

LAW SEMINARS INTERNATIONAL:
COMMERCIAL REAL ESTATE LEASES

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I. SCOPE OF MATERIALS

These materials focus on certain legal and equitable remedies available in the State of Arizona to a landlord in a commercial lease transaction. Where deemed appropriate in relation to the remedies discussed, some consideration will also be given to certain drafting suggestions.

These materials are not exhaustive of all available legal and equitable remedies and do not constitute a general discussion of commercial leases or the most common provisions in commercial leases. Excluded from coverage are specific references to tenant rights or remedies and no attempt is made to cover or include residential lease transactions. Also excluded from coverage in these materials is the filing of a petition for relief under the United States Bankruptcy Code, as this topic will be addressed by another seminar panel member. Finally, there is no coverage herein regarding environmental law issues because environmental law concerns will also be addressed by another presenter at this seminar.

Readers should bear in mind that these materials reflect only the viewpoints of the writers as to issues presented and while it is hoped these materials will be helpful, they may not be construed as an opinion binding upon the writers or their firm.

II. INTRODUCTION

The remedies of a landlord in a commercial lease transaction in Arizona are governed by: (1) statute, particularly Arizona Revised Statutes (hereinafter “A.R.S.”), Sections 33-301, et seq.; (2) Arizona case law that interprets and/or supplements statutory law; (3) the common law, except to the extent modified by statute, Arizona case law, or by the state or local legal systems (See A.R.S. § 1-201; Valley National Bank of Arizona v. AVCO Development Co., 14 Ariz. App. 56, 480 P.2d 671 (1971)); and (4) the provisions of the particular lease in question. Compare Peter D. Baird, A Study of Arizona Lease Terminations, 9 Ariz. L. Rev. 187, 187-192

(1967).¹ Knowledge and use of the law and principles governing remedies can be of invaluable assistance in the drafting, negotiation, and enforcement of commercial leases.

In commercial real estate lease negotiations, parties sometimes have a tendency to ignore, release or minimize traditional remedies available to them under applicable law. The parties may not fully understand the impact of deleting or waiving these remedies. One of the benefits a lawyer can provide is to counsel with his/her client during the negotiation and drafting processes to help the client understand the role of the various remedies and the general consequences of waiver or deletion of those remedies. It is hoped that these materials may assist in that effort.

Tenant breach problems in Arizona generally include (1) the failure of the tenant to pay rent or other charges due under the lease (collectively “Rent”) (sometimes called “monetary” defaults); (2) the failure of the tenant to abide by or comply with obligations other than the payment of Rent (sometimes called “non-monetary” defaults); and (3) the abandonment of the leased premises before the term expires and/or while Rent is or will become due and owing. The discussion of remedies will be generally organized into the above three categories of defaults.

In these discussions it is assumed that a landlord will have available to it all remedies available to landlords in Arizona at law or in equity. It should be noted that if a lease fails to specify that all other legal and equitable remedies remain available to a landlord, it may limit the remedies available to only those expressly contained in the lease. Wilson v. Pate, 17 Ariz. App. 461, 462, 498 P.2d 535, 536 (1972); Camelback Land & Investment v. Phoenix Entertainment Corp., 2 Ariz. App. 250, 255, 407 P.2d 791, 797 (1965). A party may specify that the remedies provided for in the lease are in addition to and not in lieu of other rights and remedies provided by law or in equity. Roosen v. Schaffer, 127 Ariz. 346, 348, 621 P.2d 33, 35 (Ct. App. 1980).

¹ The Baird article can also be very useful as a historical background of the subject of commercial lease terminations.

III. GENERAL CONCEPTS APPLYING TO LEASES

A. Real Property and Contract Nature of a Lease

1. A lease constitutes an interest in real property. Valley National Bank of Arizona v AVCO Development Co., 14 Ariz. App. 56, 58, 480 P.2d 671, 673 (1971). The real property interest is governed by real property law. However, the real property interest is contingent on the right to possession and without this right the real property interest may be extinguished. In re Bricker, 43 Bankr. Rep. 344, 346 (1984).
2. Contract law permits an extension of rights and remedies beyond the termination of the possessory interest. Thus, if a lease so provides, contract remedies are available. Roosen v. Schaffer, 127 Ariz. 346, 621 P.2d 33 (Ct. App. 1980); Camelback Land & Inv. Co. v. Phoenix Entertainment Corp., 2 Ariz. App. 250, 407 P.2d 791 (1965).
3. Rent and Damages
The real property remedy is for rent; the contract remedy is for damages and is subject to mitigation. Roosen v. Schaffer, 127 Ariz. 346, 621 P.2d 33 (Ct. App. 1980).

B. Statutory Provisions

1. At common law because leases were not considered to contain mutually dependent covenants, a landlord could not terminate the lease for the tenant's failure to pay rent. See the Baird article, cited infra, at 188-189. The Arizona Legislature remedied this situation by enacting A.R.S. § 33-361(A) which gives a landlord the right to terminate on two grounds: (a) failure to pay rent for at least five days after the date due; and (b) violation

of other lease provisions, both of which rights are subject to limitations established by law.

2. To exercise a right to terminate a lease, the landlord may use self-help or pursue judicial action. A landlord may re-enter and take possession of leased premises or bring an action in forcible detainer. A landlord may assert a lien on the tenant's personal property and seize that which is necessary to secure Rent payment. Janes v. Country Escrow Service, 135 Ariz. 231, 660 P.2d 482 (Ct. App. 1983). This lien is enforceable against an assignee or sublessee in the same manner as against the original tenant. A.R.S. §33-361(E).
3. Action taken pursuant to A.R.S. § 33-361 terminates the lease. In re Bricker, 43 Bankr. Rep. 344 (D. Ariz. 1984).

