"Use" Provisions in Commercial Leases

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The use provision in a commercial lease is a potential weapon in the hands of a landlord and the tenant.[1] The landlord can seek to terminate the lease, obtain money damages, or enjoin the tenant from using the leased premises in a manner not called for in the use provision. The tenant may rely on the exclusive use provision to attempt to stop the landlord from leasing to another tenant for the same use. The tenant may also apply the use provision to relieve itself of rent obligations when a use is no longer possible. Litigation, generally, falls into two types of disputes: the construction of the restrictive covenant and whether the competing tenant's anticipated or actual use is covered by that covenant. These disputes often overlap. In the vast majority of cases, the question of who wins in these disputes turns on drafting decisions that were made before the dispute arose.

Construction of the landlord's restrictive use provisions is undertaken using general contract interpretation rules.[2] Therefore, the terms must clearly restrict the landlord if the tenant is to prevent leasing to a competitor.[3] For example, in Strong v. Morrison,[4] the question was not the scope of the restrictive use provision (namely, that the lessee shall have the "exclusive grocery privilege in this market . . . ."[5]) but whether the offending tenant was violating the defendant's exclusivity. In that case, because of the defendant's "indefinite state of his own mind as to the exact limits of his exclusive privilege . . . it was certainly his duty to point out to the lessors the specific articles and give them an opportunity to correct the condition."[6] When he could not, he lost.[7] On the other hand, courts have found that a "furniture store" precludes a competing seller of carpets, rugs, and linoleum;[8] and a restriction against the sale of drugs, medicines, and cosmetics includes products that do not require a prescription.[9]

Courts have also utilized the implied covenant of good faith and fair dealing to expand upon the express restrictions of the use provision, typically by expanding the restriction to real property not expressly covered by the lease:

A restrictive covenant, such as the grant of the exclusive mercantile rights to respondents, is not merely ornamental words, inserted to please the eye. It is a living expression of the grantor incorporated in a lease as a consideration for the lessee's faithful performance. Concomitant with such a covenant is the implied obligation of the lessor not to cancel the covenant or derogate from its force by so using his adjoining property as substantially to impair the lessee's enjoyment of the leased premises.[10]

Similarly, a landlord could not build an addition to its shopping center and then lease space to a new tenant who was going to use the space in the same manner covered by a restrictive use provision.[11]

Once a default is found with respect to the lessor's duty to enforce the restrictive use provision, the question becomes what remedies are available to the tenant. If the restrictive use covenant runs to the entire consideration of the lease, then the tenant will be excused from further performance under the lease, including future payment of rent.[12] As with the tenant's exclusive right to operate a drug store in Medico-Dental Building Company of Los Angeles v. Horton & Converse,[13] the restrictive use must be "vital to [the tenant's] successful operation of its business under the circumstances which prevailed . . . ."[14] Further, "[i]n measuring the breach of a covenant not to let for a specified purpose in cases where the objectionable competition is in connection with a business of a character other than that of the party entitled to protection by the lessor, technical subterfuges will be disregarded and the substance of the situation giving rise to the controversy will determine the issue."[15] In Medico-Dental Building, the court found that
even though the competing tenant was designated a medical practice, not a drug store, the fact that the medical practice sold drugs to customers who were not medical patients demonstrated that the restrictive use provision had been violated.[16]

The Landlord’s Duty

The landlord has a nondelegatable duty to uphold that use restriction. The landlord cannot meet its duty to comply with the restrictive use provision by delegating attempted resolution of the competing tenants’ claims to them. “It could not abrogate that obligation, or excuse itself from performance of that duty by seeking to delegate its performance to others, especially to the very persons from whose competition that promise was made for the protection of the plaintiffs.”[17]

Of course, if tenants can agree upon a dividing line between their respective uses, the landlord can limit or eliminate its potential liability. Is the landlord given an opportunity to correct the problem before the tenant is excused from its obligations under the lease? In those situations in which the landlord is only indirectly at fault—that is, it did not instigate a competing use that conflicts with the restrictive use of the premises—then the landlord is “entitled to reasonable notice and time sufficient to enable it to acquire knowledge of the facts, to ascertain whether the condition could be corrected, and if possible to prevent a continued breach.”[18] On the other hand, when the landlord directly violates the restrictive use provision by, for example, entering into a new lease that clearly competes with the restrictive use provision, “the contention that notice and reasonable opportunity to comply with the terms of the covenant are necessary to put the lessor in default, has been rejected.”[19]

