CHAPTER 9

Case Law Regarding Impact of Lease Assignment Language on Business Restructurings

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I. INTRODUCTION

Over many years real estate practitioners have developed a fairly limited assortment of "standard" lease assignment clauses that frequently reappear from lease to lease with only slight tweaks in wording. Originally, the typical landlord-drafted clause simply prevented any assignment of the lease by a business tenant to another party without landlord's consent, and sometimes made it clear that the prohibition also applied to transfers that occurred by operation of law. Later it became typical to add provisions dealing with a de facto assignment orchestrated by a change in majority ownership or control of the business tenant without the landlord's consent. Still later, language became common in some leases preventing changes in parties "using" the premises, to deal with situations such as licenses and use agreements not clearly proscribed under the assignment or sublease language. Tenants have traditionally simply sought language requiring landlord's consent to not be "unreasonably withheld"; language permitting without landlord's consent transfers of stock or partnership interests in certain percentages for estate-planning purposes; and language permitting transfers to parents, subsidiaries, or affiliates of the tenant.

In the last 20 years, however, there has been an explosion of new statutory forms of business entities that renders application of the old "standard" clauses ambiguous at best. Today, most state organizational statutes permit conversions of general partnerships, limited partnerships, corporations, limited liability companies, limited liability partnerships, limited liability limited partnerships, real estate investment trusts, and business trusts into each other, either by merger or

directly without merger.[1] Business entity conversion and merger statutes are being amended every year to make the conversion process even easier. Every year there is less need for tenant entities to remain in their current forms due to tax treatment considerations. Single-member limited liability companies are now permitted in most states. Under the Revised Uniform Partnership Act, a change in partners no longer causes automatic dissolution of the partnership entity. Moreover, many states are abolishing bulk transfer restrictions, to further assist the ease of business conversions.

Therefore, not only are tenants faced with an ever-increasing array of forms of business organization in which they may operate, but they also find it easier from both legal and business perspectives to make these changes in form of business entity. These opportunities are coinciding with the rapid consolidation of tenant businesses under large regional or national owners (in both retail and nonretail service provider sectors), and the increasing need for flexibility of large business entities to restructure, spin off, or sell subsidiaries or operations that are parties to lease obligations.

Reported case law certainly continues to trail new business statutory practices. Perhaps the most significant void is in decisions regarding changes in control of tenant businesses by conversions under the new statutes. However, the assignment clause is the subject of a very great number of case decisions over the years that display considerable depth. Practitioners can make fairly reasonable predictions of a court's interpretation of assignment clauses dealing with new situations based upon principles established under this comprehensive body of existing case law. The cases regarding corporate mergers discussed below are especially helpful (though somewhat in conflict). Most of the issues involved in merger cases are the same ones that arise in newer situations, such as the conversion of limited partnerships to limited liability companies, albeit in the context of a different statutory authorization for the entity changes.

For real estate practitioners, who often become deeply engrossed drafting and negotiating specific lease language, it is all too easy to sometimes forget that there are situations where courts will not allow lease language to control and will look at the greater context of the situation, especially the original intent and subsequent actions of the landlord and tenant. However, the lease assignment clause is clearly an area in which a lawyer's attention to detail in drafting will almost certainly

1. For example, in Delaware such conversion and merger statutes can be found at Del. Code Ann. tit. 6, § 17-211 (Supp. 2012) (merger or consolidation of domestic limited partnerships into other entities), Del. Code Ann. tit. 6, § 17-217 (Supp. 2012) (conversion of certain entities to a limited partnership), Del. Code Ann. tit. 6, § 17-219 (Supp. 2012) (approval of conversion of limited partnership), Del. Code Ann. tit. 6, § 18-209 (merger or consolidation of various entities into domestic limited liability company), Del. Code Ann. tit. 6, § 18-214 (Supp. 2012) (conversion of other entities into domestic limited liability company), Del. Code Ann. tit. 6, § 18-216 (Supp. 2012) (approval of conversion of limited liability company), Del. Code Ann. tit. 8, § 251 (2011) (merger or consolidation of domestic corporations), Del. Code Ann. tit. 8, § 255 (Supp. 2012) (2011) (merger or consolidation of domestic nonstock corporations), Del. Code Ann. tit. 8, § 259 (2011) (surviving or resulting corporations following merger or consolidation), Del. Code Ann. tit. 8, § 263 (Supp. 2012) (merger or consolidation of domestic corporations or partnerships), Del. Code Ann. tit. 8, § 264 (2011) (merger or consolidation of domestic corporation and limited liability company).

matter. Although the concept of waiver by conduct can always arise,[2] as explained below courts are almost always very willing to allow specific language in the lease to control and rarely will try to find ways to circumvent lease language to reach an outcome as long as the language is specific and unambiguous enough.

