Real Estate Review

Spring 1982

VOLUME 12, NO. 1

The Real Estate Institute of New York University

WG&L

When is a tenant's default so significant that it warrants lease termination?

People and Property: When Is a Default Material?

Emanuel B. Halper

BIG IRVING AND I had known each other for twenty-two years, and we each considered the other to be a good friend. But until recently I never invited him to my home or introduced his wife to mine.

Although Big Irving is amiable and easy-going, his wife, Marcia, is high-strung and humorless. I should have anticipated that she might say something to my wife that might have been better left unsaid.

Marcia feels that the world has exploited Big Irving and doesn't recognize his obvious talents. To Marcia, Irving is George Washington, Abraham Lincoln, John Wayne, and William Zeckendorf, Sr., all in one. In the eyes of his doting, but other-

Emanuel B. Halper is a partner of the New York City law firm Zissu Berman Halper Barron & Gumbinger and an adjunct professor of real estate at New York University.

This article was adapted from part of his book, *Shopping Center and Store Leases*, as revised by its 1982 supplement.

wise disagreeable, wife, all of the money that Harry Paine has ever made in his life was earned on the back of Irving Gross.

Anyway, we invited the Grosses to Saturday night dinner a few weeks ago.

Anxious to get my wife to herself, Marcia volunteered to help in the kitchen while I sat in the living room sipping Tennessee Sour Mash whiskey with my old pal, Big Irving.

What went on in the living room was as uninteresting as it was unimportant. What has a bearing on this report happened in the kitchen. In the kitchen, Marcia stated her case against Harry Paine. She informed my wife that Harry is the meanest, cheapest, coldest, and greediest man she ever met. His talents consist principally of dominating enormously talented people like her husband and my wife.

She said that she had deep concern for my health because if Harry treats me as badly as he treats Irving, I might be plagued with diseases. She told my wife to check up on my activities and to see to it that I get enough sleep, exercise, and vitamin C.

Marcia's words made an impression that lasted through the week. I soon found a huge inventory of vitamin C in the cupboard, and I was treated to health lectures twice a day.

The health fad spread from home to office. My wife enlisted my partner, Walter Gumbinger, to caution me about my health and my irrational loyalty to Harry Paine. So even Walter, who spends his lunch hours feasting on cheeseburgers and greasy french fries, would corner me several times a day and warn me to take it easy, get plenty of sleep, and watch my diet.

Because of all this, I decided one day last month to go home early for a change. Getting out early would mean getting away from Walter and perhaps appeasing my wife. But, as I was starting out the door, I was informed that Harry Paine was on the phone.

I: Oh, it's Harry! Tell him I'll be right there.

Harry: Do you have an extra shirt?

I: What happened, yours ripped?

Harry: Don't be a wise guy. I hire you to get leases signed, not to crack jokes.

I: Harry, I'm sorry. Of course I have an extra shirt.

Harry: Then put it in your briefcase, and meet me at the Eastern Airlines shuttle in one hour. We're going to Washington.

I: Harry, my extra shirt is at home.

Harry: Then I hope what you have on is wash and wear.

When I met Harry at the airport he told me that we were going to see Brent V. Firestone and his lawyer T.D.Y. (Teddy) Anacdutra. Brent, as no doubt you will remember, is Chairman of the Board of J.B. Smythe, Ltd.

Smythe operates a chain of department stores that features the unfortunate combination of low-quality merchandise and very high prices. Because of these policies, Smythe tends to concentrate its stores in rural areas in which there are few or no competitive stores.

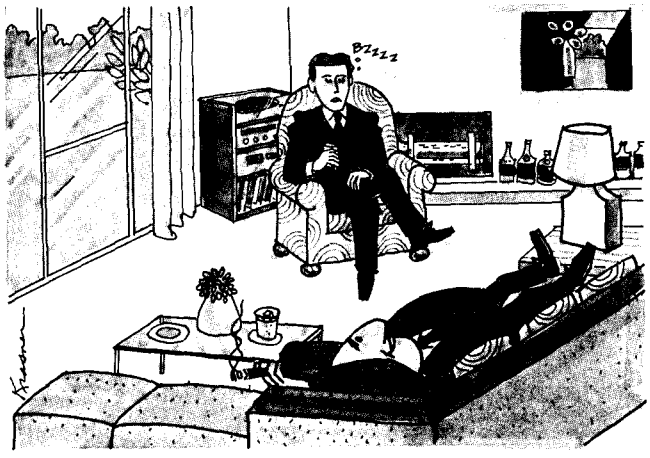
Firestone was excited about leasing three vacant, former W.T. Grant Stores owned by Harry in Erehwon, Yennervelt, and Howe's Bayou. Although these communities are a fair distance from each other, they are all served by the same newspaper, and that would mean substantial savings to Smythe.

Harry told me that he and Firestone had agreed that these leases were to be negotiated in one "round-the-clock" session. Harry said that it was a matter of honor that we work fast enough for him to fulfill this duty he owed to his old pal, Firestone. He handed me Smythe's 128-page lease and informed me that the negotiations would go easier if I mastered the form during the one-hour flight to Washington. The meeting was set to start at 10:00 A.M. of the next day in Firestone's office. But, Harry told me, I was expected to have dinner with him, Firestone, and Anacdutra and then to read the lease thoroughly before I went to sleep. He would breakfast privately with Firestone at 8:00 A.M. the next morning.

We checked into, what Harry calls, the best hotel in Washington. When the bellhop showed me to my room, I was amazed at how large a room Harry had reserved for me. It featured two huge king-sized beds, a refrigerator and a bidet. What was I going to do with all of that?

