the lease, the standard applied in determining whether he has met his obligation is fairly well settled. It is usually said that the lessor must exercise "due diligence," "reasonable diligence," "ordinary diligence," or "reasonable effort."²⁹⁶ Whether the standard will be held satisfied, of course, depends on the circumstances of the particular case. However, a few general guidelines can be drawn. First, the lessor has a duty to seek out a new lease by such means as advertising the property in newspapers, posting signs on the premises, listing the property with a real estate broker, and showing the property to prospective lessees.²⁹⁷ Second, a lessor generally has a duty to accept a new lessee sought out and found by the original lessee and offered to the lessor.²⁹⁸ However, under the following circumstances the lessor can justifiably refuse to accept a new lessee offered by the old lessee: (1) the prospective lessee is financially unreliable; (2) the prospective lessee proposes to occupy the premises under terms that vary from the original

²⁹⁴See 1960 U. ILL. L.F. 332, 335; 10 ST. LOUIS U.L.J. 532, 537 (1966).

²⁹⁵45 WASH. L. REV. 218, 225 (1970) (footnotes omitted); see Groll, *Landlord-Tenant: The Duty to Mitigate Damages*, 17 DE PAUL L. REV. 311, 319 (1968).

²⁹⁶Annot., 21 A.L.R.3d at 575-77 (1968).

²⁹⁷*Id.* at 585-87.

²⁹⁸*Id.* at 579-84, 587-89.

tenancy, such as conducting a different type of business, extending the length of the lease, or occupying a greater area of the lessor's property.²⁹⁹ Finally, the question of whether the lessee or lessor has the burden of proving a failure or lack of failure on the part of the lessor to mitigate his damages has been a subject of some debate. The courts are about equally divided between requiring the lessor to prove his exercise of due diligence in reletting the premises and requiring the lessee to prove that the lessor failed to exercise due diligence in reletting the premises.³⁰⁰

2. *Continued Recognition of Lease Coupled With a Reletting*

A second remedy available to the lessor is to continue to recognize the existence of the lease, but re-enter the premises, either by express permission of the lessee³⁰¹ or permission implied by law,³⁰² and relet for the benefit of the lessee. The problems of this remedy surround the fact that the lessee remains liable under the lease, yet cannot regain possession from the second lessee.

This remedy is undesirable from the lessor's standpoint because a cause of action against the lessee for damages does not accrue until the end of the original lease term.³⁰³ The lessor must depend on the continued solvency and availability of his defaulting lessee because an action to recover any portion of the damages will be dismissed as premature if brought before the end of the original term.

This remedy also forces the lessor to run an unjustified risk and leads to an undesirable result. Where the lessor stands aside when the lessee abandons possession, the lease continues to exist, and, along with it, the lessee's liability for rent; but, if the lessor attempts to utilize the premises by resuming possession or reletting them, he will, unless he is very careful, incur the risk of terminating the lease and with it the liability of the lessee for rent, on the theory of: (1) surrender; or (2) exercise of the power of

²⁹⁹*Id.* at 589-94.

³⁰⁰*Id.* at 577-79; 45 WASH. L. REV. 218, 227-28 (1970).

³⁰¹*Hackett v. Richards*, 13 N.Y. 138 (1855); *Ogden v. Rowe*, 3 E.D. Smith 312 (N.Y.C.P. 1854); *Schnebly, Operative Facts in Surrenders*, 22 ILL. L. REV. 117, 127-28 (1927).

³⁰²*Schnebly, supra* note 29, at 126-27, 130-31; 1 AMERICAN LAW OF PROPERTY § 3.99, at 394.

³⁰³*See Harvey, supra* note 19, at 1184.

forfeiture, where that is reserved in the lease; or (3) eviction.³⁰⁴ Many decisions assume that if the lease has been terminated in any of these three ways it necessarily follows that the lessee escapes all liability for loss thereafter accruing to the lessor.³⁰⁵

3. Termination of Lease (*Applicability of Anticipatory Breach Doctrine*)

The above-mentioned assumption that the termination of the lease ends the lessee's liability for rent thereafter accruing leads to a consideration of the third remedy available to the lessor. This remedy allows the lessor to consider the lease terminated and thereby end privity of estate between lessor and lessee.³⁰⁶ A surrender of forfeiture brings to an end the relation of lessor and lessee, and, consequently, prevents the accrual thereafter of any obligation imposed by law by virtue of the lessee's status as lessee. Viewing a lease as a conveyance of an interest in land for a term, the doctrine of "anticipatory breach" cannot be applied to this type of situation because of the view that rent reserved under a lease is not an obligation owing presently, payable in the future, but an obligation arising out of the actual occupancy of the land which is contingent on numerous conditions arising out of the lessor-lessee relationship.³⁰⁷ This view expresses the property nature of this remedy.

However, a lease has a dual nature, creating both privity of estate (a property relationship) between the parties and privity of contract (a contractual relationship) between the parties. This second relationship imposes personal obligations on each of the parties to carry out the terms of any promises or covenants that may be made in connection with the lease. Thus, even if the lessee is no longer liable on the lease because of lack of privity of estate, he may still be liable as a party to a contract. It has been argued that this principle should cause the doctrine of "anticipatory breach" to be applicable where a lessee fails or refuses, after

³⁰⁴See McCormick, *The Rights of the Landlord Upon Abandonment of the Premises by the Tenant*, 23 MICH. L. REV. 211, 212-16 (1925).

³⁰⁵Tiffany, §§ 902, 903, 906.

³⁰⁶1 AMERICAN LAW OF PROPERTY § 3.99, at 394.

³⁰⁷Re McAllister-Mohler Co., 46 F.2d 91 (S.D. Ohio 1930); *People ex rel. Nelson v. West Town State Bank*, 373 Ill. 106, 25 N.E.2d 509 (1940).

abandonment of premises, to pay rent or authorize the lessor to relet the premises:

Assuming the destruction of the *relation* and of the tenant's estate, it is submitted that the landlord's acts [of re-entry or reletting] show no desire on his part to rescind or terminate the *contract* between the parties; they are, on the contrary, perfectly consistent with an intent on his part to hold the tenant liable as for a breach of contract. Usually the tenant's abandonment has been accompanied by some present breach of covenant to pay rent, to repair, or the like, or even if not, his abandonment ought, it seems, to constitute an anticipatory breach, a repudiation in advance of his future obligations under the contract, and hence under the overwhelming weight of authority, the source of a cause of action in favor of the lessor for the value of the further performance of the contract. The value of such performance is of course the amount of the rent for the balance of the term, less the reasonable rental value or the amount received by the landlord upon the reletting.³⁰⁸

A number of jurisdictions have adopted this view of the lessor's rights upon an abandonment of the premises and a refusal to pay rent by the lessee.³⁰⁹ Viewing the lease as a contract as well as a conveyance allows the lessor to recover damages instead of grappling with the problems of rent not yet due. *Galvin v. Lovell*³¹⁰ illustrates this approach. The lessor leased premises to the lessee for a one-year term (Nov. 1, 1947 to Nov. 1, 1948). On May 13, 1948, the lessee gave notice to the lessor of his intention to abandon the lease immediately and thereafter abandoned the premises; at this time the rent was paid up to June 1. The lessor brought

³⁰⁸McCormick, *supra* note 303, at 216-17 (footnotes omitted).

