ASSIGNMENT AND SUBLETTING RESTRICTIONS IN LEASES AND WHAT THEY MEAN IN THE REAL WORLD

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Editors' Synopsis: This Article surveys the law on assignment and subletting restrictions in leases. The author notes that for good reason, these clauses often require significant attention during lease negotiation. This Article discusses some issues that practitioners should consider in drafting or negotiating these clauses for their clients.

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I. INTRODUCTION

When landlords and tenants negotiate space leases,[1] those space leases will often prohibit[2] assignment, subletting, and potentially other similar transactions. Typically a landlord's first draft will allow almost no transactions of these types, and a well-advised tenant will try to allow as much as possible. These negotiations often become a major focus of discussions.

Later, if the tenant finds the space lease no longer makes business sense, the tenant often will wish it had negotiated harder on these issues. A restriction that seemed to make sense when the parties negotiated their lease may no longer make sense, may give the landlord a revenue opportunity, and may create a corresponding burden for the tenant.

When an operating company enters into many leases for many locations, it may not want to devote the effort to negotiate each lease carefully, or it may focus more on operational issues than on unlikely future transactions.

Eventually, however, that operating company may become a target company in a corporate merger, acquisition, or other change in ownership. When that happens, any Transfer Restrictions[3] in the target company's leases may create issues for, and impede, a corporate transaction. In

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[1] A "space lease" usually means a lease of space the tenant uses for actual business operations, as opposed to real estate development or investment. Space leases typically include office leases, with an original term of five to fifteen years, and retail leases, which can go much longer (at least for large spaces) after taking into account multiple extension options. The longer the lease term and the more limited the landlord's responsibilities, the closer the transaction comes to a "ground lease," where the tenant regards its leasehold as a real estate investment. A ground lease typically will allow the tenant much more flexibility than a space lease and will be less likely to contain Transfer Restrictions as burdensome as those analyzed here.

[2] This Article treats a requirement to obtain the landlord's consent as equivalent to a prohibition because one should assume both roads usually will lead to the same place. In some states, however, a consent requirement may imply a "reasonableness" qualification, whereas an outright prohibition will not. These distinctions are, however, quite subtle, fact-specific, unpredictable, and unreliable. This Article discusses all these issues below.

[3] This term and some others are defined in Part II.B, *infra.*

extreme cases, the leases may prevent a transaction from closing or increase the cost of the transaction. Whether any of these problems arise will depend primarily on the exact words of the leases and what those words mean.

Therefore, if a target company holds important leases,[4] the Assignment Restrictions in those leases may require substantial and very focused early attention in due diligence and contract negotiations. And any participant in a corporate transaction of this type, or any tenant under a major space lease that it no longer wants, will care very much about the answers to these questions:[5]

- What should counsel look for when reviewing Assignment Restrictions in space leases?
- What do the more common Assignment Restrictions mean?
- How do Assignment Restrictions interact with mergers or other particular types of corporate transactions?
- Do similar principles apply to restrictions on subletting?[6]
- Does a particular proposed transaction require the landlord's consent?
- If a transaction does require the landlord's consent, must the landlord be reasonable about granting or withholding consent?
- If so, what does "reasonable" mean?

This Article tries to answer these questions to help landlords, tenants, and their counsel understand the issues in this area, both in drafting and

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[4] If the company has only a few leases, has generic space requirements (so it easily could replace any lost leases), or has mostly at- or above-market rent under its leases, the parties may make a business decision not to worry about leases at all. As a practical matter, the likelihood of trouble under these circumstances seems fairly low, especially if the company has good relations with its landlords and those landlords are dispersed widely. On the other hand, if the company's value lies in its leases and their below-market rents (for example, a typical supermarket chain), or if a single landlord owns many of the tenant's locations, the risk of claims by opportunistic landlords may turn these legal issues into the most important business issues in the deal. Exactly how to approach all these issues represents a strategic decision to be discussed with the client early in the transaction and confirmed in writing.

[5] Similar issues arise for valuable contracts. No reason exists to think the answers would be dramatically different.

[6] When faced with strict prohibitions on assignment, the parties, depending on the larger deal structure, instead sometimes can create a sublease to give the subtenant nearly the functional equivalent of an assignment. The question then becomes whether the lease prohibits, or requires the landlord's consent to, subleasing of this type.

negotiating leases and in structuring future lease transfers and multiple-lease transfers as part of corporate transactions.

Exit strategy issues like these have taken on particular urgency given the level of stress and uncertainty in American business since mid-2007. These pressures have forced many institutions and companies—often on an urgent basis—to rethink their space requirements and how their restructuring, merger, sale, downsizing, or bankruptcy[7] will affect their lease obligations. Thus, the issues this Article addresses have become more timely and important than ever.

After summarizing the basic legal principles that govern Transfer Restrictions in leases, this Article identifies some important categories of transfers, then analyzes how courts treat certain Transfer Restrictions that commonly appear in space leases.

This Article also examines whether a tenant must obtain landlord consent to an assignment or subletting if the lease says nothing, and if so, whether a landlord must be reasonable regarding that consent. Also, when the lease or governing law requires a landlord to be "reasonable," what does that mean?

This Article considers both New York law and general American common law principles. This Article ultimately reconfirms the importance of precision in drafting and the need to thoughtfully consider, in the drafting stage, the parties' intentions and expectations, along with how a court will respond to Transfer Restrictions, or the lack thereof, in a lease. This Article concludes with lessons and practical advice for both landlord and tenant.

Understanding what Transfer Restrictions in leases mean and how the law treats these provisions represents the first step toward avoiding future roadblocks and headaches in this area for all parties involved.

II. OVERVIEW AND SOME DEFINITIONS

A. General Common Law Definitions

These general common law principles form the basic foundation and starting point for the present discussion:

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[7] The federal bankruptcy law allows a debtor or its trustee to assume or reject unexpired leases. *See* 11 U.S.C. § 365 (2006). These provisions often override whatever the lease says, as well as some state law. Bankruptcy treatment of lease assignments lies outside the scope of this Article. As in so many other areas of transactional law, however, bankruptcy provides the ultimate test for any business document or transaction. Thus, every transactional lawyer must to some degree be a bankruptcy lawyer, or at least bankruptcy literate.

- "Restraints on Alienation." Restrictions against assignment and subletting are regarded as restraints on alienation, which the courts generally disfavor. The courts therefore construe these restrictions strictly, in favor of free alienability.[8]
- "Forms of Alienation." A covenant against one form of alienation does not prohibit another form.[9] For example, a covenant against assigning does not preclude subletting, pledging, or mortgaging.[10]

B. Terms Used in This Article

Starting from those general principles, these defined terms will apply throughout the discussion:

- "Basic Assignment Restriction" refers to an ordinary, generic provision in a lease that generally prohibits a lease assignment or requires landlord consent for such an assignment. Any such restriction does not single out particular types of assignments or specify other types of transfers that are prohibited; it merely says the tenant may not assign the lease.
- "Advanced Assignment Restriction" refers to a provision in a lease that prohibits particular types of assignments. For example, a restriction on the transfer of control of a corporation or assignment by "operation of law"[11] would constitute an Advanced Assignment Restriction.
- "Assignment Restriction" refers to Basic Assignment Restrictions and Advanced Assignment Restrictions together.

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[8] *See* Riggs v. Pursell, 66 N.Y. 193, 201 (1876) ("Such covenants are restraints which courts do not favor. They are construed with the utmost jealousy, and very easy modes have always been countenanced for defeating them.").

[9] *See* 1 MILTON R. FRIEDMAN, FRIEDMAN ON LEASES § 7:3.3 (Patrick A. Randolph ed., 5th ed. 2008).

[10] *See id.* If, however, the mortgagee or pledgee exercises its rights and remedies to bring about an absolute transfer, then the transaction usually will, and should, be deemed an assignment or transfer. In most cases, therefore, the safe harbor for a mortgage or pledge usually will not give a lender much comfort, because the lender usually will want to know it can safely realize on its collateral. On the other hand, if the lender merely wanted to achieve secured status for bankruptcy purposes, the lender might not care about this problem. In that case, counsel should consider the risks of imperfect memory on the part of clients.

[11] This Article examines what operation of law means. *See infra* Part IV.

- "Subletting Restriction" refers to an ordinary, generic provision that generally prohibits any subletting of all or part of the leased property without landlord consent.
- "Transfer Restriction" refers to Assignment Restrictions and Subletting Restrictions together.

C. Overview of Issues Addressed in This Article

This Article addresses the following five issues of law and reaches the conclusions summarized below.[12] For any individual transaction, of course, the conclusions in this Article will need to be confirmed, taking into account the specific facts, circumstances, and leasing documents at issue.