I called my wife to tell her what happened. After hearing my story, she inquired about my health. I had to admit that I was exhausted, sleepy, and a bit warm. What's more, I felt some pains in my thighs. My wife advised me to take some vitamin C and to go straight to bed. I explained that that was impossible because Harry wanted me at dinner. If I failed to attend, Harry would be beside himself with fury. He might scream at me. He might delay paying my bills even longer. He might even hire another lawyer.

I looked at myself in the mirror and could see many possibilities for improvement. Unfortunately, I could do little about most of them, but I could shave. As I looked for my razor I began to feel faint, and suddenly I did.



I can't tell you how long I lay there unconscious, but I can tell you that I dreamed of Harry Paine, and Harry was not being nice.

Finally I was roused by the telephone. It was Harry. Who else? He wanted to know why it took me so long to change. Then I told him that I was sick. To my surprise he accepted that—no yells and no screams. He said, "all right."

What did he mean by that? Was it the end of our relationship? Where could I get clients to replace him?

Meanwhile my pain got worse, and I felt very warm. I crawled to one of the king-sized beds. If only I could get some sleep, I might recover.

But I couldn't sleep, so I tried TV. Nothing on the tube could hold my attention. I turned it off and concentrated on my pains and anxiety. Soon the pains became throbbing pains, and the anxiety turned to despair. My feet were freezing and I had chills.

The only comfort I could imagine at the moment was to call home.

My wife accepted the news calmly. That wasn't much fun. I wanted sympathy and plenty of it. So I complained some more and made appropriate moans and groans. Then I got advice.

She: Why don't you do something practical to help yourself?

I: Like what?

She: For one thing, you could take your temperature.

I: I don't have a thermometer.

She: Buy one.

I: I can't even get off the bed.

She: Call a bellhop.

I: Holy mackerel! I never thought of that.

Then it came to me. The thing to do was to do whatever was practical to help myself. Good thinking. With this kind of incisive reasoning, I knew that I could take on Brent V. Firestone and T.D.Y. Anacdutra even with a fever.

I called the bell captain and asked him to buy me a thermometer, a jar of vitamin C, a package of aspirin, a wad of dental floss, a shot of brandy, an ounce of honey, and a cup of tea. I was ready to fight back.

When the bellhop arrived, he approached me cautiously. The combination of the things I had ordered and the fact that I was from New York made him feel that I was unbalanced and, perhaps, dangerous. But a $5 tip changed his attitude speedily.

The bad news was that I had a fever; the good news was that my temperature was 102° and not, as I had imagined, 108°.

I dropped a vitamin C tablet and one aspirin into the cup of tea. That was followed by the brandy and honey. After stirring carefully, I drank it swiftly and covered myself with four blankets.

Soon I began to sweat profusely, and I fell into a deep sleep. Later, perhaps much later, I was awakened by a loud knock on the door.

Before I moved, I looked at my watch and asked myself how I felt. It was 12:30 A.M., and I felt wonderful. Miraculously, my fever had disappeared. I breathed deeply and joyfully. I had the wonderful feeling of health and well-being.

But who was at the door? It was Harry, Brent V. Firestone, and T.D.Y. Anacdutra (Teddy).

Harry was in an unusually jovial mood. He gets that way only after a gourmet meal, four very dry martinis, and the prospect of increasing his already immense net worth.

Harry: How are you, old pal?

I: A lot better, thank you, Harry. I'm just sleepy. I think I'll be together after a long night of sleep.

Harry (ignoring the answer to his question): Good. I'm glad to know you're up and around. I thought I'd come to cheer you up. And since you

couldn't spend the evening with Brent and Teddy, I brought them here to spend the evening with you.

What did he mean, "spend the evening"? It was 12:30 A.M.! I soon learned. Teddy Anacdutra pulled his form lease from his briefcase, and we began to negotiate.

In an atmosphere in which one negotiator is sick and three are drunk, problems tend to get resolved quickly (but not necessarily sensibly). And so by 4:00 A.M. we covered almost all of the lease.

But then we hit the default cancellation clause. That's the clause that gives the landlord the right to cancel the lease in case of a default by the tenant.

Brent and Harry argued vehemently about this issue. Brent insisted upon notice requirements and extensive periods in which the tenant could cure contended defaults. Harry asserted that he did not want the burden of giving notice and waiting for the tenant to cure. He wanted to be able to terminate the lease at will in case the tenant violated any provision of the lease at all. He cited his ancient troubles with W.T. Grant.

Teddy had the good sense to pull Brent away from Harry as Brent was about to reach for Harry's throat. They said their good-byes, wished me good health, told me to get a good night's sleep, and asked me to remind Harry that he was to meet Brent for breakfast at 8:30 A.M.

They left, but Harry stayed. He wanted to talk about default cancellation clauses, and I wanted to go to sleep.

So we talked about default cancellation clauses. I pointed out that courts don't always enforce default cancellation clauses. He was astonished. He immediately asked me for a formal opinion on the subject. Although I could not do that, I did tell him that I was doing research in this area for another client, and I was carrying with me a memorandum in which I analyzed some of the cases I was reading. I gave it to him.

He propped himself up in the other king-sized bed and began to read. I hung the "do not disturb" sign on the door, returned to my bed, and fell into a deep sleep.

Just in case you are curious, I've included a copy of the memo in this report. Here it is:

MATERIALITY OF DEFAULTS

An important distinction between a store lease and most other types of leases is that a retail tenant who is in default faces the prospect of losing its entire business and a substantial capital investment if the lease is terminated as a result of the default.

Should the landlord's right to cancel a lease as a result of a default extend to every clause in the lease? If landlords interpreted their rights under their leases literally and the courts were willing to terminate leases because of breaches of minor obligations, all tenants would occupy their premises at the whim of their landlords. Retail tenants agree to hundreds of covenants when they execute leases. A landlord who searches diligently, can find that some kind of a breach exists under one of those covenants.