³⁰⁹Grayson v. Mixon, 176 Ark. 1123, 5 S.W.2d 312 (1928); Sagamore Corp. v. Willcutt, 120 Conn. 315, 180 A. 464 (1935); Curran v. Smith-Zollinger, 18 Del. Ch. 220, 157 A. 432 (1931); Chavin v. H. H. Rosin & Co., 246 A.2d 921 (Del. 1968); Wilson v. National Refining Co., 126 Kan. 139, 266 P. 941 (1928); Minneapolis Baseball Co. v. City Bank, 74 Minn. 98, 76 N.W. 1024 (1898); Weir v. Cooper, 122 Miss. 225, 84 So. 184 (1920); Novak v. Fontaine Furniture Co., 84 N.H. 93, 146 A. 525 (1929); Teeter v. Mid-West Enterprise Co., 174 Okla. 644, 52 P.2d 810 (1935); *In re Reading Iron Works*, 150 Pa. 369, 24 A. 617 (1892); Marathon Oil Co. v. Edwards, 96 S.W.2d 551 (Tex. Civ. App. 1936, *error dism.*); Brown v. Hayes, 92 Wash. 300, 159 P. 89 (1916); Jones v. McQuestion, 172 Wash. 480, 20 P.2d 838 (1933); Pollock v. Ives Theatres, Inc., 174 Wash. 65, 24 P.2d 396 (1933); Galvin v. Lovell, 257 Wis. 82, 42 N.W.2d 456 (1950).

³¹⁰257 Wis. 82, 42 N.W.2d 456 (1950).

action against the lessee on May 26. The lessor took possession of the premises after June 1, and attempted unsuccessfully to relet them and during the middle of June started occupying the premises for himself. The Wisconsin Supreme Court modified the trial court's judgment in the lessor's favor for the balance of the rent due under the lease from June 1 to November 1 by cutting the amount to one month's (June) rent. The court held, however, that the lessee's action on May 13, 1948, constituted an "anticipatory breach" of the lease, giving the lessor a right to treat the lease as terminated as far as further performance was concerned and an immediate cause of action for damages caused by the breach. The court also held that the lessor must use reasonable diligence to relet the premises in order to reduce the damages resulting from the lessee's breach of the lease.

The doctrine of breach by anticipatory repudiation should be distinguished from the doctrine of partial breach coupled with renunciation. "Anticipatory breach" presupposes that at the time of renunciation no executory covenant of the lease is due, and, consequently, there is no default in performance. Partial breach of lease coupled with repudiation of the lease presupposes that the covenant to pay rent has matured and that there has been a default in its performance, and considers the question of whether such default, when accompanied or followed by a repudiation of the entire lease, amounts to a total breach of the lease so as to allow the lessor to recover not only the rent in default, but also for damages for failure to pay future rent.³¹¹

Less confusion has arisen in cases where the lessee has breached his executory agreement to execute a lease or has refused to take possession of the leased premises. In these cases courts have uniformly held that the lessor has an immediate cause of action for the full amount of damages, present and prospective, which are the necessary and direct result of the violation of the con-

³¹¹See 11 Williston § 1315; *Bradbury v. Higginson*, 162 Cal. 602, 123 P. 797 (1912); *Sagamore Corp. v. Willcutt*, 120 Conn. 315, 180 A. 464 (1935). The doctrine of acceleration should also be considered in this area. This doctrine recognizes the validity of a provision that upon the lessee's default in the payment of rent or his discontinuing business or the commencement of bankruptcy proceedings against him, the entire rent for the remainder of the term shall become immediately due and payable. See 1 AMERICAN LAW OF PROPERTY § 3.74.

tract.³¹² The courts apply general contract-law principles, holding that no estate has ever passed to the lessee. The measure of damages is the difference between the rent fixed in the lease and the rental value of the premises for the entire term, at the time of the breach, together with such special damages as the lessor may plead and prove to have resulted from the breach.³¹³

C. *Lessee's Bankruptcy as Constituting Anticipatory Breach*

A problem similar to that dealing with breach of a lease by anticipatory repudiation arises in cases involving a bankrupt lessee. It involves the question of whether the lessor has a provable claim for future rental losses when the trustee in bankruptcy refuses to adopt the lease.

As far as contracts in general are concerned, it is well established that a promisee can file a claim for anticipated losses due to the promisor's bankruptcy. Two different bases have been advanced for this right in the promisee. The view of the federal judiciary has been that a provable claim against the bankrupt party to the contract exists because bankruptcy operates as an "anticipatory breach" of the contract.³¹⁴ On the other hand, the American Law Institute has taken the position that although bankruptcy of the promisor is not an "anticipatory breach" of his obligations under the contract, his contractual obligation is capable of evaluation and should be provable.³¹⁵ Under either theory, however, the result is the same. Although originally treated quite differently, a real property lease has now been brought into alignment with other executory contracts in so far as bankruptcy is concerned.

Under the Federal Bankruptcy Act of 1898, a lessor had no provable claim against the bankrupt lessee's estate for rent accruing after the filing of the petition in bankruptcy when the lease was not assumed by the trustee. The basis for this was the same

³¹²*Monger v. Lutterloh*, 195 N.C. 274, 142 S.E. 12 (1928); *Simon v. Kirkpatrick*, 141 S.C. 251, 139 S.E. 614 (1927); *Massie v. State National Bank of Vernon*, 11 Tex. Civ. App. 280, 32 S.W. 797 (1895); *Oldfield v. Angeles Brewing & Malting Co.*, 62 Wash. 260, 113 P. 630 (1911); *Annot.*, 137 A.L.R. 432 (1942).

³¹³*Simon v. Kirkpatrick*, 141 S.C. 251, 139 S.E. 614 (1927).

³¹⁴*Central Trust Co. v. Chicago Auditorium Ass'n*, 240 U.S. 581 (1916); see 3A COLLIER ON BANKRUPTCY § 63.31 (14th ed. 1969).