1. Stock Transfers

Q: Do Basic Assignment Restrictions prohibit stock transfers of a corporate tenant?

A: No, unless the lease contains an Advanced Assignment Restriction that specifically prohibits such transfers.[13]

2. Assignments by Operation of Law

Q: Do Basic Assignment Restrictions prohibit assignments by "operation of law"?

A: No. An assignment by operation of law will not violate the lease unless the lease contains an Advanced Assignment Restriction specifically prohibiting an assignment by operation of law.[14]

3. Mergers

Q: Do Basic Assignment Restrictions prohibit mergers of a corporate tenant?

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[12] The discussion generally refers only to corporate tenants. Limited liability company (LLC) tenants and partnership tenants likely would be treated the same as corporations for this purpose, but this likelihood has not been tested or researched for the present discussion. Many commercial leases restricting assignment and subletting also discuss changes of control of a corporate, LLC, or partnership tenant. For reasons this Article will make amply clear, landlords should address these points in their leases expressly if the tenant is, or could become, some type of entity.

[13] *See infra* Part III.

[14] *See infra* Part IV.

A: No. A corporate merger will not violate the lease unless the lease contains an Advanced Assignment Restriction specifically prohibiting mergers—either explicitly or as assignments or transfers by operation of law.[15]

4. Requirement for Consent If Lease Is Silent

Q: If a lease contains no Transfer Restriction, must the tenant obtain the landlord's consent before assigning or subletting?

A: Most jurisdictions favor free transferability and do not require a tenant to obtain a landlord's consent if the lease does not require it. A minority of jurisdictions require landlord consent before a tenant can assign or sublet even if the lease says nothing.[16]

5. Reasonableness in Denying Consent

Q: If a Transfer Restriction sets no standard for the landlord's consent, must the landlord act reasonably in refusing consent? If so, what standard of "reasonableness" must the landlord satisfy?

A: Only a minority of jurisdictions require landlords to be reasonable. Even where the courts require it, no single standard defines "reasonableness." The cases, and there are many of them, offer some clues, which this Article will discuss.[17]

Although the above answers represent majority views on these issues, plenty of exceptions and minority views—some of which amount to emerging trends—exist on most of the above issues. Moreover, any individual judge usually can find some basis to decide any particular case in whatever way the judge sees fit. Any potential participant in a transaction therefore should consult current case law in each applicable jurisdiction. Finally, in negotiating leases and corporate transactional documents, the parties should not leave these issues for a court to decide. They should carefully consider, negotiate, and address all these issues at the outset of each space lease transaction.

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[15] *See infra* Part V.

[16] *See infra* Part VI.

[17] *See infra* Part VII.B.

III. STOCK TRANSFERS

Under general legal principles, the sale or transfer of a corporate tenant's stock does not violate a Basic Assignment Restriction[18] because a corporation exists separately from its stockholders, and courts generally have found a landlord who enters into a lease with a corporate tenant should be deemed to know about such separate existence.[19] A corporation's separate legal existence is hardly a deep, dark secret that tenants conceal from innocent and naïve landlords. Thus, while owners of a corporation may transfer the company's stock, this transaction does not change the actual tenant under the lease, which was, is, and remains exactly the same corporation.[20]

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[18] *See In re* Ames Dep't Stores, Inc., 127 B.R. 744, 748 (Bankr. S.D.N.Y. 1991) ("In Illinois, it is settled that the transfer of all of the stock issued by a tenant corporation does not effect an assignment of the tenant's lease unless the lease so provides."); Ser-Bye Corp. v. C. P. & G. Markets, Inc., 179 P.2d 342, 345 (Cal. Dist. Ct. App. 1947) ("The inhibitions against assignment run as to the lease itself and not to the stock in the lessee corporation by one or more stockholders. When, therefore, it was covenanted that the lessee should not 'assign the leasehold estate' the lease as an entirety was meant, and not merely shares of stock in the lessee corporation.") (internal citation omitted); Nat'l Bank of Albany Park v. S.N.H., Inc., 336 N.E.2d 115, 122 (Ill. App. Ct. 1975) ("When a [shareholder] transfers all of [a corporation's] stock, the control of the corporation is also transferred, but the legal entity of the corporate lessee remains the same."); *see also* U.S. Cellular Inv. Co. v. GTE Mobilnet, Inc., 281 F.3d 929, 934–36 (9th Cir. 2002) (limited partnership agreement restriction on a corporation's sale of its general partnership interest does not restrict sale of stock by stockholders of that corporate partner); Richardson v. La Rancherita La Jolla, Inc., 159 Cal. Rptr. 285, 289 (Ct. App. 1980) (sale of all shares of stock in lessee corporation does not violate antiassignment clause); Burrows Motor Co. v. Davis, 76 A.2d 163, 165 (D.C. 1950) (transfer of majority of stock in lessee corporation producing change in control does not violate antiassignment clause); Posner v. Air Brakes & Equip. Corp., 62 A.2d 711, 713 (N.J. Super. Ct. Ch. Div. 1948) (noting that a tenant corporation becoming wholly owned by or a subsidiary of another corporation "does not under the circumstances of this case constitute an assignment of the lease or an underletting of the premises by the lessee").

[19] *See, e.g.*, Rubinstein Bros. v. Ole of 34th St., Inc., 421 N.Y.S.2d 534, 538 (Civ. Ct. 1979).

[20] *See* Branmar Theatre Co. v. Branmar, Inc., 264 A.2d 526, 529 (Del. Ch. 1970) ("[T]he rule that precludes a person from doing indirectly what he cannot do directly has no application to the present case. The attempted assignment was . . . by plaintiff corporation, the sale of stock by its stockholders."). Although courts refuse to treat a stock sale as an implied lease assignment, the New York State and New York City tax rules take a different approach. By statute, New York treats the transfer of a "controlling interest" in an entity that owns real estate as an implied transfer of the real estate. N.Y. TAX LAW § 1401(b), (e) (McKinney 2008); NEW YORK CITY ADMIN. CODE §§ 11-2101(6)–(9), 11-2102(a) (2008). A 2008 New York decision extends the transfer of a

Courts apply this rule even when a landlord previously disapproves a proposed lease assignment, and the rejected assignee then proceeds to purchase the stock of the corporate tenant[21]—a transparent and brazen attempt to get around the assignment prohibition.[22] New York courts (in the few cases on point) generally have followed the precedent of other jurisdictions on this question.[23]

A landlord, if it wants, may try to prohibit a de facto assignment of the lease through a stock transfer. To do this, the landlord must draft an Advanced Assignment Restriction specifically forbidding transfer of control of the tenant corporation.[24] Although such provisions have been enforced,[25] they restrict alienation of property; therefore, courts will construe them strictly against the landlord.[26] For example, a clause with language barring the transfer of existing stock may be held to allow the cre-

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controlling interest to include a change of voting control even if ownership percentages do not change. *See* CBS Corp. v. Tax Appeals Tribunal, 867 N.Y.S.2d 270 (App. Div. 2008). The New York tax collectors will look all the way up the chain of entities, even if (for example) a great-great-grandparent entity is an offshore entity that does not operate in New York.

[21] *See In re Ames Dep't Stores*, 127 B.R. at 749; *see also Burrows Motor Co.*, 76 A.2d at 164.

[22] The court in *Alabama Vermiculite Corp. v. Patterson*, 124 F. Supp. 441 (D.S.C. 1954), responded to the argument that tenants should not be able to use corporate stock transfers to "get around" assignment restrictions. The court saw no reason to deny stockholders the right to transfer stock solely because the result was an indirect transfer of the lease, which would have been prohibited if the tenant were an individual. *See id.* at 445.

[23] *See Rubinstein Bros.*, 421 N.Y.S.2d at 538 ("[T]he rule [of the cases previously cited] makes sense. A landlord entering a lease with a corporate tenant should be presumed to know that it is an artificial entity with a life distinct from the individuals who may from time to time be its owners."); *see also* Gasparre v. 88-36 Elmhurst Ave. Realty Corp., 464 N.Y.S.2d 106 (Sup. Ct. 1983) (extending *Rubinstein* to hold that transfer of stock of corporate property owner does not constitute sale of property under due-on-sale clause).

[24] *See* U.S. Cellular v. GTE Mobilnet, Inc., 281 F.3d 929, 936 (9th Cir. 2002) ("Had the partners intended that the sale of stock of a corporate partner be restricted, such intent could easily have been stated."). For an example of such a lease provision, see *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc.*, 582 N.Y.S.2d 216 (App. Div. 1992) (lease drafted by landlord stated that transfer or sale of 50% or more of corporate tenant's stock would constitute an assignment and require landlord's consent).