In many store lease negotiations, the landlord has a significant edge. If he controls a good retail site, the chances are that there will be more than one merchant who is eager to do business there. Good sites are hard to find. When one becomes available, it often inspires highly competitive and aggressive behavior by the interested merchants. The landlord's interest is sought after as ardently as if he were a college homecoming queen.

Judges are aware of the difference between the bargaining power of landlords and tenants.

> Landlords and tenants do not generally meet on equal footing. Land and space are limited and in short supply. Tenants more often than otherwise, must take inequitable lease provisions as offered, or not get much needed space at all. To enforce provisions of leases strictly in such circumstances is to run counter to all modern thinking.[1]

A retail, restaurant, or amusement business is tied to its location. If the location is lost, the

[1] 57 E. 54th St. Corp. v. Gay Nineties Corp., 71 Misc. 2d 353, 335 N.Y.S.2d 872, 874 (App. Term 1st Dep't 1972).

business is not likely to carry its clients to another location. Probably the tenant will lose the business.

Because of the drastic consequences of the enforcement of default cancellation clauses, courts have tended to refuse enforcement when the lease provision that was violated was not significant. Although leases usually provide that the landlord may cancel if the tenant is in default under *any* provision of the lease, judicial legislation has limited the landlord's option to cancel defaults that the courts consider to be "material."

Does the Type of Clause Tell You When the Violation Is Material?

How can you determine which obligations in a lease are considered material enough to justify cancellation of the lease?

It would appear to be a reasonable hypothesis that some types of lease provisions are material and other types are not. To test this hypothesis, the following section examines some court decisions with the cases classified according to the type of provision that was violated.

Delays in Preopening Alterations

A tenant was required to perform alterations to the premises to convert it into a Turkish bath establishment in *Lundin v. Schoeffel.*[2] Unfortunately, there were extensive delays in the course of the work.

The landlord found the delays and other things about the tenant to be rather disagreeable and attempted to cancel the lease.

This court would do no such thing. The judge held that the provision that was violated wasn't important enough to justify a forfeiture.

Sign Clause Violations

In *Madison Stores, Inc. v. Enkay Sales Corp.*,[3] a violation of a lease provision which restricted the erection of signs was held not to be a material default.[4]

Failure to Record Gross Sales

A failure to install appropriate cash register equipment was held to be a material default in *Caranas v. Morgan Hosts-Harry Hines Blvd., Inc.*[5]

Although the lease required the tenant to deposit sales proceeds in cash registers that "run continuously," the cash registers actually installed by the tenant reset themselves every time their counting devices reached $10,000. To make matters worse, the tenant violated the continuous operations clause.

Failure to Report Gross Sales

The failure to submit statements of gross sales on time was held not to be a material default in *Howard D. Johnson Co. v. Madigan.*[6]

Howard Johnson's had leased a restaurant and sublet it to a franchisee. It failed to submit statements of gross sales when required under the lease, and the landlord gave notice of the failure. Howard Johnson's replied that it wanted to submit the statements but was unable to do so because it was having a hard time getting the numbers from the franchisee. The landlord countered with a notice of termination.

Shortly thereafter, Howard Johnson's submitted

---

[2] 167 Mass. 465, 45 N.E. 933 (1897).

[3] 207 Misc. 1091, 142 N.Y.S.2d 132 (Mun. Ct. 1955). See also Madison 52nd Corp. v. Ogust, 49 Misc. 2d 663, 268 N.Y.S.2d 126, *aff'd* 52 Misc. 2d 935, 277 N.Y.S.2d 42 (1st Dep't 1966).

[4] . . . The posting of two small signs, not business signs, upon the apartment door, removed by the landlord prior to the commencement of this proceeding, was conceded by tenant and described by him as a prank intended to amuse his friends. While technically a violation of clause "Fourth" of the lease when affixed, they were removed even before the landlord sent tenant a 10-day notice to cure violations. In any event, the violation is of a trivial and inconsequential nature and clearly is not such a substantial violation as to justify the forfeiture of a lease.

Moss v. Hirshtritt, 60 Misc. 2d 402, 303 N.Y.S.2d 447 (Civ. Ct. 1969).

[5] 460 S.W.2d 225 (Tex. Civ. App. 1970).

[6] 361 Mass. 454, 280 N.E.2d 689 (1972).

the statements, but they were not certified by a Howard Johnson's officer, as required by the lease.

The court refused to enforce the default cancellation clause. Here's how the court justified its decision: "In the instant case, where the covenant broken required the submission of gross sales figures in order to fix a percentage rental, we think that the covenant broken is [only] ancillary to the covenant to pay rent. . . ." [7] The court, in brief, believed that the defaulted obligation was not important (material) enough to justify a forfeiture as a result of the default.

Insurance Clause Defaults

Rubenstein Bros. v. Ole of 34th St., Inc.[8] dealt with the question whether a failure to carry sufficient liability insurance constituted a material breach. The tenant was obliged to carry a policy with coverage limits of $500,000 per person and $1 million per occurrence. Actually, that tenant carried only one-half of the required coverage. The court held that the breach was not a material breach.

On the other hand, in *Pro-Action Partnership v. Bonaparte's Fried Chicken, Inc.*,[9] a tenant was evicted because of a failure to name the landlord as an additional insured with respect to a fire insurance policy on the premises; and in *Brainard Manufacturing Co. v. Dewey Garden Lines Inc.*,[10] a tenant was evicted because of a failure to carry sufficient fire insurance.

Failure to Release a Restrictive Covenant

In *Weissman v. DeNoto*,[11] the tenant was obliged, and refused, to release a restrictive covenant against competing uses in the shopping center in which the premises were located. The tenant also failed to comply with its obligation to repair the sidewalk in front of its store. The court found the default to be material and terminated the lease.

