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WHEN THE "BENEFIT OF THE BARGAIN" BREAKS DOWN: WHAT CAN A LANDLORD RECOVER IN DAMAGES FROM A BREACHING TENANT WHEN THE LEASE REMAINS IN EFFECT?

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Historically, a lease agreement is both a conveyance of an estate in real property and a contract between the landlord and tenant that is made in consideration of rent.[1] However, in recent years the primary consideration of many commercial lease agreements has moved away from periodic rent payments to non-monetary obligations secured by the contract, including the tenant's agreement to build significant improvements on the leased property and increase the value of the owner's land over time.[2] In conjunction, lease contracts have increased in complexity and scope, adding more rights and obligations while extending the standard lease term from years to decades.

On the commercial development side, the increase in popularity of the long-term ground lease illustrates this trend.[3] Heightened risks associated with upfront acquisition of property, including variable interest rates, unpredictable labor and material costs, and strict lending requirements, have pushed developers to instead pay property owners rent and shoulder all improvements and maintenance over the life of the lease, commonly with terms of 20 to 99 years. As an alternative to the less predictable world of traditional commercial real estate financing, the ground lease provides stability through contractually determined rent payments and reduced upfront capital costs, as well as flexibility in the form of broad usage rights granted to the tenant.

While providing a device to insulate developers from adverse market trends and giving owners rent income and valuable improvements that generally become the landowner's property at the end of the lease term, the ground lease comes with its own challenges and complexities that do not arise from simple fee ownership. One such challenge faced by landlords of a long-term ground lease is how to deal with tenant breaches of important contract terms while maintaining the valuable stream of rent income promised over the life of the lease. Specifically, whether for lease drafting considerations or inclusion in a

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pre-litigation demand letter, a landlord must know what damages it can obtain if the tenant breaches one of many lease obligations while the lease itself remains in effect.

Generally, a breach of contract entitles the non-breaching party to "the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom."[4] How does a court measure the landlord's injury when the landlord has no present possessory interest in the leased property and only retains a future reversionary interest (i.e., at the end of the lease) in the property it owns?[5]

The court in *Avalon Pacific-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC* addressed the issue in the context of a tenant's maintenance and repair obligation. In *Avalon*, the court held that recoverable damages must correspond to the injury the tenant caused to the landlord's reversionary interest in the leased property.[6] In other words, the landlord can only recover the diminution in value of the property at the end of the lease term caused by the tenant's breach.[7] In the context of a tenant's failure to maintain the leased premises, the *Avalon* court held that the landlord was barred from recovering the actual costs to repair the dilapidated property and instead was limited to the monetary equivalent of the comparative decrease in property value at the end of the lease term reduced to present value.

Over a decade has passed since *Avalon* was decided and significant questions remain. Courts have not clarified the scope of *Avalon*'s holding and how it impacts other provisions that may be breached by a tenant while the lease remains intact, particularly a tenant's improvement obligation.

This article is broken into three parts. First, it will discuss the relevant background principles applicable to a landlord's remedies upon tenant's breach. Next, the article will walk through the evolution of California case law regarding landlord's measure of damages when the tenant breaches but the lease remains in effect. Finally, the article will discuss the uncertainties that remain and provide a recommendation on how to best protect against those unanswered questions until they are concretely resolved by the courts or by statute.

I. Background: Landlord's Election of Remedies Upon Tenant Breach

To elucidate the debate as to what measure of damages should be available to

a landlord, the basic principles of landlord's options upon a tenant's breach must be understood. If a tenant fails to comply with its obligations under the lease, a landlord is faced with a number of remedies that may result in recovering possession of the property, an award of unpaid rent, and/or other types of damages.[8] That decision tree, described further below, changes depending on the type of breach and the specific provisions of the lease agreement implicated by tenant's default. In pursuing these remedies, the landlord generally has the right to sue for breach and collect contractual damages, unless such right is waived or released.

If after breaching the lease the tenant remains in possession of the property, the landlord can (i) terminate and commence eviction proceedings if the breach was material or otherwise eligible for termination under the unlawful detainer statute, (ii) regard the lease as continuing in effect and seek contractual damages for breach, (iii) enforce a liquidated damages provision if it exists, (iv) deduct against the tenant's security deposit to the extent allowable by statute, (v) pursue equitable relief (e.g., specific performance, preliminary or permanent injunction), or (vi) do nothing and risk waiving a claim for breach.[9]

If the tenant has abandoned the property,[10] or if their right to possession is terminated, the landlord can pursue present damages under Civil Code section 1951.2, including (i) accrued rent with interest, (ii) remaining rent for the balance of the term reduced to present value, and (iii) any other amount necessary to compensate for detriment proximately caused by the tenant's breach.[11] If the tenant has abandoned the property, but the landlord does not terminate the tenant's right to possession, and the lease expressly allows for it, the landlord can treat the lease as remaining in effect and sue to collect rent as it becomes due pursuant to Civil Code section 1951.4.[12] The landlord can simultaneously seek damages for any detriment caused by the tenant's breach.[13] Although the landlord has the ability to sue for contractual damages in any scenario, the measure of recoverable damages may change depending on whether the lease remains in effect or is terminated.

