Should the Commercial Landlord Have a Duty to Mitigate Damages After the Tenant Abandons?: A Legal and Economic Analysis

David Crump
Dear Law Review Editors:

Enclosed is an article entitled “Should the Commercial Landlord Have a Duty to Mitigate Damages after the Tenant Abandons? A Legal and Economic Analysis.” I would appreciate your considering this article for publication. I also have submitted it to other leading law reviews.

When a commercial tenant abandons the leasehold, the landlord’s costs continue. The landlord can sue for rent during the abandoned tenancy, but some states, roughly half, place upon the commercial landlord the entire burden of mitigating damages in this situation. Unfortunately, these states often do not place upon the tenant the obligation even to notify the landlord, much less to cooperate by cleaning, assisting in redesigning the premises, or attempting to find another tenant. One of the leading jurisdictions following this rule is Texas, and this article analyzes the Texas decisions as an example of this approach.

This landlord-only mitigation rule, in the commercial setting, appears to be based upon the tacit assumption that commercial tenants are weak and that landlords are uniformly powerful, irresponsible, and better able to employ rental agents. In fact, tenants are just as often huge entities like Wal-Mart, McDonald’s, AT&T, or Sears, and landlords are just as often relatively small entities. In addition, many commercial tenants in search of locations to lease will employ real estate agents to assist, and long lists of commercial agents can be found in every part of the country who are eager to work for tenants as well as landlords. Furthermore, the landlord is tied to the property and continues to have a strong interest in it, whereas the Texas rule encourages the tenant to be irresponsible by abandoning in the dead of night, telling the landlord nothing, prolonging the time during which the landlord is uncertain whether to re-let the premises, and encouraging the tenant not to come to terms with the landlord by negotiation. Finally, the Texas rule actually encourages the tenant to abandon, and thereby causes precisely the kind of waste that the Texas court purports to avoid.

The Pennsylvania rule is the opposite: it recognizes that the commercial tenant is as able as the landlord to mitigate damages, and it places the burden to do so on the tenant. The merits of this approach may be counterintuitive, but my article explains why the Pennsylvania approach is better, for both economic and legal reasons. At the same time, the Pennsylvania rule is itself imperfect, and the article analyzes this issue as well. Residential tenancies often present obvious differences, and my article is limited to the commercial setting.

While cognizant of the demands on your time, I would be grateful for as prompt a decision concerning the acceptance of this article as is possible. Many thanks in advance for the time that I know is always spent in reviewing any article for publication. My business phone is (713) 743-2073, my fax is (713) 743-2223, and my e-mail is dcrump@uh.edu. If I am away from the phone, messages may be left with my secretary at (713) 743-2156.

Sincerely yours,

[Signature]
Note: I have attached an abstract and a resume, as well as the article.
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ACADEMIC BACKGROUND
UNIVERSITY OF TEXAS, J.D. 1969. Projects Editor, Texas Law Review; Order of the Coif; first place team, University of Texas Hildebrand Moot Court Competition.

EXPERIENCE AS LAWYER
Shareholder (Non-Equity), Johnson & Gibbs, 1987-92.
Assistant District Attorney, Harris County (Houston), Texas, 1972-75.
Law Clerk, Judge Homer Thornberry, United States Court of Appeals for the Fifth Circuit, 1969-70.

LAW SCHOOL TEACHING
Professor of Law, University of Houston, 1988-present.
Professor of Law, South Texas College of Law, 1982-88.
Ass't, Assoc. & Full Professor of Law, University of Houston, 1975-82.
Adjunct Professor, SMU, 1972.
Acting Professor of Law, University of California (Davis), 1970-71.

COURSES TAUGHT
Recently: Property, Civil Procedure, Criminal Law, Evidence, Interdisciplinary Reasoning (interdisciplinary legal methods course), Law Practice Strategies (skills-based large course in document preparation, litigation, negotiation, etc.).
Other courses taught: Torts, Constitutional Law, Wills, Environmental Law, Law and Economics, Real Estate Transactions (team taught).
Voted “Professor of the Year” by students.

BAR ACTIVITIES; STATE BAR DIRECTORSHIP
Elected Director of State Bar of Texas in contested election determined by over 4,000 lawyers' votes, 1985. Chaired subcommittee that created Minimum Continuing Education requirements for Texas lawyers. Numerous other bar activities.

ADMINISTRATION OF CONTINUING LEGAL EDUCATION
Set up and directed CLE department at South Texas Law School. Set up similar CLE department at University of Houston, which became second largest in Texas in terms of lawyer-hours, conducted 50 to 60 two-day programs annually, and contributed more than $5 million in net income to the law school.

PROFESSIONAL PUBLICATIONS
I have twelve law school teaching books in current use, eight of which are casebooks, including national casebooks in Civil Procedure, Property, Criminal Law, Constitutional Law, and Evidence. For most of these, I put together teams of professors from different schools as co-authors and led the projects. My
articles have been published in law reviews at Harvard, Yale and many other universities. A list of my recent publications is attached.