It is a fact of life that, due to ever-increasing time pressures, transactional real estate lawyers may give advice based on their experience and what they expect case law would say in that area, without actually having researched the issues at hand. In the area of assignments, fortunately, with a very few significant exceptions as discussed below, research confirms what most experienced lawyers are probably already thinking (i.e., the lease language controls). However, research also confirms that in many cases not enough care is being taken in drafting the lease assignment clause.

II. GENERAL CONCEPTS

A. Definition of "Assignment"

The starting point in determining whether a business restructuring or change in the owners or managers of a business violates a lease assignment provision is ascertaining whether the event does indeed fall within the definition of "assignment." While most cases deal with the distinction real property lawyers are all aware of between an assignment and a sublease, it is necessary to keep in mind what these cases say about the true essence of an assignment. In an assignment, the "lessee parts with his whole term or interest as lessee, and retains no reversionary interest in the original lease."[3] Additionally, and more importantly in situations dealing with changes in tenant business entities, for an assignment to occur there must be a yielding of control of the premises as well as possession.[4] Therefore, unless specific language otherwise defines the term "assignment" as used in a lease, the granting of a license is not an "assignment," because a license is only a privilege to do one or more acts upon land without passing any possessory or control interest in the land.[5] For the same reasons, a prohibition against an "assignment" does not prevent use of premises by a tenant's employees or agents, as possession and control remain with the tenant.[6]

If language transferring a right or interest from one person to another is not qualified in some way, it is construed as a transfer of the whole interest,[7] and therefore is an assignment. If the lessee retains any reversionary interest, no matter how small, it is a sublease and not an assignment.[8] The name that the parties label the transaction as will not control. For example a "consent agreement" that described

2. *See, e.g.*, Brentsun Realty Corp. v. D'Urso Supermarkets, Inc., 582 N.Y.S.2d 216, 218 (N.Y. App. Div. 1992).
3. *E.g.*, Siragusa v. Park, 913 S.W.2d 915, 917 (Mo. Ct. App. 1996) (citations omitted).
4. Mann Theaters v. Mid-Island Shopping Plaza, 464 N.Y.S.2d 793, 799 (N.Y. App. Div. 1983), *aff'd*, 468 N.E.2d 51 (N.Y. 1984).
5. *Id.* at 798.
6. *Id.*
7. Twelve Oaks Tower I, Ltd. v. Premier Allergy, Inc., 938 S.W.2d 102, 113 (Tex. App. 1996).
8. *Id.*

the transfer as a sublease was in effect an assignment since it continued for the balance of a lease term, included additional new rights of the transferee running directly to the landlord, and did not give the transferor any right of reentry.[9]

B. Free Right of Assignment and Limitations

It is clear that a tenant generally has the unfettered right to freely assign its lease.[10] This free right of assignment is limited in only four instances: (1) the assignee's use of the property will injure the property or is a use not allowed by law; (2) the assignee uses the property in a manner inconsistent with a use clause or other clause in the lease;[11] (3) a clause in the lease explicitly prohibits an assignment;[12] or (4) a statutory provision restricts a tenant's right to assign the lease.[13]

The first two limitations do not often come into play in tenant restructurings, since there is usually little change in the nature of the actual use of the property. Real estate lawyers are in the practice of using the "use" or "purpose" clause in the lease to effectively limit tenant assignment possibilities.[14] However, this may no longer be an effective strategy, at least in New York, based on two recent decisions. Construing a restaurant lease with an assignment clause that stated that landlord's consent could not be unreasonably withheld, and a use clause that said the tenant could only sell seafood and desserts, an appellate division court upheld the trial court's denial of the landlord's summary judgment motion made on the basis that landlord had reasonably withheld its consent.[15] In the motion, the landlord stated it had refused consent because the proposed assignee's use was as a Japanese restaurant, which would have competed with another Japanese restaurant in the same center.[16] The court reasoned that although the assignee clearly violated the use clause, the landlord's exclusive reliance on the use clause in denying the assignment request "would render the assignment provisions of the lease meaningless under these circumstances."[17] International Chefs followed another similar surprising New York Appellate Division decision, one that also dealt with a fairly specific use clause (only for operating a retail bedding, home furnishings, and accessory business) and a sublease clause requiring the written approval of landlord, not to be unreasonably withheld.[18] The appellate division court in Astoria first stated that

9. Siragusa v. Park, 913 S.W.2d 915, 917–18 (Mo. Ct. App. 1996).

10. *E.g.*, Italian Fisherman, Inc. v. Middlemas, 545 A.2d 1 (Md. 1988); *Mann Theaters*, 464 N.Y.S.2d at 797.