[25] *See* Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del., Inc., 170 N.E.2d 35 (Ill. App. Ct. 1960).

[26] *See* Lipsker v. Billings Boot Shop, 288 P.2d 660 (Mont. 1955); *see also, e.g.*, N.Y. GEN. OBLIG. LAW § 13-101 (McKinney 2008 & Supp. 2009) ("Any claim or demand can be transferred" with very limited exceptions).

ation and sale of new stock, the issuance of which will change control of the corporation.[27] Although New York courts have not considered Advanced Assignment Restrictions specifically prohibiting the transfer of a corporate tenant's stock, cases suggest such clauses would be enforceable under New York law.[28] Regardless, such restrictions may be of unreliable enforceability or value when a corporation has many shareholders. For example, a court disregarded these restrictions in a case where, when the lease was signed, 40% or more of the corporation's stock was owned by over a dozen shareholders.[29] Rather than rely on the next court to reach a similar result, well-represented tenants often will ask landlords to carve out from Advanced Assignment Restrictions any limit on initial public offerings or transfers of publicly held stock.

If the tenant is an LLC, and the lease prohibits stock transfers or partnership transfers but says nothing about transfers of LLC membership interests, the courts might allow a transfer of the LLC interests. Courts dislike Assignment Restrictions and will construe them strictly. Therefore, courts probably would hold that if the landlord wanted to prohibit transfer of LLC interests, the landlord should have said so in the lease. If that is true, it places quite a burden on any landlord whose lease was drafted before Wyoming invented the LLC.

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[27] *See* FRIEDMAN, *supra* note 9, § 7:3.3[C][1]. To avoid ambiguity when attempting to prevent changes in corporate control, Friedman recommends landlords draft nonassignment clauses in the following form (which may require updating or modification in particular cases or for "Plain English" comprehensibility):

> An assignment, forbidden within the meaning of this Article, shall be deemed to include one or more sales or transfers, by operation of law or otherwise, or creation of new stock, by which an aggregate of more than 50% of Tenant's stock shall be vested in a party or parties who are nonstockholders as of the date hereof. This paragraph shall not apply if Tenant's stock is listed on a recognized security exchange. For the purpose of this paragraph, stock ownership shall be determined in accordance with the principles set forth in Section 544 of the Internal Revenue Code of 1954 as the same existed on August 16, 1954.

Id.

[28] *See* Ninety-Five Madison Co. v. Active Health Mgmt., 851 N.Y.S.2d 59 (Civ. Ct. 2007) (unpublished table) (upholding lease prohibition on transfer of more than 25% of a partnership's equity without landlord's consent); Rubinstein Bros. v. Ole of 34th St., Inc., 421 N.Y.S.2d 534, 538 (Civ. Ct. 1979) ("If a landlord wished to protect itself against such vicissitude [of corporate ownership], it could easily write into the lease a condition subsequent. One can certainly not be implied, however."); *see also* Dennis' Natural Mini-Meals, Inc. v. 91 Fifth Ave. Corp., 568 N.Y.S.2d 740 (App. Div. 1991) (citing *Rubinstein* to hold stock transfer not a violation of no-assignment clause in lease).

[29] *See* FRIEDMAN, *supra* note 9, § 7:3.3[C][1].

IV. ASSIGNMENTS BY OPERATION OF LAW

Many commercial leases prohibit assignments by "operation of law." To understand these restrictions, one first must define an assignment by operation of law. The Sixth Edition of *Black's Law Dictionary* defines operation of law as "the manner in which rights, and sometimes liabilities, devolve upon a person by the mere application to the particular transaction of the established rules of law, without the act or cooperation of the party himself."[30] The Eighth Edition of *Black's Law Dictionary* defines operation of law as "the means by which a right or a liability is created for a party regardless of the party's actual intent."[31]

"Operation of law" thus refers to the transfer of rights or liabilities by court order, statute, or the like—as opposed to a voluntary and express transfer made by a party. Assignments by operation of law would include the transition of a tenant's lease rights to the executor of the estate of a deceased tenant,[32] to a legatee,[33] to a tenant's trustee in bankruptcy[34] or receiver,[35] or through a judicial sale.[36] The passage of a corporate tenant's lease to a successor tenant through a merger of the corporate tenant also is regarded as being by operation of law.[37]

Like transfers of all the stock of a corporate tenant, assignments by operation of law do not violate Basic Assignment Restrictions.[38] Basic Assignment Restrictions are said to bar only affirmative voluntary acts by the tenant.[39] Because assignments by operation of law are not the as-

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[30] BLACK'S LAW DICTIONARY 1092 (6th ed. 1990).

[31] BLACK'S LAW DICTIONARY 1124 (8th ed. 2004).

[32] *See* Francis v. Ferguson, 159 N.E. 416, 417 (N.Y. 1927); *see also* Second Realty Corp. v. Fiore, 65 A.2d 926, 927 (D.C. 1949); Swan v. Bill, 59 A.2d 346, 348 (N.H. 1948).

[33] *See* Burns v. McGraw, 171 P.2d 148, 152 (Cal. Dist. Ct. App. 1946); *see also* Squire v. Learned, 81 N.E. 880, 881 (Mass. 1907); Buddon Realty Co. v. Wallace, 189 S.W.2d 1002, 1008 (Mo. Ct. App. 1945); Charcowsky v. Stahl, 189 N.Y.S.2d 384, 386 (App. Div. 1959).

[34] *See* Gazlay v. Williams, 210 U.S. 41, 47 (1908); *see also* Standard Operations, Inc. v. Montague, 758 S.W.2d 442, 444 (Mo. 1988); Miller v. Fredeking, 133 S.E. 375, 377 (W. Va. 1926).

[35] *See In re* Prudential Lithograph Co., 265 F. 869, 871 (S.D.N.Y. 1920), *aff'd*, 270 F. 469 (2d Cir. 1920); *see also Standard Operations*, 758 S.W.2d at 444.

[36] *See* FRIEDMAN, *supra* note 9, § 7:3.3[D].

[37] Part V *infra* covers mergers in some depth.

[38] *See* FRIEDMAN, *supra* note 9, § 7:3.3[D].

[39] *See id.*

signors' voluntary acts, Basic Assignment Restrictions do not prohibit them.[40] As one possible exception to this rule, courts might not allow assignments by operation of law that were demonstrably arranged specifically to circumvent a Basic Assignment Restriction.[41] Even then, courts would not necessarily interfere, because courts often are quite willing to endorse transactions that brazenly seek to "get around" Basic Assignment Restrictions, as discussed above.[42]

As would be the case with other types of assignments, a landlord can prohibit assignments by operation of law by using Advanced Assignment Restrictions.[43] Again, such restrictions must be drafted with extreme specificity and clarity because most courts disfavor them and will construe them strictly against the landlord.[44]

Absent an Advanced Assignment Restriction that specifically refers to transfers by operation of law, tenants generally can take comfort that such transfers should not run afoul of Basic Assignment Restrictions in their lease.

V. MERGERS

Few courts have considered whether the merger of a corporate tenant violates a Basic Assignment Restriction.[45] The courts that have considered the question typically have treated these transactions as constitut-

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[40] *See In re* Childs Co., 64 F. Supp. 282, 284 (S.D.N.Y. 1944) ("It is well settled under the cases that an involuntary assignment by operation of law, as we have here, does not constitute a breach of a covenant in a lease against an assignment thereof by the tenant without the consent of the landlord."); *see also* Burrows Motor Co. v. Davis, 76 A.2d 163, 165 (D.C. 1950); Francis v. Ferguson, 159 N.E. 416 (N.Y. 1972); Milmoe v. Sapienza, 142 A. 360 (N.J. Ch. 1928).

[41] *See* Swan v. Bill, 59 A.2d 346, 347 (N.H. 1948) ("A transfer by operation of law is not, in the absence of an express stipulation in that regard, within a provision against assignment, unless it is procured by the tenant merely for the purpose of avoiding the restriction.") (citation omitted); *see also Francis*, 159 N.E. at 417.

[42] *See supra* notes 21–22 and accompanying text.

[43] *See In re* Georgalas Bros., 245 F. 129, 131 (N.D. Ohio 1917); Pac. First Bank v. New Morgan Park Corp., 876 P.2d 761, 765 (Or. 1994) ("If a covenant not to assign a lease expressly prohibits transfers by operation of law, then transfers by operation of law breach the covenant not to assign.") (citation omitted); *see also* Clifford v. Androscoggin & K. R. Co., 115 A. 511, 513 (Me. 1921).