GENERAL-READERSHIP PUBLICATIONS

*Translation of The Aeneid.* Last year I completed a decades-long project by finishing my translation of *The Aeneid,* by Virgil, from the Latin. My translation already is in use in the Classics Department at the University of Houston. Published 2012. (Quid Pro Books.) Not a legal publication, but perhaps interesting.
Should the Commercial Landlord Have a Duty to Mitigate Damages After the Tenant Abandons?:
A Legal and Economic Analysis
By David Crump

It happens in different ways, but it often happens with the commercial tenant leaving in the middle of the night.¹ Perhaps the tenant has not been able to make a go of the business that she operated in the rented space, or perhaps the tenant has a new location to which she wishes to move and wants to avoid dealing with the landlord about breaching the lease.² The tenant does not communicate to the landlord, of course, the fact that the tenant is quitting the premises. Usually, the tenant’s action is in violation of the lease agreement, which may have a non-abandonment or continuous operation clause.³ Or, the lease may show that the rent is due, the tenant has promised it late, and the tenant has left without thinking much about the duty to pay rent, now or for the rest of the lease. The landlord learns that the tenant is no longer there by the passage of time: from rent that is due that is not received, and after a period of time, a visit to the location that finds no one present. The premises are dirty, damaged, and filled with trash, but that is the way the tenant kept them during the period of known occupancy, and the landlord cannot be sure that the tenant really is gone. No one answers the landlord’s telephone calls or emails, of course, and the landlord is hesitant to clear the premises or to try to obtain a new tenant, because the landlord’s lawyer has told her about a nasty kind of legal liability for wrongful eviction.⁴

It goes without saying that there are many stories with different conclusions about this situation, but the landlord always faces choices and difficulties. The landlord’s problem is that the landlord’s costs continue whether a tenant is in place or not: the debt service on the underlying property, payments for utilities, taxes, insurance, and all of the other expenses that an owner of property encounters whether there is a tenant or not.⁵ The law faces a question, now.

¹ John B. Neibel Professor of Law, University of Houston. A.B., Harvard College; J.D., University of Texas School of Law.

This paragraph describes experiences that the author has had, both as landlord and as a lawyer for landlords, and it must also describe the experiences of many landlords.

² Or perhaps the reason traces to one of an infinite variety of other causes. For example, one of the featured cases in this article arose because of disagreements among the principals of the tenant. See infra Pt. IA of this article.

³ A continuous operations clause requires the tenant to operate the existing business throughout the lease. A non-abandonment clause allows the tenant to use the premises in any manner, or not to use them, so long as the tenant occupies the leasehold and does not abandon it. See DAVID CRUMP et. al., PROPERTY: CASES, DOCUMENTS AND LAWYERING STRATEGIES 792-97 (2d ed. 2008).

⁴ For a recent case involving exactly this scenario, see Duhon v. Briley, 117 So.2d 253 (La. App. 2013) (landlord’s takeover of premises results in large judgment for wrongful eviction, affirmed by court of appeals, in spite of landlord’s contention that tenant had abandoned the property). A Westlaw search of “allstates” for the term wrongful eviction disclosed 1,960 cases, indicating that this cause of action is a frequent one.

⁵ So called “carrying costs” of this kind can be ruinous. See DAVID CRUMP, supra note 3, at 140-41 (discussing amount of costs).
What is the landlord’s duty in this situation? Can the landlord recover the rent from the tenant, assuming that the tenant is solvent, which actually is the case much of the time? Does the landlord have the responsibility to seek another tenant to mitigate the landlord’s damages, or can the landlord hold responsible the party that actually is in breach of the lease: the tenant?

Although there are many variations in details, there are two basic kinds of legal rules that cover this question in different states. There is the approach exemplified by the Pennsylvania courts, which is that the landlord is not bound to mitigate damages.⁶ The landlord can recover rent from the tenant without attempting to re-let the premises. The tenant, of course, can employ an agent to re-let the premises in Pennsylvania and mitigate the damages, just as the landlord otherwise would have to do. Thus, the Pennsylvania rule allows for mitigation of the damages; it just puts the onus on the party who has broken the lease and caused the damage. The second rule, as might be expected, is to put the burden of mitigating on the innocent party: the landlord. This is the approach taken by the Texas courts, and it is the majority rule, at least in the sense that the majority of jurisdictions impose the duty on the landlord at least in some cases.⁷ The Texas Supreme Court provided a set of economic arguments as well as other reasons for its conclusion, although not surprisingly, all of the arguments are debatable.

This article examines both the economic and the legal arguments for and against imposing the duty to mitigate on the landlord. Part I of the article sets out the Pennsylvania and Texas decisions that exemplify the two different approaches. Part II describes the results that flow from each of the two different rules. Part III examines consequentialist arguments about mitigation: specifically, the economic arguments. Part IV looks at what are commonly called deontological arguments: moral arguments, about right and wrong, that bear on the question. A final part summarizes the author’s Conclusions, which include the concept that the Pennsylvania approach, which places the duty to mitigate on the breaching party, is the better rule in the commercial setting, even though it is more questionable in the residential case. The Texas rule, which exemplifies in part at least the majority approach, ultimately does not withstand scrutiny.

I. THE TWO BASIC APPROACHES: SHOULD THE BREACHING OR NON-BREACHING PART BEAR THE BURDEN OF MITIGATING?

A. The Majority Rule: The Non-Breaching Party, the Landlord, Bears the Burden of Mitigating

The Texas Supreme Court considered the mitigation issue in Austin Hill Country Realty, Inc. v. Palisades Plaza, Inc.⁸ The three principals of the tenant, who happened to be real estate brokers themselves, signed a lease and a contract for building out the space. When the landlord was nearly finished with the buildout, the three principals began giving conflicting instructions to the landlord about the improvements they demanded. Palisade, the landlord, immediately

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⁶ See infra Pt. IB of this article.

⁷ See infra Pt. IA of this article.

