DO COMMERCIAL PROPERTY TENANTS POSSESS WARRANTIES OF HABITABILITY?

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The authors argue that residential habitability warranties be expanded so as to cover commercial property. Their focus is "California and the leading case of Schulman v. Vera, in which the California Court of Appeal held that the public policy considerations mandating the creation of warranty protection for residential tenants were absent in the commercial setting. Narrow and faulty reasoning prevailed in this case, according to the authors. They argue that, at the very least, warranties currently available to residential tenants be made applicable to smaller commercial tenants who lack the financial means to both pay rent and make extensive repairs.

INTRODUCTION

California has long recognized the right of a residential tenant to have habitable housing--housing with adequate heating, ventilation, and plumbing; free of leaks, pests, or infestation. To enforce this right, the California Supreme Court ruled, in Green v. Superior Court[1], that landlords, upon leasing residential housing, impliedly covenant to the tenant that they will keep the premises habitable; a promise coexistent with the tenants' promise to pay rent. Since the landmark Green decision eleven years ago, the courts have been interpreting Green expansively.[2] This, however, has not been the trend in the commercial setting. California courts have refused to extend the implied warranty of habitability to commercial tenants,[3] and have likewise refused to find the commercial tenants' covenant to pay rent dependent to the landlords' covenant (express or implied) to keep the commercial premises in good repair.

This refusal to extend the warranty of habitability to commercial property and the refusal to recognize commercial repair covenants as dependent to the rent covenant stem from the case of Schulman v. Vera,[4] where the California Court of Appeal, using narrow and what these authors believe to be faulty reasoning, refused to extend residential property unlawful detainer defenses to commercial property. The purpose of this article will be to trace the early judicial decisions, which seem to expand the Green decision to commercial tenants, and the ultimate rejection of this trend by Schulman, analyze the deficiencies in Schulman's reasoning, and present the view that the expansion of residential habitability warranties to commercial property should be made.

CALIFORNIA'S JUDICIAL DECISIONS EXTENDING RESIDENTIAL WARRANTIES

Although the California Supreme Court's decision in Green found its roots in public policy considerations concerning the rights of citizens to live in safe, warm, and clean (i.e., habitable) property, the court did not specifically foreclose at that stage expansion of the warranty of habitability to commercial properties. The Supreme Court in Green referred to residential property in its ruling, but its language could reasonably be applied to both commercial and residential property.[5] A warranty of habitability in the commercial setting would provide substantially similar protection for commercial tenants as it now does for residential tenants; for example, commercial property tenants who are renting uninhabitable business premises (lack of plumbing, heating or air conditioning, leaky roof, etc.) would be afforded the same right as residential tenants to repair the premises and deduct such costs from their rent, or withhold their rent until the defective condition was cured.[6]

The court of appeal first took a step in the direction of expanding residential warranties to commercial property in the case of Golden v. Conway.[7] In Golden, the court recognized that where commercial property had been converted to residential property, and retained characteristics of both, the warranty of habitability would be applied.[8] However, the court in Golden was not asked directly to decide if commercial tenants would be afforded the same terms and/or safeguards as were residential tenants. Golden involved the right of a tenant to sue a landlord for a defective condition, not the right of a tenant to withhold rent for an uninhabitable condition. Accordingly, the language of Golden, while relevant, was not conclusive.[9]

The language in Golden was adopted and expanded in the case of Four Seas Investment Corp. v. International Hotel Tenants Association,[10] an appellate case decided two years after Golden. The court of appeal (again without having before it a case clearly on point) recognized that residential real property warranties permitting the withholding of rent could, in proper cases, be applied to small commercial businesses. The Four Seas court stated: "Moreover, the warranty of habitability could, since Golden v. Conway [citation omitted], extend to small commercial operations if the facts warranted ...."[11]

Left with the language in Golden and Four Seas, the lower courts had indications but not clear direction that they were permitted to apply residential warranties and standards of habitability to commercial tenancy situations "if the facts warranted."[12] In July 1980, the court of appeal was given a model case upon which to reach a decision as to whether commercial tenants would be given the same rights as residential tenants to withhold their rent payments when their premises were dilapidated. Surprisingly, the court refused to continue this expansive trend and rejected the concept that warranties currently applicable to residential rental property could be/applied to permit commercial tenants to offset their rent against the costs of needed repairs.