11. Funk v. Funk, 633 P.2d 586, 588 (Idaho 1981).

12. Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del., Inc., 170 N.E.2d 35, 37 (Ill. App. Ct. 1960).

13. *Twelve Oaks Tower I, Ltd.*, 938 S.W.2d at 112 (applying Tex. Prop. Code Ann. § 91.005 (Vernon 1995) to commercial lease).

14. *See, e.g.*, Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, 238 S.W.2d 321, 323 (Mo. 1951) (lease limited use to "playing championship baseball games in the National League").

15. Int'l Chefs Inc. v. Corporate Prop. Investors, 658 N.Y.S.2d 108, 110 (N.Y. App. Div. 1997).

16. *Id.* at 109.

17. *Id.* at 110.

18. Astoria Bedding, Mr. Sleeper Bedding Ctr., Inc. v. Northside P'ship, 657 N.Y.S.2d 796, 797 (N.Y. App. Div. 1997).

use limitations would be given effect, but "this principle does not necessarily apply with equal force to covenants seeking to limit the right to assign or sublet since such covenants are restraints on the free alienation of land which courts do not favor."[19] The court held that the withholding of consent could not be deemed reasonable as a matter of law, since in applying the rule of strict construction the lease did not contractually limit the right to sublet to those engaged in the retail bedding business.[20] In other words, there were no sublessee or assignee use limitations in the assignment clause itself, and the lease purpose clause was not incorporated by reference into the assignment and subleasing provisions.

The landlord most certainly will want to use the third limitation, lease language, to change the common law rule and control assignments in leases by commercial tenants, even if the landlord is not concerned about the persons running or controlling the tenant business, because the landlord will want the new entity on the hook for "personal" obligations under the lease. Under landlord-tenant law, an assignee has only privity of estate, not privity of contract, which means that the assignee will not be personally liable for covenants in the lease that do not "touch or concern" the land.[21] In addition, a landlord will not want to have to rely on the uncertain results under corporate law relating to the liability of a successor corporation, which provides that a company that purchases or otherwise receives assets of another company is generally not liable for debts and liabilities of the selling corporation, with four exceptions: (1) the purchasing corporation expressly or impliedly agrees to assume the liabilities; (2) circumstances surrounding the transaction warrant finding there was a consolidation or de facto merger; (3) the purchasing corporation is merely a continuation of the selling corporation; or (4) the transaction is fraudulent in fact.[22]

Statutory provisions requiring landlord consent to assignments, the fourth limitation, do not exist in most states, and in states where they do exist they are frequently limited in application to residential leases of dwelling units.[23]

C. Construing Assignment Limitation Language

Given the limitations just discussed, the only relevant limitations affecting changes in tenant entities are clauses expressly limiting assignment rights in the lease. Express tenant assignment restrictions are valid[24] and will be enforced, based in part upon a landlord's "substantial interest in controlling the assignability of leases."[25]

19. *Id.* at 797 (citations omitted).

20. *Id.*

21. *E.g.*, MidSouth Railcorp v. Citizens Bank & Trust Co., 697 So. 2d 451, 455 (Miss. 1997).

22. *E.g.*, Kaiser Found. Health Plan of the Mid-Atlantic States v. Clary & Moore, P.C., 123 F.3d 201, 204 (4th Cir. 1997).

23. *E.g.*, N.Y. Real Prop. Law § 226-b (McKinney 2004). *But see* Tex. Prop. Code Ann. § 91.005 (Vernon 2004) (no residential limitation).

24. *E.g.*, Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del., Inc., 170 N.E.2d 35, 38–39 (Ill. App. Ct. 1960).

25. Mann Theaters v. Mid-Island Shopping Plaza, 464 N.Y.S.2d 793, 798 (N.Y. App. Div. 1983) (citation omitted), *aff'd*, 468 N.E.2d 51 (N.Y. 1984).