IV. REMEDIES FOR MONETARY DEFAULT

A. Self Help Remedies

1. Lock-Out: Following an appropriate default, a landlord may re-enter and take possession of leased premises pursuant to A.R.S. § 33-361(A). This may be accomplished by a lock-out or by judicial action. As for a lock-out, while advisable in most cases, apparently no notice is required unless the lease so requires. Janes v. Country Escrow Service, 135 Ariz. 231, 660 P.2d 482 (Ct. App. 1983).
 - a. Re-entry terminates the tenant's right to possession and the lease (absent contract provisions to the contrary). The tenant is relieved of further liability under the lease unless a contract remedy is provided therefor. See infra IV. B. 1. b. v., p. 25.

- b. A lock out must not involve a breach of the peace. It is recommended that a lock-out be accomplished by changing locks and posting a notice.

2. Landlord's Liens

There are two types of landlord's liens which may be placed upon the tenant's property: (a) statutory, pursuant to A.R.S. §§ 33-361 (D) and 33-362; and (b) contractual, i.e., a security interest governed by the Uniform Commercial Code ("UCC") as enacted in Arizona. United States (Treasury Dept., IRS) v. Globe Corp., 113 Ariz. 44, 49-50, 546 P.2d 11, 16-17 (1976).

- a. Statutory Landlord's Lien

A.R.S. § 33-361(D) grants landlords a lien upon the tenant's personal property if the tenant fails to pay Rent. A.R.S. § 33-362(A) grants the landlord a lien upon "all property" of his tenant not exempt by law. Arizona courts have not reconciled what is meant by personal property (A.R.S. § 33-361(D) and all property (A.R.S. § 33-362(A)), but certainly the argument can be made that each statute gives rise to a separate lien and the lien of A.R.S. § 33-362(A) is broad enough to cover literally all kinds of a tenant's property, including fixtures, intangibles, notes, drafts, receivables, accounts, etc. that may be described as being located upon or used on the premises. See Annotation; Subject Matter Covered by Statutory Lien For Rent, 9 A.L.R. 300, 313 (1920),

and cases cited therein. For a definition of “personal property,” see A.R.S. § 1-215.

i. Attachment

- a. The lien attaches to the personal property at the later to occur of the commencement of the tenancy or the moment the personal property is brought onto the premises. Bates & Springer of Arizona, Inc. v. Friermood, 109 Ariz. 203, 205, 507 P.2d 668, 670 (1973); Ex-Cell-o Corp. v. Lincor Properties, 158 Ariz. 307, 309, 762 P.2d 694 (Ct. App. 1988).
- b. It attaches to property not exempt by law, placed upon or used on the premises, and not belonging to a third person. A statutory landlord’s lien will also attach to the personal property of a sublessee even if there is no written sublease, provided that the sublessee is liable for rent as a possessor of the leased premises under A.R.S. § 33-323. State ex rel. Childers v. East Ariz. Biltmore Circle Corp., 152 Ariz. 295, 731 P.2d 1239 (Ct. App. 1986). The lien does not secure rent accruing after tenant’s death, bankruptcy or assignment for benefit of creditors. A.R.S. §§ 33-362(A) and (B). Property sold in the usual course of business and removed

from the premises is exempt from the lien as well. Bates & Springer of Arizona, Inc., 109 Ariz. at 205, 507 P.2d at 670.

- c. Because the lien is for rent due, no notice is necessary to assert the lien. Lake v. Stewart, 117 Ariz. 520, 573 P.2d 920 (Ct. App. 1977).
- d. Special rules for crops are found in A.R.S. §33-362(C).

ii. Priority

Statutory liens are excluded from the UCC and do not constitute security interests as defined therein. A.R.S. §47-9104(2).

- a. The rule established in Bates & Springer of Arizona, Inc., is that a statutory landlord lien's priority will be determined in accordance with case law precedent rather than the UCC. Bates & Springer of Arizona, Inc., 109 Ariz. at 206, 507 P.2d at 671. Case law rules, however, are not well established and may lead to confusion when asserting priority against UCC Article Nine security interests. See Ex-Cell-o, 158 Ariz. at 309 (following the approach dictated by the UCC because "it is a more practical, logical approach

which conforms with the mobile life-style of our times”).

- b. The landlord’s lien priority dates from the later of the date of the lease or the time the personal property is placed on the premises and is superior to any subsequent lien on the personal property. Gila Water Co. v. International Finance Corp., 13 F. 2d 1 (9th Cir. 1926). Gila Water Co. concerned crops, but this statement was later reaffirmed in Dewar v. Hagans, 61 Ariz. 201, 146 P.2d 208 (1944).
- c. A landlord’s lien is inferior in priority to a UCC Article Nine security interest that covers goods before they are brought onto the leased premises. The Arizona Court of Appeals has reached this conclusion because a different rule “would mean that a party holding a security interest in goods subsequently brought onto premises leased by the debtor could never take priority over the landlord’s lien, even though his interest was perfected before the goods arrived on the leasehold” and the court did not believe that the legislature desired such a result. Ex-Cell-o, 158 Ariz. at 309.