³¹⁵RESTATEMENT OF CONTRACTS § 324 & comment (1932).

reason advanced by courts adopting the rule that there can be no breach of a lease of real property by anticipatory repudiation: future rent reserved under a lease is not an obligation owing presently, but an obligation not owed until the time stipulated for the payment arrives.³¹⁶

Not only was future rent, as such, not a provable claim in bankruptcy, but also, courts consistently held that a covenant in a lease giving the lessor the right to re-enter and relet the premises and providing that the lessee should indemnify the lessor against any loss of rent incurred by such termination, could not be made the basis of a proof of debt against the estate of the lessee in bankruptcy for future rent because of the contingent character of the claim, regardless of whether the re-entry occurred before the filing of the bankruptcy³¹⁷ or after.³¹⁸ Neither could such a claim for future rent be successfully maintained where the lease provided for ipso facto termination upon bankruptcy of the lessee and gave the lessor a right to recover an amount equal to the rent for the balance of the term.³¹⁹ However, where the lease provided that the bankruptcy of the lessee would ipso facto terminate the lease and that the lessor would be entitled to recover an amount equal to the rent reserved for the balance of the term, less the fair rental value of the premises, a claim based on such amount was held provable on the theory that the provision was for liquidated damages and not for rent reserved under the lease or for a penalty.³²⁰ Although technically sound,³²¹ this distinction was opposed to policies underlying the disposition of bankrupt estates and was changed by amendments to the Bankruptcy Act.³²²

In 1934 the Bankruptcy Act was amended³²³ by adding a clause which made provable "claims for damages respecting executory contracts including future rents, whether the bankrupt be an individual or a corporation." The amended Act was construed to give

³¹⁶*Manhattan Properties v. Irving Trust Co.*, 291 U.S. 320 (1934), *rehearing denied*, 292 U.S. 607 (1934).

³¹⁷*Miller v. Irving Trust Co.*, 296 U.S. 256 (1935).

³¹⁸*Manhattan Properties v. Irving Trust Co.*, 291 U.S. 320 (1934), *rehearing denied*, 292 U.S. 607 (1934).

³¹⁹*Kothe v. R. C. Taylor Trust*, 280 U.S. 224 (1929).

³²⁰*Irving Trust Co. v. A. W. Perry, Inc.*, 293 U.S. 307 (1934).

³²¹See 1 AMERICAN LAW OF PROPERTY § 3.98, at 389.

³²²*Bennett, The Modern Lease—An Estate in Land or a Contract (Damages for Anticipatory Breach and Interdependence of Covenants)*, 16 TEX. L. REV. 47, 60 (1937).

³²³Act of June 7, 1934, ch. 424, 48 Stat. 911, 923.

a lessor a provable claim for damages, subject to a limitation on the amount of the claim, where the trustee in bankruptcy elected to reject the lease.³²⁴ A lessor had a provable claim under these circumstances whether the lease contained a covenant of indemnity or not.³²⁵

The 1934 Amendment was changed in 1938 to read as follows :

Debts of the bankrupt may be proved and allowed against his estate which are founded upon . . . (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property: *Provided, however,* That the claim of a landlord for damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever occurs first, whether before or after bankruptcy, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date. . . .³²⁶

Therefore, today, a lease of real property is treated as other contracts are in so far as the doctrine of breach of anticipatory repudiation is concerned, with the exception of the limitation on the amount of the claim.³²⁷ It has been said that, "where the transaction actually amounts to a lease . . . § 70b [of the Bankruptcy Act] applies to such lease the same rules enunciated with respect to executory contracts in general."³²⁸ *In re Winn Shoe Co.*³²⁹ points out the distinction between the Bankruptcy Act's treatment of a lease of real property as a contract for the purpose of applying the "anticipatory breach" doctrine and the common law treatment of a lease as a conveyance rather than a contract. In that case the lessee was adjudicated a bankrupt and the trustee rejected the lease. The lessor re-entered and relet the premises. The lease contained no covenant relating to reletting or indemnity and the

³²⁴*Rocky Mountain Fuel Co. v. Whiteside*, 110 F.2d 778 (10th Cir. 1940).

³²⁵*City Bank Farmers Trust Co. v. Irving Trust Co.*, 299 U.S. 433, 441 (1937).

³²⁶11 U.S.C. § 103(a) (9) (1964).

³²⁷For a discussion of this limitation, see Bennett, *supra* note 327, at 60-61.

³²⁸4 A COLLIER ON BANKRUPTCY § 70.44[4], at 548 (14th ed. 1969).

³²⁹7 F.2d 713 (2d Cir. 1937).

trustee contended that under the law of the situs (Maine), the lessor's re-entry and reletting effected a surrender by operation of law and released the bankrupt from any further liability for future rents. The court rejected the trustee's contention, stating that it was unnecessary to consider the dispute as to the state law because the 1934 Amendment to the Bankruptcy Act (also found in the present Bankruptcy Act) had made provable the claim of a lessor for injury resulting from the rejection by the trustee of an unexpired lease of real estate, notwithstanding the re-entry and reletting.

VIII. IMPOSSIBILITY OF PERFORMANCE AND FRUSTRATION OF PURPOSE DOCTRINES

The connected doctrines of impossibility of performance and frustration of purpose have long been a part of the law of contracts. They also play a part in the law of real property leases. A portion of this section acts as a companion to Section IV. There the subject of leases rendered impossible to perform because of existing legal impediments was discussed under the heading of Illegal Contracts; here the subject of leases rendered impossible to perform because of supervening legal impediments is discussed.

A. *Contract Principles*

The early English common law did not recognize impossibility as an excuse for failure to perform a promise on the basis that the parties could have provided against any and all contingencies, and, if they did not do so, the law would not remake their bargain for them.³³⁰ This attitude reflects the theories of freedom of contract and stability of contracts, discussed earlier,³³¹ which have been so engrained in the law of contracts. Gradually, however, the judiciary has departed from this position in certain areas.

There are three classes of cases in which it is well settled today that the promisor will be excused from performance unless he either expressly agrees in the contract to assume the risk of performance, whether possible or not, or the impossibility is due to

³³⁰Paradine v. Jane, Aleyn 26, 82 Eng. Rep. 897 (1647); 3 J. Kent, COMMENTARIES 466 (14th ed. 1896).

³³¹See Section VI-A *supra*.

his fault: (1) impossibility due to domestic law; (2) impossibility due to the death or illness of one who by the terms of the contract is to do an act requiring his personal performance; and (3) impossibility due to fortuitous destruction or change in character of something to which the contract relates, or which by the terms of the contract is made a necessary means of performance.³³² When the word "impossibility" is used, extreme and unreasonable difficulty, expense, injury or loss is meant, rather than scientific or actual impossibility.³³³ A fourth class of cases, which does not fall strictly within the boundaries of impossibility, has emerged as being subject to the same principles as the first three. The name "frustration of purpose" has been given to this class.³³⁴ Performance remains literally possible, but the entire value of the performance to one or more of the parties and the basic reason for entering into the contract has been destroyed by a supervening and unforeseen event. Two conditions must be present before this doctrine will be applied: (1) the risk must be one that the parties would not have expected the promisor to assume if they had considered the matter in advance; and (2) the frustration must be full and complete—it is not sufficient that the contract is rendered unprofitable by the subsequent change of circumstances.³³⁵

B. *Real Property Leases*

1. *Impossibility Due to Domestic Law*

The doctrine of impossibility of performance³³⁶ has been applied in the leasehold area when domestic law renders any further permissible use of the premises illegal. This doctrine will apply only where the use of the premises is restricted to that use which becomes illegal because of the enactment of legislation by the federal, state or local government. If only one of several permissible uses

³³²See 6. S. Williston, A TREATISE ON THE LAW OF CONTRACTS § 1935, at 5418-19 (rev. ed. S. Williston & G. Thompson 1938).