This general rule of enforceability includes clauses prohibiting changes in form of tenant entities. Tenant restructurings can be affected by specific language limiting changes in tenant entities, changes in control of the tenant, or merger or consolidation of the tenant; or can result from application of general language restricting assignments. As mentioned above, courts will try to apply an assignment limitation based on intent determined solely, if possible, from the language of the lease itself.[26]

While assignment restrictions in lease language are generally enforceable, they are limited in scope by courts to a considerable extent. This is due to a general disfavor of assignment restrictions as a restraint on alienability of property.[27] Therefore, lease assignment restrictions are very strictly construed.[28]

The effectiveness of assignment prohibitions is further limited in a significant number (but less than half) of the states by the doctrine that implies a "reasonableness" standard to the landlord's consent if the clause requiring landlord's consent to the assignment is silent on the standard for withholding consent.[29] A few states have codified this doctrine, although such statutes typically apply only to noncommercial leases.[30] These cases change the traditional common law rule that "in the absence of a clause prohibiting the unreasonable withholding of consent, a landlord may refuse to consent to the assignment of a lease which contains an express restriction against assignment without the landlord's consent."[31]

The common law rule allowing arbitrary refusal of consent (unless the clause otherwise provides) continues to be well established in the states that have not adopted the minority view.[32] Although the implied reasonableness requirement is said to be the modern trend, it is notable that the two latest published decisions on this issue (in South Carolina and Washington) maintain the common

26. Int'l Chefs, Inc. v. Corporate Prop. Investors, 658 N.Y.S.2d 108, 109 (N.Y. App. Div. 1997).

27. *See, e.g.*, Julian v. Christopher, 575 A.2d 735, 739 (Md. 1990).

28. *E.g.*, Segal v. Greater Valley Terminal Corp., 199 A.2d 48, 50 (N.J. Super. App. Div. 1964) ("courts are astute in finding ways to avoid even an express provision restricting transfer by operation of law"); Astoria Bedding, Mr. Sleeper Bedding Ctr., Inc. v. Northside P'ship, 657 N.Y.S.2d 796, 797 (N.Y. App. Div. 1997) (citation omitted) (assignment restrictions "are construed with the utmost jealousy, and very easy modes have always been countenanced for defeating them"); *Mann Theaters*, 464 N.Y.S.2d at 798.

29. *E.g.*, Homa-Goff Interiors, Inc. v. Cowden, 350 So. 2d 1035 (Ala. 1977); Hendrickson v. Freericks, 620 P.2d 205 (Alaska 1980); Tucson Med. Ctr. v. Zoslow, 712 P.2d 459 (Ariz. Ct. App. 1985); Warmack v. Merchs. Nat'l Bank of Fort Smith, 612 S.W.2d 733 (Ark. 1981); Kendall v. Ernest Pestana, Inc., 709 P.2d 837 (Cal. 1985); Warner v. Konover, 553 A.2d 1138 (Conn. 1989); Fernandez v. Vazquez, 397 So. 2d 1171 (Fla. Dist. Ct. App. 1981); Funk v. Funk, 633 P.2d 586 (Idaho 1981); Jack Frost Sales v. Harris Trust & Sav. Bank, 433 N.E.2d 941 (Ill. App. Ct. 1982); Truschinger v. Pak, 513 So. 2d 1151 (La. 1987); *Julian*, 575 A.2d 735; Newman v. Hinky Dinky Omaha-Lincoln, 427 N.W.2d 50 (Neb. 1988); Boss Barbara, Inc. v. Newbill, 638 P.2d 1084 (N.M. 1982); Pac. First Bank v. New Morgan Park Corp., 876 P.2d 761 (Or. 1994).

30. *See* Del. Code Ann. tit. 25, § 5508(b) (2004); Haw. Rev. Stat. § 516-63 (2003).

31. Caridi v. Markey, 539 N.Y.S.2d 404, 405 (N.Y. App. Div. 1989).

32. *E.g.*, Vaswani v. Wholetz, 396 S.E.2d 593 (Ga. Ct. App. 1990); First Fed. Sav. Bank of Ind. v. Key Mkts., Inc., 559 N.E.2d 600 (Ind. 1990); 21 Merchs. Row Corp. v. Merchs. Row, Inc., 587 N.E.2d 788 (Mass. 1992); White v. Huber Drug Co., 157 N.W. 60 (Mich. 1916); Gruman v. Investors Diversified Servs., Inc., 78 N.W.2d 377 (Minn. 1956); Segre v. Ring, 170 A.2d 265 (N.H. 1961); *Mann Theaters*, 464 N.Y.S. 2d 793; Isbey v. Crews, 284 S.E.2d 534 (N.C. Ct. App. 1981); F & L Ctr. Co. v. Cunningham Drug Stores, Inc., 482 N.E.2d 1296 (Ohio Ct. App. 1984); Dobyns v. S.C. Dep't of Parks, Recreation & Tourism, 480 S.E.2d 81 (S.C. 1997); B & R Oil Co. v. Ray's Mobile Homes, Inc., 422 A.2d 1267 (Vt. 1980); Johnson v. Yousoofian, 930 P.2d 921 (Wash. Ct. App. 1996).