[44] *See* Morris v. Canadian Four State Holdings, Ltd., 678 N.Y.S.2d 214, 215 (App. Div. 1998) (holding that general language prohibiting assignment "whether by operation of law or otherwise" did not contain "very special" language needed to treat devolution to executors as being a prohibited assignment); *see also Francis*, 159 N.E. at 417.

[45] *See* FRIEDMAN, *supra* note 9, § 7:3.3[E][2].

ing transfers by operation of law, not voluntary assignments.[46] As a result, such transfers do not violate Basic Assignment Restrictions.[47] One New York court reasoned:

> [T]he merger of the subsidiary corporation into its parent corporation did not constitute an assignment for purposes of violating the nonassignment covenant in the lease. The merger did not change the beneficial ownership, possession, or control of [the subsidiary's] property or leasehold estate. Only [the subsidiary's] corporate form was affected, not the corporate property. Therefore, no assignment or similar transfer of the lease occurred.[48]

Although most jurisdictions agree that Basic Assignment Restrictions do not prohibit mergers of corporate tenants, courts disagree over whether the change of ownership of a leasehold estate through a merger should be classified as an actual assignment of the lease, or as a mere transfer by operation of law. Therefore, the wording of the restriction in any particular lease (in the context of the particular state's law) can become quite important. The wording of the merger closing documents also may play a role.

Under a strict construction of Basic Assignment Restrictions, courts would prohibit mergers only if mergers pass rights through assignments rather than through mere transfers by operation of law. This question of construction becomes quite important given that most modern Assignment Restrictions specifically prohibit assignments by operation of law.

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[46] *See* Middendorf v. Fuqua Indus., Inc., 623 F.2d 13, 16 (6th Cir. 1980) ("[T]he effect under Ohio law of the merger of [two corporations] was to transfer the leasehold by operation of law and not by assignment.").

[47] *See* Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, 238 S.W.2d 321, 325 (Mo. 1951) ("The merged corporation having succeeded to the rights of the original lessee by operation of law, it follows that there was no assignment within the prohibition of the covenant in question"); Segal v. Greater Valley Terminal Corp., 199 A.2d 48, 50 (N.J. Super. Ct. App. Div. 1964) ("In authorizing a corporate merger, the Legislature provided that the rights, privileges, powers, franchises 'and all and every other interest' of each component corporation shall vest in the successor corporation. R.S. 14:12-5, N.J.S.A. The passage of such interests under the statute, whether labeled an assignment, sublease, or transfer, is by operation of law, and it will not operate as a breach of a covenant barring assignment.").

[48] Brentsun Realty Corp. v. D'Urso Supermarkets, Inc., 582 N.Y.S.2d 216, 217–18 (App. Div. 1992).

The majority answer to this question of construction is that clauses specifically prohibiting assignments by operation of law do prohibit mergers.[49] For example, an Oregon Court stated:

> Although there is "meager authority" addressing the effect on a nonassignment clause of mergers by corporate tenants, where such clauses prohibit transfers "by operation of law," such mergers are a breach of the nonassignment clause "if the effect is to transfer the lease to an entity other than that of the original tenant" *even though no interest in property is impaired by the merger*.[50]

Other courts, however, have held that mergers, although "transfers" by operation of law, are not "assignments" of any kind and therefore are not covered by such clauses.[51] Given most courts' hostility toward restraints on alienation, it is unclear whether courts will continue to follow the majority rule or adopt the second, more permissive view. Landlords wishing to prohibit mergers of their corporate tenants therefore should do so specifically, prohibiting both mergers in particular and all transfers, subleases, or assignments made by operation of law in general, in order to prohibit mergers under either reading. And a tenant should be equally vigilant to assure that a lease with Assignment Restrictions expressly permits mergers.

Given the cases just discussed, a corporate tenant planning a merger might not want to execute a document entitled "Assignment Agreement" or in any other way suggest in the merger documentation that any lease

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[49] *See* Citizens Bank & Trust Co. v. Barlow Corp., 456 A.2d 1283, 1289 (Md. 1983) ("The nonassignment clause used . . . in the lease of the subject premises may be characterized as of the strict type. Its inclusion of assignments by operation of law embraces transfers by merger.").

[50] Pac. First Bank v. New Morgan Park Corp., 876 P.2d 761, 765 (Or. 1994).

[51] *See* Albermarle, Inc. v. Eaton Corp., 357 S.E.2d 887, 888 (Ga. Ct. App. 1987) (surviving corporation after merger more accurately described as successor than assignee); Standard Operations Inc. v. Montague, 758 S.W.2d 442, 443 (Mo. 1988) ("The present lease makes use of the phrase, 'operation of law,' which was used in the Dodier opinion to describe the transaction we found not to be covered, but continues to use the term, 'assignment,' which we there found to be an inappropriate description of the effect of a merger."); Sante Fe Energy Res., Inc. v. Manners, 635 A.2d 648, 649 (Pa. Super. Ct. 1993) (characterizing a transfer of rights of action and property pursuant to a merger properly as succession, not assignment). The *Standard Operations* court justifies this conclusion under the theory that forfeitures must be viewed with disfavor and therefore the governing documents must be interpreted as strictly as possible.

was ever assigned. The tenant later may wish to assert that the transaction was merely a change in the identity of the tenant but in no way an assignment of the lease or a violation of a prohibition against assignments by operation of law. Making this argument might be difficult if the parties executed an Assignment Agreement. Therefore, the parties may want to name the document "Merger Implementation Agreement" or "Succession of Lease," or to let the merger speak for itself—a reasonable position if, in fact, the parties believe the lease was never transferred and the merger did whatever it did without an assignment of the lease.

A careful purchaser of a corporate tenant should, however, consider the possibility that any merger might be deemed a prohibited assignment by operation of law—even if the closing documents try to portray the transaction as something else—and should proceed accordingly.

VI. REQUIREMENT FOR CONSENT IF LEASE IS SILENT

Unless a lease expressly restricts the tenant's right to assign its leasehold interest, most jurisdictions hold that the tenant may freely assign.[52] Many state legislatures have codified this result.[53] A handful of states adopt the opposite view, providing by statute that a tenant cannot transfer its leasehold estate without the landlord's consent even if the lease says nothing on the issue.[54]

Courts generally disfavor restrictions on alienability and typically will refuse to find any implied restrictions.[55] In practice, therefore, leases

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[52] *See* Joseph Bros. Co. v. F.W. Woolworth Co., 641 F. Supp. 822 (N.D. Ohio 1985), *modified*, 844 F.2d 369, 374 (6th Cir. 1988) (tenant did not need landlord's consent to sublease absent restriction in lease); Jenkins v. Eckerd Corp., 913 So.2d 43, 50 (Fla. Dist. Ct. App. 2005); Cole v. Ignatius, 448 N.E.2d 538, 541 (Ill. App. Ct. 1983); Dress Shirt Sales, Inc. v. Hotel Martinique Assocs., 190 N.E.2d 10, 11 (N.Y. Ct. App. 1963); Int'l Chefs Inc. v. Corporate Prop. Investors, 658 N.Y.S.2d 108 (App. Div. 1997); *see also* RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 15.1 (1977).

[53] *See, e.g.*, DEL. CODE ANN. tit. 25, § 5512(a) (1989 & Supp. 2008); LA. CIV. CODE ANN. art. 2713 (2005). Other statutes set tenant-friendly rules for residential leases, but those lie beyond this discussion.

[54] *See, e.g.*, ALASKA STAT. § 34.03.060 (2008); GA. CODE ANN. § 44-7-1 (1991); S.C. CODE ANN. § 27-35-60 (2007); TEXAS PROP. CODE ANN. § 91.005 (Vernon 2007) (tenant may assign without landlord's consent if lease permits); WIS. STAT. ANN. § 704.09(1) (West 2001).

[55] *See* Mann Theatres Corp. v. Mid-Island Shopping Plaza Co., 464 N.Y.S.2d 793, 797 (App. Div. 1983). For two rare examples of courts inferring restrictions on transferability, see *Stacy v. Midstates Oil Corp.*, 36 So. 2d 714, 720 (La. 1947) (lease allowed removal of minerals, and court concluded that an increase in the number of persons extracting minerals would impose a burden on landlord's estate), and *Nassau*

are rarely entirely silent on the issue of transferability. Leases almost always seek to restrict the tenant's power to transfer his or her leasehold interest. Few commercial landlords or their counsel will tolerate silence on assignment restrictions in a lease.

