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Avalon Pacific-Santa Ana, L.P. v Hd Supply Repair & Remodel, LLC (2011)

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***Avalon Pacific-Santa Ana, L.P. v HD
Supply Repair & Remodel, LLC (2011) 192
CA4th 1183, 122 CR3d 417***

Lessor could not recover cost of repair damages for lessee's breach of maintenance and repair obligations when lease had neither expired nor been terminated. Similarly, when lease will be in effect for extended term, lessor may recover waste damages before lease expiration or termination only on showing of substantial *and* permanent damage resulting in reduced market value.

Lessee leased property with the intent to demolish existing office space and to establish a Home Depot retail business. The lease had a 10-year term, originally expiring in 2017, but included three 5-year options to extend the term to 2032. Lessor approved a conceptual plan detailing Lessee's planned conversion of the property into a retail facility and on May 15, 2007, delivered the property to Lessee. The home building and construction market began to suffer, and Lessee suspended renovation operations in August 2007, having already begun removing office space walls. Thereafter, the vacant property was heavily vandalized and burglarized, defaced by graffiti, and occupied by homeless people. The fire alarm, lighting, and sprinkler systems became inoperable and landscaping became overgrown. The local municipality issued approximately 15 notices to Lessor demanding it clean up the premises and ultimately fined Lessor for its failure to do so. Lessee began to restore the facility, but hoped to get a subtenant for the property and thus did not restore the property to its original condition at the time of delivery of the property. The cost of restoring the property to its original condition was estimated at \$1 million.

In April 2008, Lessor successfully sued Lessee and/or Home Depot for breach of lease, waste, declaratory relief, and breach of guaranty. At no time did Lessor terminate the lease, nor did Lessee repudiate or abandon the lease. Notably, Lessee never stopped paying the required monthly lease payment of \$50,000.

The jury awarded Lessor damages for both breach of lease and waste. After the jury found that Lessee acted "willfully or maliciously," the trial court trebled the waste damages, resulting in a total damage award of \$2.36 million. The court of appeal reversed.

On appeal, Lessor contended that under the lease terms, Lessee must “*finish* the Retail Facility, *fix* the Premises, *or pay* for the damage.” (Emphasis added.) Both the trial court and the court of appeal held that the lease terms did not require Lessee to complete the proposed renovations. But once Lessee began demolition, it could be found in violation of maintenance, repair, and waste covenants under the lease. Further violations could be found in the damage to the building from theft, vandalism, homeless occupation, and graffiti. Nevertheless, Lessor sought to enforce nonmonetary covenants under the lease while the lease was still in effect. That could only be done by seeking specific performance against Lessee for maintenance and repair obligations—which Lessor did not do. Further, neither California statutory law (CC §1951.2) nor California case law allows a lessor to recover cost of repair damages without first terminating the lease. The reasoning behind this proscription is the concern that a lessor conceivably would receive a windfall, particularly because the lessor need not actually spend the money on repairs, nor would the lessor be able to make repairs (not having legal possession of the property) without the lessee’s consent and cooperation. Further, the lessee might yet make the repairs before lease termination—here, many years later. One exception to this general rule might apply here. The local municipality sought immediate repairs and clean-up and fined Lessor, but Lessor should have sought specific performance, not repair costs. Although a lessor may recover the diminution of a reversionary interest due to a lessee’s breach of maintenance and repair covenants during the lease term, here Lessor provided no evidence of damage to its reversionary interest.

The court of appeal also held that Lessor could not recover for waste, even though Lessee had stopped renovations after demolition of the office space and had failed to secure and maintain the premises, which could constitute waste. Noting that waste constitutes damage to a lessor’s reversion interest (not to a lessee’s present possessory interest), the court held that “damage from waste likely would have to be both substantial and permanent,” resulting in the diminishment or decrease in market value of the property—particularly when, as here, the lease term ends many years later. Thus, the trial court erred by instructing the jury that waste need only cause substantial *or* permanent diminution in market value. The same reasons that bar a lessor from obtaining a windfall by collecting the cost of repairs for breach of maintenance and repair covenants while the lease is in effect also act to bar a lessor from recovery of waste damages based on cost of repairs when a lessee retains possession of the leased property.

The Editor’s Take: A peculiar consequence of leases is that, because the remedies available to one party for nonperformance by the other endure so long, they often change over time. For instance, a tenant who fails to pay the rent should be simply liable for that month’s amount due, but if he has combined his rent default with an abandonment or an eviction by the landlord, then the measure may be altered by virtue of CC §1951.2 into the difference between what he was supposed to pay and what the landlord could get from someone else, or perhaps into some other number if the lease included a rent acceleration clause and the court upheld it.

Property professors have always told their students that the measure of damages for waste by a tenant depends on when the action was brought: A landlord suing after expiration of

the lease can recover the cost of repairs, whereas the recovery of one suing before that time is limited to injury to the reversion, making this decision hardly remarkable. All of the court's rulings of law as to waste, covenants to repair, and covenants to restore completely conform to hornbook law.

That means that a landlord who hopes to recover more (or sooner) than that must have some special language in its lease. Avalon, for instance, needed to have a lease that either required Home Depot to rebuild immediately after demolition, or permitted Avalon to do so itself, or recited some special injuries that would result from leaving the premises unimproved. Under ordinary circumstances, it seems unlikely that the demolition of vacant warehouses would cause much foreseeable harm, even in a shopping center context, so that greater, special damages seem remote.

It is also understandable that a tenant who had already torn down an existing old structure before realizing that the economic tide had turned against it, and who was then trying to assign or sublease those premises to a third party, would prefer to leave the land unimproved until the replacement had been found, so that it could then offer to "build to suit" for the new occupant. Why immediately throw up some new building that might be exactly what the newcomer doesn't want? Leaving the property dilapidated might be malicious waste when its occupant moves into better premises and wants to keep the old premises in bad condition so as to deter the threat of more competition, but not when one is waiting to see what a potential new occupant wants.

I doubt that any kind of provision could have been drafted that would have effectively entitled this lessor to recover the damages it sought while the lease term was unexpired and the existing tenant was continuing to pay the rent. That this lessor succeeded in recovering such a large amount (and, indeed, then having it trebled) in the trial court was an impressive accomplishment, but ultimately unsustainable.—*Roger Bernhardt*