There are two primary situations where a landlord will sue for contractual damages while the lease remains in effect: (1) the tenant remains in possession of the property after breaching the lease and the landlord does not seek to terminate; and (2) the tenant breaches the lease and abandons the property and the landlord pursues the remedy under Civil Code section 1951.4, provided the lease agreement complies with statute.

Regarding the first scenario, the breach of a lease covenant is merely grounds for recovery of damages and does not work a forfeiture of estate (i.e., a termination of lease), unless that breach is material.[14] Only a breach that is material (sometimes described as "substantial" or "total") will justify treating the contract as terminated.[15] Although a partial or immaterial breach does not justify termination of the lease, the landlord still has the right to sue for contract damages stemming from that breach.[16] However, when a breach is partial, the landlord may only recover damages for nonperformance up to the time of trial and not for anticipated future nonperformance.[17]

The more likely occasion resulting in a suit for damages while the tenant remains in possession is when the tenant materially breaches the lease but continues to pay rent. For example, if a retailer or developer that is tenant to a 50-year ground lease violates a provision requiring construction of a building or retail store within the first few years of the lease, the tenant may opt to continue paying rent and the landlord-owner may decide to recognize the lease as still in effect, continue to accept rent, and sue for damages over the tenant's failure to build in accordance with the lease agreement.

As to the second scenario listed above, if the tenant refuses to build *and* abandons the property the landlord may similarly treat the lease as active—if the agreement complies with Civil Code section 1951.4—and sue for rent as it becomes due in addition to damages over the tenant's failure to build in accordance with the lease agreement. One primary advantage of suing for rent as it becomes due is the duty to mitigate damages (e.g., reletting the premises) shifts from the landlord to the tenant.[18]

II. Case Law on Recoverable Damages When Lease Remains in Effect

Few published cases have addressed the specific measure of damages available to the landlord while the lease remains in effect. The modern opinions that have ruled on such damages have not fashioned broadly applicable principles and generally cabined holdings to the idiosyncrasies of the case and lease agreement language at issue.

A. *Gold Mining & Water Co. v. Swinerton*, 23 Cal. 2d 19 (1943)

In 1943, the California Supreme Court established the landscape of available damages for lease violations in the pivotal case *Gold Mining & Water Co. v.*

Swinerton (Gold Mining).[19] In *Gold Mining*, plaintiff landlord entered into a ten-year mining lease with tenant-defendants whereby the tenants promised to (i) install and maintain mining equipment and water facilities, (ii) commence operations for the next mining season and operate continuously thereafter, and (iii) pay the landlord rent in the form of a royalty percentage of gross values of all minerals extracted based on a graduated scale.[20] The tenants refused to start mining operations, failed to restore and improve the water system, and repudiated the contract.[21] The Court affirmed the damages awarded by the trial court, set at $25,000 for the reasonable cost of improvements and repairs contemplated by the lease.[22]

In reviewing the damages available to a landlord, the California Supreme Court expressed the rule that after expiration or termination of the lease the landlord may recover cost of repair damages for the tenant's breach of maintenance and repair covenants.[23] This has been termed the "restoration principle" and is a settled rule of recovery in California.[24] In addition, the court recognized the general rule that injury to the landlord's reversionary interest is the measure of damages when the lease has not expired or been terminated:

> Where, during the continuance of the tenancy, the landlord brings an action for the breach of a covenant to repair by the tenant, the measure of damages is generally held to be the amount by which the reversion is injured on account of the property being out of repair. It would not be fair or just, particularly where the lease has a long time to run, to take the amount necessary to put the premises into repair as the measure of the damages; for in such cases, when the damages are awarded to the landlord, he is not bound to expend them in repairs, nor can he do so without the tenant's permission to enter on the premises.[25]

Despite laying out the rationale for reversionary injury damages during the lease term, the court went on to note that, "[i]n some cases, however, it has been held that a landlord is entitled to recover the cost of putting the premises in proper repair, although the action is brought by him before the termination of the lease."[26]

Regarding covenants to improve the premises, the California Supreme Court was similarly inconsistent:

> The general rule is that upon a lessee's breach of covenant to make improvements, a lessor can recover only what it would cost to make them, and the difference in the rental value of the land until they could be made after the expiration of the term. But it is also held that the measure of damages where the lessee removes the improvements he has covenanted to make and leave for the benefit of the lessor is

> the difference between the value of the premises with and without the improvements. Damages for breach of covenant to make an improvement within a specified time within the term have been measured by the injury to the reversion at the end of the term reduced to its present value, or by such sum as, with interest, will produce the fair cost of improvement at the end of the term.[27]

For damages caused by a tenant's failure to improve the premises sought while the lease remains active, the Court did not definitively state whether "the injury to the reversion at the end of the term reduced to its present value" or "the fair cost of improvement at the end of the term" would control.[28]

Ultimately, the California Supreme Court held that when a lease expires or is terminated, as it was by the tenant's repudiation, "the lessor is entitled to recover the reasonable cost of the improvements or repairs which the lessees agreed to make under the terms of the lease."[29]

B. *Sanders Construction Co. v. San Joaquin First Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d 387 (5th Dist. 1982)

Almost 40 years after the California Supreme Court's decision in *Gold Mining*, the Fifth District Court of Appeal was tasked with applying similar damages principles in *Sanders Construction Co. v. San Joaquin First Fed. Sav. & Loan Assn.* (*Sanders Construction*).

