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Landlord and Tenant - Leases - The Validity of Rent Acceleration Clauses

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a reasonable time. Although this may work a heavy hardship upon a promisor who is forced to pay before he feels himself able, to hold such language as a condition precedent would work a heavier hardship upon a promisee who might never receive value for what he has given. However, the hardship on the promisor could be lightened, to a certain extent at least, by construing a reasonable time most liberally in favor of the promisor. To the average person this would seem the fairest of two difficult alternatives. He would consider such a promise as one requiring payment at some time.

Thus in the light of the balancing of the hardships and an attempt at substantial justice, the Wisconsin court in any future decision should, it seems, follow the lead of the Iowa court in *Sanford v. Luce.*

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Landlord and Tenant—Leases—The Validity of Rent Acceleration Clauses—The plaintiff leased premises to the defendant for a three year period, rent payable monthly in advance. Under the terms of the lease,[1] the lessor, without demand or notice, could lawfully declare the term ended and re-enter the premises should the lessee default in any of his contractual obligations. Furthermore, the lessor had an option, in addition to his other remedies on default, to give the lessee written notice of any default or neglect and to advise the lessee that unless all the conditions and covenants of the lease were complied with within thirty days, the entire rent for the remainder of the term would become immediately due and payable. Eight months after the beginning of the term, the lessee vacated the premises and shortly thereafter defaulted in the payment of the rent due. The lessor brought an action for rent on the rent acceleration clause in the lease. Judgment was rendered for the lessor, and the lessee appealed. *Held:* Judgment for the plaintiff reversed. Any clause in a lease of real property for rent acceleration effective upon the breach of a covenant to pay rent is void since it is either an agreement for liquidated damages, when the damages are readily ascertainable, or a penalty. *Ricker v. Rombough, 261 P. 2d 328 (Cal. 1953).*

The courts are not in agreement concerning the validity of rent

[1] "Lessor may likewise at lessor's option and in addition to any other remedies which lessor may have upon such default, failure or neglect, give to lessee written notice of such default, failure or neglect and advise lessee thereby that, unless all the terms, covenants and conditions of the lease are fully complied with within thirty (30) days after giving of said notice, the entire amount of rent herein reserved or agreed to be paid and then remaining unpaid shall immediately become due and payable upon the expiration of said thirty days. . . ."

acceleration clauses.[2] Jurisdictions in agreement with the instant case usually view such a clause as an attempt to provide for liquidated damages where such damages are not determined with any relation to the actual harm suffered. Thus, the clause is held to be an unenforceable penalty.[3] Pomeroy in his work on Equity states that equity will step in to forbid penalties or forfeitures in certain cases:

> "Whenever a penalty or a forfeiture is used merely to secure the payment of a debt, or the performance of some act, or the enjoyment of some right or benefit, equity, considering the payment, or performance, or enjoyment to be the real thing intended by the agreement, and the penalty or forfeiture to be only an accessory, will relieve against such penalty or forfeiture by awarding compensation instead thereof, proportionate to the damages actually resulting from the non-payment or non-performance, or non-enjoyment, according to the stipulations of the agreement."[4]

The test used by equity is whether compensation can or cannot be adequately made for breach of the obligation which is secured. If the penalty secures the payment of money, compensation can always be made by paying the principal and interest. If it secures the performance of some collateral act, and compensation for the non-performance can be made, equity will award damages and then relieve the defaulting party of any further liability.[5]

In *Gentry v. Recreation, Inc.*, the court drew a distinction between the acceleration of an ordinary debt and the acceleration of rent. In the case of an ordinary debt, the court declared, the debtor has already received the entire consideration either in money or property, while a rent acceleration requires payment for something the debtor has not received.[6]

Notwithstanding the arguments advanced in behalf of voiding acceleration clauses on equity principles, such agreements have been held in many instances to be valid.[7] The reasoning of the courts upholding

[2] For a complete discussion, see notes, 58 A.L.R. 300; 128 A.L.R. 750.

[3] Note, 106 A.L.R. 292,293: The distinction between liquidated damages and a penalty is that a penalty is a surety for non-performance while liquidated damages are damages to be paid in the event of non-performance. Factors often considered by the courts in determining whether a pecuniary forfeiture is for liquidated damages or a penalty are; (a) the reasonableness of the stipulated sum in relation to probable damages, (b) the difficulty in ascertaining actual damages and (c) the importance of the breaches covered by the same forfeiture.