⁸ 948 S.W.2d 293 (Tex. 1997)
notified the tenant that it had to stop work, and it requested that the three principals appoint one spokesperson empowered to make decisions.\(^9\)

The relationship between the parties went downhill from there. After nearly a month of inaction, Palisades notified Austin Hill that its conduct was an anticipatory breach of the lease. The parties met to try to resolve their differences but were unsuccessful. Palisades, the landlord, then sued Austin Hill and the three principals for anticipatory breach of the lease.\(^{10}\) At trial, the defendants tried to introduce evidence that the landlord had failed to mitigate the damages by renting to someone else, and it attempted to get the judge to submit an instruction telling the jury to reduce the damages by the amount that Palisades “could have avoided by the exercise of reasonable care.” The trial judge correctly stated that under existing law, “a landlord doesn’t have any obligation to try to fill the space.” The jury rendered a verdict for 29,716 in damages. The court of appeals affirmed, again following the existing law.\(^{11}\)

The state supreme court began its analysis by pointing out that the law of the state, beginning with a decision in 1897, had held that the landlord could not be “subjected to damages for failing to let the premises to another, to prevent rent accruing the [tenant].” And the state courts, the court pointed out, had “consistently followed this no-mitigation rule.”\(^{12}\) Surprisingly, however, the court was unanimous in reversing the judgment.

The court began its analysis by pointing out that there were some situations in which Texas law did impose the duty on the landlord, including cases in which the damages were not in the form of rent and when the landlord re-entered and controlled the premises.\(^{13}\) But the real beginning of the reasoning was the court’s observation that “[f]orty-two states and the District of Columbia have recognized that a landlord has a duty to mitigate damages in at least some situations: when there is a breach of a residential lease, a commercial lease, or both.”\(^{14}\) The court glossed over the point that many states make distinctions between residential and commercial leases, providing more favorable treatment of the tenant in residential cases. If the states that confine the landlord’s duty to mitigate are subtracted, the so-called majority virtually disappears, but this observation did not support the court’s agenda.\(^{15}\) The court also pointed out that changes since the original adoption of the mitigation rule have seen the nature of rental become different

\(^9\) Id. at 294-95.
\(^{10}\) Id.
\(^{11}\) Id. at 295.
\(^{12}\) Id. at 295-96.
\(^{13}\) Id. at 296.
\(^{14}\) Id. But see infra note 15 (pointing out that the so-called majority rule is barely a majority rule).
\(^{15}\) See 948 S.W.2d at n.1, which shows that of the forty-two states that impose the duty on landlords in at least some cases, fifteen (15) impose it only in residential cases and do not impose it in commercial cases. When these fifteen are added to the six (6) that place no duty on the landlords and the one (1) where there is no clear rule, twenty-two (22) states fail to follow the majority rule in commercial cases, which were the subject of the Texas case and are the subject here.
and more complex, so that a lease operates both as contract and a conveyance.\textsuperscript{16} The “trend,” said the court, disfavors “contractual penalties.”\textsuperscript{17} The mitigation rule, said the court finally, was unsound in practice because the lease arrangement is not personal in nature, and a landlord does not have to accept unacceptable tenants.\textsuperscript{18}

The more interesting reasoning of the court, however, was about what the court referred to as “public policy.”\textsuperscript{19} The court’s arguments here were economic in nature. To require mitigation by the landlord “discourages economic waste and encourages productive use of the property.” Quoting another court, the judges observed that unless the landlord is required to mitigate, “a landlord could allow the property to remain unoccupied while still holding the tenant liable for rent. This encourages both economic and physical waste.”\textsuperscript{20} As a related argument, the court suggested that “a mitigation rule helps prevent destruction of or damage to the leased property.” If the landlord is not charged with mitigating, the court concluded, “the possibility of physical damage to the property through accident or vandalism is increased.”\textsuperscript{21}

As a later part of this article will show, the court was correct in deploring economic waste. The efficient employment of all available factors of production is an important economic goal.\textsuperscript{22} The court did not explain, however, why the duty of mitigation must be put entirely on the landlord, with the tenant having no duty to do anything, even to communicate or to cooperate.

B. \textit{The Better Rule: The Breaching Party, the Commercial Tenant, Has the Duty to Mitigate}

The very next year, the Pennsylvania Supreme Court reached the opposite result. In \textit{Stonehedge Square Limited Partnership v. Movie Merchants, Inc.},\textsuperscript{23} the Pennsylvania court placed the burden of mitigating on the tenant. “[W]e hold that a non-breaching landlord whose tenant has abandoned the property in violation of the lease has no duty to mitigate damages.”\textsuperscript{24}

In the first place, said the court, “this rule is firmly established in Pennsylvania.” Leases had been bargained for in reliance on this rule. “Business decisions and structured financial

\textsuperscript{16} Id. at 297-98.

\textsuperscript{17} Id. at 298.

\textsuperscript{18} Id. at 298-99.

\textsuperscript{19} Id. at 298.

\textsuperscript{20} Id. at 298, \textit{quoting} Schneiker v. Gordon, 732 P.2d 603, 610 (Colo. 1987).

\textsuperscript{21} 948 S.W.2d at 298.

\textsuperscript{22} \textit{See infra} Pt. III A of this article.

\textsuperscript{23} 715 A.2d 1082 (Pa. 1998).

\textsuperscript{24} Id. at 1084.
arrangements have been made with the expectation that this rule, which has been the law, will continue to be the law."25 This was an argument that the Texas court had not analyzed.