However, in 1970—before *Sanders Construction* was decided—the California Legislature, acting pursuant to a recommendation of the California Law Revision Commission, enacted Civil Code sections 1951.2 and 1951.4.[30] Although since 1872 the Civil Code had specified that a lease is a contract, courts still treated leasehold estates primarily as an interest in property subject to certain rules that cut against traditional concepts of contract termination and resulting damages.[31] For example, before the 1970 enactments, if a tenant abandoned the premises during the lease term and a landlord repossessed the property, the landlord was not immediately entitled to full contract damages covering the balance of the term remaining.[32] Instead, the landlord could either (i) terminate the lease and waive recovery of any rent or damages other than those accumulated to date or (ii) relet the premises for the benefit of the vacated tenant and recover the difference in the rental amount *once the lease term was over*.[33]

Civil Code section 1951.2 was meant to "engraft the contract remedy of loss of bargain onto real property law," allowing for recovery of accrued lost rent with interest as well as remaining rent discounted to present value and any

other detriment caused by the tenant's breach.[34] The purpose of the new enactments was to allow for an immediate cause of action for damages upon lease termination with one exception: Civil Code 1951.4 captured the common law "specific performance" remedy allowing a landlord to treat the lease as remaining in effect and collect rent as it becomes due.[35]

In *Sanders Construction*, the landlord leased a portion of an unimproved lot to the tenant for twenty-five years.[36] As part of the agreement, the parties agreed that the landlord would construct a 6,000-square-foot building on the leased lot with a 2,000-square-foot portion designated for use in the tenant's retail bank operation.[37] At first, the tenant agreed to pay for construction costs for its portion of the building with the landlord contributing an initial $140,000.[38] The landlord obtained financing and constructed a foundation, but the tenant then agreed to take over construction and hired a contractor.[39] The tenant thereafter failed to commence further construction and, upon demand to commence building, claimed that the lease had been rescinded.[40]

Finding the tenant in breach and the contract terminated, the court endeavored to apply the standards of Civil Code 1951.2 to the tenant's failed construction of an improvement. At the trial court level, the cost of construction was utilized and the landlord was awarded $164,000 related to the tenant's failure to construct the building.[41] The trial court deducted the estimated cost of construction—$304,000—by the promised contribution amount—$140,000—to determine the landlord's detriment stemming from the tenant's failure to improve the premises as promised.[42] On appeal, the tenant argued that awarding the full value of its cost of construction gave the landlord a windfall and more than it bargained for, since the landlord would not have been able to use the building until the lease expired, twenty-five years after occupancy.[43] Instead, the tenant argued, the landlord was only entitled to the diminution in value of its reversionary interest in the property, which should be discounted to present value.[44]

The Fifth District Court of Appeal agreed with the tenant. The present cost of improvements, the court held, was an erroneous measure of damages because the landlord would not be able to enjoy those improvements until the end of the lease term when the building would have depreciated in real value.[45] Noting that "[t]here is little guidance as to what measure of damages is appropriate" and that "[i]t is difficult to devise a remedy for the loss of reversionary interest," the court ultimately held that even though the lease contract was terminated,

the building should have been valued at the end of the lease and that amount should have been discounted to present value.[46] The court of appeal was guided by the principle that the landlord was entitled to "the full benefit of its bargain, and no more," and went so far as declaring an offset in damages in the tenant's favor due to the loan interest that the landlord would have had to pay on the $140,000 contribution amount.[47]

But what about the *Gold Mining* opinion? As explained above, the California Supreme Court there found that "the lessor is entitled to recover the reasonable cost of the improvements . . . which the lessees agreed to make under the terms of the lease."[48] The *Gold Mining* case also stated the "restoration principle" that California follows whereby the measure of damages after lease termination for the tenant's failure to repair is the actual cost of repair. Under the logic of *Sanders Construction*, a landlord would obtain a windfall if it was awarded the actual costs of repair or improvement when the "benefit of the bargain" only entitles it to the depreciated value of the repairs or improvements at the end of the lease term. *Sanders Construction* did not reconcile these apparent tensions and instead casts its opinion as "attempt[ing] to give some guidance to the trial court on remand" because "[i]t is impossible to be more specific without knowledge of the terms of any subsequent lease and the financing used" where the issue is "as much one of economics as it is of law."[49]