[4] 2 POMEROY, EQUITY §433 (5th ed., Symons 1941).

[5] *Ibid.*

[6] 192 S.C. 429, 7 S.E. 2d 63 (1940).

[7] Maddox v. Hobbie, 228 Ala. 80, 152 So. 222 (1934); Hoefer v. Fortmann, 219 Iowa 746, 259 N.W. 494 (1935); Shepard Realty Co. v. United Shoe Stores Co., 193 La. 211, 190 So. 383 (1939); Abel v. Paterno, 245 App. Div. 285, 281 N.Y.S. 58 (1935); Moretti v. Zanfino, 127 P. Super. 286, 193 A. 106 (1937); Logan v. Green, 53 S.W. 2d 119 (Tex. Civ. App. 1932); 1 AMERICAN LAW OF PROPERTY §3.74 (1952).

the validity of rent acceleration provisions is that since the parties might legally contract to pay all the rent in advance, they may also agree on the acceleration of such rent on the happening of stated contingencies.[8]

New York has held that a contract accelerating rent on the breach of a covenant to pay rent is a penalty.[9] However, in the *Belnord* case, the court opened the door for a valid acceleration clause which hinged on the mere wording of the clause. In that case, the lease provided that the rent for the whole term was payable at the time of the making of the lease, but provided that it could be paid in stated installments for the lessee's convenience unless there was a default in the installments. If there was such a default, the entire rent was accelerated. This acceleration clause was held to be valid since the parties had liberty to contract and could validly agree to pay all the rent in advance. The court stated that the fact that another clause in the lease permitted monthly installments could not render what was otherwise valid a penalty.[10]

Many courts are reluctant to enforce a rent acceleration clause where the lessor re-enters the premises and takes possession of them before the end of the term.[11] Such a provision has often been considered unreasonable and unenforceable. However, in *Erickson v. O'Leary,* where the lessor accepted possession of farm land upon the default of the lessee and sued for the accelerated rent, the court held the acceleration clause valid and declared that the lessor need not let the land go fallow.[12]

A second circumstance which may invalidate an otherwise enforceable acceleration provision is the presence in the lease of a multiplicity of trivial terms or covenants the breach of which will accelerate the remaining rent for the term. The New York court held that a lease with exhaustive restrictions left the lessee at the mercy of the lessor for any breach of a trivial nature. Some restrictions were held to be so trivial and so lacking in any real damages that the court would not allow any acceleration of rent.[13]

Wisconsin View

The status of rent acceleration clauses in Wisconsin has not been definitely determined in all respects. Indeed, only one case on this

[8] 52 C.J.S. §512; 32 Am. Jur. §§463, 464.
[9] 884 West End Ave. Corp. v. Pearlman, 201 App. Div. 415, 198 N.Y.S. 670, 673 (1922).
[10] Belnord Realty Co. v. Levinson, 204 App. Div. 12, 193 N.Y.S. 184, 186 (1923).
[11] Maddox v. Hobbie, *supra,* note 7 at 226; Pirkle & Williams v. Shreveport Jitney Jungle, 19 La. App. 729, 140 So. 837, 840 (1932); 58 A.L.R. at 306; 32 Am. Jur. §465.
[12] 127 Kan. 12, 273 P. 414, 415 (1929); *accord,* Sliman v. Fish, 177 La. 38, 147 So. 493 (1933).
[13] *Supra,* note 9.

subject has been adjudicated in the state.[14] It would be wise before discussing this case to consider Wisconsin court decisions in an analogous field, the liability of a lessee for future rents upon default. The court considered this problem in the *Selts* cases. The first *Selts* case[15] involved a lease which contained a clause which provided that if there was a default in the payment of rent or on any of the covenants or agreements, it would be lawful for the lessor to declare the term at an end and re-enter without prejudice to any remedies which might otherwise be used for arrears in rent or breach of covenant. Such re-entry was not to affect the liability of the lessee for past rent due or future rent to accrue under the lease. Payments of the rent were to be made monthly in advance. The lessee failed to pay the rent in September, and the lessor gave him a three day statutory notice to pay his rent or vacate the premises. The lessee vacated the premises on the 15th of September. The lessor then brought an action for the rent due and unpaid for that month. The court noted that under the lease the rent was due September 1st and that had the lessee paid the month's rent in advance and then vacated, he could not have recovered that money:

> "It thus becomes evident that it was not contemplated by the legislature when it enacted the unlawful detainer statutes that an election on the part of the lessee to surrender would in any way affect his obligation to pay whatever rent had become due and which remained unpaid."[16]

The second *Selts* case[17] was based upon the same facts as the first case, but was an action for future rent based on the clause allowing collection of such rents. Three months rent was involved. The court held that where premises were surrendered by the lessee and accepted by the lessor, the lease was terminated with the result that no basis existed to warrant any further rents.

There was a rehearing, however, in which the prior opinion was reversed. It was determined that the common law was not abrogated by the statutory provisions in question and that the lease thus authorized a suit for future rents:

> "The lessee, however, expressly covenanted in the lease that it would pay the rent for the entire term in accordance with the provisions of the lease, forfeiture or no forfeiture, so that, while the relationship of landlord and tenant ceased with the forfeiture, the *contractual relation* between these parties con-

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[14] Patton v. Milwaukee Commercial Bank, 222 Wis. 167, 268 N.W. 124 (1936).
[15] Selts Investment Co. v. Promoters of F.N. of W., 197 Wis. 471, 220 N.W. 220 (1928).
[16] *Id.* at 475.
[17] Selts Investment Co. v. Promoters of F.N. of W., 197 Wis. 476, 220 N.W. 222, 222 N.W. 812 (1929).

> tinued. Therefore, the acceptance of the premises by the plaintiff . . . manifested a termination of the landlord and tenant relationship, but had no effect whatsoever upon the liability of the lessee for subsequently accruing rents."[18]

The court cited 36 C.J. at 336 to the effect that a tenant may continue to be liable after the termination of included provisions imposing liability for rent. The decision stated that this is the prevailing view supported by overwhelming authority and was persuasive of the court's error in the prior opinion.[19] The court went on to hold, however, that in these cases, the lessor had an obligation to re-enter the premises in order to lease them again and thus mitigate damages.[20]

Anderson v. Andy Darling Pontiac[21] is the latest Wisconsin decision on this subject. The lease provided that on the breach of any terms, the lessors could re-enter and take possession of the premises without such re-entry working a forfeiture of the rents to be paid and the covenants to be kept by the lessee. The court cited *Selts* case to the effect that a clause for the payment of "rent" unaccrued at the time of re-entry permitted the mere recovery of damages. Then the court continued:

> "The provision in the lease here involved for the payment of the unaccrued rent in case of breach by the lessee is in realty a penalty entirely disproportionate to any damage that could reasonably be expected to ensue. . . ."[22]

The court declared that it was in accord with the *Kothe* case[23] and had been led to its decision by the result in the *Selts* case.[24]

The Wisconsin court in this decision relied heavily on two decisions which have been distinguished on their facts. The *Pearlman* case[25] out of New York held against an acceleration clause because of the multiplicity of acceleration contingencies.[26] The *Kothe* case, a Federal decision, involved the acceleration of all rent due for the duration of the term upon the bankruptcy of the tenant. The court pointed out that the parties thus contracted for payment to be made out of the bankrupt estate and not for something the lessee personally would be required to pay. Thus, it appeared that the real design was to obtain preferential treatment for the lessor in the event of bankruptcy, and this the court held to be against the spirit of the Bankruptcy Act. The court indicated ,however that had the facts shown a proper purpose or

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[18] *Id.* at 484.
[19] *Ibid.*
[20] *Supra,* note 17 at 486.
[21] Anderson v. Andy Darling Pontiac, Inc., 257 Wis. 371, 43 N.W. 2d 362 (1950).
[22] *Id.* at 364.
[23] Kothe v. Taylor Trust, 280 U.S. 224 (1930).
[24] *Supra,* note 21 at 364
[25] *Supra,* note 9.
[26] *Ibid.*

the term been shorter the argument for the lessor would have been more persuasive.[27]