VII. REASONABLENESS IN DENYING CONSENT

A. Whether Required

In most states, including New York, the rule remains that if a lease prohibits assignment or subletting without the landlord's consent, the landlord may refuse consent arbitrarily and for any or no reason at all—and may even extract payment as a condition for consent[56]—unless the lease specifically requires any refusal of consent to be reasonable.[57] Under the traditional majority rule, a landlord bears no obligation to act "reasonably" or "in good faith" in considering a request for such consent.[58]

Hotel Co. v. Barnett & Barse Corp., 147 N.Y.S. 283, 285 (App. Div. 1914) (tenant was experienced hotel operator paying percentage rent).

[56] *See* Alwen v. Tramontin, 228 P. 851, 852 (Wash. 1924) (enforcing a lease provision requiring tenant to pay a fee for landlord's consent to assignment in a jurisdiction that does not require a landlord to act reasonably in withholding consent). *But see* Banc of Am. Secs. LLC v. Solow Bldg. Co. II, L.L.C., 847 N.Y.S.2d 49, 57 (App. Div. 2007) (landlord's demand for a large payment as a condition to consenting to tenant's alterations treated as quasi-tortious monetary harm absent lease provision requiring fee; holding based less on the words of the lease than on a tort-like analysis of landlord's acts).

[57] Courts (although not necessarily all courts) in these jurisdictions have adopted this majority rule: Colorado, Connecticut, Delaware, Georgia, Indiana, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Vermont, and Washington. Because of the frequency with which this issue arises and the likelihood of changes in the law, the preceding list (which was based on limited research) should not be relied upon. For a description of cases in some of these jurisdictions, *see* James C. McLoughlin, Annotation, *When Lessor May Withhold Consent Under Unqualified Provision in Lease Prohibiting Assignment or Subletting of Leased Premises Without Lessor's Consent*, 21 A.L.R.4TH 188, § 3 (2004).

[58] In New York, at least, the courts apply similar principles in interpreting and applying any contract that requires the other party's consent but does not expressly require the other party to act reasonably. *See, e.g.*, State St. Bank & Trust Co. v Inversiones Errazuriz Limitada, 374 F.3d 158 (2d Cir. 2004); Teachers Ins. & Annuity Ass'n of Am. v. Wometco Enters., Inc., 833 F. Supp. 344 (S.D.N.Y. 1993). These cases teach that New York courts will not infer a reasonableness requirement from some kind of implied covenant of good faith and fair dealing. In *State Street Bank*, the party withholding consent demanded payment in exchange for consent, and the court

A small but growing minority of jurisdictions hold, however, that a landlord must act reasonably in withholding consent even if the lease does not require reasonableness. One commentator suggested the following basis for this trend:

> The reasoning behind the rule allowing nearly total landlord control over tenant transfers, in the absence of a lease provision to the contrary, no longer holds sway with many judges, lawmakers, and commentators. Relationships between landlord and tenant have become more impersonal . . . . These changes and concerns have had a profound impact on courts and legislatures . . . . [M]odern courts have almost universally adopted the view that restrictions on the tenant's right to transfer are to be strictly construed.[59]

Florida and Illinois, among other states,[60] have adopted this position. California codified a presumption of reasonableness for purposes of ascertaining whether a landlord's consent was reasonable, and placed the

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specifically allowed that. *See* 374 F.3d at 169. Texas also has refused to infer a general duty of good faith and fair dealing in real property contracts. *See* Trinity Prof'l Plaza Assocs. v. Metrocrest Hosp. Auth., 987 S.W.2d 621, 625–26 (Tex. App. 1999).

[59] 2 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 17.04[1][c][ii] (Michael Allan Wolf ed., 2008).

[60] Courts, though not necessarily all courts, in these jurisdictions have adopted this minority rule: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, District of Columbia, Florida, Georgia, Idaho, Illinois, Louisiana, Maryland, Massachusetts, Nebraska, New Mexico, North Carolina, Ohio, Oregon, and Tennessee. Because of the frequency with which this issue arises and the likelihood of changes in the law, the preceding list (based on limited research) should not be relied upon. For a description of cases in some of these jurisdictions, *see* James C. McLoughlin, Annotation, *When Lessor May Withhold Consent Under Unqualified Provision in Lease Prohibiting Assignment or Subletting of Leased Premises Without Lessor's Consent*, 21 A.L.R.4TH 188, § 3 (2004). *See also* Pac. First Bank v. New Morgan Park Corp., 876 P.2d 761, 762 (Or. 1994) (applying contractual duty of good faith to lease agreements, which requires adherence to reasonable expectations of parties—a standard that may in practice leave it all up to the judge, potentially many years after the fact); Cafeteria Operators, L.P. v. AMCAP/Denver Ltd. P'ship, 972 P.2d 276, 278 (Colo. Ct. App. 1998) ("[W]ithout a freely negotiated provision in the lease giving the landlord an absolute right to withhold consent, a landlord's decision to withhold must be reasonable."); RESTATEMENT (SECOND) OF PROP.: LANDLORD & TENANT § 15.2(2) (1977) (lease may prohibit lessee's assignment without lessor's consent, but lessor may not withhold consent unreasonably unless a freely negotiated provision confers absolute discretion on lessor).

burden of proof on the tenant to determine otherwise.[61] The California statute allows the parties to contract around this presumption by setting express standards in the lease.[62]

A 2005 California federal court case[63] restated this rule by holding that when the contract unambiguously grants one party an unqualified right, "in its sole discretion, to terminate the negotiations with any prospective [s]ubtenant or assignee at any time and to refuse to enter into any sublease or with any prospective subtenant,"[64] that party can not only refuse to enter into any sublease proposals but also can refuse even to consider any and all proposed sublease agreements.[65]

As in so many other areas, New York diverges from California and follows the majority rule, tending to prefer private negotiations over judicial improvement (and often rewriting) of privately negotiated agreements. If a New York lease contains a Transfer Restriction, the landlord need not be reasonable in refusing consent unless the lease language specifically so requires.[66] Absent an agreement otherwise, a New

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[61] *See* CAL. CIV. CODE §§ 1995.010–.340 (West 1985 & Supp. 2009). Other states also have enacted statutes providing that a landlord cannot unreasonably withhold consent to a transfer by the tenant. *See* ALASKA STAT. § 34.03.060 (2008) (commercial and residential leases); DEL. CODE ANN. tit. 25, § 5512(b) (1989) (residential leases). In New York, a landlord cannot unreasonably refuse consent to assignment of a residential lease but may withhold consent arbitrarily for commercial leases. *See* N.Y. REAL PROP. LAW § 226-b (McKinney 2006 & Supp. 2009).

[62] Well-represented landlords presumably will do so. Hence, each lease now may contain yet another state-specific paragraph, probably in all capital letters and requiring the parties to add their initials to prove they were awake. And leases will grow a little bit longer yet again.

[63] *See* Turkus v. Egreetings Network, Inc., No. C 05-1091 MJJ, 2005 WL 2333834 (N.D. Cal. Sept. 19, 2005). The court also restated the rule that "where a discretionary right in a contract i[s] unambiguous, a party may not invoke the implied covenant of good faith and fair dealing." *See id.* at *4 n.3. This case involved a real-estate-related consent right other than the typical landlord's right to consent to a sublease, but the same principles should apply.

[64] *Id.* at *4.

[65] *See id.*

[66] *See* Mann Theatres Corp. v. Mid-Island Shopping Plaza Co., 464 N.Y.S.2d 793, 797–98 (App. Div. 1983) ("[W]here the lease contains an express provision restricting assignment or subletting without the landlord's consent, the landlord may arbitrarily refuse consent for any or for no reason, unless the provision requires that consent not be unreasonably withheld."), *aff'd*, 468 N.E.2d 51 (N.Y. 1984); *see also* Caridi v. Markey, 539 N.Y.S.2d 404, 405 (App. Div. 1989) (recognizing the need to protect a landlord's substantial interest in controlling assignability of leases in New York); Arlu Assocs., Inc. v. Rosner, 220 N.Y.S.2d 288 (App. Div. 1961), *aff'd*, 185 N.E.2d 913 (N.Y. 1962);

York landlord may impose conditions, including payment, as a prerequisite to consent.[67] (One court, however, held such conditions may amount to economic duress,[68] demonstrating yet again how these outcomes can depend on the particular judge rather than the consistent application of predictable legal principles, even in New York.) Like other restrictions on alienation of property, though, Transfer Restrictions are disfavored. Therefore, courts will construe such clauses strictly against any restrictions on alienation.[69]

B. What Constitutes Reasonableness

Even if a Transfer Restriction or governing law requires a landlord to act "reasonably" or not "unreasonably" in withholding consent, it is not at all clear what "reasonable" means. Although landlords cannot seize on absolutely any creative excuse to withhold consent, no single rule or set of rules for defining reasonableness exists.