Second, the established rule had “the virtue of simplicity.”26 If the landlord were to be required to relent the premises, “there is unlimited potential for litigation initiated by the tenant, concerning the landlord’s due diligence, whether the landlord made necessary repairs which would be required to rent the premises, whether the landlord was required to borrow money to make repairs, whether the landlord hired the right agents or a sufficient number of agents to rent the premises, whether the tenants who were refused should have been accepted, and countless other questions in which the breaching tenant is permitted to mount an assault on whatever the landlord did to mitigate damages, alleging that it was somehow deficient.” The potential for “complexity, expense, and delay,” said the court, would adversely influence commercial development.27

These arguments seem sound, and in fact there has been litigation about whether landlords have been careful and inventive enough in re-letting abandoned properties.28 The Texas court did not consider these arguments. But there was a point that the Pennsylvania court did not consider: specifically, that factual issues arise, also, if the duty to mitigate is placed on the tenant.29

Third, the court pointed out that the Pennsylvania legislature had enacted comprehensive regulation of the lease relationship, and in doing so, the legislature did not change the established rule that the landlord had no duty to mitigate.30 This was an argument that the Texas court did not consider, although Texas also has had extensive regulation of the landlord-tenant relationship.

Fourth, the court saw a “fundamental unfairness” in allowing “the breaching tenant to require the nonbreaching landlord to mitigate damages caused by the tenant.” The landlord would thus be “depriv[ed] . . . of the benefit of his bargain.” The landlord would be forced to expend time, energy and money to respond to the tenant’s breach, and also, would be “put[ ] . . . at risk of further expense of lawsuits and counterclaims in a matter which he justifiably had considered closed.”31 This was another issue not considered by the Texas court. The nonbreaching landlord, in the scenario described at the beginning of the article, will undertake risk of liability, expend resources, and suffer losses that are unlikely to be measurable in damages.

25 Id.
26 Id.
27 Id. at 1084-85.
28 See infra notes 43, 49 and accompanying text.
29 For example, many kinds of factual issues arise about potential new tenants whom the abandoning tenant claims to have presented but to whom the landlord ultimately does not lease. See infra notes 43, 49 and accompanying text.
30 715 A.2d at 1085.
31 Id.
Fifth, “in this case, the tenant was in a position to mitigate his own damages.” The tenant, the Pennsylvania court observed, “could have provided the landlord with a sublessee, and the landlord had a duty not to unreasonably withhold consent.”32 In fact, prospective tenants often use agents to find commercial properties, just as new home buyers employ agents to help them purchase a home. The Texas court failed to consider the argument that the average commercial tenant can employ an agent just as easily as the average landlord can.33

II. RESULTS OF THE TWO RULES—INTENDED AND UNITNENDED

A. The Results of the Texas Rule: Putting the Burden of Mitigation on the Landlord

As is indicated above, one striking feature of the Texas court’s opinion is its tacit assumption that mitigation by the tenant is impossible. The established rule, which did not place the burden of mitigation on the landlord, says the court, “encourages both economic and physical waste.”34 This is true only if one is exceptionally naive: naïve enough, that is, to be unaware of the frequency with which commercial tenants actually do obtain rental agents to find properties. In most areas of the country, a few clicks on the internet will find dozens, or hundreds, or even thousands of commercial real estate agents who can be engaged by either tenants or landlords.35 These agents can find tenants to mitigate damages, just as they can find rental space for tenants. The Pennsylvania court correctly saw that a tenant can “mitigate his own damages” by obtaining a tenant. The Texas court neglected to observe that the tenants before it were themselves real estate agents who operated in the area, so that actually, they probably could have found other tenants even more easily than the landlord.

The fallout from this simple assumption is disadvantages that are several-fold. The first disadvantage is that the Texas court did not recognize any duty on the tenant who abandons in the dead of night. The court did not require the tenant to cooperate with the landlord or even to communicate with the landlord about the tenant’s intentions to abandon the property. Nor did it require the tenant to leave the property in rentable condition or even clean up trash. This approach of the Texas court causes exactly the kind of conditions that the Texas court claimed its rule would remove. It causes delay that loses rent and creates exactly the “economic waste” that the court rightly wanted to avoid,36 while the factor of production represented by the leasehold is empty.

32 Id.

33 See infra note 35 and accompanying text.

34 The Texas court treated the case in which the landlord has not duty to mitigate as through it automatically would always result in an empty leasehold and therefore would cause waste, without even mentioning the possibility of the tenant’s acting. See supra notes 19-21 and accompanying text. The Pennsylvania Court did recognize this point. See supra note 32 and accompanying text.

35 As an example, the author of this article was able to find fully tow hundred fifty-eight (258) pages under the heading, “Houston, Texas Commercial Real Estate Broker Directory” by googling “commercial real estate agents” and clicking once. See http://www.loopnet.com/texas/houston-commerical-real-estate-brokers (last visited August 30, 2013).

36 See supra notes 19-20 and accompanying text.
A second disadvantage is illustrated by the case in front of the Texas court, under its facts. A commercial tenancy, unlike a residential one, often requires buildout to accommodate the tenant. The premises must be designed and constructed. In the case before the court, the tenants were real estate agents, and they would have needed a different space design, with solitary offices and conference areas, as compared to, say, a retail business, which would need visibility from outside and plenty of display space. The tenant, in the actual case, allowed the buildout that the landlord was doing to proceed nearly to completion, gave contradictory directions for improvements, delayed for substantially a month before attempting to meet and straighten things out, and simply abandoned the property for the landlord to puzzle over, with an awareness that it would not be suitable for many kinds of replacement tenants. The Texas court’s opinion does nothing to counteract these tendencies by the tenant.