C. *Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th 1183 (4th Dist. 2011)

After *Sanders Construction* was decided, the courts of appeal remained largely silent as to damages resulting from the tenant's breach of an improvement obligation. On the other hand, the "restoration principle" allowing landlords to recover the full cost of repairs after lease termination was further established as a controlling principle of recovery.[50]

In 2011, the Fourth District of the California Court of Appeal continued to develop the landscape of recoverable damages in *Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC* (*Avalon*). In *Avalon*, the landlord and tenant entered into a ten-year lease with three five-year extension options whereby the tenant would demolish existing vacant warehouses and build a new retail facility.[51] The tenant proceeded to demolish the existing structures but a year into the lease, after experiencing a downturn in sales at other locations, ceased all construction at the site.[52] Although it halted construction, the tenant

continued to pay periodic rent and did not abandon the lease.[53] After renovations stopped, the building site was burglarized and vandalized.[54]

Approximately two years after entering into the lease, the landlord filed a lawsuit seeking to recover damages for the tenant's waste and breach of its obligations to maintain the premises in good condition and construct improvements.[55] The trial court ruled that the lease gave the tenant the right to construct improvements but did not impose a duty to do so, barring the landlord's breach claim as to any improvement obligation from moving forward.[56] The remaining claims proceeded to trial.[57] The landlord prevailed, and the jury awarded the full cost of repairing the premises to good condition.[58]

On appeal, the tenant argued that the landlord should not be awarded the full cost of restoring the premises to good condition because the lease remained in effect and the landlord would be receiving a windfall.[59] The court of appeal agreed and reversed the damages award, holding that the landlord's "measure of damages for breach of the maintenance and repair covenants and for waste is the diminution in value of its reversion interest" and concluded that the jury's verdict awarding the full present cost of repair impermissibly allowed the landlord to "hav[e] and eat[] the proverbial cake."[60]

1. *Avalon*'s Reasoning

In denying the landlord's argument that the award of actual repair costs as damages was proper, the court of appeal started with the language of the lease agreement.[61] The section of the lease entitled "Remedies" provided the following:

> If Tenant shall at any time be in default under this Lease beyond applicable cure periods, then Landlord shall be entitled, at its election, to bring suit for the collection of the rent or other amounts for which Tenant may be in default, or for the performance of any other covenant or agreement devolving upon Tenant, all without entering into possession or terminating this Lease.[62]

The landlord argued on appeal that its right to "bring suit for the collection of . . . other amounts for which Tenant may be in default" without terminating included the actual costs of repairing the damage to the premises caused by and/or left unrepaired by the tenant.[63] The court of appeal disagreed. Instead, a reasonable construction of the lease, reasoned the court, construed the reference to "other amounts" to apply solely to specific monetary obligations imposed by the lease on the tenant.[64]

The court of appeal found that its construction of the lease (i.e., cost of repair damages are not recoverable during the lease term) was consistent with statutory and California case law, relying particularly on the California Supreme Court's holding in *Gold Mining*.[65] The court of appeal recited the portion of the *Gold Mining* justifying reversion injury damages while the lease remains in effect, stating specifically that it would be unfair to the tenant to award actual repair costs, especially where the lease has a long time to run, because the landlord is not required to use the damages to actually make the repair and would need the tenant's permission to enter the premises to do so.[66]

The *Avalon* court backed up its conclusion by surveying out-of-state cases, which largely supported the principle that repair costs could not be obtained without an expired or terminated lease.[67] Those cases further developed the reasoning relied on by the court, including that awarding the present repair cost would give the landlord a windfall equivalent of an improvement because the landlord would not rightfully come into possession of the premises until the expiration of the lease term, after the value of repairs made during the term has substantially declined.[68] Further, the entitlement to cost-of-repair damages during the lease term is entirely speculative because the tenant may make the repairs before the lease expires.[69] The rationale, therefore, is based on principles of fairness, avoiding a windfall, and minimizing speculation.

2. The Five *Avalon* Exceptions

The court of appeal analyzed the cases underlying the California Supreme Court's statement in the *Gold Mining* opinion that "it has been held that a landlord is entitled to recover the cost of putting the premises in proper repair, although the action is brought by him before the termination of the lease" and with those cases, along with its survey of various out-of-state cases weighing on available damages while the lease remains in effect, the *Avalon* court identified numerous exceptions to the general "no-cost-of-repairs" rule.