The question of "reasonableness" therefore generally remains an issue for the trier of fact to decide,[70] with the result that consistent legal

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Kruger v. Page Mgmt. Co., Inc., 432 N.Y.S.2d 295 (Sup. Ct. 1980) (including subletting in the majority rule).

[67] *See* Durand v. Lipman, 1 N.Y.S.2d 468, 473–74 (Mun. Ct. 1937) ("The landlord . . . could withhold such consent, even arbitrarily. Hence the landlord was at liberty to impose such conditions as he deemed proper as a prerequisite to his consent to the assignment."); *see also* Herlou Card Shop, Inc. v. Prudential Ins. Co., 422 N.Y.S.2d 708 (App. Div. 1979). Friedman notes, however, that the courts do not view such practices favorably, and this aversion may be driving some jurisdictions to the minority rule. *See* FRIEDMAN, *supra* note 9, § 7:3.4[A]. ("[T]he minority cases generally involve a demand by landlord from tenant for something in excess of the tenant's lease obligations, usually a rent increase or equivalent, which one court called 'blood money' . . . . A few more 'blood money' cases could provoke a change [in other jurisdictions to requiring reasonableness in withholding consent].").

[68] *See* Equity Funding Corp. v. Carol Mgmt. Corp., 322 N.Y.S.2d 965 (Sup. Ct. 1971), *aff'd* 326 N.Y.S.2d 384 (App. Div. 1971).

[69] *See Kruger*, 432 N.Y.S.2d at 299; *see also* Chanslor-Western Oil & Dev. Co. v. Metro. Sanitary Dist., 266 N.E.2d 405, 408 (Ill. App. Ct. 1970); Ring v. Mpath Interactive, 302 F. Supp. 2d 301, 306 (S.D.N.Y. 2004).

[70] *See* Worcester-Tatnuck Square CVS, Inc. v. Kaplan, 601 N.E.2d 485, 488 (Mass. App. Ct. 1992) ("Whether a lessor acts reasonably in withholding his consent to a sublease, therefore, is a question for the finder of fact."); Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc., 297 N.Y.S.2d 156, 159 (Sup. Ct. 1969) ("The standards of 'reasonableness' have not heretofore been clearly delineated by any single New York case, but are left to the trial court to determine in accordance with the particular factual patterns before it, and the conceptual boundaries may be only faintly discerned in the few reported cases."); *see also* CAL. CIV. CODE § 1995.260 (West 2004).

principles—or predictable results—are quite hard to find in this area. Friedman wrote: "What is 'reasonable' at one time may not be at another."[71] This standard requires the factfinder to consider whether a reasonably prudent person in the landlord's position would have withheld consent.[72] Considerations of mere personal taste and convenience—personal idiosyncrasies of the landlord—probably are not reasonable.[73] The test of reasonableness is an objective one, based on the standard of a reasonable prudent person without considering the particular circumstances or agenda of the landlord.[74]

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[71] FRIEDMAN, *supra* note 9, § 7:3.4[D][3].

[72] *See* Ramco-Gershenson Props., L.P. v. Serv. Merch. Co., Inc., 293 B.R. 169, 177 (M.D. Tenn. 2003) (applying commercial reasonableness standard to landlord's withholding of consent); Ringwood Assocs., Ltd. v. Jack's of Route 23, Inc., 379 A.2d 508, 511 (N.J. Super. Ct. 1977); Ernst Home Ctr. v. John Y. Sato, 910 P.2d 486, 492 (Wash. Ct. App. 1996).

[73] *See Worcester*, 601 N.E.2d at 488–89; *see also* Broad & Branford Place Corp. v. J.J. Hockenjos Co., 39 A.2d 80, 82 (N.J. 1944); John Hogan Enters. v. Kellogg, 187 Cal. App. 3d 589, 592 (1986); *Chanslor-Western*, 266 N.E.2d at 405; Maxima Corp. v. Cystic Fibrosis Found., 568 A.2d 1170, 1176 (Md. Ct. Spec. App. 1990) (any landlord is "normally expected to act pursuant to reasonable commercial standards, without regard to subjective attitudes personal to the landlord"); Ontel Corp. v. Helasol Realty Corp., 515 N.Y.S.2d 567, 568 (App. Div. 1987) (calling a situation in which lessor's general manager denied consent because he thought assignee's representative should have contacted him to discuss assignee's financial status an example of "subjective concerns and personal desires" that "cannot play a role in a landlord's decision to withhold its consent").

[74] Tenet v. Jefferson Parish Med. Ctr., 426 F.3d 738, 743 (5th Cir. 2005). In this well-reasoned Fifth Circuit case, a real estate investor leased space to a tenant for a medical use. The lease said the landlord would not unreasonably withhold consent to an assignment. The original landlord sold the property to a hospital. The original tenant proposed to assign to a different type of medical use, one the lease would allow but that would compete with the hospital in ways the previous tenant would not have. The hospital, as the new landlord, withheld consent based on concern about competition. *See id.* at 740. The hospital argued that: (a) reasonableness depends in part on the identity and circumstances of the landlord at the moment the tenant requests the landlord's consent and (b) if the current landlord wants to protect itself from competition, that constitutes a reasonable basis to withhold consent. *See id.* at 742–44. The court disagreed, stating: "In determining whether a landlord's refusal to consent was reasonable in a commercial context, only factors that relate to the landlord's interest in preserving the leased property or in having the terms of [the] prime lease performed should be considered." *Id.* at 743. The court also reasoned that a future landlord's ability to tighten the scope of permitted assignments based on circumstances peculiar to that landlord would amount to an expansion of the landlord's rights under the lease without the tenant's consent. *See id.* at 744. (Of course, this court also would not have allowed the original landlord to assert its own personal circumstances, *see id.* at 744, so the argument carries little additional

Despite the nebulous nature of the reasonableness standard, the court in *American Book Co. v. Yeshiva University Development Foundation, Inc.*[75] set forth a nonexhaustive list of objective standards for determining reasonableness. Other courts have followed them.[76] These standards:

> are readily measurable criteria of a proposed subtenant's or assignee's acceptability, from the point of view of *any* landlord:
>
> (a) financial responsibility [of the proposed subtenant][77]
> (b) the "identity" or "business character" of the subtenant—i.e. his suitability for the particular building
> (c) the legality of the proposed use[78]
> (d) the nature of the occupancy—i.e. office, factory, clinic, or whatever.[79]

Starting with the first criterion suggested above, a landlord probably acts reasonably in refusing consent unless the tenant gives the landlord reasonable evidence that the proposed assignee is ready, willing, and able

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weight.) *See also* Logan & Logan, Inc. v. Audrey Lane Laufer, LLC, 824 N.Y.S.2d 650, 651 (App. Div. 2006) (if a landlord has agreed not to unreasonably withhold consent, the landlord may consider only "objective factors such as the financial responsibility of the [proposed assignee], the [proposed assignee's] suitability for the particular building, the legality of the proposed use and the nature of occupancy"); Sayed v. Rapp, 782 N.Y.S.2d 278, 281 (App. Div. 2004); Astoria Bedding, Mr. Sleeper Bedding Ctr. v. Northside P'ship, 657 N.Y.S.2d 796, 797 (App. Div. 1997).

[75] 297 N.Y.S.2d 156, 160 (Sup. Ct. 1969).

[76] *See* Fernandez v. Vazquez, 397 So. 2d 1171 (Fla. Dist. Ct. App. 1981); *Ernst Home Ctr.*, 910 P.2d at 493 (discussing factors landlord can reasonably consider).

[77] This item is perhaps more important than ever in an era when creditworthy financial institutions commonly vanish over a weekend.

[78] If the proposed assignee or subtenant would or might use the premises in violation of the lease (whether the use clause, an obligation to comply with law, or any other lease terms), why shouldn't the landlord be relegated to its rights and remedies if and when a violation actually occurs? Why should this discussion be a component of reasonableness at all? The answer may be that the courts cannot be relied upon to enforce the landlord's rights and remedies for a nonmonetary breach, and therefore the landlord should be able to point to the likelihood of such a breach as a reason to withhold consent. And an ordinary, objectively motivated landlord would have precisely that concern, so it fits into the template of reasonableness.