The third disadvantage is the uncertainty that the Texas rule creates for the landlord, especially since it places no duties even of communication on the tenant. The landlord may find the tenancy in operable condition when the tenant abandons it. The tenancy may be empty, but the landlord who is not given clear information by the tenant cannot know that it is abandoned. A tenant who has left surreptitiously may refuse communications, leaving the landlord unable to be sure whether to clear the property, rebuild, and undertake the process of finding a new tenant. If the landlord guesses wrong about these issues, the landlord knows that there will be crushing liability for wrongful eviction. A partial answer may lie in the possibility that the landlord might be able to recover these costs from the tenant, who has breached the lease, after all. But the landlord cannot know this. Some costs, such as the managerial effort involved in finding out about the tenancy, cleaning, redesigning, and seeking new tenants may be difficult to measure or otherwise nonrecoverable. This is why the Pennsylvania court recognized the costs created by abandonment, including both re-letting costs and “risk of liability.” Risk, in fact, is a factor of production, and investment that accepts risk has to be paid for somehow; the Texas rule places it on the nonbreaching landlord and does not encourage the tenant to mitigate the risk.

A fourth disadvantage, as the Pennsylvania court’s recognized, is that rule putting the burden of mitigation on the landlord means that “the breaching tenant is permitted to mount an assault on whatever the landlord did to mitigate damages, alleging that it was somehow deficient.” The Texas court failed to recognize that its approach was a litigation magnet. The Pennsylvania court observed that the tenant can accuse the landlord of failing to exercise due diligence in assessing the situation, delaying the decision to rebuild, declining to borrow money to rebuild, not hiring

37 948 S.W.2d at 295.

38 See supra note 4 and authority therein cited (citing case in which landlord re-entered leasehold that landlord claimed was abandoned but was held liable for large judgment for wrongful eviction, which was affirmed on appeal).

39 715 A.2d at 1085.

40 See infra note 51, and accompanying text.

41 715 A.2d at 1085.
enough agents or the right kind, refusing tenants the landlord considered unacceptable, and “countless other questions.”\textsuperscript{42} These are realistic approaches by a tenant’s defense lawyer in today’s litigation environment, and there are even simpler accusations that have materialized. For example, tenants have attempted to avoid liability by arguing generally that their landlords “clearly could have done more” to re-rent their leaseholds, which is always a possibility for a landlord.\textsuperscript{43}

A fifth disadvantage of the Texas approach is that it does not encourage the tenant to negotiate with the landlord about either mitigation or paying for a predictable portion of damages. In some kinds of leaseholds, the problem of tenants who choose to or must leave is so frequent that buyout plans are already established.\textsuperscript{44} In any event, the landlord will nearly always be motivated to meet with the tenant and attempt to solve the problem by agreement, because the landlord has ongoing costs for the leasehold property and will continue to own and manage the space in question. The tenant who abandons in the dead of night acts irresponsibly, heedlessly of the future and of the losses thus imposed, and with the hope of escaping without having to pay for any damage—and the Texas rule encourages the tenant to act in this way. The Texas rule thus causes the kind of economic waste that the court’s opinion claims to avoid. In fact, the disadvantages of the Texas rule could be reduced if the court were to impose some sort of duty of communication and cooperation on the tenant. For example, a decision to place the duty to mitigate on the landlord, although it is debatable in the first place, would be made less problematic by a provision requiring the tenant to communicate the fact of abandonment unequivocally and to cooperate with the landlord in preparing and re-letting the leasehold, as a condition for reducing damages by non-mitigation.

Overall, the Texas court’s opinion seems motivated by a fundamental mistake: that of assuming that tenants are always weak, and that landlords are uniformly powerful and rich. If a student rents a residence from a large apartment building owner who has across the board rules, plenty of desirable (or at least, acceptable) tenants, and a nonnegotiable lease instrument, the assumption may be correct. But in commercial settings, the reverse is often true. The tenant may be powerful and the landlord weak. In teaching property, I find that students typically share the assumption that the Texas court evidently indulged, even in commercial leasing situations. They find that they have to re-examine their bias when they come across one particular case in which the landlord is a local shopping center and the tenant is Wal-Mart.\textsuperscript{45} They tend to try to reason around the rules they have preferred up to that point by hypothesizing a new set of rules that apply to a “big” or “rich” tenant, although these categories remain undefined. And of course, the basic endeavor of having one set of rules for big parties and another for little parties comes to an early end. The trouble with the Texas court’s approach to the mitigation question is that it

\textsuperscript{42} Id.


\textsuperscript{44} “A lease buyout serves to break the lease… before the terms written in the lease have expired.” The amount to be paid “is usually equivalent to 2 months’ rent.” \url{http://www.ehow.com/about_5217522_apartment-lease-buyout.html} (last visited August 30, 2013).

naively accepts the big landlord-weak tenant fallacy with its tacit and erroneous assumption that hiring an agent to mitigate damages is impossible for a tenant.

B. Results of the Pennsylvania Rule: Putting the Burden of Mitigation on the Tenant

The Pennsylvania rule avoids some of the disadvantages of the Texas approach. A tenant aware of the rule and able financially to respond in damages probably will be motivated, in Pennsylvania, to notify the landlord clearly of the desirability of re-letting, to clean the premises, to remove its property whether abandoned or retained, and generally to cooperate with the landlord, because the tenant’s own finances are at stake in these matters. Similarly, one might expect the tenant and landlord to attempt resolution of the issue by a buyout of the lease, more probably than would happen in Texas. The tenant would be motivated to minimize risk for the landlord that might lead to wasteful and mistaken decisions, because again, it is the tenant who actually is responsible for losses. And finally, the Pennsylvania rule requires the breaching party, the tenant, to try to re-let the premises by finding a tenant. As the Pennsylvania court recognized, contrary to the Texas court’s tacit assumptions, obtaining an agent is a common step for tenants and is perfectly easy for a tenant to accomplish.