Exception # 1. Recovery of repair costs is allowed when such costs would be less than the diminution in value of the reversion.[70] If the present repair costs are less than the diminished value of the property at the end of the lease term, the landlord would not be receiving a windfall if the repairs costs themselves were used as the measure of damages.[71]

Exception # 2. Recovery of repair costs is allowed when a lawsuit is brought while the lease is in effect but the lease is terminated by the time damages are computed.[72]

Exception # 3 & # 4. Recovery of repair costs is allowed when the landlord makes repairs at its own expense and seeks reimbursement from the tenant.[73] Alternatively, the landlord may recover repairs costs if, after the lease is terminated, the landlord takes possession and makes the repairs.[74]

Exception # 5. Recovery of repairs costs is allowed for immediate repairs that are mandated by governmental authority.[75] Regarding preventative or reparative actions required by laws and orders governing leased premises, if the tenant assumes the duty to institute and pay for such actions, the landlord is allowed to recover actual costs if the tenant fails to do so during the lease term.[76]

In each of these situations, the *Avalon* court held, the justifications for the no-cost-of-repairs rule did not apply, meaning (i) the landlord would not receive a windfall if awarded repair costs, (ii) the landlord had the ability, either as allowed under the lease or after re-taking the property after lease termination, to enter the premises and conduct repairs, and (iii) whether the repairs would actually take place was non-speculative.

III. Recovering Damages for Breach of an Improvement Obligation During the Lease Term

Although the trial court in *Avalon* dismissed the landlord's claim that the tenant breached an obligation to construct a retail facility, the opinion provides helpful guidance for what a landlord can expect if it files suit to recover damages for a tenant's failure to build improvements on the leased premises while the lease remains active. Many of the cases relied on by *Avalon* appear to treat improvements and repairs interchangeably, indicating that the same measure of damages should apply for both. In many ways, the same rationale exists for the "no-cost-of-repairs" rule to similarly apply as the "no-cost-to-build" rule for construction and improvement obligations. However, as discussed further below, significant questions remain.

A. Reconciling *Sanders Construction* with the Restoration Principle

The *Avalon* opinion declared that in reaching its conclusion that reversionary interest damages was the controlling measure for breach of repair and mainte-

nance obligations "[t]he most significant facts, indeed the facts driving our decision, are that [landlord] has not terminated the lease, the lease has not expired, [tenant] continues to pay [landlord] monthly rent . . . and . . . [tenant] has not abandoned the lease."[77] Regarding claims for breach of improvement obligations, the *Sanders Construction* case does not appear to align with *Avalon*'s pronouncement.

The *Sanders Construction* case involved a damages claim in the context of a breached improvement obligation analyzed under Civil Code section 1951.2, which applies to terminated leases.[78] Under the standard of recovery regarding a breached maintenance obligation (the "restoration principle"), the landlord would be entitled to the reasonable costs of repair and not limited to the end-of-term damage to the reversionary interest.[79] However, regarding a breached improvement obligation, *Sanders Construction* holds otherwise in its finding that, even after termination, the landlord's recovery is limited to the depreciated value of the building at the end of the lease term (and not the present costs to construct a new building).[80]

The logic of *Sanders Construction* indicates the end-of-term reversionary injury measure of damages applies to any maintenance or repair claim brought after termination and before the end of the original term. Under the *Sanders Construction* model, diminution in value at the end of the lease term should be the controlling measure of damages regardless of lease termination. Arguably, the landlord's recovery of repair costs is a windfall because they are only entitled to the depreciated value of those repairs at the end of the original term. This is especially true where the tenant's written obligation to maintain and surrender routinely excepts "ordinary wear and tear" from tenant's duty, indicating the landlord understands at signing that repairs will be in a less-than-new state at the term's expiration.

The *Avalon* opinion did not mention the *Sanders Construction* case and no published case after has harmonized the "restoration principle" with the *Sanders Construction* opinion, nor has any published case distinguished repair obligations from improvement obligations in a way that would resolve this apparent tension.

B. Applying the *Avalon* Opinion and Exceptions

The reasoning in *Avalon* may be applicable to a tenant's failure to perform a major improvement project, but no published opinion yet applies the *Avalon*

rationale to an improvement obligation. On the other hand, the qualitative differences between a repair and an improvement may dictate a more restrained approach that bars a landlord from recovering monetary damages based on a breached improvement obligation *at all* while the lease remains in effect.

The three primary rationales for the *Avalon* holding establishing reversionary injury damages as the proper measure (i.e., fairness, avoiding a windfall, and minimizing speculation) are more potent, and potentially overriding, in the context of an improvement obligation. For example, if the tenant agrees to build a retail store for its own business and fails to do so, the tenant may be operating at much more of a loss than in the maintenance and repair context. Similarly, if the tenant's obligations provide sparse details on the actual construction and subsequent operations, fashioning an equivalent value to represent the diminution in value of the property at the end of the lease term risks intolerable speculation and variation from the landlord's actual detriment. The *Avalon* opinion contemplates the use of reversionary interest damages as a way to address the inherently speculative nature of obtaining damages while the lease remains in effect, particularly for covenants that may still be satisfied by the tenant before the end of the term.[81] However, even the use of reversionary interest damages (as opposed to cost-to-build recovery) may not adequately protect the tenant from an overly-speculative request for damages, and a court may see fit to deny recovery to a landlord on those grounds.

