

Recovering the Landlord's Damages For Breach By the Tenant By Dale Alberstone, Esq.

The recovery of damages for breach of a lease, rental agreement or other contract in the State of California can be summarized in one sentence: The court will place the non-breaching party in the same position he/she would have been in had the other party not breached the agreement. Landlords and law students who understand that concept will sail through the bar examination on questions pertaining to breaches of contract.

The principle is simple enough, but its application is often confusing, which is why about one year of law school is devoted to the law of contracts. Consider, for example, a 12-year lease in which the rent is \$1,000 per month, or \$12,000 per year. If the tenant stops paying rent and vacates the premises at the end of the second year, what is the monetary recovery for which a landlord is entitled?

Simple mathematics would suggest that the recovery of damages should be \$120,000, calculated as follows: \$12,000/year times 10 years equals \$120,000. However, there are three factors which must be taken into consideration.

First, it may be unfair for the landlord to recover 10 years worth of rent from the breaching tenant since the landlord might be able to re-rent the premises and obtain the same, or perhaps more, rent from a new tenant. The law of contracts takes that into account. Specifically, a tenant is entitled to a reduction (or offset) in the amount of rent he owes to the landlord for the unexpired term by the amount which the lessee establishes that the premises could have been re-rented for. That law is found in California Civil Code Section 1951.2. It is a fair law as it prevents the non-breaching party from obtaining a double recovery, that is, rent from the breaching tenant, together with an equal amount of rent from the new tenant.

Second, there will be a reduction in the amount of the award which the landlord receives for rent due over many years to come. In other words, the future rent which the landlord would have received over time must be discounted to a present value.

Reduction to a present value can be understood as follows. If the landlord waited each month to receive the rent from the tenant, at the end of the remaining 10 years, he would have \$120,000, plus interest which accumulated in the bank. If, instead, he obtained the entire \$120,000 up front as an award of damages, and then deposited that money in the bank, at the end of 10 years he would have far more money (due to interest accruing on \$120,000 for 10 years) than he would if he made monthly deposits throughout the 10 years. Thus, the court will reduce the amount of damages to offset the additional interest that the landlord will receive.

That discount is based on the Federal Reserve Bank of San Francisco's rate at the time of the court's judgment, plus 1%. Technically, it is called the worth at the time of the award.

There is another factor which may be confusing. In the recent case of Millikan v. American Spectrum decided on April 22, 2004 by the California Court of Appeal, the appellate court determined that, under certain circumstances, the landlord may sell the property and then recover from the breaching tenant the selling expenses, including the brokerage commission and any prepayment penalty on the landlord's loan. Frankly, this is an amazing case. In Millikan, the tenant leased an entire office building from the landlord. Even though the lease was for 5 years, the tenant vacated on only 30 days of advance notice. Evidently, the landlord could not re-lease the building.

The court found that the tenant could have reasonably inferred that the landlord might not be able to bear the burden of a vacant building indefinitely, and that at some point it was reasonably probable the landlord would elect to sell the building to stem further losses. That is precisely what the landlord did.

The property sold for \$1,217,000 and the landlord paid about \$136,000 in selling expenses,

including \$57,000 as a prepayment penalty on the loan, a brokerage commission of \$73,000 and miscellaneous closing costs of more than \$6,000.

The court determined that had the tenant not breached, the landlord would have been able to retain the building (including its equivalent value of \$1,217,000), and not have paid the nearly \$140,000 of expenses. The court found that it was reasonable to assess the tenant's selling expenses so that the landlord would remain in the same financial condition had the tenant not breached.

CONCLUSION

Landlords need to carefully analyze tenants' breaches, keeping in mind that the court will award the landlord an amount of money to put the landlord in the same position he would have been in had the tenant not breached. With apartment dwellings, this will generally be limited to the rent due over the term of the lease minus what the landlord could re-rent the unit for. That sum of rent will be reduced to present value.

In commercial or industrial buildings, the lost rent is only one measure of the landlord's recovery. The landlord may also be able to reimburse himself for the selling expenses of the building, as occurred in the Millikan case.

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The foregoing discussion is intended solely as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

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