This does not mean that the Pennsylvania rule is free from all undesirable consequences. The Pennsylvania court pointed out that the Texas rule creates incentives for nonproductive litigation, and this is true. But so does the Pennsylvania rule, at least to some degree. The landlord can accuse the tenant of failing to mitigate damages in various ways, while the tenant maintains that the tenant has actually acted reasonably but the landlord has prevented the re-letting of the premises. Among other consequences, the landlord may refuse to rent to a new lessee proferred by the tenant. This result actually occurred in Austin Hill, the Texas case. The landlord refused to re-let the property to an entity composed of two of the original principals, and it also refused to lease to an entity composed of the remaining original principal and another individual. The landlord may have been justified in these refusals, because after all, the original principals had proven difficult if not impossible to deal with. This kind of controversy is another potential source of wasteful litigation, as it was in fact in Austin Hill. And the independent issue remains: the Pennsylvania rule provides a lesser incentive to the landlord to resolve the dispute or to accept a means of mitigating damages.

III. CONSEQUENTIALIST ARGUMENTS: THE ECONOMICS OF MITIGATION

A. Efficient Use of Resources: Empty Premises, Deterioration, and Incentives

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46 See supra note 43 and accompanying text.

47 See supra note 34-36 and accompanying text.

48 948 S.W.2d at 295

49 See supra notes 8-11 and accompanying text.
One major economic goal of a society is the efficient use of “factors of production.” This term refers to the resources that go into production of the goods and services that people in the society want. Factors of production include different kinds of land, capital of various sorts, labor, management, and entrepreneurship, which includes the willingness to accept and fund risk. As a general proposition, the market system forces firms to use factors of production efficiently. Briefly stated, it does so by encouraging firms, which are attempting to attain profit, to employ each given factor of production up to the point at which its marginal productivity equals its marginal cost. In other words, the producer uses a given resource in a quantity that produces valuable goods and does not use them in a quantity so great that their cost exceeds the production that they support. In this way, the market system results in efficiency. Hundreds of years ago, in fact, Adam Smith elegantly described the way in which the market system produces these results by comparing these motivations to an “invisible hand.”

A corollary of this principle is that the society desires that every productive resource be employed in its best use, and this kind of efficiency results also from the price or market system. Firms in the marketplace will be forced to use resources in their best uses. In this manner, firms produce the largest market basket of goods and services chose by consumers that current technology will allow. There are, of course, failures in the market system, sometimes because these efficiencies are most probable when the market is relatively competitive, and partly because of other sources of waste, but the economic system tends toward these efficiencies better than alternatives such as central planning.

The abandonment of a leasehold by the tenant indicates that one of these sources of waste probably is occurring. The courts in both Pennsylvania and Texas are correct to see the failure of efficient use of resources as undesirable. The question remains, how can the law create a rule that encourages the least amount of waste in these circumstances?

In addition, the collateral consequences of abandonment may be significant, as the Texas court points out. An empty leasehold invites deterioration through natural causes, accidents, or vandalism. Perhaps even more significantly, an empty, boarded-up storefront where the lessee has chosen to “go dark” has adverse effects on surrounding properties such as other businesses in a shopping center, because it discourages customers generally. Furthermore, the transaction

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50 See DAVID C. COLANDER, ECONOMICS Ch.1 (1993) [hereinafter cited as COLANDER]; DAVID CRUMP, supra note 3, at A9-A10.

51 See COLANDER Ch.1; DAVID CRUMP, supra note 3, at A11-A12.

52 See COLANDER Ch. 21; DAVID CRUMP, supra note 3, at A12.

53 See COLANDER Ch.1; DAVID CRUMP, supra note 3, at A4-A5.

54 See COLANDER Ch. 21; DAVID CRUMP, supra note 3, at A12-A13.

55 See COLANDER Ch.1; DAVID CRUMP, supra note 3, at A14-A15.

56 See COLANDER, Ch.38; DAVID CRUMP, supra note 3, at A4.

57 See DAVID CRUMP, supra note 3, at 797.
costs—the expenses that are occasioned by the fixing of the problem—can be high.\footnote{See DAVID CRUMP, supra note 3, at A37 (discussing transaction costs).} The expenses of hiring real estate agents, redesigning and building the leased space, and litigating the complex of issues that arise, are among the transaction costs that result from abandonment.

Neither rule has perfect consequences, but the Pennsylvania approach probably results in greater efficiency in the use of resources and less waste. In the first place, the Pennsylvania rule encourages the tenant to keep and maintain the lease. This is a kind of efficiency that is not mentioned by either court. In the alternative, if it really is better for the tenant to leave the premises from an efficiency standpoint, because the tenant’s business is failing, or the tenant has a better potential location in mind, or another reason, the Pennsylvania rule encourages the tenant to notify the landlord and seek a buyout of the lease payments. This result of the Pennsylvania approach means that the landlord has less risk and uncertainty about re-letting the property and can install a new tenant with less delay. It means, in general, that the tenant will be motivated to communicate with the landlord and cooperate in preparing the leasehold for re-letting and in making way for the new tenant. The landlord, who is going to remain concerned about the premises anyway, after the tenant leaves, is less likely to need these kinds of incentives to minimize loss.