THE DIRECTION CHANGES WITH SCHULMAN V. VERA

The case of Schulman v. Vera[13] presented a most compelling set of facts: a landlord leased to a tenant a commercial building which was used as a restaurant. The lease between the parties expressly provided that the landlord was required to repair the roof and exterior walls at the landlord's expense within a reasonable time after receiving written notice from the tenant that repair was necessary. The tenant gave such notice, but repairs were not made. The tenant refused to make rent payments and the landlord filed an action for unlawful detainer to evict the tenant.

The tenant alleged as a defense that the landlord had breached his express covenant to repair, the roof of the building which caused the tenant damages in excess of $10,000. The tenant claimed that throughout the spring rains the roof leaked water, forcing the tenant to operate the restaurant with buckets on the tables to catch the leaking water and creating two inches of standing water on one portion of the floor of the restaurant. The tenant, however, did not file a separate suit against the landlord for this damage; he sought in the unlawful detainer action to offset his rent against the interior damage and his loss of profits. The trial court refused to consider the tenant's defense and granted judgment for the landlord ordering the tenant evicted.

In argument before the court of appeal, the tenant pleaded that his obligation to pay rent was a covenant dependent on the obligation of the landlord to maintain the premises in a habitable condition or to repair the premises when needed.[14] The tenant further argued that the decision in Green was applicable to commercial properties as well he alleged he was entitled to withhold his rent until such time as the restaurant's roof was repaired; his restaurant was no longer "habitable" as he could not .use the property as intended because of the defect,[15] Rejecting these arguments, the court of appeal, in a forceful opinion, ruled that the public policy considerations which mandated the creation of warranty protection for residential tenants were absent in the commercial setting.[16] Judgment was accordingly rendered for the landlord.

The court of appeal in Schulman based its ruling upon two separate grounds: (1) the policy in favor of preserving the summary nature of unlawful detainer proceedings and (2) the ability of commercial tenants to protect their legal interests.

As to the first ground, the court found that if defenses such as breach of warranty were permitted to be litigated in unlawful detainer proceedings, what was once a summary remedy would soon become a protracted and expensive remedy, affording the landlord no protection against recalcitrant tenants.[17] As to the public policy considerations, Schulman pointed to language in Green noting that a residential tenant would not have sufficient funds to make expensive repairs yet at the same time pay rent to avoid eviction, while commercial tenants would likely have more equal bargaining power and have the financial ability to concurrently make repairs and bring an action against the landlord.

The court in Schulman properly recognized that the commercial tenant is not without remedy to cure dilapidated commercial premises: He could bring a separate action for breach of contract or breach of warranty against the landlord---the damages which the restaurant suffered would have been recoverable, if proven, in that action.[18] However, the court stated that in order to preserve the summary nature of the unlawful detainer proceeding, a commercial tenant could not assert the condition of the property as a defense to eviction, nor could such tenant bring a cross-action in the unlawful detainer case to

recover damages. The commercial tenant's only remedy was filing a separate court action against the landlord.[19]

SCHULMAN'S PROGENY

As Schulman was heard by a different court of appeal than was Golden and Four Seas, an apparent conflict was created between different districts. The issue of whether residential real property warranties could be asserted by commercial tenants seemed ripe to be decided by the California Supreme Court. But Schulman was not appealed to the California Supreme Court, nor was a rehearing sought. The inconsistency thus remains. The three reported cases following Schulman maintained this inconsistency by failing to mention the contradictory Golden and Four Seas decisions. In Kemp v. Schultz,[20] the court was asked to decide if a landlord could retaliate against a residential tenant for having previously complained about the habitability of the premises. The court found in favor of the tenant, however, noting in dicta that the defense raised by the tenant in the Kemp action "cannot be interposed in an unlawful detainer action involving commercial leases," citing Schulman.[21]