Failure to Pay Sales Taxes

In *L.C. Hudson v. Price*,[12] a restaurant tenant was evicted because of a violation of a lease provision that required the tenant to pay all sales taxes imposed on sales in the restaurant. Although I presume that the court understood the default to be material, it did not discuss the question.

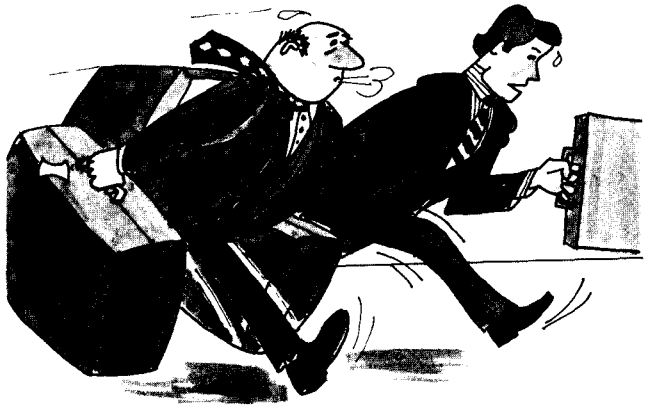
Alterations Clause Defaults

In *Pollock v. Adams*,[13] a restaurant tenant erected a removable partition in violation of the alterations clause that prohibited alterations without consent of the landlord. The court held that violation was not substantial (material) enough to justify forfeiture.

Rent Defaults

In *57 East 54th Realty Corp. v. Gay Nineties Realty Corp.*,[14] the court refused to terminate a tenant's lease because the tenant paid its rent late.[15]

But in *Fifty States Management Company v. Pioneer Auto Parts, Inc.*,[16] a tenant who failed to pay two rent installments in a row didn't fare as well. The landlord sought to enforce a provision in the lease that accelerated all future rent payments in case of a default. Such an acceleration lease is usually at least as punitive as forfeiture of the tenant's leasehold estate.



The court held that the default was material, and made this statement:

> A covenant to pay rent at a specified time . . . is an essential part of the bargain as it represents the consideration to be received for permitting the tenant to remain in possession of the property of the landlord. Often the

[7] *Id.*, 280 N.E.2d at 692.
[8] 101 Misc. 2d 563, 421 N.Y.S.2d 534 (Civ. Ct. 1979).
[9] 392 So. 2d 146 (La. App. 1st Cir. 1980).
[10] 78 A.D.2d 365, 435 N.Y.S.2d 417 (4th Dep't 1981).
[11] 66 A.D.2d 843, 411 N.Y.S.2d 394 (2d Dep't 1978), *appeal dismissed* 47 N.Y.2d 833 (1979).
[12] 273 S.W.2d 518 (Mo. App. 1954).
[13] 548 S.W.2d 239 (Mo. App. 1977).
[14] 71 Misc. 2d 253, 335 N.Y.S.2d 872 (App. Term 1st Dep't 1972).
[15] See Chapter 1601(a)(i) for a discussion of lease clauses to avoid cancellation of the tenant's leasehold estate because of an inadvertent failure to pay rent on time.
[16] 46 N.Y.2d 573, 389 N.E.2d 113, 415 N.Y.S.2d 800 (1979).

landlord relies on timely payment of rent to meet his own outstanding obligations, such as a mortgage on the demised premises. Thus, an acceleration clause, so common in other commercial transactions, is merely a device in the landlord-tenant relationship intended to secure the tenant's obligation to perform a material element of the bargain and its enforcement works no forfeiture.[17]

In *Birnbaum v. Yankee Whaler, Inc.*,[18] the court considered the plight of a tenant who failed to pay rent on time for at least three months in a row. A lower court had held that the default was not material enough to justify forfeiture. But New York's appellate division held that the default was material. It stated that the "payment of rent" is a "central part of the bargain between the landlord and tenant." [19]

Defaults Under the Use Clause and Related Clauses

Cases that deal with violations of use clauses are divided as to whether a violation of a use clause is material enough to justify forfeiture.

In *Hignell v. Gebala*,[20] a California intermediate appellate court heard the appeal of a real estate broker whose leasehold interest in an apartment house was terminated as a result of the application of a default cancellation clause. Although the use clause of the lease limited the use of the premises to the conduct of an apartment house building, the tenant had conducted her real estate brokerage business at the premises.

The appellate court held that the default was "substantial" (material). However, the appellate court remanded the case so that the trial court could determine whether cancellation would be justified under the circumstances because of equitable considerations.

The tenant in *Beck v. Giordano*[21] leased a building from the landlord and was "to use and occupy the same as a restaurant." For a twenty-day period, the tenant permitted her son to operate a fireworks stand in front of the restaurant. The landlord contended that this usage violated the use clause. The court held that the violation "was not sufficiently grave to authorize a termination of the lease. . . ." [22]

In *Feist & Feist v. Long Island Studios, Inc.*,[23] the tenant wanted to convert a motion picture studio into a discotheque in violation of the use clause of the lease. The lease restricted the use of the premises to a motion picture studio. The use of the premises as a disco may also have caused a violation of the local zoning ordinances. In addition, the tenant made alterations to the premises that were prohibited by the lease and which changed the character of the premises. The court held that the defaults were material defaults.[24]

Nissen v. Wang[25] dealt with a tenant who violated the use clause of his lease by conducting some business operations in the apartment in which he lived. The court stated that "the mere use of a primary residence for some commercial purpose is not in itself a substantial [material] violation. . . . To so hold, would mean that a tenant who received an occasional business telephone call at home would be subject to an eviction." [26]

Compliance Clause Defaults

Many courts have wrestled with the question whether a violation of a compliance clause in a lease is a material default. There is no clear and

[17] *Id.*, 415 N.Y.S.2d at 803.

[18] 75 A.D.2d 708, 427 N.Y.S.2d 129 (4th Dep't 1980).