A last wrinkle to be considered is whether the tenant’s prior failure to pay rent excuses the landlord’s duty to enforce the restrictive use provision. The answer is yes and no. “Default by the lessee in payment of rentals does not waive the lessor’s performance of the restrictive covenant unless the lease provides expressly or by necessary implication that performance thereof depends upon the payment of rentals.”[20] However, if the lessor opts to terminate the lease following the rental default, there is no further restrictive use obligation. Conversely, if the lessor “elected to consider the lease in force it was bound to an observance of its covenant.”[21] Still, the tenant has an obligation to cure its default:

The plaintiff [tenant], being in default under the lease, was not entitled to rescind without curing his default by tendering the amount due to the time of the claimed breach by the lessor. Breach of the restrictive covenant would not entitle the plaintiff to escape his obligation to pay that portion of the rentals that had accrued to the date of the alleged breach and which he was bound to pay.[22]

The Tenant’s Duties

Landlords often seek to limit tenants’ use of the premises through permitted use provisions. The express provisions of the lease agreement are crucial to any dispute. Although a lease consists of contractual and real property components,[23] it is interpreted like any other contract.[24] In the absence of a specific limitation on the use of leased premises, the tenant may use the property “for any lawful purpose not materially different from that in which they are usually employed, to which they are adapted or for which they were constructed.”[25] Indeed, Civil Code Section 1997.210(b) provides that “[u]nless the lease includes a restriction on use, a tenant’s rights under a lease include any reasonable use of leased property.”[26]

Generally, however, “[r]easonable use restrictions are valid and enforceable.”[27] Section 1997.210 of the Civil Code provides that, subject to certain limitations,[28] a lease may include a use restriction. The Civil Code provides that these restrictions can include an absolute prohibition against change in use by the tenant,[29] that a change in use is
subject to an express standard or condition,[30] and that a change in use is subject to the consent of the landlord.[31]
Any ambiguity in a restriction on use of leased property shall be construed in favor of unrestricted use.[32]

Landlords often include a generalized use provision that precludes the tenant from violating applicable laws:[33] Sachs v. Exxon Company, U.S.A.[34] is an example of how the courts of appeal can give an expansive construction of the “compliance with law” provision, while Deutsch v. Phillips Petroleum Company[35] shows how the courts can narrowly construe the scope of the provision. In Sachs, the landlords asked their tenants for permission to conduct tests at a service station that the tenants had leased from them for several years. The landlords advised the tenants that an environmental expert had told them that there was evidence of soil contamination on the property and that further investigation was needed.[36] When the tenants refused the landlords access to the leased property to conduct those tests, the landlords filed a complaint seeking that right based upon the lease’s provision that the tenants would operate in compliance with law.

The trial court granted the defendant tenants’ motion for summary judgment, but the appellate court reversed, rejecting the tenants’ argument that the landlords must wait until the end of the lease term before taking any action.[37] The appellate court relied upon the tenants’ duty to “comply with all ordinances and laws” and held that the contamination of which the landlords were concerned could support a cause of action under state or federal environmental protection laws.[38] Therefore, because liability under state and federal law “may exist,” the landlords may be subject to liability, and therefore, according to the appellate court, the tenants had breached the applicable covenant.[39]

In determining what remedies should be available to the landlords, the court first held that the assurance that the tenants would not violate any law “is of little benefit to the landlords if they are precluded from assuring themselves that no such violations are taking place, particularly in circumstances in which they reasonably suspect violations.”[40]

Since contamination which would give rise to a violation of environmental law is usually hidden from a layman’s view, the means by which a violation can be ascertained requires the use of expert investigation. Thus, good faith and fair dealing as respects the covenant of lawful activity requires a reasonable means by which the Sachses can assure themselves as to the status of environmental hazards which may be the result of the tenant’s activities.[41]

The appellate court gave instructions that if upon remand the trier of fact determines that further investigation is appropriate, the investigation must be limited to what is reasonably necessary under the circumstances. “We raise this point because we wish to make it clear that the implied covenant we have recognized establishes an objective standard of performance; in the absence of an expressed agreement to the contrary, the Sachses have no right to insist upon satisfaction of any subjective standard of testing or investigation.”[42]