On the other hand, the Texas rule creates precisely the wrong incentives about these issues. It tells the tenant, “You need not worry about waste caused by an empty leasehold. That’s the landlord’s problem. It will not be surprising if the tenant, especially if of the less responsible type, leaves surreptitiously, in the dead of night, and does not care whether the landlord hesitates to re-let the property because of potential legal liability. The tenant is not encouraged, either, to approach the landlord to resolve the issue, or to leave the premises in rentable condition.

This reasoning does not mean that the Pennsylvania approach cannot create inefficiencies. In the Texas case, Austin Hill, for example, the tenant offered two alternative new tenants, both of which the landlord rejected.\footnote{See supra notes 48-49 and accompanying text.} It is possible that the landlord was motivated by the then-existing legal rule, which was that the landlord has no duty to mitigate damages. On the other hand, there is reason to believe that the landlord’s decision was sensible, because the proposed tenants were variations of the original tenant, which had a track record full of trouble; and in that event, the landlord’s refusal should not affect the landlord’s freedom from the burden of mitigation. As a general proposition, however, the Pennsylvania rule would be improved by a clear statement that the landlord cannot refuse an alternate tenant without very good reason.

\subsection*{B. The Place for Private Negotiation about the Duty to Mitigate: Can It Be Allocated in the Original Lease, as Part of the Bargain?}

This next point can be understood best by hypothesizing a prospective tenant who wants to rent a particular space and is willing to pay for it. But the landlord refuses. When the tenant asks why, the landlord candidly answers, “I don’t have confidence that your business will succeed, and you may abandon the premises. Although you’re financially solvent, the law of this state is
that the landlord must mitigate damages, meaning that I’d have to undertake the costs, expenses, risk, and losses involved in finding a new tenant. I just don’t want to do that.”

Imagine that the tenant, then, replies, “Well, I’ll be glad to put a provision in the lease saying that notwithstanding the usual rule, I agree that I’ll be responsible for mitigating damages. I see your point, and we can agree to this modification of the mitigation burden as a matter of private bargaining.” The parties then reach an agreement that otherwise would have been impossible and that arguably is efficient.

This hypothetical situation brings to mind the Coase Theorem. This construct, the Coase Theorem, posits that if transaction costs are zero, it does not matter what the default legal rule is, because the parties will reach the efficient solution by private bargaining.60 In this case, one can venture the conclusion that the hypothetical parties described here would have reached their efficient agreement as the Coase Theorem might predict. This is a debatable conclusion, because the Coase Theorem is a theoretical construct that probably is never exactly applicable in the real world. There always are transaction costs. The cost of paying lawyers to give advice and of bargaining the solution are nonzero in the hypothetical case, and therefore, the conditions for applying the Coase Theorem are not present if one looks at the matter strictly.61 But perhaps there is a range of near-zero transaction costs, or transaction costs that approach zero, so that the Coase Theorem might give useful guidance. The parties to this commercial lease are going to have to consult lawyers extensively anyway, and they will have to negotiate and construct an agreeable lease instrument. Perhaps the transaction costs in this hypothetical are near enough to zero so that it is sensible to consider Coase.

The conclusion that would result, in that event, is that it would not matter which legal rule a particular jurisdiction adopts, whether that of Pennsylvania or Texas, so long as the parties have freedom to negotiate. The tenant and landlord will reach the solution that is efficient in their case through private bargaining. If they should want to reject the usual rule, all that would be necessary would be for the lease to contain a provision saying that “the landlord shall have no duty to mitigate damages for breach of this lease, and all burden of mitigation shall be borne by the tenant, subject to the landlord’s duty to act reasonably in accepting or refusing a new tenant.” Or, if the rule of the state were consistent with the parties’ intended bargain, they might leave the lease silent on this point.

Strangely, this kind of bargaining is impossible in Texas. After having observed the rule that the landlord has no duty to mitigate for more than a century, and seeing the state supreme court reverse that rule as a matter of judicial legislation in a dubious opinion, the Texas legislature passed a statute outlawing private bargaining. The statute reads as follows:62

(a) A landlord has a duty to mitigate damages if tenant abandons the leased premises in violation of the lease.

60 See DAVID CRUMP, supra note 3, at A40-A41.

61 See Id. at A42.

(b) A provision of a lease that purports to waive a right or exempt a landlord from a liability or duty under this section is void.

Perhaps this bargaining-is-void provision can be justified by arguments related to information asymmetries or the like, with assertions to the effect that landlords will place no-mitigation clauses in all of their leases and that tenants are so poorly informed, in comparison, that they will not know to bargain. This justification, however, depends again on the tacit assumption that landlords are uniformly powerful and tenants uniformly weak, an assumption that decidedly does not fit the world. Even if the concern were valid, it could be addressed by means short of outlawing people’s chosen agreements, such as requiring that a no-mitigation provision be conspicuous, in the manner of some waivers of warranties or negation of liability for negligence, or by requiring that the tenant separately sign such a provision. But as the statute is as passed, if the conclusions in this article are correct, Texas has thus made two mistakes that will impair the efficiency of commercial leasing in the state. In the first place, it has adopted the less efficient of two possible rules. Second, it has made it impossible for parties to avoid the inefficiencies that it thus imposes upon them.

IV. THE RIGHT-VERSUS-WRONG ISSUE: DEONTOLOGICAL ARGUMENTS

The simplest argument made by the Pennsylvania Supreme Court concerned the “fundamental unfairness” of allowing “the breaching tenant to require the nonbreaching landlord to mitigate damages caused by the tenant.” The Texas statute, which adopts the opposite rule, sounds awkward: “A landlord has a duty to mitigate damages if tenant abandons the leased premises in violation of the lease.” This sentence invited the question, “Don’t you mean that the tenant has a duty about damages if the tenant breaches the lease?”