³³³*Id.* § 1931, at 5410.

³³⁴*Id.* § 1935, at 5418-19.

³³⁵See 43 MICH. L. REV. 598 (1944).

³³⁶It is arguable that the correct doctrine applicable to this situation is "frustration of purpose." Since the lessee is not ordinarily required to occupy and use the premises, and since he can still pay rent, performance of his obligation has not been rendered truly "impossible." See 1 AMERICAN LAW OF PROPERTY § 3.104, at 401.

becomes illegal, the doctrine will not apply.³³⁷ If the statement of uses in the lease is permissive and not restrictive, legislation making the use illegal will not result in application of the doctrine of impossibility.³³⁸ And, if what is made illegal may be made legal through administrative or judicial action, the doctrine will not apply.³³⁹

The Eighteenth Amendment to the United States Constitution, prohibiting the manufacture, sale or transportation of intoxicating liquors, brought the doctrine of impossibility into play. *Industrial Development & Land Co. v. Goldschmidt*³⁴⁰ illustrates the effect of this Amendment on certain leases. In 1915 the lessor leased to the lessee premises for a term of five years, restricting the use of the premises to that of a winery and wholesale and retail liquor business. When the Eighteenth Amendment became effective, the lessee tendered the unpaid rental up to that effective date and considered the lease terminated. The lessor sued for the rent owing for the remainder of the term, arguing that a lessee is not relieved from his contract because the only use to which the premises may be put becomes thereafter unlawful. The court, recognizing the authority sustaining the lessor's position, stated that the lessee's position ". . . places the argument on a sounder basis, and points to a fundamental rule of the law of contracts,"³⁴¹ and held that the lease was terminated by the Amendment and the lessee was liable for rent only until its effective date.

Restrictions on the importation and sale of enemy goods during World War II also brought the doctrine of impossibility into play. in *119 Fifth Avenue, Inc. v. Taiyo Trading Co.*³⁴² the lessor, in 1940, leased premises to the lessee for three years by a lease restricting the use of the premises to the sale of Japanese, Chinese and Oriental goods. After the attack on Pearl Harbor, the Alien Property Custodian, acting pursuant to government authority, pad-

³³⁷1 AMERICAN LAW OF PROPERTY § 3.44 n. 4, at 266.

³³⁸*Id.* n. 6 & 7.

³³⁹*Id.* n. 11.

³⁴⁰56 Cal. App. 507, 206 P. 134 (1922); *accord*, *Kaiser v. Zeigler*, 115 Misc. 281, 187 N.Y.S. 638 (Sup. Ct., App. Term 1921); *Doherty v. Monroe-Eckstein Brewing Co.*, 198 App. Div. 708, 191 N.Y.S. 59 (1921).

³⁴¹206 P. at 135.

³⁴²73 N.Y.S.2d 774 (Sup. Ct., Special Term 1947), *aff'd*, 275 App. Div. 695, 87 N.Y.S.2d 430 (1949); *accord*, *Schantz v. American Auto Supply Co.*, 178 Misc. 909, 36 N.Y.S.2d 747 (Sup. Ct. 1942); *Gardiner Properties, Inc. v. Samuel Leidner & Son, Inc.*, 279 App. Div. 470, 111 N.Y.S.2d 88 (1952).

locked the premises and took possession of the contents. The lessee, although a domestic corporation, was a foreign national, since a majority of its stock was owned by Japanese nationals. The lessee vacated the premises and refused to pay further rent; therefore, the lessor sued for accrued rent. The court applied the doctrine of frustration of purpose to the facts, stating:

. . . [T]here are cases which refuse to apply the doctrine of frustration to leases, on the ground that an estate is conveyed to the lessee which carries with it all the risks. . . . [But] the modern cases apply the doctrine to all contracts, including leases, especially where, as has been stated, there has been a total or nearly total destruction of the purpose for which, in the contemplation of the parties, the lease was executed. . . . Similarly, the courts of this state have repeatedly applied the doctrine to leases.³⁴³

On the state level, as on the federal, prohibition caused the doctrine of impossibility to become connected often with real property leases. *Greil Bros. Co. v. Mabson*³⁴⁴ illustrates the way court have dealt with the leasehold problems caused by state prohibition. In 1907 the lessor leased premises to the lessee "for occupation as a bar and not otherwise." Alabama passed a prohibition act in 1909, whereupon, the lessee vacated the premises, claiming that the lease was ended. When the lessor sued to recover rent accruing after the effective date of the prohibition act, the Alabama Supreme Court ruled in favor of the lessee, holding that the fact forbade the very business and purpose for which the property was leased, and, that, under general contract law principles, the lessee-promisor was relieved of his obligation to pay rent.

In the area of eminent domain, it is generally held that when the entire leased premises are taken the lessee's covenant to pay rent is discharged.³⁴⁵ One theory that has been used to justify

³⁴³73 N.Y.S.2d at 778.

³⁴⁴179 Ala. 444, 60 So. 876 (1913); *accord*, Kahn v. Wilhelm, 118 Ark. 239, 177 S.W. 403 (1915); Hooper v. Mueller, 158 Mich. 595, 123 N.W. 24 (1909); Heart v. East Tennessee Brewing Co., 121 Tenn. 69, 113 S.W. 364 (1908); The Stratford, Inc. v. Seattle Brewing & Malting Co., 94 Wash. 125, 162 P. 31 (1916); Brunswick-Balke-Collender Co. v. Seattle Brewing & Malting Co., 98 Wash. 12, 167 P. 58 (1917).

³⁴⁵2 P. Nichols, THE LAW OF EMINENT DOMAIN § 5.23[3], at 5-98 (3d ed. J. Sackman & P. Rohan 1970).

this result is that of impossibility of performance. In *2814 Food Corp. v. Hub Bar Building Corp.*³⁴⁶ the lessor leased premises to the lessee for ten years for use as a supermarket with an option in the lessee to renew the lease for eleven years. While the lessee was making installations of improvements, and had not yet gone into possession, the city gave notice of intent to condemn the land for school purposes. The lessee sued the lessor for a return of rent paid and the court rendered judgment for the lessee, holding that the action of the city in condemning the property frustrated the lease contract of the parties.