The overall policies of Schulman were affirmed in Custom Parking, Inc. v. Superior Court,[22] yet the court found that where strong public policy considerations are present, a commercial tenant could assert retaliatory eviction as an affirmative defense to a landlord's unlawful detainer action. In Custom Parking, .a landlord sought to evict tenants because the tenants refused to perjure themselves at the landlord's request in a trial in which the landlord and other parties were involved. The court found that where strong public policy considerations exist, the residential commercial lease distinction would be overcome by those policy considerations; in this case, the public policy was that against suborning perjured testimony. In Custom Parking, however, the court of appeal affirmed the basic residential/commercial distinctions enunciated in Schulman. The decision in Custom Parking referred to the "sound analysis of Schulman" in discussing the validity of the commercial/residential distinction.[23]

Finally, the case of Fish Construction Co. v. Mosell Coach Works,[24] Inc. found that a commercial tenant who had vacated property prior to eviction proceedings could assert the landlord's breach of a covenant to repair and maintain the premises as a defense to the breach of lease action being brought by the landlord. In doing so, the court of appeal noted that "the defense of implied warranty of habitability is not applicable to unlawful detainer actions involving commercial tenancies," citing Schulman v. Vera.[25]

DO COMMERCIAL WARRANTIES OF HABITABILITY SURVIVE SCHULMAN?

Given the recent reliance on the Schulman decision by the courts in Fish Construction and Custom Parking, the Schulman case will now be cited as the foundation for denying commercial tenants either the warranty of habitability or the right to have the landlords' covenant to repair (either express or implied) dependent to the tenants' covenant to pay rent. These authors believe that such deference should not be given the Schulman decision. The Schulman decision was based on two major policy considerations--the need to preserve the landlord's, summary eviction remedies and the lack of strong public policy considerations for helping commercial tenants, who were considered to have more equal bargaining power

and more incentive to repair their premises than residential tenants. However, both lines of reasoning are faulty and of questionable validity. A well-thought-out attack on Schulman in the proper case may be successful.

The main concern of the court in Schulman was to preserve the unlawful detainer remedy as a summary, efficient proceeding for gaining possession of the leasehold from the tenant. As was discussed by the court in Schulman:

The real issue in determining whether a lessor's breach of covenant may be litigated by a lessee in defense of an unlawful detainer action is whether the need for litigating that matter and unlawful detainer action is so vital as to overcome the public policy underlying the summary nature of unlawful detainer .... In the case at bench, if lessees had been permitted to litigate their claim of damages from lessor's breach of covenant to repair, the summary nature of the unlawful detainer procedure would have been destroyed. There would have been injected into the action issues of whether or not lessees properly notified the lessors of the need for repairs, whether the repairs were in fact needed, whether or not lessors failed to repair within a reasonable time, the nature and extent of the damages resulting from the failure to repair, whether or not the lessees took proper measures to mitigate damages, the reasonable cost of making the required repairs, and whether or not lessees had the means to have the repairs made by themselves."[26]

The Schulman decision ignored that each of these "parade of horribles" defenses is the same defense that a residential tenant can assert when he undertakes his "repair and deduct" remedy for the landlord's breach of the warranty of habitability. The preservation of the "summary nature" of the unlawful detainer proceeding has not been a factor in permitting the defense in the residential context. In fact, the courts have now recognized that complicated, lengthy defenses may be litigated in unlawful detainer proceedings. For instance, in Asuncion v. Superior Court,[27] the court of appeal found that claims of fraud, deceptive practices, and other torts as well as title defenses could be raised as defenses to an unlawful, detainer proceeding and litigated as a cross- complaint. Other courts have likewise held that complex issues such as claims of retaliatory eviction based on a tenant's assertion of statutory rights may now be litigated as defenses to unlawful detainer proceedings.[28]

The court in Schulman relied principally on Union Oil v. Chandler[29] in holding that due to the public policy in favor of a summary resolution to the landlord's possessory right, commercial lease "habitability" defenses were unsuitable for unlawful detainer proceedings.[30] However, the trend of much more recent cases than Union Oil is to permit complex or lengthy defenses to be raised in unlawful detainer proceedings.