The only case in which the acceleration of rent problem has arisen is *Patton v. Milwaukee Commercial Bank*.[20] The lease gave the lessor an option in case of default by the lessee to declare all the rent for the term due and payable. The court held that as a claim for future rent, no debt could arise until the installments became due. Speaking of the rent acceleration clause, the court said:

> "It is at all events plain that it is a penalty and not a provision for liquidated damages. It is applicable to a breach of the least important covenant of the lease as it is to its complete abandonment or repudiation, and even with respect to the latter, it must be considered to be grossly in excess of the damages reasonably to be anticipated as a result of the breach. For this reason it cannot be considered a bona fide effort to liquidate damages. It follows it must be a penalty, and, as such, it is not enforceable."[28]

Conclusion

The Wisconsin court would thus seem to be in accord with the main case. Nor does it appear likely that the court will adopt the decision in the *Belnord* case. The second *Selts* case could have been used as precedent for such a holding, but language appearing in the *Darling* case makes it apparent that the present supreme court would not have allowed the recovery in the second *Selts* case.

> "The court might properly have added, as has been observed by courts of other jurisdictions, that such a stipulation in a lease is an agreement for a penalty; that it is unreasonable in character and therefore void."[29]

But even were a rent acceleration clause held to be valid, does it give a lessor any adequate remedy for the breach of a lease? If the lessor accepts the accelerated rents, he must stay out of possession of the leasehold and subject himself to possible deterioration of the premises and other hazards attendant upon his prolonged exclusion from the property. And staying out of possession, even considering that the lessor has the rents for the remainder of the term, is no advantage to him unless the remainder of the term is short. In Wisconsin, it is clear that the lessor would have to enter the leasehold as a trustee for the lessee and give a strict account to the lessee of all rents as a mitigation of damages.

What the lessor really seeks are damages for the breach of the lease and the right to re-enter the premises. In the *Patton* decision, the court stated that future damages upon the breach of a lease were

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[27] *Supra*, note 23 at 227.
[28] *Supra*, note 14 at 126.
[29] *Supra*, note 21 at 375.

too contingent, conjectural and speculative to be determined. The court imposes upon the re-entering lessor a painful dilemma: either he will be held, prima facie, accountable for the same rent which the lessee was obligated to pay, on the assumption that the lease-rents are the best "guess" of the value of the leasehold, or else he will be forced to prove an unprovable—that the lease will not be dissolved during the balance of the term by the operation of Section 234.17 of the Wisconsin Statutes.[30]

It is submitted that the question of awarding damages for the breach of a lease should be reconsidered by the Wisconsin court. Acceleration clauses were originally designed as a means of avoiding the old rule that a lessor could not treat the lessee's *refusal* to pay rent as an anticipatory breach of the contract.[31] But since the Wisconsin court has adopted the anticipatory breach theory in lease cases,[32] the need of an acceleration clause has withered. Upon the substantial breach of the contract, the lessor may treat the non-performance as an anticipatory breach and bring suit at once for damages. The damages, however, are limited to those incurred up to the time of trial.[33] Are the obstacles really too great to have competent realtors estimate the reasonable rental value of the leasehold for the remainder of the term? This amount, when determined from evidence, could then be subtracted from the contractual rental value as the measure of damages. As for the leasehold being substantially destroyed, this is really a very remote contingency and one that could be compensated for by the use of insurance tables .This plan would thus give the lessor an adequate remedy for the breach and preclude the burdensome task of his becoming a trustee to mitigate damages.

This solution would seem to be not only feasible, but would do justice and equity to both landlord and tenant. Furthermore, it would circumvent the problem of rent acceleration, a lessor's remedy which has been neither satisfactory to landlords nor equitable to tenants.

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[30] "Where any building, which is leased or occupied, is destroyed or so injured by the elements, or any other cause as to be untenantable, and unfit for occupancy, and no express agreement to the contrary has been made in writing, the lessee or occupant may, if the destruction or injury occurred without his fault or neglect, quit and surrender possession of the leasehold premises, and of the land so leased or occupied; and he is not liable to pay to the lessor or owner, rent for the time subsequent to the surrender."

[31] 1 AMERICAN LAW OF PROPERTY, *supra*, note 7.

[32] Galvin v. Lovell, 257 Wis. 82, 42 N.W. 2d 456 (1950).

[33] *Ibid.*