The New York *Multiple Dwelling Law* was held in *O'Neil v. Derderian*³⁴⁷ to bring a lease to an end on the basis of impossibility of performance. The lessor had leased a building to the lessee "to be used and occupied only for furnished rooms." When this use subsequently became illegal because of the enactment of the *Multiple Dwelling Law*, it was held, when the lessor brought suit for rent accruing after passage of the *Law*, that the lease was ended because its purpose had become prohibited.

Municipal regulations have also had the effect of ending a lease on the basis of impossibility of performance. In *McCullough Realty Co. v. Laemmle Film Service*³⁴⁸ the lessee leased premises "for Film Exchange and theater supplies purposes only." During the term of the lease, Davenport, Iowa, where the premises were located, passed an ordinance making it unlawful to manufacture, keep, store, handle, or repair any inflammable motion picture films in buildings that were not fireproof. The building under lease fell within the prohibition of the ordinance. The lessee was able to prove that ninety-seven percent (97%) of its business was handling films. When the lessor sued to collect rent, the court agreed with the lessee that its obligation to pay rent terminated because it was deprived of the beneficial use of the premises due to a subsequent change in the law.

In *Manger v. Mills*³⁴⁹ the lessee had leased a pier to be used "for the purpose of landing passenger boats only." During the term of the lease the Village of Rye, New York passed an ordinance which prohibited the lessee from using the pier unless the

³⁴⁶59 Misc.2d 80, 297 N.Y.S.2d 762 (Sup. Ct., Trial Term 1969).

³⁴⁷138 Misc. 488, 246 N.Y.S. 341 (N.Y. City Mun. Ct. 1930).

³⁴⁸181 Iowa 594, 165 N.W. 33 (1917).

³⁴⁹137 Misc. 535, 242 N.Y.S. 705 (N.Y. City Ct., Special Term 1930).

written consent of the village trustees was first obtained. The lessee applied to the trustees for permission and was refused. Later, when the lessor sued for unpaid rent, the court ruled in favor of the lessee on the basis that the passage of the law subsequent to the execution of the lease rendered performance of the lease impossible.

In *Hizington v. Eldred Refining Co.*³⁵⁰ the lessee leased premises "for the distribution and sale of gasoline, oil, greases and petroleum products." During the term of the lease the Syracuse, New York, Commissioner of Public Safety adopted various regulations governing storage and handling of gasoline and other explosives. The leased premises could no longer be used for the purposes for which they were rented without violating these regulations. When the lessor sued the lessee for unpaid rent, the court agreed with the lessee that the lease had become void and no recovery could be had on it.

2. *Impossibility Due to Destruction of Premises*

The doctrine of impossibility of performance³⁵¹ has also been applied in the leasehold area when there is a destruction of the premises. That the doctrine has been adopted demonstrates a dissatisfaction with the common law rule generally applied in this area: a lease is not terminated by the destruction of a building on the leased premises, although the building may be the principal subject matter of the lease.³⁵² One reason behind this general rule is based on the view that a lease is a conveyance and not a contract. Since the lessee has received his estate upon execution of the lease, he is the owner of a term and must pay, in the form of rent, for what he has purchased.³⁵³ A second reason for the general rule is based on the view that rent issues out of the land, and, so long as the land remains, the lessee's obligation to pay rent continues.

There are several reasons why this rule is a harsh one.³⁵⁴ First, although the lessee may insure his interest, the lessee of a short term often does not, causing any loss due to a destruction of the

³⁵⁰235 App. Div. 486, 257 N.Y.S. 464 (1932).

³⁵¹See note 336 *supra*.

³⁵²1 AMERICAN LAW OF PROPERTY § 3.103.

³⁵³*Id.*

³⁵⁴*Id.* at 398.

premises to fall heavily on him. Second, the lessor is usually in a better position to carry the risk of loss. And, third, the lessee does bargain for the day-to-day use of the premises. These reasons have caused American courts to depart from the general rule in some areas and apply the doctrine of impossibility of performance.

This doctrine is applied when there is a destruction of the realty that forms the subject matter of the lease. In *Waite v. O'Neill*³⁵⁵ the lessor owned lots, one side of which consisted of a river bluff which descended to a "footing" or "landing" which was below the high water mark of the river but above the low water mark of the river. This "landing" was leased to the lessee for the purpose of mooring, storing and unloading coal, wood and ice barges or boats. During the term of the lease certain government works up the river gave way because of a strong current and high water, causing an uncontrollable current to pound the bluff, causing it to collapse. The "landing" was completely destroyed. All that remained of the lessor's lots was a narrow fringe that presented a vertical bluff eighty feet above water which, because of its depth and strength of current, made it dangerous to land barges or boats. The lessee treated the lease as terminated; the lessor then sued to recover the rent for the balance of the term. The trial court's determination that the lease continued and was not terminated by the destruction of the "landing" was reversed by the United States Circuit Court of Appeals. In holding that the lease was terminated by the destruction of the "landing," the court pointed out that the general rule applied in cases where improvements upon realty are destroyed is based on the theory that the subject of the lease is the land, the improvements being a mere incident. But in this case, since the subject matter of the lease was the "landing," its destruction caused the lease to end and ended the lessee's liability for rent.

The doctrine of impossibility of performance is applied when there is a destruction of a building that is leased separate and apart from any realty. In *Davis v. Shepperd*³⁵⁶ the lessee leased

³⁵⁵76 F. 408 (6th Cir. 1896); *accord*, *Gamble-Robinson Co. v. Buzzard*, 65 F.2d 950 (8th Cir. 1933).

³⁵⁶196 Ark. 302, 117 S.W.2d 337 (1938); *accord*, *Pizitz-Smolian Co-op Stores v. Randolph*, 221 Ala. 458, 129 So. 26 (1930); *Whittaker v. Holmes*, 165 Ark. 1, 263 S.W. 788 (1924); *Norman v. Stark G. & E. Co.*, 237 S.W. 963 (Tex. Civ. App. 1922, *error ref'd*).

the "business house located on the E ½ of Lot 4 in Block 2 on Main Street in the City of Clarksville, Arkansas." When the building was destroyed by fire during the lease, the lessee refused to pay rent accruing thereafter, and the lessor sued to recover this rent. The Arkansas Supreme Court held that there is a well recognized exception to the general rule to the effect that where performance depends on the continued existence of the building leased and the building is destroyed so that it cannot be used for the purposes for which it was leased, the consideration for the lease contract fails and the lessee is no longer obligated to pay rent.

The same rule is applied when only a portion of a building is leased. In *Ainsworth v. Ritt*³⁵⁷ the lessor owned a building located on ground owned by the City of Stockton, California. The lessee leased the west half of the building. One month after the lease was executed, the building was demolished by a third person without the consent of either the lessor or lessee. The lessor failed in his effort to recover rent accruing after this demolition, the court holding that since the lease was of a portion of the building and not of the land upon which it rested, a destruction of the building, the subject matter of the lease, terminated the lease and no action could be maintained by the lessor for rent accruing subsequent to the destruction of the building.