[19] Hignell v. Gebala, 90 Cal. App. 2d 61, 202 P.2d 378 (1st Dist. 1949).

[20] In Taylor, Inc. v. Teller, 28 Misc. 2d 507, 208 N.Y.S.2d 148 (1960), the tenant was evicted because of repeated failures to pay rent on time.

[21] 144 Colo. 372, 356 P.2d 264 (1960).

[22] *Id.*, 356 P.2d at 265. The court went on to justify its opinion as follows: "To terminate the lease would terminate a restaurant business in which the defendant had invested thousands of dollars and nearly five years of her time, a business which she had reason to expect to continue for another five years."

[23] 29 A.D.2d 186, 287 N.Y.S.2d 257 (2d Dep't 1968).

[24] The installation of a washing machine that was not "obnoxious" was held to be a default but not a material default. Kon v. Providencia Miah, 11 Misc. 2d 252, 171 N.Y.S.2d 363 (Mun. Ct. 1958).

[25] 105 Misc. 2d 251, 431 N.Y.S.2d 984 (Civ. Ct. 1980).

[26] *Id.*, 431 N.Y.S.2d at 986.

consistent pattern in the decisions. Judges have considered the importance of the law that was violated. If they believed that the law that was violated was an important part of the social fabric, they permitted the violator to be evicted. Courts that have not been outraged by the violation have seen no reason to add the forefeiture of a leasehold to the punishment of a misdemeanor or minor legal violation.

In *Fli Hi Music Corp. v. 645 Restaurant Corp.*[27] the judge said that he would not permit a tenant's leasehold interest to be terminated, even if the tenant was in default, unless the default would be "so substantial (material) and gross as to warrant the termination of the lease." [28] In that case, the lease required the tenant to cure violations of the regulations of New York City's Department of Buildings, and the tenant failed to do so.

Keating v. Preston[29] concerned a violation of a gambling law by a restaurant tenant. The hotel restaurant, situated in the landlord's hotel, was apparently the favorite haunt of the town's horse racing devotees. Anxious to serve her customers well, the restaurant owner occasionally delivered money and bets to the track. Such goings-on were very upsetting to the landlord who sought to terminate the restaurant lease for a violation of the compliance clause of the lease and Section 337(a) of the California Cure Code that, among other things, prohibited delivering bets.

The California court refused to terminate the lease for many reasons. One reason was that the violation was "too slight and trivial" (not material enough)[30] to justify forfeiture of the tenant's leasehold interest.[31]

First National Stores v. Yellowstone Shopping Center, Inc.[32] concerned the tenant's failure to comply with a notice of violation of New York City's building code. The notice advised the landlord of a supermarket premises that the premises were in violation of the code as a result of the way then tenant conducted its business. The city charged, among other things, that the way the tenant stored its merchandise in the basement was a fire hazard. The landlord and tenant each contended that the other should comply with the notice. An intermediate appellate court held that, although it was the tenant's obligation to correct the violation, the default did not justify the cancellation of the tenant's leasehold interest. The court of appeals, the court of last resort in New York, reversed and enforced the cancellation.

In *Zotalis v. Cannellos,*[33] the tenant leased a two-story building. On the first floor he operated a cigar stand. A creative retailer, the tenant's customary ritual was to play double-or-nothing with his customers—perhaps to stimulate sales. If the customer won the roll of the dice, he got a free cigar. If the customer lost, he'd pay for two cigars and get one.

The landlord (obviously not a cigar smoker) attempted to cancel the lease on the grounds that this practice violated the compliance clause of the lease. The tenant's defense was that the violation was too trivial (not material enough) to justify a cancellation.

The Minnesota court held that the default was material because the landlord was in danger of criminal prosecution. The court made this statement: "The violation of a condition in the lease cannot be said to be trivial when the violation is of such a character that the lessor may be subject to a criminal prosecution on account thereof." [34]

A Washington court heard a case that involved the subtenant of another cigar store who, to ac-

---

[27] 64 Misc. 2d 302, 314 N.Y.S.2d 735 (Civ. Ct. 1970), *aff'd* 71 Misc. 2d 302, 335 N.Y.S.2d 822 (1st Dep't 1972).

[28] *Id.*, 314 N.Y.S.2d at 736.

[29] 42 Cal. App. 2d 110, 108 P.2d 479 (3d Dist. 1940).

[30] *Id.*, 108 P.2d at 483.

[31] In Ruffino v. Ruffino, 138 So. 2d 609 (La. App. 1962), the court held in effect that, even if the violation of the compliance clause (selling untaxed cigarettes) constituted a default under the lease, the default was not material enough to justify forfeiture. The court further stated that "Plaintiff has not shown any legal or material damage to the leased premises because of this single misdemeanor." *Id.* at 610.

[32] 21 N.Y.2d 630, 237 N.E.2d 868, 290 N.Y.S.2d 721 (1968).

[33] 164 N.W. 807 (Minn. 1917).

[34] *Id.*, 164 N.W. at 808.

commodate the needs of his steady customers, "acted as a stakeholder for persons desiring to wager." He also shook the dice with the local boys for cigars on a double-or-nothing basis.

The landlord sought to evict the tenant on the grounds that the behavior of his subtenant was a misdemeanor and, consequently, a violation of the lease covenant not to permit the premises to be used for unlawful purposes.

Among other defenses, the tenant asserted that the violation was too trivial to justify a forfeiture. The court held that, since the default also consisted of a misdemeanor, it was material enough to justify forfeiture.[35]

MATERIALITY OF DEFAULT DEPENDS UPON THE CIRCUMSTANCES OF THE CASE

Whether or not a default is material cannot be determined solely by examining the type of the lease provision that the tenant violated. To determine whether a default is material, courts usually consider the importance of the provision involved, the nature and extent of the default, and the effect of the default on the landlord. If the default arises from a failure to comply with legal requirements, the court also considers the type of law involved.