- d. A landlord's lien is also inferior to a conditional sales contract and a trust receipt that cover the property before it is brought on the premises because a tenant only brings onto the property "the interest remaining after the conditional seller's interest." Schatt-Ajax Industries v. Churchill, 3 Ariz. App. 34, 37, 411 P.2d 457, 460 (1966); Bates & Springer of Arizona Inc., 109 Ariz. at 206, 507 P.2d at 671.
- e. Federal tax liens take priority over a landlord's lien unless the landlord's lien is perfected at the time the federal lien is filed. To be perfected, for purposes of priming a federal tax lien, the actual amount of the lien, the property to which it is attached, and the landlord's identity must be known. Rent must already be in arrears and the property seized for perfection to occur for federal tax lien priority purposes. United States (Treasury Dept., IRS) v. Globe Corp., 113 Ariz. 44, 49-50, 546 P.2d 11, 16-17 (1976).
- f. Arizona Department of Revenue ("ADR") tax liens have priority over all liens that have not been recorded prior to the time the Department records a

notice of its lien. A.R.S. § 42-1824(B). This statute really does not fit a landlord's lien situation since under Arizona law one does not record or file any document in order to assert or perfect a landlord's lien. A.R.S. § 33-362. One is left to wonder how one may satisfy A.R.S. § 42-1824(B) in the assertion of such a lien. Possibilities would include any one or more of the following: (1) recordation of the lease in question; (2) recordation of a notice/statement by the landlord that it has asserted a landlord's lien, generally describing the property seized, the leased premises and the legal description of the parcel on which the premises is located; and/or (3) seizure of the property prior to recordation of the ADR notice of lien and the assertion that by seizure of the property, the landlord has "perfected" its lien (see above), which perfection satisfies the intent of A.R.S. § 42-1824(B) (For some support of this theory, see Jackson v. Phoenixflight Productions Inc., 145 Ariz. 242, 700 P.2d 1342,1347 (1985), in which the Arizona Supreme Court considered A.R.S. § 42-1824(B) in a contest between (a) a judgment and a

writ of garnishment and (b) an ADR tax lien and held that the ADR tax lien was superior based upon a finding that the writ and the judgment “did not create a lien” prior to the date upon which the ADR tax lien was recorded. Following that line of reasoning, it would seem that if a landlord’s lien were “created” (i.e., “perfected”) by seizure of the property prior to the recordation of an ADR lien notice, then the landlord’s lien should have priority). A landlord should also check applicable city ordinances regarding priority of city tax liens. See, e.g., Article I, Section 14.31.1 and Article V, Section 14-590 of Chapter 14 of the Phoenix City Code (providing that all liens are subordinate to city tax liens unless recorded before the notice of the City’s tax lien). Research did not reveal Arizona cases regarding a contest in priority between a city tax lien and a landlord’s lien.

iii. Enforcement

- a. The landlord “may seize for rent any personal property of his tenant found on the premises.” A.R.S. § 33-362(A). Despite the language of A.R.S. § 33-361(D), which provides that the

landlord may seize only as much property as necessary to secure the rent, the lien apparently covers all the property and therefore the landlord may seize all the property. Janes v. Country Escrow Service, 135 Ariz. 231, 660 P.2d 482 (Ct. App. 1983).

- b. The landlord can institute an action for possession if the tenant refuses to yield possession. A.R.S. § 33-362(B). These actions are brought pursuant to the replevin statutes, A.R.S. §§ 12-1301 to 1314.
- c. The landlord does not waive statutory lien rights by taking other actions. Attachment and garnishment may be pursued because (although the attachment and garnishment statute prohibits this remedy if the debt is fully secured) a statutory lien is not fully secured until a landlord reduces it to possession. Prior to actual seizure the landlord cannot know the extent of the security. Kaminski v. Walpole, 10 Ariz. App. 260, 458 P.2d 127 (1969).
- d. Enforcement of a landlord's lien will not give rise to conversion even if there has been a wrongful termination of the lease, provided Rent is in arrears.

Janes v. Country Escrow Service, 135 Ariz. 231, 660 P.2d 482 (Ct. App. 1983).

iv. Sale of Property

- a. If the rent is unpaid within sixty days after seizure, the landlord may sell the property. A.R.S. § 33-361(D).
- b. At least 10 days prior to the sale of the property, the landlord must make demand upon a tenant whose residence is located in the county where the property is located to pay the delinquent rent, specifying the amount due. If the tenant fails to pay the specified sum within 10 days, the landlord may proceed with the sale. A.R.S. § 33-1023(A). The landlord need not give the 10 day notice and opportunity to cure to an owner whose residence is not in the county where the property is located. Id. A lease may require a longer notice period.
- c. The sale shall be by public auction, upon five days' notice to the tenant of the date, time and place of the sale if he can be found, and if not, then the landlord must give notice by two publications in a newspaper published in the county. A.R.S. § 33-1023(A) and (B).