Regarding the five exceptions to the reversionary injury rule laid out in *Avalon*, several may apply in the improvement context to justify the landlord obtaining the full cost to build promised additions. As to the first exception, if the costs to build the improvements are less than the diminution in value of the property without the improvement, a court may order the build costs as the appropriate measure of recovery. Regarding the second exception, at least one published case in California has held that once the term of the lease expires, the costs of making improvements the tenant failed to make is recoverable if the landlord enters the premises and makes them unilaterally.[82] However, the *Sanders Construction* case holds that a landlord is only entitled the diminution in value of the promised improvements if the lease is terminated prior to the original expiration date.

The other exceptions described in *Avalon* are less applicable in the improvement context. Exceptions 3 & 4 would allow the landlord to recover the full cost to build improvements if the landlord were to unilaterally construct and

then seek reimbursement from the tenant during the lease term. Many lease agreements include self-help rights for the landlord, but those rights are unlikely to be interpreted as to allow landlord to perform a major construction project in tenant's stead and then bill the tenant for all costs incurred. Not only would the landlord risk violating the implied covenant of quiet enjoyment, it would risk violating other lease provisions pertaining to the promised improvements (i.e., tenant's rights to design choices, signage, and construction choices).

Certain aspects of the *Avalon* opinion appear to be readily transferrable to a tenant's breached promise of constructing improvements, but uncertainty remains as to the applicability of the *Avalon* holding to such a scenario.

C. A Note on Consequential Damages and Specific Performance

Standard lease agreements routinely exclude special and consequential damages from recovery by either landlord or tenant in the case of default. California law distinguishes between general damages and special/consequential damages, whereby general damages are those that "flow directly and necessarily from a breach of contract, or that are a natural result of a breach" and special/consequential damages are those that do not arise directly and inevitably from breach but are derivative losses arising from circumstances that are particular to the contract or to the parties.[83] A tenant may argue that the diminution in value of leased property caused by the tenant's failure to construct promised improvements is a consequential damage not recoverable by the landlord. However, such damages are not categorically consequential, and courts in out-of-state jurisdictions have found that diminution in value of real property may be a direct form of contract damages.[84] Characterizing the damage to the landlord's reversionary interest based on a tenant's failure to build improvements as direct rather than consequential is in line with the modern trend of utilizing lease agreements as a financing and construction tool, rather than simply a means of steady rent income.

In *Avalon*, the court stated that "[t]o enforce the nonmonetary covenants of the Lease, such as maintenance and repair obligations, without terminating the Lease, Avalon's remedy . . . was to sue HD Supply for specific performance."[85] Specific performance of a lease provision is ordered only where the terms of the contract are sufficiently definite and where the duty to be enforced does not require constant supervision by the court.[86] Although a court may order specific performance of simple maintenance and repair work, a court is much less likely

to order specific performance for a major construction project given the (i) successive acts involved in such an endeavor, (ii) the less-than-definite terms included in the lease regarding the improvements, (iii) and need for the court to provide supervision over a continuous effort.

IV. Conclusion and Takeaways

Very few published cases opine on what damages a landlord can recover for the breach of a nonmonetary obligation by tenant while the lease remains in effect and California case law has not yet answered what measure of damages (if any) is appropriate for the tenant's breach of an improvement obligation while the lease remains in effect, and California case law has not yet answered what measure of damages (if any) is appropriate for the tenant's breach of an improvement obligation while the lease remains in effect. Given the increased popularity of long-term ground leases as a tool for developers to construct significant improvements on leased property, the scope of recoverable damages by a property owner in a breach action will need to be clarified by California case law or statute.

The *Avalon* opinion and holding establishing reversionary injury as a touchstone can be interpreted as applying to *any* breach by tenant of a nonmonetary covenant while the lease remains active. However, issues remain to be resolved before a landlord can feel comfortable with the notion that they will be able to recover at least the diminution in value in all tenant breach scenarios. In particular, the rationale underlying the *Avalon* opinion indicates in part that a court may hold a landlord's claim to diminution in value based on a tenant's failure to improve the leased premises as overly speculative and not recoverable.

To guard against this uncertainty, landlords should consider additional lease language, including a specific endorsement of a measure of recovery for particular breaches. For example, regarding the tenant's obligation to build a retail store, the lease should expressly state that (i) the promise to build the store, and the increased value of the leased premises based on the improvement, is material consideration and inducement to enter into the lease, (ii) if the tenant fails to build the store by a date certain, the landlord is entitled to the present costs to construct the improvements (without further discount or deduction), and (iii) any damages based on the tenant's failure to construct the promised improvements are direct damages and not consequential or special. Moreover, landlords should consider drafting specific self-help rights for primary nonmonetary

obligations, including improvement duties, that do not conflict with other lease provisions and provide a clear path to utilize one of the *Avalon* exceptions if the tenant breaches and claims that, at most, landlord can recover injury to its reversionary interest.

