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Commercial Landlord Allowed to Re-Let Leased Premises

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10-15-2007

In the commercial lease context, a landlord in Pennsylvania is not required to find a replacement tenant where the original tenant leaves the leased premises before the lease term expires. In a case like this, the landlord may allow the leased premises to remain vacant during the lease term and instead collect the rent due under the lease agreement from the vacating tenant.

A tenant who leaves the leased premises without permission usually does so for financial reasons. As such, a landlord will most likely be unable to successfully collect rent from such a tenant. Equally important is that no commercial landlord wants any portion of its property to remain vacant because such a vacancy may detrimentally affect the fair market rental value of the property. Such a landlord will nonetheless attempt to secure a replacement tenant.

In *Trizechahn Gateway, LLC v. Titus*, the Superior Court of Pennsylvania confronted such a situation, in which a landlord did attempt to mitigate its damages by finding a replacement tenant. The case illustrates the legal ramifications for doing so.

In the mid-1990s, Trizechahn Gateway, the owner of a commercial office building located in downtown Pittsburgh, and a now-defunct law firm, Titus & McConomy, entered into a 10-year lease agreement for occupation of one and one-half floors and basement storage space in that building.

Several years later, the law firm closed its business operations and offered to work toward subletting the office space. Shortly thereafter, the law firm vacated the office space but left behind files in the basement storage spaces. For a short period of time after leaving the building, the law firm continued making its monthly rental payments due under the lease agreement.

After the law firm ceased making the rental payments, the landlord indicated its intention to recover the portion of the storage space necessary to correct a building code violation. The landlord then utilized a portion of the recovered storage space to construct an egress from the basement of the building for the

benefit of a new tenant.

The landlord eventually re-let the office space to other tenants for a term that extended beyond the term contained in the agreement with the law firm. Due to the weakened condition of the commercial lease market, the landlord was forced to give rent abatements to the replacement tenants.

The landlord then commenced an action against the law firm and its general partners seeking the remaining amounts due under the lease agreement.

At trial, the law firm was found to have breached the lease agreement, and judgment was entered against the firm in favor of the landlord for the accelerated amount due under the lease, less the amount the landlord would receive under the new lease agreements.

On appeal, the law firm asserted that the landlord breached both the covenant of good faith and fair dealing and the covenant of quiet enjoyment by retaking the rented storage space to correct a building code violation and by obstructing the re-letting of the office space.

The Superior Court first addressed the law firm's argument that the landlord breached its duty of good faith and fair dealing to the law firm, which, in turn, excused its performance under the lease agreement.

According to the law firm, the landlord first notified the law firm that the landlord needed to retake the storage space in order to correct a building code violation. The law firm contended that the landlord, prior to sending this notice, already had decided to take back the space so it could commit the space to a new tenant for purposes of building an egress. This misrepresentation, the law firm believed, stripped the law firm of information that could have been used as leverage in buyout negotiations.

Although the Superior Court noted that every contract imposes a duty of good faith and fair dealing on the parties in the performance and the enforcement of the contract, it summarily dismissed that the landlord breached this duty.

Under the lease agreement, the landlord was entitled to enter the storage space and make any alterations to that space without terminating the lease agreement.

Keeping that lease provision in mind, the Superior Court emphasized that once the law firm defaulted on the lease agreement, the landlord was entitled to enter the storage space and make the alterations it felt were necessary to allow that space to be re-letted. The Superior Court thus believed that the original notice to the law firm about curing a building violation was immaterial, because even if the law firm had known about the landlord's impending plan to use the storage space to create an egress for a new tenant, the law firm would not have had any greater leverage in settlement negotiations because the landlord was entitled to alter the storage space as a matter of right.

In a footnote, the Superior Court did point out that this conclusion would have been different if "a general rule existed whereby anytime a landlord alters or interferes with a portion of a leasehold the entire lease is terminated." The Superior Court noted that such a general rule did not exist in

Pennsylvania and refused to create one.

The Superior Court also found that the landlord did not obstruct the law firm from re-letting the leased premises based upon what it described as its painstaking review of the record below. The court stated that the earliest mention of the law firm taking any affirmative action to re-let the leased premises was more than two years after the original default when the law firm started "the process of concluding discussions with a leasing agent." The court found no evidence that the law firm actually presented a prospective replacement tenant that was rejected to the landlord.

Since the landlord did not breach its duty of good faith and fair dealing to the law firm, the Superior Court held the law firm was not relieved from further performance under the lease agreement.

The Superior Court next addressed whether the landlord's alteration of the leased premises breached its quiet enjoyment to the leased premises and thus constituted an eviction from and termination of the entire lease agreement that relieved the law firm of further performance under the lease agreement.

The law firm argued that although the landlord was permitted to make alterations necessary for re-letting the leased premises, "it was permitted to do so only if the re-letting [wa]s done in a way that [wa]s not hostile to the first lease and create[d] an estate that [wa]s subordinate to and consistent with that of the original tenant."

According to the Superior Court, after the law firm defaulted on the lease agreement and abandoned the premises, the landlord was entitled to take possession of the premises and make the alterations it deemed necessary to re-let them. By abandoning the building, the Superior Court stated that the tenant had no possessory interest that could be disturbed.

The Superior Court also did not believe that these alterations constituted acceptance by the landlord of the law firm's surrender of the leased premises. In doing so, the court embraced the concept promulgated by the Supreme Court between "a 'hostile' second lease with that of a 'beneficial' second lease."

In Pennsylvania, a landlord may rent a property that has been abandoned for the benefit of the original tenant, and that tenant remains liable for any deficiency in the rent. The original tenant's duty to pay rent is only relieved when rent of an equal amount is paid under the replacement lease. As such, any deficiency in rent between these leases will be bourn out by the original tenant.

The Superior Court warned that the replacement lease only becomes "hostile" to the original lease when the landlord accepts the original tenant's abandonment of the property. In doing so, the court clarified that the burden of proving a landlord's acceptance of tenant's surrender of the leased premises is on the tenant to establish, by convincing evidence, that the landlord committed an "unequivocal act" constituting acceptance of the surrender.

The law firm argued that, by granting rent abatement to the replacement tenant and extending the term of the new lease agreement beyond the term set forth in the original lease agreement, the landlord unequivocally accepted the law firm's surrender of the leased premises.

The Superior Court found that giving rent abatement to the replacement tenant was a "commercially reasonable inducement," considering that the local commercial real estate market was in a state of decline. As a result, the law firm would be required to reimburse the landlord for the amount of this rent abatement.

The Superior Court did not believe that the landlord accepted the law firm's surrender of the leased premises by entering into lease arrangements with the replacement tenants for a term that exceeded the original term. The court pointed out that the "Supreme Court has given a strong indication that when a landlord enters into a second lease that contains a longer term than the first lease that is in default, this fact is insufficient to establish acceptance of surrender."

Moreover, the Superior Court stressed, "although commercial landlords have no duty to mitigate their damages[,] [i]t would be logically inconsistent to punish a landlord by stripping him or her of the benefit of the bargain for re-letting a premises, to the benefit of the breaching lessee, by concluding acceptance of surrender has taken place simply because the landlord entered into a subsequent lease with a longer term — a transaction which is both economically efficient as a general matter and beneficial to the landlord as a specific matter."

LESSONS LEARNED

The Superior Court in *Trizechahn Gateway* merely confirmed that while a commercial landlord may mitigate its damages, its tenant is not absolved from making the landlord whole. If the court had ruled otherwise, landlords in Pennsylvania would be less inclined to mitigate their damages.

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