In the recent case of *Crowe Lumber & Building Materials Co. v. Washington County Library Board*³⁵⁸ the lessee leased "the street level floor only" of a building which was accidentally destroyed during the term of the lease by fire. The lease contained no provision excusing the lessee from rent in event of fire or other damage, nor any covenant requiring the lessor to rebuild. The court ruled in the lessee's favor in a suit brought by the lessor for rent accruing after the building's destruction. The court reasoned that the lease of a floor in the building did not grant to the lessee any interest in the land, and, in the absence of any covenant to rebuild or any provision regarding termination because of destruction of the premises, the lease was terminated because of the destruction of the subject matter of the lease.

Most of the cases in this area have dealt with the effect of a building's destruction on the lease of a room within the building.

³⁵⁷38 Cal. 89 (1869).

³⁵⁸428 S.W.2d 758 (Mo. Ct. App. 1968).

*Womack v. McQuarry*³⁵⁹ is illustrative of the approach taken by courts to this situation. Here the lessee leased a sawmill and one room in an adjoining factory building from the lessor. Both the sawmill and the factory building were accidentally destroyed by fire. Upon the lessee's refusal to pay rent, the lessor sued to recover rent accruing after the fire. The court held that the lessee was still liable for the rent on the sawmill, but was not liable for the rent on the room in the adjacent building which had been destroyed. The court adopted the general rule in holding the lessee liable for rent on the sawmill. But as to the lessee's liability on the room in the building destroyed, the court said:

There are, however, some . . . cases in which an exception to this [general] rule has been held to exist. . . . This exception applies only to cases where the demise is of part of an entire building, as a cellar or upper room; and it is founded upon the idea that in such cases it is not the intention of the lease to grant any interest in the land, save for the single purpose of the enjoyment of the apartment demised, and that when that enjoyment becomes impossible, by reason of the destruction of the building, there remains nothing upon which the demise can operate.³⁶⁰

Many jurisdictions have enacted legislation dealing with the effect on leases of destruction of the premises. The New York statute is typical of the way many states have modified the general common law rule. It provides:

Where any building, which is leased or occupied, is destroyed or so injured by the elements, or any other cause as to be untenable, and unfit for occupancy, and no express agreement to the contrary has been made in writing, the lessee or occupant may, if the destruction or injury occurred without his fault or neglect, quit and surrender possession of the leasehold premises, and of the land so leased or occupied; and he is not liable to pay to the lessor or owner rent for the

³⁵⁹28 Ind. 103 (1867); *accord*, *McMillan v. Solomon*, 42 Ala. 356 (1868); *Alexander v. Dorsey*, 12 Ga. 12 (1852); *Winston v. Cornish*, 5 Ohio 477 (1832); *Harrington v. Watson*, 11 Or. 143, 3 P. 173 (1884); *Stockwell v. Hunter*, 11 Met. Mass. 448 (1847); *Shawmut Nat'l Bank v. City of Boston*, 118 Mass. 125 (1875); *Graves v. Berdan*, 26 N.Y. 498 (1863); *Moving Picture Co. of America v. Scottish Union & Nat'l Ins. Co.*, 224 Pa. 358, 90 A. 642 (1914).

³⁶⁰28 Ind. at 104.

time subsequent to the surrender. Any rent paid in advance or which may have accrued by the terms of a lease or any other hiring, shall be adjusted to the date of such surrender.³⁶¹

Somewhat different approaches have been taken to the problem in other jurisdictions. The California statute places the duty to make repairs on the lessor, except where the damage is due to the lessee's negligence, and provides that if the lessor fails to repair within a reasonable time, the lessee may vacate and be discharged from liability under the lease.³⁶² The Louisiana statute provides that the lease ends if the property is destroyed by an unforeseen event, and, that if the property is partly destroyed, the lessee may demand a diminution in rent or a revocation of the lease.³⁶³ The North Carolina statute provides that if a building, the use of which was the main inducement to the lease, is destroyed or so damaged that it cannot be repaired except at a cost exceeding one year's rent, the lessee can surrender his estate in the premises within ten days after the destruction and be discharged.³⁶⁴

IX. CONFLICT OF LAWS DOCTRINE

The dual nature of a real property lease plays an important role in conflict of laws problems. Whether the controversy revolves around a property aspect of the lease or a contractual aspect of the lease affects the decision of what law is to be applied in a multijurisdictional situation.

A. *Property Nature of a Lease — Lex Loci Rei Sitae*

Generally, the validity and effect of a transaction by which a

³⁶¹N.Y. REAL PROP. LAW § 227 (McKinney 1945); see also ARIZ. REV. STAT. § 33-343 (1956); CONN. GEN. STAT. ANN. § 47-24 (1960); KY. REV. STAT. § 383.170 (1962); MD. ANN. CODE art. 53, § 39K (1968); MICH. COMP. LAWS § 554.201 (1967); MINN. STAT. ANN. § 504.05 (1947); MISS. CODE § 898 (1956); N.J. REV. STAT. § 46:8-6 to 8-7 (1940); OHIO REV. CODE § 5301.11 (1971); R. I. GEN. LAWS ANN. § 34-18-7 (1956); S. D. COMP. LAWS § 43-32-19 (1967); TENN. CODE ANN. § 64-702 (1955); VA. CODE ANN. § 55-226 (1969); W. VA. CODE ANN. § 36-4-13 (1966); WIS. STAT. ANN. § 234.17 (1957). For construction of these statutes, see 1 AMERICAN LAW OF PROPERTY § 3.103, at 398-99.

³⁶²CAL. CIV. CODE §§ 1941-42 (West 1954); see also MONT. REV. CODE §§42-108, 109 (1961); N. D. CENT. CODE §§ 47-16-12, 13, 14 (1960); OKLA. STAT. tit. 41, §§ 31, 32 (1971).

³⁶³LA. CIV. CODE ANN. art. 2697 (1952).

³⁶⁴N. C. GEN. STAT. § 42-12 (1966).

leasehold interest is created or transferred is governed by the law of the situs of the land—the *lex loci rei sitae*.³⁶⁵ If the right in controversy is in rem, created in the land itself, the law of the situs of the property will control.

B. Contractual Nature of a Lease — *Lex Loci Contractus*

However, if the controversy centers on covenants between the parties to the lease, the contractual rights and liabilities inherent in them are controlled by the proper law of the contract—the *lex loci contractus*.³⁶⁶ This is true although the covenants are contained in a contract affecting realty.