The court’s argument is an exercise in what is called deontology: a philosophy that considers the morality of a given principle not by totaling costs and benefits or economic efficiencies, but by its intrinsic rightness or wrongness. The greatest proponent of deontological morality was Immanuel Kant, who evaluated moral actions not by their consequences in economic or cost-benefit terms, but by a universal imitation principle: an action is moral if an actor can wish that it would be imitate by all, as a “universal law.” Perhaps this philosophy is too cumbersome to be controlling of most questions of law. Economic efficiency has its place. But too-prevalent pursuit of principles that violate deontological norms—or in other words, too much acceptance of unfair rules—produces results, including disrespect for law, that even consequentialists have come to recognize. The fact that the deontological reasoning of the Pennsylvania court coincides with the economic efficiency of the Pennsylvania rule reinforces its conclusion.

63 See DAVID CRUMP, supra note 3, at A38-A39 (discussing information asymmetries).

64 See supra note 45 and accompanying text.

65 See supra note 31 and accompanying text.


67 See Id.
CONCLUSION

The Texas rule, which places solely upon the commercial landlord the duty to mitigate damages when the tenant—not the landlord, but the tenant—breaches the lease, has too many disadvantageous consequences. It encourages the tenant, especially the irresponsible tenant, to quit the premises surreptitiously, in the dead of night, knowing that this strategy places all of the burden of risk and loss from mitigation of the tenant’s breach onto the innocent party, the landlord. It thus discourages the tenant from cooperating with the landlord about re-letting the premises, and in fact it discourages the tenant from even communicating with the landlord. This means that it discourages the tenant from informing the landlord and attempting to negotiate a solution. Although it purports to avoid waste, in fact it does the opposite. It results in delaying information to the landlord that would create certainty about the propriety of re-letting the leasehold, during a period of time in which the landlord learns of the abandonment and until the landlord ascertains that there is no risk of huge liability for wrongful eviction. It creates a wide range of potential issues for satellite litigation in which the tenant accuses the landlord of not acting reasonably to cure the tenant’s own breach. It encourages the tenant to ignore whether the premises are in condition to be leased again, since it does not motivate the tenant to clean the premises. Worse yet, the tenancy is likely to have resulted in buildout that will not be suitable for future tenants, and the tenant is relieved of responsibility for these issues. Risk, in turn, is a factor of production, and the Texas rule unnecessarily increases it.

Thus, the Texas rule has a variety of deleterious economic consequences related to the full use of resources and the efficient choice of factors of production. As the Pennsylvania court’s opinion points out, the Texas rule also is unsatisfactory from a deontological or moral right-and-wrong point of view, because as the Pennsylvania court put it, it is “fundamentally unfair” to place the burdens of mitigation on the innocent party and send the breaching party off scot free of those burdens. And probably the worst aspect of Texas law of mitigation is that it is nonnegotiable. Even if the parties would be better off by reversing the burden and would otherwise reach the efficient solution by negotiation, Texas law provides that any such agreement is void.

These disadvantages seem related to two tacit assumptions of the Texas court, both of which were naïve and thoughtless. First, the Texas court apparently did not consider the fact that it is easy for commercial tenants to employ real estate rental agents. It is common, in fact, for tenants to obtain agents to assist them in finding suitable rental space. It is difficult to know whether that use of real estate agents is more frequent than use by landlords, but it happens that landlords sometimes do not employ agents but operate by visual notice and word of mouth. The Texas court’s conclusion was that inevitably, there would be more empty leaseholds and more deterioration if it placed the burden of mitigation on the tenant, and this conclusion simply does not make sense. Actually, the court could easily have seen, if it had considered it, that the landlord has a continuing connection to the property and a continuing interest in seeing it occupied, and that the party needing an incentive to be concerned about that, rather than freed of responsibility, is the tenant.

But perhaps the more naïve of the Texas court’s tacit assumptions was the apparent conclusion that landlords are uniformly big and powerful and tenants uniformly weak. On the contrary, tenants are often gargantuan entities such as Wal-Mart, McDonald’s, AT&T, or Sears,
and they often are dealing with small entities that need to rent their strip centers or single parcels. As an example, the most recent lease negotiation in which the author of this article represented a party, ironically, concerned The Hertz Corporation as a tenant and a middle-aged single woman of modest means as landlord. My client had obtained title to the rental property in the settlement of a divorce. The Texas court’s reasoning about the relative abilities of the parties simply was far off the mark, in that case. The relationship may be different in the residential setting, but in the commercial leasing area, it happens quite often that tenants are the far larger and more powerful parties, just as it frequently happens that landlords are.

For the same reasons, the Pennsylvania approach, which places the burden of mitigating damages on the tenant, who after all is the one who has breached the lease, is the better rule. It fits deontological reasoning, as the court points out in deploring the “fundamental[] unfair[ness]” of the Texas rule. Pennsylvania does not seem to be influenced by the naïve assumptions of the Texas court. It recognizes squarely that the breaching tenant has the ability to mitigate damages, and it does not seem to indulge the unrealistic tacit belief that commercial tenants are generally weak and landlords powerful. It thus avoids visiting on the people of Pennsylvania most of the economic disadvantages of the Texas rule. It should be added that no rule in this area is likely to be perfect. The Pennsylvania approach can create satellite issues in litigation and increase transaction costs, just as the Texas rule is likely to do, and the Pennsylvania rule would be improved if there were incentives for the landlord to accept new tenants offered by the departing tenant. But notwithstanding these issues, the Pennsylvania solution--which places the burden on the breaching party, the tenant—is the preferable rule.