Schulman also based its decision on the notion that the strong public policy to help residential tenants unable to otherwise afford to maintain their premises in a habitable condition was lacking in commercial settings. As Schulman stated:

The primary rationale for the decision in Green was a change of the relationship between landlord and tenant in respect to urban, residential leases, and the Court repeatedly restricted its statements and its holding to residential leases. The Court stressed the complexity of modern apartment buildings having complicated heating, electrical and plumbing systems hidden from view, the limited tenure of today's urban tenant which frequently will not justify extensive repair efforts, the unavailability to the average urban apartment dweller of financing for major repairs, and the unequal bargaining power of the landlord and tenant resulting from the scarcity of adequate housing in urban areas.[31]

The court then noted that in a commercial setting the parties are "more likely to have equal bargaining power, and more importantly, a commercial tenant will presumably have sufficient interest in the demised premises to make needed repairs and the means to make the needed repairs himself or herself, if necessary, and then sue the lessor for damages."[32]

The "equal bargaining power" justification by Schulman is faulty when applied to tenants who lease a relatively small percentage of the available space in a shopping center, shopping mall, or office building, especially if the tenant is not a subsidiary or franchise of a larger business organization. Such a small commercial tenant, realistically, has no more bargaining power than his residential counterpart. Similar to a residential tenant, a commercial tenant is usually presented a long, onerous and boiler-plate-type lease on a take-it-or-leave-it basis. As with the residential tenant, the small commercial tenant has no real ability to negotiate or change the terms of the lease. Moreover, all of the concerns of the Schulman court concerning the complexity of modern apartment buildings having "complicated heating, electrical and plumbing, systems hidden from view" are equally applicable to small commercial leaseholds. Commercial tenants often maintain a lease for only a year or two's duration, and like their residential counterparts, they have limited ability to obtain "financing for major repairs" and have limited economic incentive to make extensive repairs to their premises.

The tenant in Schulman was as financially impecunious as his residential counterpart. From the text of Schulman, it is clear that the restaurant's owner had no real financial ability to concurrently undertake the rather extensive roof repairs needed and still pay rent. Indeed, in Schulman, it can be surmised that the cost of repairs would have far exceeded the rent then due. The approach in Schulman, leaving the small commercial tenant to his civil remedies, was callous given the total lack of bargaining power possessed by the tenant, the extreme disrepair, of his leasehold, and the landlord's breach of an express covenant to keep the premises in good repair.

The reasoning in Schulman is simply incorrect in asserting that public policy considerations are lacking when a commercial tenant asserts a warranty of habitability, especially in light of the dubious public policy cited for preserving the summary nature of unlawful detainer proceedings, a public policy which in fact has been superseded by recent case law allowing complicated legal and factual issues to be litigated in the unlawful detainer forum.

THE CASE FOR EXTENDING RESIDENTIAL PROPERTY WARRANTIES TOSMALL COMMERCIAL TENANTS

Golden and Four Seas recognized distinctions between "small commercial tenancies" and other commercial tenancies. The issue which must be addressed is whether this distinction is substantial enough to mandate a softening of the Schulman rule to allow for a case-by-case balancing of the policy in favor of summary unlawful detainer proceedings versus permitting certain defenses and self-help remedies to any tenant lacking equal bargaining power with his landlord. The authors believe the distinction is significant for the reasons discussed below.

Large commercial tenants generally do not need "warranty" protection. They are able to absorb the cost of performing repairs while concurrently making timely rent payments on

the property. As such, the financial bind within which small commercial tenants find themselves is simply not applicable to large commercial tenants.

Given the rent that large commercial tenants pay for the property, the cost of repairs becomes proportionately smaller. The financial solvency of large commercial tenants enables them to pay rent, make payments for repairs on the property, and bring a lawsuit against the landlord to recover the cost in damages, all at the same time. Furthermore, the importance to the landlord of large commercial tenants enables those tenants to negotiate with their landlords on a more or less equal footing. Landlords recognize the stability factor in retaining large commercial tenants, both in creating a steady stream of income and in making the project salable. Large commercial tenants, accordingly, are often able to resolve repair or maintenance problems with their landlord without resorting to litigation.