Some authorities take the view that both rights in rem created in the land itself and rights in personam created in the covenants contained in the lease should be governed by the law of the situs of the property. It is argued that such a result provides for maximum certainty and avoids confusion in solving these problems.³⁶⁷ Also, some authorities believe that such a result would be more within the contemplation of the parties.³⁶⁸

The American Law Institute takes the following position on this subject:

The contractual duties imposed on the parties to a deed of transfer of an interest in land are determined, in the absence of an effective choice of law by the parties, by the local law of the state where the land is situated unless, with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6 to the transaction and the parties, in which event the local law of the other state will be applied.³⁶⁹

In the commentary following this section, it is related to leases in the following way:

A distinction must be drawn between a transfer of a leasehold or security interest in the land and contractual questions re-

³⁶⁵H. Goodrich, *CONFLICT OF LAWS* § 148, at 293 (4th ed. E. Scoles 1964); R. Leflar, *AMERICAN CONFLICTS LAW* § 170, at 420-21 (1968).

³⁶⁶Goodrich, *supra* note 365, at § 149, at 296-97; Leflar, *supra* note 365; A. Ehrenzweig, *CONFLICT OF LAWS* § 234, at 614-15 (1962).

³⁶⁷Ehrenzweig, *supra* note 366.

³⁶⁸G. Stumberg, *PRINCIPLES OF CONFLICT OF LAWS* 345 (3d ed. 1963).

³⁶⁹RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 190 (1971).

lated to the transfer of such an interest. The transfer of interests in land is determined by the law selected by application of the rule in § 223 [which applies the law of the situs of the land]. An example of a contractual question related to such a transfer is whether the lessor can mingle with his own funds a deposit made by the lessee as security for the payment of rent. Such contractual questions will be determined by the law selected by application of the rule of this Section.³⁷⁰

1. Priority of Lessor's Lien for Rent

The cases which have dealt with the subject under discussion bear out the position of the American Law Institute. There are certain areas of a real property lease controlled by the *lex loci contractus*. In *Lee Wilson & Co. v. Fleming*³⁷¹ the Arkansas Supreme Court dealt with the priority of a lessor's lien for rent over other liens. The plaintiff-lessor had leased land located in Mississippi to the lessee by a lease entered into in Arkansas. The lease, which ran for one year, reserved rent of \$1750. The lessor agreed to furnish the lessee certain farm equipment for which the lessee agreed to pay an additional rental of \$700. The security for the payment of the rent note and the \$700 was the retention of a lessor's lien upon all crops produced on the land. The lease contained the following clause: "First party [lessor] hereby agrees to waive his rent to any person . . . for the purpose of allowing the second party [lessee] to obtain furnish money, to the extent of . . . \$1500. . . ." The defendant furnished \$935 to the lessee and took the crops produced on the leased land as security, relying on the lessor's waiver. The lessor sued for the amount of the rent note and the \$700, claiming its lien was superior to the defendant's. The court, in holding that the lessor did waive its lien in favor of the defendant, relied on the law of Arkansas, stating that the nature, validity and interpretation of contracts are to be governed by the law of the place where they are made.

2. Covenant to Pay Rent

*In re Newark Shoe Stores, Inc.*³⁷² dealt with the covenant to

³⁷⁰*Id.* comment *e.*

³⁷¹203 Ark. 417, 156 S.W.2d 893 (1941).

³⁷²2 F. Supp. 384 (D.C. Md. 1933). See Stumberg, *supra* note 368, for a criticism of this case.

pay rent found in a lease in a multijurisdictional case. The lessor and lessee entered into a lease of premises located in Chicago, Illinois. The lessor signed the lease in Chicago and the lessee signed it in Baltimore, Maryland. The lease stated that rent was payable in advance in monthly installments. The lessee filed for bankruptcy and adjudication occurred on February 19, 1932. The lessee had not occupied the premises in February or paid the February rent. The referee allowed the lessor's claim for a full month's rent for February. The court upheld this decision on the basis that, under Maryland law, rent was not apportionable as to time. The court relied on Maryland law for the following reasons:

. . . [W]hat occurred was an offer to lease, made in Illinois, which was accepted in Maryland, the latter place thereby becoming the place of execution of the lease. Thus, in so far as the lease created rights in rem in the land, the law of the situs of the land governs; but, in so far as the lease created any rights in personam by virtue of its covenants, the law of the place of execution governs. . . . Therefore, although the duty to pay rent is sometimes said to arise out of the land, it is in fact the covenant to pay rent that is relied upon, that is, the contractual part of the lease, and, therefore, the applicable law is that of Maryland where the contract to lease was made.³⁷³

3. *Covenant to Pay Taxes*

The covenant to pay taxes contained in a lease is governed by the *lex loci contractus*. In *United States v. Warren R. Co.*³⁷⁴ the lessors had leased to the defendant-lessees railroad lines by a lease which obligated the lessees to pay taxes, assessments, and impositions which might legally be made upon the premises leased and to pay and discharge all legal claims which might accrue against the lessors or on account of any matter connected with the lines leased. The United States sued to collect from the lessees income tax owed by the lessors. The court held that, under the lease, the lessees did not undertake to pay income taxes owed by the lessors. This decision was based on the view that contractual obligations created by the lease were determined by the law of the place where the lease was entered into, New York, and, under

³⁷³2 F. Supp. at 384.

³⁷⁴127 F.2d 134 (2d Cir. 1942).

New York decisions, there was no such clear and specific obligation to pay income taxes which would be necessary in order to hold the lessees liable.

4. *Covenant Concerning Security Deposit*

Another area where the *lex loci contractus* controls concerns covenants involving security deposits. *In re Barnett*³⁷⁵ involves a lease concerning land located in Pennsylvania that was executed in New York. The lease contained a clause stating that if bankruptcy proceedings were brought by or against the lessee, the lease would end three days after notice of termination was sent by the lessor to the lessee and all future installments of rent would become immediately due and payable. The lessor held \$1200 as a security deposit for performance of the lessee's covenants. After the lessee became bankrupt, the trustee claimed that the lessor could only take \$625 for accrued rent out of the \$1200 and must return the balance to the trustee. The court held that the provision in the lease giving the lessor the right to recover the total amount of the rent for the term less the rent actually paid upon any default of any covenant was illegal under New York law because such a provision is regarded as a penalty rather than as liquidated damages. The court relied on New York law because the lease was executed in New York and both parties maintained offices and conducted business there; therefore, the covenant in controversy, involving the personal rights of the parties, would be governed by the law of the jurisdiction where the lease was executed, the deposit was made and the rent was payable. This case serves as a good example of a situation envisioned by the American Law Institute where the *lex loci contractus* of a lease controls because a state other than the situs of the property has more significant relationship to the transaction and the parties.³⁷⁶

In *Mallory Associates v. Barving Realty Co.*³⁷⁷ the plaintiff-lessee leased from the defendant-lessor property located in Virginia. Both the lessor and lessee were New York corporations with offices in New York. The lease was executed in New York.

³⁷⁵12 F.2d 73 (2d Cir. 1926), *cert. denied*, 273 U.S. 699 (1926).

³⁷⁶See note 369 *supra* and accompanying text.

³⁷⁷300 N.Y. 297, 90 N.E.2d 468 (Ct. App. 1949), *reh. denied*, 300 N.Y. 680, 91 N.E.2d 331 (1950).