- d. The proceeds of the sale shall be applied first to accrued charges, the remainder to the “person entitled thereto”. A.R.S. § 33-1023(A). If the person so entitled is unknown or removed from the county, the balance shall be paid to the state school fund. An individual has two years to establish his right to such funds. A.R.S. § 33-1023(C).
 - e. The procedure for sale of motor vehicles must be in accordance with the Arizona Transportation Department, Motor Vehicles Division. A.R.S. § 28-1401 et seq.
- b. Contractual Liens
- i. The UCC specifically excludes landlord’s liens from Article Nine Secured Transactions. A.R.S. § 47-9104(2). In United States v Globe Corp., 113 Ariz. 44, 546 P.2d 11 (1976), the court held, however, that contractual liens in a lease, unlike statutory landlord’s liens, are not excluded from the UCC. Consequently, contractual liens constitute Article Nine security interests in favor of the landlord and are subject to the UCC requirements.
 - ii. The lease itself may constitute a security agreement if the lease document satisfies the requirements for a security agreement. A.R.S. § 47-9203.

iii. Perfection

- a. Perfection may be by possession of the goods. A.R.S. § 47-9305. Goods seized pursuant to a statutory landlord's lien may become perfected under the UCC as well.
- b. Filing a financing statement is the alternative method of perfection and is preferable in order to secure first-in-time priority. The lease itself may be filed as a financing statement if it contains the names of the debtor and the secured party, it is signed by the debtor, there is an address for each party, and a description of the collateral. A.R.S. § 47-9402(A). A copy of the lease-security agreement is sufficient if the copy is signed by the debtor. Id. A reproduction is sufficient if the security agreement so provides or if the original is filed in this state. Id. Alternatively, a UCC-1 financing statement, signed by the lessee may be filed. These must be filed in the UCC index for financing statements as required by the UCC. The landlord must file the financing statement with either the office of the Secretary of State or in the

office of a County Recorder depending upon the type of the collateral. See A.R.S. § 47-9401.

iv. Default

The rights of the landlord upon tenant's default are governed by Chapter 5 of Article 9.

- a. Unless otherwise agreed, the landlord may, without judicial process, take possession of the collateral if this can be done peaceably. A.R.S. § 47-9503.
- b. The landlord may sell the collateral by public or private sale but must provide the notice required in Article 9 and conduct the sale in a commercially reasonable manner. See A.R.S. § 47-9504(C).
- c. Proceeds of the sale shall be applied in the following order to:
 - Expenses of sale including attorneys' fees
 - Satisfaction of indebtedness
 - Satisfaction of indebtedness of subordinate security interest
 - The debtor. A.R.S. § 47-9504(A)
- d. The landlord in possession may retain the collateral in satisfaction of the debt unless, in the case of non-consumer goods, other secured parties object. A.R.S. § 47-9505(B).

- e. The tenant or other secured party may redeem the collateral at any time before its disposition pursuant to A.R.S. §§ 47-9504 or 47-9505. A.R.S. § 47-9506.
- c. Retention of Security Deposit or Prepaid Rent and Application thereof to the Monetary Default
 - i. A lease clause that provides for retention of advance rent as liquidated damages is generally upheld. Grizzle v. Runbeck, 74 Ariz. 92, 244 P.2d 1160 (1952).
 - ii. If advance rent payment is made as security for performance and the sum is treated as a trust fund to which the landlord may look when damages are proved, it is valid only to that extent. Loew v. Antonick, 82 Ariz. 204, 310 P.2d 825 (1956).
 - iii. An advance payment made in “consideration of the lease” execution is nonrefundable upon tenant’s default. Id.
 - iv. A “security deposit” or “advance rent” payment generally may not be forfeitable upon tenant’s default. Id.; but see Thompson v. Harris, 9 Ariz. App. 341, 346, 452 P.2d 121, 127 (1969) (note, however, that landlord could retain tenant’s prepaid rent in partial satisfaction of lease obligation).

B. Court Actions

1. Forcible Entry and Detainer

- a. Upon tenant's violation of the lease and the expiration of five days, the landlord may commence an action to retake possession of the premises. A.R.S. § 33-361(A). The action brought for possession must be in the nature of and is governed by the forcible detainer statutes. A.R.S. § 33-361(B).
- b. Forcible detainer actions are summary, statutory proceedings that must be brought and maintained in strict accordance with A.R.S. § 12-1171 et seq. The only issue to be determined in such an action is the right to present and actual possession of the premises. Andreola v. Arizona Bank, 26 Ariz. App. 556, 557, 550 P.2d 110, 111 (1976). A forcible detainer action may be maintained against a tenant who is not in actual possession of the premises at the commencement of the action. Standage v. Planned Investment Corp., 160 Ariz. 287, 772 P.2d 1140 (Ct. App. 1988). The defendant need only claim that he or she is entitled to exercise dominion and control and not have abandoned his or her claim. *Id.* Counterclaims, offsets and title matters may not be injected or inquired into in a forcible detainer action. Id.; A.R.S. § 12-1177(A).
 - i. Some confusion may arise regarding whether written notice and demand for possession is required prior to bringing a forcible detainer action. A.R.S. § 33-361(A) provides no

“formal demand” is required. A.R.S. § 12-1173(A)(1) provides, however, that there is no forcible detainer without first giving a written demand for possession. The court in Alton v. Tower Capital Co., 123 Ariz. 602, 601 P.2d 602 (1979), resolved the question in favor of requiring the five day notice then required by A.R.S. § 12-1173(A)(1). The five day requirement has since been deleted from the statute and only “written demand” for possession is required. A.R.S. § 12-1173 (pocket part, 1986). Thus, written demand for possession is apparently required prior to instituting an action in forcible detainer but the timing is uncertain. Because A.R.S. § 33-361(A) still refers to rent being due and unpaid for five days before a right to terminate ripens, it is recommended that the five day period be used.