Additionally, the terms which could be negotiated by large commercial tenants are far more favorable than those which small commercial tenants are given on a take-it-or-leave-it basis. It is feasible for a large commercial tenant to negotiate a "repair and deduct" clause in the lease.

Because of their size, the smaller commercial tenants have none of the foregoing capabilities. Without either the clout which accompanies leasing a major portion of a project or the financial means to both pay rent and make extensive repairs, the small commercial tenant is more akin to a residential tenant than the commercial tenant described in Schulman. Future judicial decisions must recognize this distinction and revise the Schulman rule in favor of a case-by-case balancing approach to habitability issues in commercial leases.

The balancing approach is not revolutionary and has been recognized in the unlawful detainer context. Consider the Custom Parking case where a commercial tenant was able to raise the defense of retaliatory eviction, based on public policy considerations, when the landlord sought to evict the tenant because of the tenant's refusal to commit perjury. In that case, the court held that even in the commercial setting "a valid defense of retaliatory eviction may be advanced if, on balance, the public policies furthered by protecting a tenant from eviction outweigh the state's interest in ensuring that unlawful detainer proceedings are truly summary."

Obviously, the clear direction of the courts is to ignore the summary nature of unlawful detainer proceedings in appropriate cases in the interest of fairness in order to afford the tenant, whether renting commercial or residential property, an opportunity to present a complete defense.

CONCLUSION

California currently does not extend residential-type habitability warranties, or repair and deduct rights, to commercial tenants. This rule was established in Schulman, which cited two reasons to support its holding. First, the court found that the harm to commercial tenants in denying the habitability defense was outweighed by the need for a summary unlawful detainer proceeding. Second, the commercial tenant was considered on a somewhat more equal footing with his landlord than the urban apartment tenant for whom these protections were designed.

However, the financial dilemma faced by a small commercial tenant is not appreciably different than that faced by a residential tenant. Like their residential counterparts, small commercial tenants lack true bargaining power and the financial ability to correct substantial defects without a right to an offset in rent. Likewise, the ability of small commercial tenants to assert residential- type habitability warranties or repair and deduct covenants, would not unduly add to the complexity of unlawful detainer proceedings, especially given recent case law expanding the defenses available to both commercial and residential tenants defending unlawful detainer lawsuits. These authors propose that rather than the "hard and fast" rule stated in Schulman, a balancing approach be adopted to protect against commercial landlord abuses.

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[1] 10 Cal.3d 616, 517 P.2d 1168, 111 Cal.Rptr. 704 (1974).

[2] Indeed, the state supreme court has expanded its ruling in Green and held that even where a tenant knew of an uninhabitable condition when he moved into an apartment, he was still entitled to offset or deduct rent payments until the premises were rendered fully habitable. As a corollary, the court held that the preexisting uninhabitable condition of the residential property may be asserted as a defense in an unlawful detainer case; this ruling has the effect of guaranteeing the residential tenant a rent-free premises until the condition is corrected. Knight v. Hallsthammar, 29 Cal.3d 46,623 P.2d 268, 171 Cal.Rptr. 707 (1978).

[3] Although the term "habitability" as applied to nonresidential housing is somewhat of a misnomer, the cases have used this term as a familiar one and this article will also refer to this warranty as one of habitability. The correct term for this warranty, however, is the warranty of fitness for a particular purpose, closely akin to the Uniform Commercial Code warranty of the same name. See Cal. U.C.C. § 2315. In the property setting, the landlord would be warranting that the leased commercial premises are fit for the purpose for which they are intended (i.e., a restaurant, store, etc.). This warranty would obviously encompass aspects of the "habitability" warranty as well, such as the right to commercial leasehold where the roof was not leaking, the plumbing was working, and adequate ventilation, heating and air conditioning was provided. See generally Greenfield & Margolies, "An Implied Warranty of Fitness in Nonresidential Leases," 5 Albany L. Rev. 855 (1981); Note, "Landlord-Tenant--Should a Warranty of Fitness Be Implied in Commercial Leases?" 13 Rutgers L.J. 91 (1981)

[4] 108 Cal.App.3d 552, 166 Cal. Rptr. 620 (1980).