Courts almost always hold that a default is material, if the default is based upon the failure to pay rent a few months in a row. The failure to pay rent is usually the most material of all material defaults. A tenant's failure to pay rent discontinues the income stream that the landlord needs to provide essential services and to pay the mortgage debt and real estate taxes. A rent default may result in the landlord losing its property altogether.

A second type of default that a court is likely to consider material is a default that deprives the landlord of an important benefit from the lease.

Although it is true that, under most circumstances, the most significant motive a landlord may have for entering into a lease is the desire to collect rent, this is not always the exclusive motive. In a shopping center a landlord may willingly go along with a marginal rent structure to induce an anchor tenant to sign a lease because the presence of the anchor will attract other tenants. It is not unusual for a landlord to rent space to an attractive tenant at a rate that is below the landlord's cost. The quid pro quo for such an arrangement is often the covenant to conduct business in a particular way.

In addition, some of the tenant's obligations play a role so important that, unless the obligation is complied with, it would be impossible for the term of the lease to begin or for rent to be computed.

For example, the failure of a tenant, the local school district, to use a building constructed on leased land as a "school house" constituted a material default in *School District RE-2(J) v. Panucci*.[36] The landlord had leased the premises to the school district for ninety-nine years for total rent of $1, provided the structure was used only as a schoolhouse. The lease specified that the tenant's leasehold interest would be forfeited if the use as a schoolhouse was to be discontinued. When the school district stopped using the building as a "schoolhouse," the landlord sought to terminate the lease.

The court held that the landlord was entitled to terminate the lease because his decision to lease the premises to the school district wasn't motivated by a desire to make a profit or to earn a return of any sort. The landlord's only motive was to know that the building on his land was being used as a schoolhouse, and since that motive was frustrated, forfeiture was justified.

The failure of a tenant to dredge a creek was held to be a material default in *City of New York v. Skyway-Dyckman, Inc.*[37] New York City leased a

---

[35] Shephard v. Dye, 137 Wash. 180, 242 P. 381, 49 A.L.R. 824 (1926). In Baca v. Walgreen Co., 630 P.2d 1185 (Kan. App. 1981), a tenant argued that its default was not material because there was a bona fide dispute over whether the landlord or tenant was required to perform the obligation. The court rejected the argument and held the default, a failure to comply with a legal requirement to install a fire-extinguishing system, was a material default.

[36] 30 Colo. App. 184, 490 P.2d 711 (Div. I 1971).

[37] 22 A.D.2d 506, 256 N.Y.S.2d 840 (1st Dep't 1965), *appeal dismissed* 16 N.Y.2d 706, 261 N.Y.S.2d 899 (1965).

marina to the tenant. In holding that the tenant's leasehold estate should be terminated as a result of the default, the court made the following observation:

> [T]he main purpose of the City was not to utilize the land for its gain, but rather to make available certain services to the public. Rather than provide the services itself, the City elected to do it through the medium of renting the land to one who was required by the lease to perform them. The covenants of the lease are designed to this end. Among the services was the providing of certain facilities to people using small boats. Failure to comply with the covenant in question resulted in a failure to have these services available. Obviously, it affected one of the [main] purposes of the lease, and hence, was indubitably material.[38]

The court, in *Caranas v. Morgan Hosts-Hines Blvd., Inc.*,[39] rejected the tenant's claim that the tenant's failure to install cash registers with a continuous counting device was not a material default. Although the court didn't say why specifically, it's easy to see why. The landlord had bargained for percentage rent in addition to minimum rent. It was obvious that the landlord didn't trust the tenant to report sales accurately. The provision that required the continuous counting devices was in the lease because the landlord wanted a way to check up on the tenant. But, the registers installed by the

tenant reset themselves whenever they reached $10,000; thus, there was no way for the landlord to know how much cash found its way into the registers. So the default went right to the heart of one of the landlord's main objectives in making the deal.

Poundstone v. Gofoor[40] concerned a ground lease of farmland. The rent was to be a share of the crops. The lease required the tenant to commence operations on or before March 27, 1927. When the tenant failed to start preparing the land and plowing on time, the landlord sought to enforce the default cancellation clause and evict the tenant.

The court held that the default was substantial (material) and gave these reasons:

> In considering whether or not there had been a substantial compliance with this lease, the circumstances surrounding the parties, the season of the year, the character of crop that was to be grown, the things that it was shown were required to [be done] . . . in order to successfully raise such a crop, all must be considered. . . . Through the defendant's continued neglect to discharge in any substantial manner his obligations under the lease, the plaintiffs were faced with the necessity of either terminating the lease or running the risk of an entire crop failure on their land; the agreed rental being a share of the crop.[41]

DEFAULTS THAT CAUSE THE LANDLORD SUBSTANTIAL HARM

A third important factor considered by the courts in determining whether a default is a material default is whether or not the landlord suffered any substantial harm or had reason to anticipate that he would suffer substantial harm as a result of the default. Thus, courts have held that a material default arises from a tenant's failure to perform obligations which, if not performed by the tenant, would result in the loss of the landlord's estate in the premises, a violation of a mortgage, a violation of a legal requirement, or an impediment to a mortgage or sale of the property.[42]

---

[38] *Id.*, 22 A.D.2d at 509, 256 N.Y.S.2d at 843.

[39] 460 S.W.2d 255 (Tex. Civ. App. 1970).

[40] 104 Cal. App. 212, P. 403 (3d Dist. 1930).

[41] *Id.*, 285 P. at 405.42.