- ii. A tenant may assert only those defenses that would obviate the landlord’s right to possession. DVM Co. v. Stag Tobacconist Ltd., 137 Ariz. 466, 671 P.2d 907 (1983). Absent lease provisions to the contrary, a landlord’s unreasonable failure to consent to an assignment is actionable and may subject the landlord to liability for damages. See Esplendido Apts. v. Metro Condo Ass’n., 158 Ariz. 487, 489, 763 P.2d 983 (Ct. App. 1988) vacated

161 Ariz. 325, 778 P.2d 1221 (1989). Furthermore, if refusal is unreasonable, consent may be implied by operation of law, and the assignee entitled to possession. Tucson Medical Center v. Zoslow, 147 Ariz. 612, 615, 712 P.2d 459, 462 (Ct. App. 1985). Similarly, courts will hear the affirmative defense of waiver of the alleged default. Cottonwood Plaza Associates v. Nordale, 132 Ariz. 228, 332, 644 P.2d 1314, 1318 (Ct. App. 1982).

- iii. If the tenant/defendant is found guilty of forcible detainer, the landlord/plaintiff is entitled to possession of the premises, plus costs and, at the landlord's option, all "rent" found to be due and owing as of the date of judgment. A.R.S. § 12-1178(A). Charges due under the lease that are not characterized by the lease as "rent" are not recoverable in a forcible detainer action. T.H. Properties v. Sunshine Auto Rental, Inc., 151 Ariz. 444, 728 P.2d 663, 665 (Ct. App. 1986). A writ of restitution shall be granted, but may not be issued until five days after the judgment is rendered. A.R.S. § 12-1178(C).
- iv. Attorneys' fees are not available in a commercial forcible detainer action. See Foundation Development Corp. v. Loehmann's, Inc., 162 Ariz. 26, 780 P.2d 1074 (Ct. App. 1988) vacated by 56 Ariz. Adv. Rep. 8 (March 15, 1990)

(denying a landlord's request for attorney's fees stating "we have been unable to find any statutory provision allowing attorney's fees in a commercial forcible detainer action"). Rather, a separate action must thereafter be brought to seek recovery of attorneys' fees. DVM Co. v. Stag Tobacconist, Ltd., 137 Ariz. 466, 671 P.2d 907 (1983).

- v. Frequently, leases provide that an action for forcible detainer will not operate to terminate the lease. The intent is to permit possession to be swiftly transferred while preserving the right to accrue future rent. However, the United States Bankruptcy Court for the District of Arizona, in the case of In re Bricker, 43 Bankr. 344, 346 (D. Ariz. 1984), in interpreting Arizona law, held that a lease terminates upon re-entering the premises pursuant to A.R.S. § 33-361. Nonetheless, recovery of damages for future rent is possible if the lease is drafted so as to provide for a contractual right to recover the value of future rents as damages, subject to the landlord's duty to mitigate its damages. See Roosen v. Schaffer, 127 Ariz. 346, 348-49, 621 P.2d 33, 34-35 (Ct. App. 1980); Thomas v. Given, 75 Ariz. 68, 251 P.2d 887 (1952). Such a damages clause should clearly provide that the right to damages based upon future rent shall survive the termination of the lease.

vi. In a forcible entry and detainer action the court held that where the lease rental is based in part upon a minimum fixed rent and in part upon a percentage of the tenant's sales and where the fixed rent is found to be inadequate and below market, a covenant of continuous operation may be implied upon certain conditions and enforced against the tenant, entitling the landlord to damages for rent calculated on the basis of the lease's percentage rent provisions. First American Bank & Trust Co. v. Safeway Stores Inc., 151 Ariz. 584, 729 P.2d 938 (Ct. App. 1986). The First American Bank holding is broad enough to be applied outside of the forcible entry and detainer context. See also, Carter v. Safeway Stores Inc., 154 Ariz. 546, 744 P.2d 458 (Ct. App. 1987), a breach of lease case which distinguished First American Bank, holding that the covenant of continuous operation will not be implied where, even without the payment of percentage rent, the fixed rent is a fair market rent.

2. Action on Contract

a. Acceleration of Future Rent Based Upon Present or Past Default.

An acceleration clause demands immediate payment of future rents. Although other states have upheld such clauses, research found no cases yet in Arizona expressly interpreting whether such

clauses are enforceable. See, e.g., Emrich v. Joyce's Submarine Sandwiches, Inc., 751 P.2d 651 (Colo. App. 1987); Sunset Fuel & Engineering Co. v. Compton, 97 Or. App. 244, 775 P.2d 901 (1989), rev. den., 308 Or. 466 (1989). This discussion will, therefore, refer only to the position of the Restatement (Second) of Property. It should be recognized, however, that no Arizona court has yet accepted this Restatement position. A landlord may not terminate a lease if an acceleration clause is to be enforced. Restatement (Second) of Property § 12.1 comment k. The rental acceleration clause, while permitting an acceleration of rent, must also have a present value discount factor or a mitigation factor incorporated. Otherwise it may be deemed unconscionable. Id. The Restatement also cautions that if the tenant provides adequate security for the payment of rent as it accrues, this may prevent the acceleration clause from being enforceable. Id. The reader should also note that even if an acceleration clause is enforceable, Arizona landlords have a duty to mitigate their damages and thus recovery on an acceleration clause may not be permissible until either the lease term has expired or the duty to mitigate damages has been fulfilled. See Roosen v. Schaffer, 127 Ariz. 346, 621 P.2d 33 (Ct. App. 1980).

b. Liquidated Damages

Liquidated Damages are a generally permissible remedy under contract law. To the extent a lease is a contract, it would therefore follow that they should be enforceable in the lease context. Research did not find Arizona authority supporting such logic, however. Liquidated damage clauses must meet certain tests and penalty clauses are unenforceable.