In Deutsch,[43] the appellate court did not allow a landlord to rely upon an expansive construction of a “compliance with law” provision to terminate a lease. The parties’ commercial lease of a gasoline service station provided that the tenant “shall conduct its business on the said demise premises in conformity with all State or Federal Statutes and Municipal Ordinances applicable thereto.”[44] The landlord sought to evict the tenant based upon a final judgment in favor of the United States that found the tenant liable for federal and state antitrust violations.[45] The Deutsch court recognized that “[i]llegal or unlawful activity may be made the basis of a termination of a leasehold by either statute . . . or express covenant,”[46] but held that the “antitrust violation which is the basis of this suit is a violation of a statute which is directed to the conduct of defendant’s business rather than to the premises which are the subject of this lawsuit.”[47] The court held that the “thrust of this covenant is directed to the functional use of the property.” In reaching its decision, the appellate court held that the purpose of the use provision relied upon by the landlord “is to protect the lessor’s interest in the demised premises by limiting the functional use of the property.” Further, “it serves as
an additional assurance to the lessor that the lessee will utilize the demised premises in a manner conducive to the lessor's interest so as to secure the continued payment of the rental obligations. The antitrust violations did not, according to the court, go to the purposes of the use covenant. The court held that the result was consistent with Civil Code Section 1442, which "abhors forfeitures," requiring that forfeiture provisions are to be strictly construed against the party who asserts them.

Similarly, in Rowe v. Wells Fargo Realty Services, Inc., the landlords sought to use the “compliance with law” provision to terminate the lease after their attempt to force an increase in rental payments failed. The landlords sought to “reaffirm” certain building rules that they had not previously submitted to the tenant, including limitations on thermostat adjustments for heating and air conditioning. About one month later, the landlords then sent a Three-Day Notice to Quit based, in part, upon the tenant allegedly “repeatedly us[ing] the premises for unlawful purpose . . . by tampering with the plenum temperature control of the heating and air conditioning system of the property so as to cause the temperature within the premises to lower below the limit allowed by the Department of Energy . . . ’”

Before the landlords’ action went to trial, they took the matter off calendar. However, the tenant then moved for summary judgment. As in the Deutsch case, the court did not find that the tenant’s conduct constituted the type of unlawful conduct precluded by the use provision:

Here, [the tenant’s] alleged violation of the Department of Energy regulation does not threaten the physical safety of the property, nor is it the type of unlawful criminal activity which would stigmatize the premises. Further, [landlords] have not alleged facts to indicate their continued receipt of rent was in any way impaired merely because [the tenant] reset the temperature on the premises.

The appellate court then held that the landlords’ claim was meritless on several levels. The court held that “[unless] the lease specifically limits the use of the property to a particular purpose, or that restriction is necessarily inferred from the language which is employed, the lease may not be forfeited on account of the mere use of the property for another purpose even though that be an illegal use prohibited by statute, for the reasons said forfeitures of leases are not favored by the law.” The court pointed out that the lease limits the use of the property to general office purposes and data processing and that was exactly the function for which the property was being used by the tenant.

An additional twist on the legality of use for the premises occurs when the sole use allowed for the premises becomes unlawful. When that use becomes unlawful, the courts have excused the tenant from further obligations under the lease. Such a situation occurred in the early part of the twentieth century when tenants who were required to use their leased premises for the sale of alcoholic beverages were faced with “Prohibition.” ”A lease restrictive in its terms as to the business permitted to be done upon the premises becomes inoperative upon the event that the law shall prohibit the doing of that business.” In this situation, the trial court first looks to see if the restrictive use is permissive or mandatory, and, if mandatory, whether the governmental order or law makes the use unlawful.

In addition to the application of “compliance of law” provisions, case law also has construed specific restrictive provisions with respect to the tenant’s use of the leased premises. For example, in Purity Stores, Ltd. v. Linda Mar Shopping Center, Inc., the court had to determine whether the tenant’s use provision limiting its operation to the sale of groceries allowed the tenant to sell beer. Relying upon the parties’ predispute conduct, the appellate court found that the tenant’s permitted use provision did not include the sale of beer. In an irony not lost on the court, because the landlord’s restrictive use provision was similar to that of the tenant’s use provision, if the tenant had the right to sell beer, it also had the exclusive right to do so. Because the tenant admitted it did not have the exclusive right to sell beer (in fact, the tenant had allowed a liquor store to open and operate in the shopping center), the parties could not have understood that the tenant’s operation of a grocery store included the sale of beer.
Use provisions are creatures of drafting and must be thoughtfully considered so as to conform to the parties’ understanding. Many of the disputes may be avoided if the drafters use specific definitions for the restricted and allowed uses of the parties.