[42] In 57 E. 54th Realty Corp. v. Gay Nineties Realty Corp., 71 Misc. 2d 353, 335 N.Y.S.2d 872 (App. Term 1st Dep't 1972), the court offered this criterion to determine whether a breach by a tenant is sufficiently material to justify the forfeiture of the tenant's leasehold interest. The court stated that the "tenant" should be relieved of the default since the landlord was not harmed or prejudiced thereby.

In Nissen v. Wang, note 25 *supra*, the judge set forth some criteria to determine whether a default is a material default. First he noted that it "is the quality of the use, as well as the quantity which must be evaluated." Then he offered these criteria to determine whether defaults are material: "(1) Is the character of the building materially affected by the default? (2) Does the default materially damage or burden the landlord's property? and (3) Does the default materially disturb the buildings or other tenants in the peaceful use of their apartments?" *Id.*, 431 N.Y.S.2d at 986.

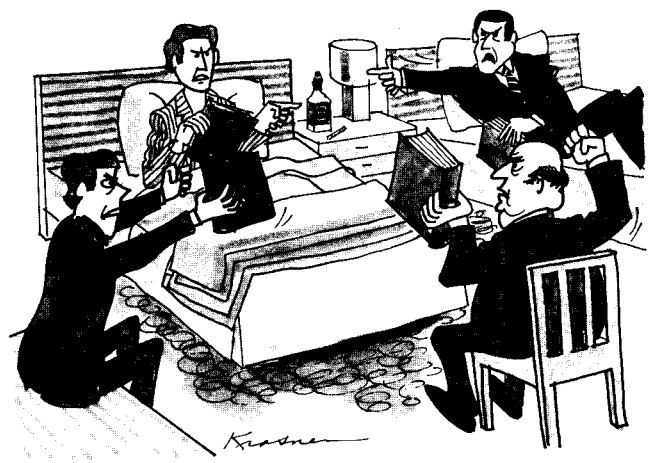
Accordingly, since neither the landlord nor the property was harmed or faced a danger of harm as a result of the defaults by the tenants in many of the cases I have examined (*Fli Hi Music Corp. v. 645 Restaurant Corp., Keating v. Preston, Ruffino v. Ruffino, Madison Stores, Inc. v. Enkay Sales Corp., Howard D. Johnson Co. v. Madigan, Pollock v. Adams, Lundin v. Schoeffel,* and *Nissen v. Wang*), the tenants' defaults in these cases were held not to be material.

Here is a further example. Although the tenant in *Lundin v. Schoeffel*[43] failed to complete alertions to the premises in accordance with the schedule provided in the lease, the judge refused to terminate the lease. Here is the judge's discussion of his decision:

> There was no damage to the lessor's property, no waste, no omission to make needed repairs, no increased risk of loss by fire as in the case of an omission to keep the premises insured, and it is not suggested in argument that there was any such damage to the lessors as calls for compensation. The default on the part of the lessee was hereby the omission to proceed promptly enough with the work of making improvements. It was a failure to pay out money for this purpose. If the lessee's failure had been an omission to pay rent promptly as it became due, it is plain that a court of equity might relieve against a forfeiture on this ground, though the omission was even willful. But the lessee's failure in this case was merely an omission to do promptly something which was only useful to the future payment of rent. It was not like a case where the omission caused a present injury or increase of risk to the lessors, as in the case of waste, nonrepair, or noninsurance. . . .[44]

Conversely, many of the decisions that held that defaults were material were based on the courts' finding that actual harm was suffered by the landlord or that there was significant danger of substantial future harm. This was probably the reasoning in the following cases I examined: *Pro-Action Partnership v. Bonaparte's Fried Chicken*; *Brainard Mfg. v. Dewey Garden Lanes, Inc.*, *Feist & Feist v. Long Island Studios, Inc.*, and *Zotalis v. Cannellos.*

In *First National Stores v. Yellowstone Shopping Center*, the court held that a breach of a compliance clause was material.[45] The *Yellowstone* landlord faced a danger to its property and its bank balance. It had cause to be concerned that its shopping center, situated in the midst of a densely populated and affluent residential community in New York City, would be destroyed by fire. Its ability to sell or mortgage its property was impaired by an official notice of a violation of a legal requirement. Although a violation of a legal requirement, by itself, seldom upsets a prospective purchaser or mortgagee of a shopping center, an official notice of the violation can foul up an impending mortgage, loan or sale. Neither a violation nor a notice of a violation is a lien against property; but most New York City attorneys react to a notice of violation as if it were a cloud on title, and some of them consider an official notice of violation as if it were a clue to the presence of the Angel of Death.



In *Zotalis v. Cannellos*, the landlord had reason to fear criminal prosecution.

Rubenstein Bros. v. Ole of 34th Street, Pro-Action Partnership v. Bonaparte's Fried Chicken, Inc., and *Brainard Manufacturing Co. v. Dewey Garden Lanes Inc.* have similar fact patterns but different results. In each case, the tenant violated the insurance clause. The default was held to be material in *Pro-Action* and *Brainard* but not in *Rubenstein.*

One possible distinction among the above cases, insofar as the issue of materiality of the default is concerned, may lie in the type of insurance involved.

In *Rubenstein*, the default was that the tenant did not carry sufficient liability insurance. The liability limits of the tenant's policy were nevertheless respectable. The danger that the landlord would

---

In Baca v. Walgreen Co., 630 P.2d 1185 (Kan. App. 1981), a tenant argued that its default was not material because there was a bona fide dispute over whether the landlord or tenant was required to perform the obligation. The court rejected the argument and held that the default, a failure to comply with a legal requirement to install a fire extinguishing system, was a material default.

[43] 167 Mass. 465, 45 N.E. 933 (1897).

[44] *Id.*, 45 N.E. at 934.

[45] Note 32 *supra.*

actually sustain any loss was remote because the limits were not absurdly low and because the potential liability of the landlord to customers and the tenant's employees was more theoretical than real.