[79] Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc., 297 N.Y.S.2d 156, 160 (Sup. Ct. 1969).

to perform under the lease.[80] A reasonable belief (supported by reasonable evidence) that a proposed assignee cannot pay the rent should almost always give a landlord reasonable grounds to deny consent.[81] A landlord also almost always should be deemed reasonable in refusing consent if the proposed assignee does not deliver adequate financial information in a timely manner so that the landlord can ascertain whether the proposed assignee is financially responsible.[82]

Other considerations can, however, sometimes outweigh financial responsibility. For example, a landlord's refusal to allow financially responsible parties as multiple subtenants was upheld when subdivision of the leased space would have been undesirable in a "prestige building."[83]

Although the second factor listed above, the "identity" or "business character" of the subtenant/assignee, may be used as a reasonable basis for a landlord to reject an assignment, landlords asserting this argument bear a heavy burden of proof.[84]

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[80] *See* Golf Mgmt. Co. v. Evening Tides Waterbeds, Inc., 572 N.E.2d 1000 (Ill. App. Ct. 1991). One can determine what makes an assignee ready, willing, and able from, for example, *Vranas & Assocs., Inc. v. Family Pride Finer Foods, Inc.*, 498 N.E.2d 333 (Ill. App. Ct. 1986) (a buyer is ready, willing, and able, for purposes of a purchase and sale contract, if the buyer has sufficient resources on hand or can command necessary funds within the required time).

[81] *But see* Ring v. Mpath Interactive, 302 F. Supp. 2d 301, 306 (S.D.N.Y. 2004) (landlord's unsubstantiated assertion that some unspecified documents showed subtenant to be a financial risk constitutes an unreasonable refusal of consent); *see also* FRIEDMAN, *supra* note 9, § 7:3.4[D][3]. Friedman points out "[i]nasmuch as neither assignment nor subletting releases the original tenant from his lease obligations, it may be argued that the landlord has all he bargained for regardless of the wealth or skill of the assignee or subtenant." *Id.* Friedman notes, however, that the little relevant authority on the issue has held that the landlord is entitled to a responsible assignee. *See id.* In practice, landlords prefer a financially responsible assignee or subtenant to minimize the likelihood of default and litigation against the tenant, even though the tenant will remain liable on the lease. That preference generally is accepted and taken seriously in the real estate industry.

[82] *See* 200 Eighth Ave. Rest. Corp. v. Daytona Holding Corp., 740 N.Y.S.2d 330, 331 (App. Div. 2002) (noting financial information later submitted by proposed assignee showed proposed assignee was not financially capable of assuming lease obligations).

[83] Time, Inc. v. Tager, 260 N.Y.S.2d 413, 415–16 (Civ. Ct. 1965). Here, the tenant sought the landlord's consent to sublet part of the leased space to a subtenant. The court found the landlord's decision to withhold consent reasonable, even though after terminating the lease with the tenant, the landlord proceeded to rent the space to the same proposed subtenant. *See id.*

[84] *See* Ernst Home Ctr. v. John Y. Sato, 910 P.2d 486, 493 (Wash. Ct. App. 1996) (while tone and image are valid considerations, landlord must be able not only to express (concoct?) appropriate concerns but also to "produce evidence that a trier of fact could examine objectively"). *But see* Mowatt v. 1540 Lake Shore Drive Corp., 385 F.2d 135,

One New York case involved an Assignment Restriction that required the landlord to be reasonable, but stated that the landlord could consider the "business reputation of the proposed assignee or subtenant," as well as "the effect that the proposed assignee or subtenant's occupancy or use of the demised premises would have upon the operation and maintenance of the building and the landlord's investment therein."[85] Although the court in that case began by analyzing the factors listed above, it rejected the landlord's substantial evidence that assignment to a financially responsible bank with an alleged "bad business reputation" would lower the value of the property.[86] This case reflects judicial skepticism of landlords who turn down assignments based on allegedly bad characteristics of the assignee.

Courts have, however, held that a landlord reasonably may deny consent under these circumstances:

- A landlord is unaware of the assignee's proposed use;[87]
- A proposed subtenant would compete with other businesses in the same shopping center, prejudicing the landlord's relationship with other tenants;[88]

137–38 (7th Cir. 1967) (landlord was reasonable in withholding consent based on criteria such as insolvency, association with disreputable people, and noisiness, which would be undesirable characteristics of cotenants). The lease in *Mowatt* was residential, but the court's reasoning does demonstrate criteria to assess a landlord's reasonableness. *See id.*

[85] Chase Manhattan Bank, N.A. v. Lincoln Plaza Assocs., 201(5) N.Y.L.J. 22 col. B (Jan. 9, 1989).

[86] *Id.* Chase Manhattan wanted to assign its lease to Bank Leumi. The landlord rejected the assignment, saying Bank Leumi had a "bad business reputation," was plagued by "image problems," and was "simply not a Chase Manhattan." As evidence, the landlord introduced (among other things) news articles on indictments of several of the bank's low-level officers and economic problems and stock scandals in Israel, Bank Leumi's home country. The landlord also presented affidavits by real estate attorneys and appraisers that a Bank Leumi tenancy would lower the value of the building. Presumably the tenant offered competing affidavits from other attorneys and appraisers.

[87] *See* Kroger Co. v. Rossford Indus. Corp., 261 N.E.2d 355 (Ohio Ct. Com. Pl. 1969).

[88] *See* Kenney v. Eddygate Park Assocs. 825 N.Y.S.2d 297 (App. Div. 2006). In this New York case, a tenant had wanted to assign its lease to a Korean restaurant in 1999. The landlord rejected the assignment because the complex already had a Chinese restaurant, and the landlord had said it did not want to see competition it considered inappropriate. *See id.* at 298. Several years later, the plaintiff moved out. In 2003, the landlord leased the exact same space to a Korean restaurant. The first tenant sued, claiming the landlord unreasonably had withheld its consent to the proposed 1999 assignment. The court ruled the landlord reasonably had based its first decision on

- Gross sales, and thus percentage rents, would drop (in the case of a percentage lease);[89] and
- The mix of tenants is critical to the success of the landlord, such as in a shopping center.[90]

Unreasonable grounds for denial, as found by courts, include:

- A proposed subtenant would compete with the landlord's business;[91]
- A tenant would make a profit from the assignment or sublease;[92]
- A landlord has philosophical objections to the proposed tenant's business;[93]

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objective factors because in 1999 the first tenant did not offer to indemnify the landlord against claims from the Chinese restaurant, something the new tenant did agree to do. *See id.* at 299. In addition, the marketplace had changed enough from 1999 to 2003 to justify the landlord's later decision that an increasing demand for Asian food would support both a Chinese restaurant and Korean restaurant. *See id.* This case demonstrates how a reasonableness standard, though objective, might change over time depending on both particular facts and overall market conditions. *See also* Norville v. Carr-Gottstein Foods Co., 84 P.3d 996, 1002 (Alaska 2004) (recognizing that concerns about competition with a primary tenant were plausible).

[89] *See Norville*, 84 P.3d at 1002*; see also* Worcester-Tatnuck Square CVS, Inc. v. Kaplan, 601 N.E.2d 485, 489 (Mass. App. Ct. 1992) ("[Landlord] could reasonably insist upon a subtenancy that would be likely to generate at least a reasonable amount of percentage rent.").

[90] *See* Warmack v. Merchants Nat'l Bank, 612 S.W.2d 733, 735 (Ark. 1981) (upholding landlord's refusal to consent to assignment from bank to savings and loan, where savings and loan would draw neither the same nor as many customers as bank); *see also* Ramco-Gershenson Props. L.P. v. Serv. Merch. Co., 293 B.R. 169, 174–75 n.3 (M.D. Tenn. 2003) ("[T]he tenant mix in a shopping center may be as important to the lessor as the actual promised rental payments . . . .") (quoting H.R. REP. No. 95-595, at 348–49 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6305).

[91] *See* Tenet Healthsystem Surgical, LLC v. Jefferson Parish Hosp., 426 F.3d 738, 744 (5th Cir. 2005) (landlord's withholding of consent unreasonable when premised on concern that the assignee would compete with the landlord's business; instead, landlord's refusal "must relate to the ownership and operation of the leased property, not lessor's general economic interest."); *see also* Edelman v. F.W. Woolworth Co., 252 Ill. App. 142 (1929) (finding a similar denial unreasonable where landlord's business was located a block away from potential competitor's business).

[92] *See* Stauffer Chemical Co. v. Fisher-Park Lane Co., 312 N.Y.S.2d 243, 245 (Sup. Ct. 1970); *see also* Kendall v. Ernest Pestana, Inc., 709 P.2d 837, 845, 847–48 (Cal. 1985) (stating that a landlord has no claim to financial benefits a tenant may gain by alienating the leasehold during its term); Carter v. Safeway Stores, 744 P.2d 458, 461 (Ariz. Ct. App. 1987).