The lease provided that the lessor would hold a security deposit of \$65,000 which could be used toward the purchase of the property and that the lessor would return \$3000 per year until the lease expired, provided the lessee was not in default of any of the terms of the lease. A New York statute³⁷⁸ provided that the security deposit remained the money of the depositor and should be held in trust by the deposittee and not mixed with his personal money. The lessor mixed the deposit with personal money and the lessee sued to recover the deposit on the basis that the statute had been violated. The court upheld judgment in the lessee's favor, stating:

The provision in the lease for the deposit of security is a personal covenant between the contracting parties, creating rights in personam. It is not concerned with the creation or transfer of any interest in real property. The question presented by the instant case relates solely to the rights and liabilities of the parties as a matter of contractual obligation. Accordingly, it is to be determined by the law governing the contract even though the subject matter of the contract may be land in another state.³⁷⁹

X. SUMMARY AND CONCLUSION

The nature of a lease of real property has been evolving since its origin. Early in our legal history, when the great mass of individuals in England were villeins holding land in unfree tenure, the interest involved was that of status. Although the status of the villein holding at the will of his lord was precarious in theory, the force of manorial custom made it more protected in fact. As a result of the introduction of the mortgage into capitalism to provide security for money lending and the effect of the Black Death on the agricultural labor force, the leasehold interest developed into a term of years which created contractual rights in the lessee. The real actions were not originally available to protect a leasehold interest, but, during the thirteenth, fourteenth and fifteenth centuries, actions to protect a leasehold evolved which culminated in the action of ejectment, which ultimately replaced many of the old forms of action and gave the leasehold interest a predominantly

³⁷⁸N.Y. REAL PROP. LAW § 233 (McKinney 1945).

³⁷⁹300 N.Y. at 300-301, 90 N.E.2d at 471.

property characteristic. Since the eighteenth century, however, changes in English and American society have reintroduced a contractual aspect into real property leases that has caused the real property lease to become a blend of property and contract.

The struggle between the property and contractual aspect of leases is evident in the approach taken to covenants contained therein. Unlike the rule in the law of contracts, covenants in real property leases have been generally considered to be mutually independent unless the covenants are so important as to go to the whole consideration of the lease. One device that has been used extensively to bring some flexibility into this area is that of constructive eviction. However, the fact that only the lessee may rely on it and the fact that the lessee must vacate the premises at his peril have limited the utility of this property doctrine. There now appears to be a trend toward implying mutual dependency to important covenants in a lease. Public policy, housing codes and certain state statutes are being used to achieve this result.

The principle of illegality of contract is one that has long been applied to leases executed for certain illegal or immoral purposes, such as the illegal sale of liquor, the illegal conduct of gambling operations and the illegal conduct of prostitution. More recently, leases which violate zoning ordinances have been brought under this rule. And, most recently, this approach has been used in urban areas where residential leases have substantially violated municipal housing codes. The last approach demonstrates the enlargement of traditional remedies given the lessee of sub-standard housing.

This enlargement of remedies available to the lessee of sub-standard housing is also apparent in the area of implied warranty of quality in leases. Based on the view that a lease is a conveyance of an estate in land, the common law rule has been that there is no implied warranty that the premises are habitable or fit for the purpose intended. Although there have long been some exceptions made, such as for a short-term lease of furnished premises and for a lease of premises in the process of construction, not until substantial strides had been made toward implying warranties in other transactions such as sales of personalty, leases of personalty and sales of realty, did any jurisdiction consider implying a warranty of quality in a real property lease. Today, public policy is

beginning to alter this view, and is being strengthened by state statutes and housing codes that are being construed to imply a warranty of quality in leases.

The doctrine involving the unenforceability of unconscionable clauses has had a similar history in leases to that of illegality of contract. For many years the doctrine has been applied to real property leases in the guise of strict construction against the draftsman of the clause. This strict construction approach has been generally limited to clauses attempting to exculpate the lessor from the consequences of his own negligence. In situations where the lessor acts in some capacity other than that of lessor, where his negligence occurs before entry into the lease, where he commits affirmative negligence, where his negligence occurs on premises under his control, or where the injury to the lessee results from negligence occurring off the demised premises, the lessor has not been allowed to rely on an exculpatory clause to release him from liability for his own negligence. More recently, public policy considerations against allowing one to relieve himself of liability for his own negligence, along with the consideration of whether the parties are in an approximate equality of bargaining position so as to prevent the lease from being a contract of adhesion, have been relied on to void exculpatory clauses. Also, several jurisdictions have construed municipal codes or state statutes to void an exculpatory clause.

When a lessee abandons leased premises and refuses to pay rent, two principles of contract law have affected the remedies to which the lessor is entitled. First, although a majority of jurisdictions still recognize the right of the lessor to allow the premises to stand idle and sue for rent as it falls due, a substantial minority have adopted the "mitigation of damages" principle and refuse to allow the lessor to recover damages he could have avoided by exercising reasonable efforts to obtain a new lessee. Second, some jurisdictions have applied the doctrine of "anticipatory breach" and allow the lessor to recover total damages immediately upon breach, based on privity of contract, even though privity of estate may have ended under the circumstances of the case. The Bankruptcy Act now follows this approach by considering the bankruptcy of a lessee to constitute breach of the lease by anticipatory repudiation, assuming the trustee rejects the lease. Consequently, a lessor

can now enter a provable claim in bankruptcy proceedings.

When unforeseen events arise after entry into the lease which frustrate the purpose of the parties in entering into the transaction, the doctrine of impossibility of performance and frustration of purpose may be applicable. Where federal, state or local law enacted subsequent to entry into a lease renders any further permissible use of the premises illegal, the lease comes to an end. Also, although as a general rule destruction of a building on leased premises does not terminate the lease, where there is a destruction of the land, or where only a building or portion thereof is leased apart from the land, a destruction of such premises does terminate the lease. A number of states have modified the general rule by statute in situations where it might otherwise apply.

In a situation where a lease transaction is a multijurisdictional one, because a lease is considered a contract as well as a conveyance, certain areas of the lease are controlled by the proper law of the contract, the *lex loci contractus*. These areas include the various nonconveyancing aspects of the lease, such as priority of the lessor's lien, covenants to pay rent, covenants to pay taxes, and covenants concerning security deposits.

It is difficult to predict the ultimate effect contractual principles will have on real property leases. However, there is little likelihood the law will draw back from the inroads already made. Unless other solutions are found to the contemporary problems surrounding leases, it appears that even greater reliance will be placed on various principles of contract law. The approach of treating a lease solely as a conveyance of an estate has failed to solve many of the problems surrounding leases; likewise, treating a lease as a contract should not be expected to serve as a panacea for these problems. Combined, however, these two aspects of the real property lease make it a more flexible instrument for the parties involved and for contemporary society in general.

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