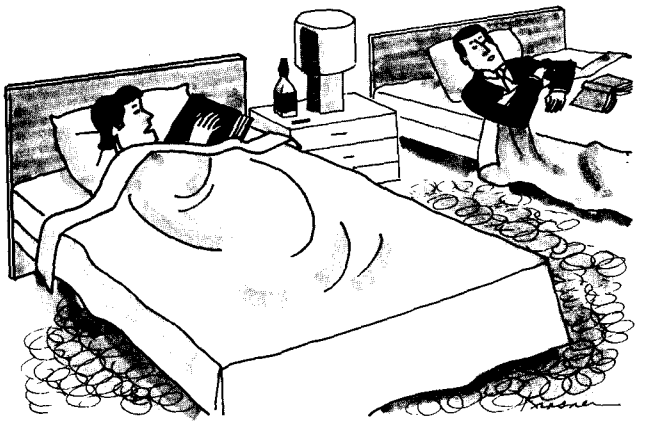
In *Pro-Action* and *Brainard*, the default concerned the requirement to carry fire insurance, and the courts held that the default was material. Although no actual harm came to the landlord in either case, the landlord might have lost a substantial sum if the premises were destroyed by fire. A failure to carry sufficient fire insurance can be said to create a *danger* of substantial harm, and that danger is not theoretical—particularly when the lease requires the landlord to make all repairs which arise because of fire or other casualty.

Property owners are legitimately concerned about their ability to mortgage their property. Mortgage lenders customarily insist that the mortgagor carry fire insurance, but they seldom require the property owner to carry liability insurance. Thus, a failure to carry sufficient fire insurance might be seen as a material default, because it substantially reduces the mortgageability of the property, while a failure to carry sufficient liability insurance would not affect the ability of the landlord to mortgage the property.

DECISIONS ARE NOT ALWAYS RATIONAL

In *Hignell v. Gebala*,[46] the court held a default to be substantial [material] because the tenant *willfully* continued to conduct a real estate business at the premises in violation of the use clause of the lease even after the notice of default was given. The court indicated that, when the default is "willful," it need go no farther to determine whether or not the default is material. This decision did not consider whether or not the landlord or the property suffered any harm at all as a result of the default.

I see little justification for this decision. The mere fact that the tenant *intended* its violation does not establish that the violation is material. Some lease clauses are so trivial that neither the landlord nor the tenant is conscious of their presence. In my experience, the number of real estate people who *read* the documents that they sign is a distinct minority. Even when lessors read them they pass over many clauses lightly as "boilerplate" and deal with them as carefully as a teen-ager reviews legal notices adjoining comic strips in a newspaper. Fortunately for the tenant in *Hignell v. Gebala*, the court didn't have the heart to evict the tenant anyway and remanded the case to the trial court to consider the effect of a California statute that provides relief against forfeitures.



The rationale for the decision of the Washington Supreme Court in *Shephard v. Dye*[47] is also unfortunate. That court decided that a violation of a lease's compliance-with-laws clause by a cigar store tenant was a material default, because the tenant's action in playing dice with his customers for cigars was a misdemeanor. The decision would be understandable if the landlord were faced with prosecution for the misdemeanor. However, the decision does not indicate whether the court was actually concerned about the possibility that the landlord was in danger of being prosecuted. It is also possible that the court felt that dice rolling and bookmaking cast a cloud on the value and desirability of the landlord's property, but we'll never know for sure.

EQUITY

It is important to understand that, even if a judge decides that a default is material, he is still in a position to refuse to enforce the default cancellation clause. Courts have decided that the question whether a lease should be cancelled is determined on the basis of the principles of "equity." Equity courts flourished in England for hundreds of years. They purported to provide a more humane and

[46] 90 Cal. App. 2d 61, 202 P.2d 378 (1st Dist. 1949).

[47] 137 Wash. 180, 242 P. 381 (1926).

flexible approach to disputes than the rigid law courts. Equity traditions were imported to this country along with the rest of the British system of jurisprudence. One principle of equity is that equity abhors forfeitures. What that means is that a judge is supposed to lean over backwards to decide a case so that a forfeiture such as the termination of a leasehold estate may be avoided.

When and whether a judge will actually do this is another story and a long one. So it must await another opportunity.

HARRY IS MISSING

At 10:30 A.M. I was awakened by a telephone call. It was T.D.Y. Anacdutra. Brent V. Firestone was fuming and fussing; he said Harry didn't show up for his 8:30 A.M. breakfast with Brent. Brent had called Harry's room without success.

Where could Harry be? It was unusual for him to fail to show up when money was involved. I figured that Harry must be in his room and hadn't heard the telephone when Brent called, because he was shaving or taking a shower.

I took the elevator to Harry's floor and jogged to his room. I banged on the door and shouted. Harry didn't reply. Maybe Harry caught what I had last night. Maybe Harry was lying on the floor in pain. Oh my!

I found the hotel detective. He opened the door to Harry's room with his passkey. The room was immaculate. The two huge king-sized beds had not been slept in.

I looked under them. No Harry. I looked in the bathroom, in the shower, and in the closet. Still no Harry. Perhaps he had been kidnapped. The hotel detective got all excited. He insisted that I call the police. They said they would come right over.

There was nothing left to do but return to my room and take my vitamin C pill. You won't believe this. I missed Harry. If only I could hear his voice again. I would be so relieved.

Just then I heard a moaning and bellowing in the room that reminded me of an old and sick cow. Could it be the ghost of Harry Paine?

Something moved on the huge king-sized bed in which I had last seen Harry. Then there was a thud. Something or someone fell on the floor covered by a mound of blankets and clutching a form lease in one hand and a bottle of Jack Daniels in the other.

It was Harry Paine—alive, reasonably well, and in the throes of a dreadful hangover.