- A landlord dislikes a particular business or method of doing business;[94]
- The prospective assignee is already an existing tenant;[95] and
- A landlord attempts to "extract a financial concession or to improve its financial position."[96]

The above hardly represents a complete list of all factors that courts have considered in determining reasonableness. Potential assignors and assignees should consult case law regarding reasonableness in each applicable jurisdiction and should remember that courts may rule differently on the same grounds for rejection, depending on the facts of the particular case, and, perhaps, on what the judge had for breakfast. Landlords, in turn, should plan carefully and consult counsel before taking any action or imposing any condition on a tenant that could create an appearance of acting in an idiosyncratic, unreasonable, or indefensible manner. Landlords and their counsel should be careful about creating a paper (or email) trail that suggests anything but pure, objective, and reasonable motivations.

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[93] *See* Am. Book Co. v. Yeshiva Univ. Dev. Found., Inc., 297 N.Y.S.2d 156 (Sup. Ct. 1969) (refusal to consent to assignment was unreasonable where landlord, a religious university, objected to tenant's sublease to a Planned Parenthood office). A landlord with special sensitivities of this type may wish to build appropriate restrictions into the lease or insist on an absolutely discretionary right of approval.

[94] *See* Broad & Branford Place Corp. v. J.J. Hockenjos Co., 39 A.2d 80 (N.J. 1944) (holding refusal to consent to assignment was unreasonable where proposed assignee was a dressed poultry store); *see also* Roundup Tavern, Inc. v. Pardini, 413 P.2d 820 (Wash. 1966) (objection to tavern).

[95] *See* Catalina, Inc. v. Biscayne Ne. Corp. of Fla., 296 So. 2d 580, 582–83 (Fla. Dist. Ct. App. 1974) (noting that such a refusal to consent would be reasonable if proposed sublease would have destroyed or adversely affected preexisting lease).

[96] *See* Worcester-Tatnuck Square CVS, Inc. v. Kaplan, 601 N.E.2d 485, 489 (Mass. App. Ct. 1992); *see also* Kendall v. Ernest Pestana, Inc., 709 P.2d 837, 845 (Cal. 1985) ("[T]he lessor's desire for a better bargain than contracted for has nothing to do with the permissible purposes of the restraint on alienation . . . ."); Campbell v. Westdahl, 715 P.2d 288 (Ariz. Ct. App. 1985); Giordano v. Miller, 733 N.Y.S.2d 94, 95 (App. Div. 2001) (landlord's demand that tenant pay landlord a fee as a condition precedent to landlord's granting of consent was unreasonable). Although New York law allows a landlord to demand payment as a condition to granting consent if the lease is silent, the lease in *Giordano* specified that the landlord could not withhold its consent unreasonably, and the lease did not allow such a fee. Hence, the court regarded the landlord's fee request as unreasonable.

C. Withholding Consent Versus Refusing Consent

One Colorado case purported to distinguish between a landlord's "withholding" and "refusing" consent to a proposed assignment.[97] In *Parr*, the lease allowed the tenant to assign with the landlord's prior consent, and also said the landlord could not unreasonably "withhold" that consent.[98]

The tenant told the landlord it wanted to assign the lease, and the landlord asked for certain information. The tenant provided all the information and the landlord did nothing.[99] The landlord deferred making any decision at all, even though the tenant told the landlord that timing was crucial. The tenant turned out to be right, and "lost the deal."[100]

The court concluded that the provision stating the landlord could not "withhold" consent meant the landlord could not silently let an unreasonable amount of time go by without a response.[101] The court suggested that if the lease had said the landlord could not "refuse" consent, then the landlord might violate the lease only if the landlord took some affirmative action to refuse consent, or made some affirmative statement of rejection; mere inaction, however, might be just fine.[102] Because the lease prohibited unreasonable withholding of consent (not "refusal" of consent), the landlord's failure to respond amounted to a withholding of consent.[103] In contrast, if the lease had said the landlord could not "unreasonably refuse" consent, then mere silence might have been acceptable.

No court in any other case reviewed for this Article drew any similar distinction between a landlord's "withholding" or "refusing" consent. Nevertheless, if this distinction actually exists, then landlords' counsel might want any lease to say the landlord will not "unreasonably refuse" consent. Correspondingly, tenants' counsel might want to use the words "unreasonably withhold" consent. In any event, the case is hardly persuasive. Most lease provisions on this issue do tend to use the words "unreasonably withhold" rather than "unreasonably refuse" consent.

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[97] *See* Parr v. Triple L&J Corp., 107 P.3d 1104 (Colo. Ct. App. 2004).

[98] *See id.* at 1105–06.

[99] *See id.* at 1106.

[100] *See id.* at 1107.

[101] *See id.*

[102] *See id.* at 1108.

[103] *See id.*

VIII. LESSONS FOR A LANDLORD

A landlord should consider these suggestions when writing or reviewing Transfer Restrictions in leases:

- *Uphill Battle*. Courts dislike restrictions on alienation and will strictly construe them. When landlord's counsel drafts such a restriction, counsel should draft both broadly and precisely, and think also about every likely or possible future transaction.
- *Prohibit Equity Transfers*. Include specific language that prohibits the transfer of control of a corporate or other entity tenant. This language also should prohibit the creation and sale of new stock or other equity interests. The language should be broad enough to refer to all present and future entity types and equity types, including any not yet created.
- *Change of Control*. Prohibitions against the transfer of control seem appropriate only when dealing with corporations that have a small number of shareholders. If the landlord really cares about these restrictions, the lease or a separate document should memorialize who actually holds the tenant's stock on the date of lease signing.
- *Operation of Law*. Include language prohibiting transfers, subleases, or assignments by operation of law.
- *Murkiness on Mergers*. A landlord should specifically prohibit mergers or, more generally, prohibit a whole laundry list of possible transactions—"all (a) assignments, subleases, mergers, and consolidations, and (b) transfers of any kind occurring by operation of law."
- *Consent Standards*. Explicit standards regarding consent tend to prevail over any presumed reasonableness standard, so it is better to state what the parties consider "reasonable." Without a specific standard, the outcome is unpredictable, which may concern a tenant more than a landlord. If the parties intend to allow the landlord to be unreasonable, then the drafter should, just to prevent possible issues, state that the landlord can withhold consent in its sole and absolute discretion, can impose a fee for consent, and need not even consider the tenant's request for consent.
- *Idiosyncratic Tastes.* If the landlord wants the right to withhold consent for reasons specific to that particular landlord—religious beliefs, personal tastes, the landlord's own activities—the lease

should say so expressly or, better yet, give the landlord an absolute discretionary right to withhold consent.

- *Liability for Unreasonableness*. If a landlord agrees to be reasonable, the landlord should disclaim any liability for failing to be reasonable. The lease should say that the tenant's only remedy in that case would be to obtain equitable relief deeming the landlord's consent granted.

IX. LESSONS FOR A TENANT

A tenant should consider these suggestions to mitigate the risks of Transfer Restrictions:

- *Cut Them Back*. Try to limit Transfer Restrictions as much as possible. If feasible, avoid Advanced Assignment Restrictions entirely. If avoiding these restrictions is not possible, at least try to obtain the landlord's preapproval of certain likely corporate transactions that obviously would not constitute devices to evade the Assignment Restrictions (for example, any bona fide corporate transaction, or transactions affecting the tenant's entire business or at least multiple tenant sites, such as at least 50% of the tenant's locations in California). State that the landlord will not unreasonably "withhold" consent as opposed to unreasonably "refuse" consent. Consider adding a statement that any transaction not expressly banned shall be deemed permitted, though the courts typically will reach this conclusion anyway, as noted above.[104]
- *Define Reasonableness Favorably.* Consider any issues particularly likely to arise if the tenant ever tries to assign. Does a particular type of alternative use of the space seem particularly likely? If so, perhaps ask the landlord to preapprove that particular use (and change of permitted uses, if necessary) to prevent arguments that a reasonable landlord would never allow it. Or, if the tenant might want to assign to a range of possible business categories, the lease might list all of them, with a sample brand name for each category to define a standard of operation that will be deemed automatically reasonable; for example, "an office supply store similar to or better than Staples®."
- *Early Attention.* Particularly for a real-estate-intensive tenant with high-value leases, consider the effect of Assignment Re-

[104] *See supra* Part VI.

strictions in the earliest stages of structuring the transaction. Treat them as fundamental business issues.

- *Identify and Use Leverage*. If the landlord ever requests any accommodation or amendment related to an existing lease, try to use it as an opportunity to trim back any Transfer Restrictions in the lease.

X. CONCLUSION

Transfer Restrictions can create unpleasant surprises for both landlords and tenants. As the first step toward preventing those surprises, parties to commercial leases initially need to understand what the various Transfer Restrictions mean, and then confirm that those restrictions reflect the parties' expectations. This Article offers that starting point.