In *Avalon*, the court construed generic lease language allowing landlord to "bring suit for the collection of the rent or other amounts for which Tenant may be in default" as *not* allowing landlord to recover the actual costs of conducting repairs and maintenance while the lease remained active.[87] Accordingly, a landlord should opt for specificity to allow the lease language itself to dictate the recoverable damages, rather than undeveloped case law.

To insulate from the unpredictable measure of damages when the lease remains in effect, specificity in drafting is key. With long-term ground leases on the rise, landlords should continue to pay attention to developing case law on the scope of recoverable damages and, in the meantime, implement lease provisions to guard against the current uncertain legal landscape.

ENDNOTES:

[1]*Avalon Pacific-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th 1183, 1190, 122 Cal. Rptr. 3d 417 (4th Dist. 2011); see also Miller & Starr, California Real Estate (4th ed. 2025), § 34:16 (Lease as a contract and conveyance).

[2]Stein, *How Ground Leases Create New Opportunities for Long-Term Real Estate Owners* (Dec. 20, 2024) Forbes, available at https://www.forbes.com/sites/joshuastein/2024/12/20/how-ground-leases-create-new-opportunities-for-long-term-real-estate-owners/ (last accessed May 19, 2026).

[3]13 Cal. Real Estate Law & Practice § 474.06.

[4]Civ. Code, § 3300.

[5]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1190.

[6]*Id*. at 1183.

[7]*Id*.

[8]Miller & Starr, California Real Estate (4th ed. 2025), §§ 34:189, et seq. (Landlord's Recovery of Damages for Tenant Default).

[9]Civ. Code, §§ 1950.7, 1951.2-1951.8; see also 1 MB Practice Guide: CA Landlord-Tenant Litigation 7.03.

[10]See Civ. Code, § 1951.35 (describing requirements for tenant abandon-

ment of commercial real property to include (i) written notice by landlord, (ii) rent default under the lease, (iii) and failure of tenant to dispute abandonment).

[11]*Id*.; see also Miller & Starr, California Real Estate (4th ed. 2025), § 34:189 (Summary and overview of landlord's right to recover damages for tenant breach of lease).

[12]*Id*.

[13]9 Cal. Law Rev. Comm. 417-418 (1968).

[14]*Knight v. Black*, 19 Cal. App. 518, 522, 126 P. 512 (1st Dist. 1912). ("A breach of a condition upon which an estate is granted works a forfeiture of the estate, while a breach of a covenant is merely ground for the recovery of damages"). Whether a breach is material is a question of fact but may be determined as a matter of law if "reasonable minds cannot differ on the issue." *Boston LLC v. Juarez*, 245 Cal. App. 4th 75, 87, 199 Cal. Rptr. 3d 452 (2d Dist. 2016).

[15]*Bos. LLC v. Juarez*, 245 Cal. App. 4th at 82; see Civ. Proc. Code, § 1161 (describing grounds for unlawful detainer).

[16]Compare *Gonzalez v. Bolanos*, 116 Cal. App. 5th Supp. 12, 26, 340 Cal. Rptr. 3d 153 (Cal. App. Dep't Super. Ct. 2025) (tenant's violation of city ordinance was material breach of lease) with *NIVO 1 LLC v. Antunez*, 217 Cal. App. 4th Supp. 1, 5, 159 Cal. Rptr. 3d 922 (App. Dep't Super. Ct. 2013) (tenant's failure to maintain insurance was not a material breach of lease).

[17]*Coughlin v. Blair*, 41 Cal. 2d 587, 598, 262 P.2d 305 (1953).

[18]*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.*, 2 Cal. 4th 342, 365, 6 Cal. Rptr. 2d 467, 826 P.2d 710 (1992); see *In re Lomax*, 194 B.R. 862, 865 (B.A.P. 9th Cir. 1996). Arguably, the shift of the burden to mitigate damages when the lease remains in effect pursuant to Civil Code section 1951.4 applies beyond just the duty to "avoid[] the consequences of the vacancy" and applies to damages stemming from tenant's breach of nonmonetary covenants.

[19]*Gold Mining & Water Co. v. Swinerton*, 23 Cal. 2d 19, 142 P.2d 22 (1943).

[20]*Id*. at 24.

[21]*Id*. at 25-28.

[22]*Id*. at 37.

[23]*Id*. at 38.

[24]*Polster, Inc. v. Swing*, 164 Cal. App. 3d 427, 432, 210 Cal. Rptr. 567 (2d Dist. 1985) ("In the majority of jurisdictions, including California, the restoration principle is employed; i.e., where an action is brought after expiration of a term for breach of a lessee's covenant to keep the premises in repair or to surrender them in good repair or in a specified condition, the measure of damages is the reasonable cost of putting the demised premises into the required state of repair or the condition contemplated by the covenant").

[25] *Gold Mining & Water Co. v. Swinerton*, 23 Cal. 2d at 37-38.

[26]*Id.* at 38.

[27]*Id*. at 37.

[28]*Id*. at 37.