i. “The test for whether a contract fixes a penalty or liquidated damages for a breach is whether payment is for a fixed sum or varies with the nature and extent of the breach.” Larson-Hegstrom & Assoc. v. Jeffries, 145 Ariz. 329, 333, 701 P.2d 587, 591 (Ct. App. 1985).

a. A lease should provide, therefore, that damages will reflect the length of time remaining in the lease or the rental value’s excess over market value.

b. A flat sum may be unenforceable as being a penalty.

ii. An amount agreed to prior to default must meet two tests:

a. The amount must be “a reasonable forecast of just compensation for the harm that is caused by the breach.” Id.

b. The harm caused by the breach must be difficult to estimate, or incapable of estimation. Id.; Restatement (Second) of Contracts § 356. For a

landlord, a statement that the future value and demand in the rental market is uncertain suggests difficulty of estimation.

iii. The objective of a liquidated damages clause is to compensate, not penalize. Id. at comment a.

a. An excessive amount will be deemed unconscionable. Id.

b. Reasonableness is determined as of the time of making the contract. Id.

3. Ejectment, A.R.S. § 12-1251, et seq.

An action in ejectment is prosecuted as an ordinary civil action and is, therefore, not as quickly resolved as a forcible entry and detainer action.

A.R.S. § 1251(B). An action in ejectment permits a trial of the issue of title to the premises and may serve the dual purpose of quieting title to the premises. A.R.S. § 12-1251. A prevailing landlord is entitled to immediate possession of the property, the value of the use and occupation of the property for five years or less, and rental value from date of judgment until possession is delivered. A.R.S. §§ 12-1251, 12-1256, and 12-1259. Because the remedy of forcible detainer is more expeditious, the remedy of ejectment is rarely used to regain possession of rental property.

4. Action to Recover Rent

With respect to commercial leases, an action for rent may be prosecuted pursuant to A.R.S. § 12-1271 upon any of the following conditions:

1. When rent is due and in arrears on a lease; or
2. When lands are held and occupied without a special agreement for rent, or when a tenant remains in possession after termination of his right of possession. An action for rent based upon A.R.S. § 12-1271 will lie therefore, unless the terms of the lease exclude this remedy. Camelback Land & Investment Co. v. Phoenix Entertainment Corp., 2 Ariz. App. 250, 407 P.2d 791 (1965). A.R.S. § 12-1271 permits recovery for “. . . rent, or a fair and reasonable satisfaction for the use and occupation of real property...”. The “fair and reasonable satisfaction” language has been held to permit recovery from a holdover tenant of a rental that is the “reasonable value” of the land even if the “reasonable value” is different from (higher than) the previous rental rate that was being paid by the holdover tenant during the term of the tenancy. See Anderson v. Bureau of Indian Affairs, 764 F.2d 1344 (9th Cir. 1985) (Lessee planted a crop on land with knowledge that the lease for such land was previously terminated. Lessor recovered the proceeds of the harvested crop less the costs incurred by lessee in harvesting the crop in lieu of damages equal to rent calculated at the previous rental rate). An action under A.R.S. § 12-1271 is prosecuted as an ordinary civil action and consequently, is not resolved as quickly as a forcible detainer action.

C. Potential Limitations On Remedies

1. Time of the Essence

- a. In order to require timely performance by a tenant of its obligations, a time of the essence provision must be included in the lease. Acceptance of late rent payments normally results, however, in a waiver of the right to terminate for that breach. DVM Co. v. Bricker, 137 Ariz. 589, 591, 672 P.2d 933, 935 (1983). Thus, a landlord may not idly sit by, accept late payments, and then declare a breach for failure to pay in a timely manner when it suits him to do so.
- b. A landlord may reinstate a time is of the essence provision by giving notice of the intent to reinstate, granting reasonable time to cure, and reaffirming the lease provisions. T.H. Properties v. Sunshine Auto Rental, Inc., 151 Ariz. 444, 728 P.2d 663 (Ct. App. 1986) (a three day reinstatement period was deemed sufficient).
- c. Waiver
 - i. Acceptance of rent by a landlord after notice or knowledge of a breach of the lease by the tenant for which a forfeiture of the lease might have been declared is normally deemed to constitute a waiver by the landlord of the right to declare a forfeiture for that particular breach or any other breach that occurred prior to acceptance of the rent. Butterfield v. Duquesne Mining Co., 66 Ariz. 29, 32, 182 P.2d 102, 103 (1947). But see T.H. Properties v. Sunshine Auto Rental,

Inc., 151 Ariz. 444, 728 P.2d 663, 664-665 (Ct. App. 1986) and DVM Co. v. Bricker, 137 Ariz. 589, 591, 672 P.2d 993, 995 (1983) for limited exceptions to the general waiver rule.

ii. Drafting Suggestion: Nonwaiver Clause. At least two courts have held that the presence of a nonwaiver clause in a lease will prevent acceptance of rent after knowledge of a default from constituting a waiver of the right to declare a forfeiture for such default. Cottonwood Plaza Associates v. Nordale, 132 Ariz. 228, 644 P.2d 1314 (Ct. App. 1982) (insertion of a nonwaiver clause constitutes a negotiated relinquishment of a tenant's right to claim waiver); Sec. & Exch. Comm'n v. Lincoln Thrift Ass'n, 557 F.2d 1274 (9th Cir. 1977) (acceptance of late rent payment did not act as waiver of breach that occurred by appointment of a receiver).

d. In Foundation Development Corp. v. Loehmann's, Inc., 56 Ariz. Adv. Rep. 8 (March 15, 1990), the Arizona Supreme Court limited the effect of a "time is of the essence" provision by holding that such provision will not, absent other factors, automatically convert a trivial breach into a material one. The Court stated that a time is of the essence provision is merely one factor to be considered when determining if a breach is material. Id. at 15. The inquiry

must always involve the facts of the individual case and the effect of the breach on the injured party. Id.