Restrictions on the use of property can also arise in deeds transferring the fee interest in real property. See, e.g., Boughton v. Socony Mobil Oil Co., Inc., 231 Cal. App. 2d 188, 190 (1965) (Deed prohibiting the dispensing of petroleum products was enforceable); Doo v. Packwood, 265 Cal. App. 2d 752, 756 (1968) (Deed prohibiting the retail sale of groceries was a legitimate restrictive covenant against competition). Restrictions can also apply to subleasing and assignment. See, e.g., Pay ’N Pak Stores, Inc. v. Superior Court, 210 Cal. App. 3d 1404, 1411 (1989). In addition, use restrictions can arise in reciprocal easement agreements; conditions, covenants, and restrictions; as well as exclusive use and/or restriction agreements tailored for the purpose of limiting use of the premises. Pay ’N Pak Stores, Inc., 210 Cal. App. 3d at 1410.

See Carr v. King, 24 Cal. App. 713, 722-723 (1914) (Landlord who was precluded from leasing to another for the same use was not stopped from selling the property to a competitor of the tenant.). But, see, Hudson Oil Co., Inc. v. Shortstop, 111 Cal. App. 3d 488, 497 (1980) (Because the buyer of a property knew that the seller was subject to a restrictive use of the property pursuant to a lease to the plaintiff, the court found that it could enforce the restrictive covenant against the buyer as an equitable servitude.).

Id. at 170.
Id. at 171.
Id.
Kulawitz, 25 Cal. 2d at 669.
Id. at 420.
Id. at 428.
Id.
Hildebrand v. Stonecrest Corp., 174 Cal. App. 2d 158, 164 (1959). A landlord can avoid or limit disputes as to its restrictive use duties by not only avoiding the overlap between the permissive use provisions of one tenant and the exclusive use rights of another but also by expressly precluding tenants from using the premises for uses already exclusively are given to another tenant.
Kulawitz, 25 Cal. 2d at 673.
Id.
Id. at 670.
Id.
Id. at 669.
**“Use” Provisions in Commercial Leases (Continued)**

CIV. CODE §1997.210(b). See generally CIV. CODE §§1997.010, et seq., which apply “to a restriction on use of leased property by a tenant under a lease of real property for other than residential purposes.”


CIV. CODE §1997.220.


Sachs, 9 Cal. App. 4th 1491.


Sachs, 9 Cal. App. 4th at 1493. See also Brown v. Green, 8 Cal. 4th 812 (1994) (Court construed all terms of the lease, including the repair and compliance with laws obligations, to determine whether the landlord or tenant should be responsible for the cost of environmental cleanup).

Sachs, 9 Cal. App. 4th at 1493.

Id. at 1496-97. The court identified the federal Resource Conservation and Recovery Act, 42 U.S.C. §§6901 et seq. and HEALTH AND SAFETY CODE §25359.7.

Sachs, 9 Cal. App. 4th at 1497-98.

Id. at 1498.

Id. at 1499.


Id. at 588.

The original tenant was Tidewater Associated Oil Company, which had subsequently sold various properties, including approximately 3,250 service stations to Phillips Petroleum Company, including one in Encino. Shortly after the acquisition by Phillips, the United States filed an antitrust action against Phillips and Tidewater. Seven years later, the U.S. District Court held that Phillips’ acquisition of the Tidewater assets was a violation of the Clayton Act. That decision was affirmed by the U.S. Supreme Court. On the same day that the Supreme Court affirmed the judgment, the plaintiff/landlord notified Phillips that the landlord was terminating the Encino service station lease based upon the “compliance with law” provision and the Clayton Act violation. Id. at 587-89.

Id. at 589.

Id. at 590.

Id. at 591.

Id. at 592.


The applicable use provision precluded the tenant from doing or permitting to be done “in or about the premises . . . anything which is prohibited by or will any way conflict with any law, statute, ordinance or governmental rule or regulation now enforced or which may hereafter be enacted or promulgated . . . . Lessee shall not . . . use or allow the premises to be used for any improper, immoral, unlawful or objectionable purpose . . . .” Id. at 313.

Id. at 315.

Id.

Id. at 318 [footnote omitted].

Id. (citations omitted).

"Use" Provisions in Commercial Leases (Continued)

Id. at 509.
See Security Trust & Sav. Bank v. Claussen, 44 Cal. App. 735, 737 (1919) (Language that the premises were to be "used for the purpose of conducting and carrying on the business pertaining to a general retail liquor establishment . . ." is permissive not restrictive.).
Id. at 574.
Id. at 573-74.