[29]Civ. Code, § § 1951.2, 1951.4 added by 1970 Stats. Ch. 89 (A.B. 2033) *Id*. at 38.

[30]Civ. Code, § § 1951.2, 1951.4 added by 1970 Stats. Ch. 89 (A.B. 2033) https://clrc.ca.gov/pub/1970/M70-001.pdf (last accessed May 19, 2026).

[31]Robinson, D., *Landlord-Tenant Legislation: Revising an Old Common Law Relationship*, McGeorge L. Rev., vol. 2, issue 1 (Jan. 1, 1971), available at https://scholarlycommons.pacific.edu/cgi/viewcontent.cgi?article=1437&context=mlr (last accessed May 19, 2026).

[32]*Id.*

[33]*Id.*

[34]*Sanders Construction Co. v. San Joaquin First Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d 387, 398, 186 Cal. Rptr. 218 (5th Dist. 1982).

[35] https://clrc.ca.gov/pub/1970/M70-001.pdf (last accessed May 19, 2026).

[36]*Sanders Construction Co. v. San Joaquin Frist Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d at 391.

[37]*Id.* at 395.

[38]*Id.* at 394.

[39]*Id.* at 396.

[40]*Id.* at 397.

[41]*Id.*

[42]*Id.*

[43]*Id.*

[44]*Id.* at 398.

[45]*Id.*

[46]*Id.* at 401.

[47]*Id.*

[48]*Gold Mining & Water Co. v. Swinerton*, 23 Cal. 2d at 38.

[49]*Sanders Construction Co. v. San Joaquin Frist Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d at 401.

[50]*Polster, Inc. v. Swing*, 164 Cal. App. 3d at 432.

[51]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1189.

[52]*Id.*

[53]*Id.*

[54]*Id.* at 1192.

[55]*Id.* at 1195.

[56]*Id.*

[57]*Id.*

[58]*Id.*

[59]*Id.* at 1189.

[60]*Id.*

[61]*Id.* at 1200.

[62] *Id.*

[63]*Id.*

[64]*Id.*

[65]*Id.* at 1201.

[66]*Id.* at 1202.

[67]*Id.* at 1204.

[68]*Id.* at 1205.

[69]*Id.*

[70]*Id.* at 1209.

[71]*See Ed Miller & Sons, Inc. v. Earl*, 243 Neb. 708, 716, 502 N.W.2d 444, 451 (1993).

[72]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1209.

[73]*Id.*; *see also Glickman v. De Berry*, 11 S.W.2d 367 (Tex. Civ. App. Austin 1928) ("Where, however, the landlord has made the repairs, or the lease has expired, the rule is that the covenant to repair renders the tenant 'liable to the extent of the amount required to do what he covenanted to do, but did not do' ") (citation modified).

[74]*Id.*

[75]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1209.

[76]*Brown v. Green*, 8 Cal. 4th 812, 822, 35 Cal. Rptr. 2d 598, 884 P.2d 55 (1994); see also *Strecker v. Barnard*, 109 Cal. App. 2d 149, 240 P.2d 345 (1st Dist. 1952) (awarding repair costs to landlord during lease term upon tenant's refusal to comply with government order to install elevator safety measures).

[77]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1189.

[78]*Sanders Construction Co. v. San Joaquin Frist Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d at 397.

[79]*Polster, Inc. v. Swing*, 164 Cal. App. 3d at 432.

[80]*Sanders Construction Co. v. San Joaquin Frist Fed. Sav. & Loan Assn.*, 136 Cal. App. 3d at 399.

[81]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1206.

[82]*Sprague v. Fauver*, 71 Cal. App. 2d 333, 338, 162 P.2d 865 (2d Dist. 1945) ("Since the improvements, changes and additions called for by the terms of the rider were not completed, the plaintiff was justified in securing their completion at reasonable prices and calling upon the defendant in an action at law to meet that expense").

[83]*Lewis Jorge Construction Management, Inc. v. Pomona Unified School Dist.*, 34 Cal. 4th 960, 968, 22 Cal. Rptr. 3d 340, 102 P.3d 257 (2004).

[84]See, e.g., *Latham Land I, LLC v. TGI Friday's, Inc.*, 96 A.D.3d 1327, 948 N.Y.S.2d 147, 152-153 (3d Dep't 2012); *Clymo v. American States Insurance Company*, 2019 WL 2814665, at *3 (D. Or. 2019), report and recommendation adopted, 2019 WL 2774325 (D. Or. 2019).

[85]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1200-1201.

[86]*Blackburn v. Charnley*, 117 Cal. App. 4th 758, 766, 11 Cal. Rptr. 3d 885 (2d Dist. 2004); *Darbun Enterprises, Inc. v. San Fernando Community Hospital*, 239 Cal. App. 4th 399, 405 n.2, 191 Cal. Rptr. 3d 340 (2d Dist. 2015).

[87]*Avalon Pac.-Santa Ana, L.P. v. HD Supply Repair & Remodel, LLC*, 192 Cal. App. 4th at 1200-1201.