2. Mistake or Trivial Breach

The Arizona Supreme Court broadened the application of the mistake or trivial breach exception to a landlord's power to declare the termination of a lease. The Court in Thomas v. Given, 75 Ariz. 68, 70, 251 P.2d 887, 889 (1952), explained the exception as follows: although the general rule is that "equity cannot relieve against a statutory forfeiture, it can and will do so on the grounds of fraud, accident or mistake." Id. at 70, 251 P.2d at 889. The Thomas exception has been restated but not applied. See DVM Co. v. Bricker, 137 Ariz. 589, 592, 672 P.2d 933, 936 (1984); Bolon v. Pennington, 6 Ariz. App. 308, 432 P.2d 274 (1964) (breach must be more than "trivial"). The scope of the Thomas exception was expanded in Foundation Development Corp. v. Loehmann's, Inc., 56 Ariz. Adv. Rep. 8 (March 15, 1990). The Court held that a trivial or immaterial breach would also be sufficient grounds for granting relief against forfeiture of a leasehold. Id. at 16. The Court held that a landlord's right to forfeit a leasehold pursuant to A.R.S. §33-361 or pursuant to a lease provision is not unlimited. Id. The Court adopted the following standards set forth in the Restatement (Second) of Contracts §241 for determining the triviality or immateriality of a breach in the landlord-tenant context:

The factfinder must consider, among other things, the following:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be adequately compensated [by damages] for the part of that benefit of which he will be deprived;
- (c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
- (e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing. Id. at 13.

3. Implied Obligation of Reasonableness Regarding Requests to Assign or Sublet

- a. Three decisions of the Arizona Court of Appeals have held that a landlord may not unreasonably withhold consent to a request by a tenant to permit an assignment or subletting unless the lease expressly so permits. Esplendido Apts. v. Metro. Condo. Ass'n., 158 Ariz. 487, 763 P.2d 983 (Ct. App. 1988); Campbell v. Westdahl, 148 Ariz. 432, 436, 715 P.2d 288, 292 (Ct. App. 1985); Tucson Medical Center v. Zoslow, 147 Ariz. 612, 615, 712 P.2d 459, 462 (Ct. App. 1985).

- b. The Campbell court also held that unless a lease expressly provides otherwise, a landlord must accept or reject a proposed assignee or sublessee based upon the same criteria that the landlord used in deciding to accept the original tenant under the lease. Campbell, 148 Ariz. at 436, 715 P.2d at 292. The Zoslow court suggested a nonexclusive list of reasonable objections to a requested assignment. See Zoslow, 147 Ariz. at 615, 712 P.2d at 462.
- c. Drafting Suggestion: Assignment and Subletting Clause. In view of the Campbell and Zoslow cases, if a landlord desires maximum discretion in being able to refuse a request to permit assignment or subletting, the clause might include language similar to the following: “Tenant covenants and agrees that it shall not assign this lease or any interest therein, or sublet all or any part of the premises without Landlord’s prior written consent in each and every instance, which consent may be given or withheld by Landlord in its sole and unfettered discretion, whether or not reasonable in nature. A consent to one assignment or subletting shall not be deemed or construed as a consent to any other or further assignment or subletting.”
- d. Percentage Rent in Sublease/Assignment: If a lease provides for the payment of percentage rent and landlord elects to consent to an assignment or subletting, landlord should be careful to condition the consent upon tenant’s and sublessee’s (or assignee’s) agreeing

to pay (during the term of the sublease or assignment), an adjusted percentage rent in an amount at least equal to the estimated dollar value of percentage rent that would be expected to be paid by the original tenant if there were no sublease or assignment. See Carter v. Safeway Stores, Inc., 154 Ariz. 546, 744 P.2d 458 (App. 1987).

V. REMEDIES FOR NON-MONETARY DEFAULTS

A. Injunctive and Declaratory Relief

Both injunctive and declaratory relief are available pursuant to A.R.S. §§ 12-1801, et seq. and 12-1831, et seq., respectively. These remedies may be useful to enforce compliance with non-monetary lease covenants when termination of the lease is not desired. Injunctive and declaratory relief are governed by principles of equity. A.R.S. §§ 12-1801(3) and 12-1831. Declaratory relief may be sought either before or after a breach has occurred. A.R.S. § 12-1833. Declaratory and injunctive relief can be sought in the same action. Trico Electric Co-op v. Ralston, 67 Ariz. 358, 196 P.2d 470 (1948).

B. Other Remedies

A landlord may pursue all the remedies available for monetary defaults, described in Section IV hereof, other than an action for rent or a landlord's lien. The same limitations with regard to waiver, assignment and subletting apply.

VI. REMEDIES FOR ABANDONMENT

A. Abandonment Defined

Unjustified vacating and non-payment of Rent.

B. Election of Remedies

Arizona courts recognize two choices with regard to abandonment:

1. Accept a surrender and terminate the lease; or
2. Refuse to accept surrender and enforce tenant's obligations.

Roosen v. Schaffer, 127 Ariz. 346, 348, 621 P.2d 33, 36 (App. 1980). While these two elections are mutually exclusive by their nature, the provisions of a lease may play a large role in their actual effect and can work a blending of the two such that the landlord can refuse to accept the surrender while reserving the right subsequently to terminate for the abandonment.