[5] It is true that Green spoke of the "habitability of the dwelling unit" as the very essence of the residential lease (10 Cal.3d at 635). However, the "habitability," or usability of a commercial setting is no less important to the commercial tenant as is the condition of a dwelling unit to the residential tenant.

[6] In fact, the seminal case on residential warranties, Reste Realty Corp. v. Cooper, 53 N.J. 444, 251 A.2d 268 (1969), involved the rent of residential premises at the basement of a commercial building.

[7] 55 Cal.3d 948, 128 Cal.Rptr. 69 (1976).

[8] Id. at 962.

[9] A few foreign jurisdictions have not foreclosed the extension of the warranty of habitability to commercial leases, among them Illinois (Ing v. Levy, 26 Ill. App.3d 889, 326 N.E.2d 51 (1975); McArdle v. Courson, 82 Ill. App.3d 123,402 N.E.2d 292 (1980)) and Pennsylvania (Pawco, Inc. v. Bergman Knitting Mills, Inc., 283 Pa. Super. 443,424 A.2d 891 (1980); Teodori v. Werner, 490 Pa. 58, 415 A.2d 31 (1980). Dicta in several decisions has indicated that certain foreign jurisdictions may have not foreclosed the imposition of residential warranties to commercial leaseholds. See, e.g., Olson v. Scholes, 17 Wash. App. 383,391,563 P.2a 1275 (1975) ("It may well be that a situation will arise where such a warranty should be imposed in a commercial lease, but we decline to do so in this case."); Vernes v. American Dist. Tel. Co., 312 Minn. 33, 251 N.W.2d 101 (1977).

[10] 81 Cal.App.3d 604, 146 Cal.Rptr. 531 (1978).

[11] ld. at 613.

[12] Presumably, this meant in the proper case that a court could find that a commercial tenant possessing a warranty of habitability could offset his rent on the basis of the habitability warrant was dependent upon the landlord's warranty that the premises would be kept in proper condition.

[13] 108 Cal.App.3d 552, 166 Cal.Rptr. 620 (1980).

[14] In fact, the landlord in Schulman expressly covenanted to the tenant that the building would be kept in good repair. Id. at 556.

[15] Surprisingly, the tenant apparently did not support his argument with citation of the earliest cases of Four Seas Investment Corp. and Golden v. Conway, as the court in Schulman found that there was no authority for permitting residential warranties of habitability or the concept of dependent rent and warranty covenants to be extended to commercial properties.

[16] Schulman, 108 Cal.App.3d at 560-561.

[17] Id. at 563.

[18] Id. at 561, 563

[19] Id.

[20] 121 Cal.App.3d Supp. 13 (1981)

[21] Kemp, 121 Cal.App.3d Supp. at 16

[22] 138 Cal.App.3d 90, 187 Cal.Rptr. 674 (1982)

[23] Id. at 101

[24] 148 Cal.App.3d 654, 196 Cal.Rptr. 174 (1983)

[25] Id. at 658

[26] 108 Cal.App.3d at 562-563

[27] 108 Cal.App.3d 141, 166 Cal.Rptr. 306 (1980)

[28] See, e.g., Ernst Enterprises, Inc. v. Sun Valley Gasoline, Inc., 139 Cal.App.3d 355, 188 Cal.Rptr. 641 (1983)(defenses under Cal. Bus. & Prof. Code § 20999.1 pertaining to gasoline station franchises may be litigated as defenses to unlawful detainer); Vargas v. Municipal Ct., 22 Cal.3d 902, 587 P.2d 714, 150 Cal.Rptr. 918 (1978) (retaliatory eviction defenses under the Agricultural Labor Relations Act may be asserted in unlawful detainer proceedings).

[29] 4 Cal.App.3d 716, 84 Cal.Rptr. 756 (1970)

[30] Schulman, 108 Cal.App.3d at 561-562

[31] Id. at 560-561

[32] Id.