C. Accepting Surrender of the Premises

1. Accepting surrender terminates the lease and relieves the tenant of liability for future rent. The landlord can sue for accrued rent and expenses due prior to the lease termination. Roosen v. Schaffer, 127 Ariz. 346, 621 P.2d 33 (App. 1980). Notwithstanding the general rule, a lease may, as in Wingate v. Gin, 148 Ariz. 289, 293, 714 P.2d 459 (App. 1985), provide that a landlord may terminate and recover not only past rent, but also the rent for the remainder of the term in excess of the then reasonable rental value of the premises or, alternatively, the rent in excess of that amount recouped via mitigation efforts. Id. This result is possible because of the contractual provisions of the lease. The doctrine of anticipatory breach, although unaddressed in Arizona, is gaining acceptance in lease contract law in cases of abandonment as courts accept the contractual nature of a lease. See Kwall, Retained Jurisdiction in Damage Actions Based on Anticipatory Breach, 37 Case W. Res. 273, 282-83 (1986); see also Cal.

Civ. Code § 1951.2 West Supp. 1984) (lessor's remedies include anticipatory breach).

2. Abandonment and Surrender are Questions of Intent.

a. Surrender by operation of law occurs when there has been an initial abandonment by the tenant and a subsequent unqualified retaking by the Landlord. Riggs v. Murdock, 10 Ariz. App. 248, 251, 458 P.2d 115, 118 (1969).

b. The question often arises whether the landlord has exercised control for his own benefit or on behalf of the tenant. Id. If the tenant agrees to landlord's reletting on tenant's behalf, or if the landlord expressly refuses to accept a surrender, the landlord acts as an agent and is not accepting surrender. Id. Thus, repossession and attempts to relet alone may not be sufficient to indicate acceptance of surrender if it can be shown that these steps were merely an attempt to mitigate damages by seeking to relet the premises for the account of the tenant.

c. A landlord should avoid conduct indicating acceptance of surrender unless he/she intends to release the tenant from liability for future rent. A landlord should:

i. Continue to demand rent and expressly state that landlord has not accepted any surrender of the premises.

ii. not refund security deposit.

- iii. In correspondence, refer to the “default” and not “surrender”, “forfeiture”, “termination”, etc.

D. Refusal to Accept a Surrender of the Premises

By refusing to accept surrender of the lease a landlord may hold a tenant liable for rent and sue from time to time therefor as it accrues.

1. A landlord who refuses to accept surrender and who recovers possession of the premises, must make reasonable efforts to mitigate damages. Wingate v. Gin, 148 Ariz. 289, 291, 714 P.2d 459, 461 (Ct. App. 1985); Roosen v. Schaffer, 127 Ariz. 346, 349, 621 P.2d 33, 36 (Ct. App. 1980). The efforts need only be reasonable, not “heroic”. Wingate, 148 Ariz. at 291, 714 P. 2d at 461; see also Butler Products Company, Inc. v. Roush, 153 Ariz. 500, 738 P.2d 775 (App. 1987) (landlord’s attempt to relet at 8% above rental stated in defaulting tenant’s lease would not mandate a finding that the landlord was acting on its own behalf rather than merely trying to mitigate its damages resulting from the default of the tenant). A landlord should create a record establishing efforts to mitigate.
2. Drafting Suggestion: To avoid termination include provisions which specify non-terminating actions that landlord may take upon tenant’s abandonment. Specify that these actions will not release the tenant from liability for future rents or other obligations under the lease. Specify further that damages to landlord shall include all expenses incurred in relation thereto.
 - a. Landlord may lease a greater or lesser area than the original lessee’s area.

- b. Landlord may relet for a longer or shorter term.
 - c. The landlord may change or remodel the premises to suit the new lessee's use.
 - 3. State that landlord's actions do not constitute acceptance of surrender.
Define an acceptance method requiring written notice.
- E. Drafting Suggestion: Elements of Damages Must be Specified in the Lease
Define the elements of damages that the tenant will be liable for in the event of default. The damages may include the following:
 - 1. Legal expenses and costs incurred;
 - 2. Reletting costs including advertising, brokerage and management commissions, and repairs for reletting;
 - 3. Alteration and remodeling costs;
 - 4. Costs of protecting and caring for the premises while vacant; and/or
 - 5. Cost of removing and storing tenant's property.
- F. Other Remedies
Whether the landlord accepts or refuses to accept surrender of the premises, the landlord may pursue all those remedies described in Section IV hereof (except those for possession of the premises), and is subject to the same limitations described therein.

VII. CONCLUSION

This outline discusses certain remedies available under commercial leases in the case of monetary defaults, nonmonetary defaults, and abandonment. Remedies for monetary defaults include: 1) repossession of the premises; 2) enforcement of a landlord's lien; 3) a forcible entry and detainer action; 4) an action on the contract; 5) an action for

ejectment; and 6) an action for rent. Remedies for non-monetary defaults include: 1) declaratory relief; 2) injunctive relief; 3) repossession of the premises; 4) a forcible entry and detainer action; 5) an action on the contract; and 6) an action for ejectment. Remedies for abandonment include: 1) accepting surrender of the premises and terminating the lease; 2) refusing to accept surrender of the premises and collecting mitigated damages; 3) enforcing a landlord's lien; 4) an action on the contract; and 5) an action for rent. A lease cannot contravene applicable statutes but it may both limit or expand statutory or common law remedies.