law doctrine. This suggests that the two distinct approaches adopted by the various jurisdictions will both continue for quite some time to come. Of course, in all jurisdictions, courts will give effect to clear language that negates any implied reasonableness requirement to consent.[33]

The cases dealing with what constitutes "reasonable" conduct in withholding consent, both under the implied reasonableness requirement in the minority jurisdictions or under express language in the lease saying that the landlord cannot unreasonably withhold consent, are instructive in dealing with unclear areas of tenant restructurings. These cases make it clear that the "unreasonableness" of a landlord is determined based on the objective standard of a reasonably prudent person in the landlord's position.[34] In fact, decisions have noted what type of factors can "reasonably" be considered by the landlord in withholding consent, such as the following: (1) financial strength of tenant;[35] (2) legality of assignee's intended use;[36] (3) nature of tenant's occupancy;[37] (4) whether the new tenant's use will require alterations of the premises;[38] and (5) compatibility with the use of other tenants in the same shopping center or office building.[39]

Examples of unreasonable grounds for refusal include refusal solely to secure a rent increase[40] and considerations of personal taste, sensibility, or convenience.[41] Therefore, unless a lease specifically prevents a certain change in form of tenant entity, a merger, or other similar change that could be construed as "technical," and not affecting any of the factors discussed above, a landlord's withholding of consent to the restructuring could be construed as having been "unreasonably withheld."[42]

D. Nonwritten Assignments

The fact that no assignment document needs to be signed in connection with any conversion, merger, or restructuring under the applicable state business organization statutes certainly does not mean that the assignment clause does not affect the transaction. It is clear that an assignment of a lease does not need to be in writing unless stated in the lease, and therefore it is possible for the operation of corporate merger statutes to effectuate a true assignment.[43]

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33. *E.g.*, *Julian*, 575 A.2d at 740.
34. Ernst Home Ctr., Inc. v. Sato, 910 P.2d 486, 492 (Wash. Ct. App. 1996).
35. *Id.* at 493.
36. *Id.*
37. *Id.*
38. Rowley v. City of Mobile, 676 So. 2d 316, 319 (Ala. Civ. App. 1995).
39. *Id.*
40. Julian v. Christopher, 575 A.2d 735, 739 (Md. 1990).
41. *Rowley*, 676 So. 2d at 319.
42. Standard Operations, Inc. v. Montague, 758 S.W.2d 442, 445 (Mo. 1988) (indicating that to be reasonable, landlord should be concerned with issues that touch and concern the lease, and "the merger does not relate directly to the leasehold estate or to the transfer of any other specific property").
43. *See* Twelve Oaks Tower I, Ltd. v. Premier Allergy Inc., 938 S.W.2d 102, 113 (Tex. App. 1996).

III. SALE OF STOCK AS ASSIGNMENT

If the language of a lease simply prohibits an assignment without consent, such general assignment clause will not prohibit the sale of stock of a tenant corporation, even a sale of stock that results in change in control of the corporation.[44] Courts have reached this holding even though they recognize that the stock sale can be an effective manner of completely avoiding the nonassignment provision and changing the control of the tenant: "The rule that precludes a person from doing indirectly what he cannot do directly has no application to the present case."[45] However, just as consistently, courts have enforced language in the lease that prevents the sale of stock.[46]

IV. MERGERS AS ASSIGNMENTS

A. General Assignment Restrictions

In construing whether or not a merger violates a lease assignment provision, the first point of analysis is whether the merger even constitutes an "assignment." If the lease clause simply prohibits assignments without the landlord's consent, without mentioning specifically assignments by operation of law, most cases indicate no assignment has occurred.[47] This is especially true in the case of an "upstream" merger of a subsidiary into a parent corporation, since such a merger "in no way changed the beneficial ownership, possession, or control of . . . [the] property or leasehold estate."[48] In upstream mergers, it has been said that only the tenant's "corporate form was affected, not the corporate property."[49] However, such findings are certainly not limited to situations dealing with upstream mergers, as courts have based such conclusions on facts other than change in identity. For example, it has been said that in dealing with a long-term lease to a corporate entity, the landlord could not reasonably rely upon the notion that changes in the corporate tenant would not occur during the term of the lease, and if merger were a true concern the landlord could have prohibited it by express lease language.[50]

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44. *E.g.*, Branmar Theater Co. v. Branmar, Inc., 264 A.2d 526, 528 (Del. Ch. 1970) (citations omitted) ("in the absence of fraud . . . transfer of stock of a corporate lessee is ordinarily not a violation of a clause prohibiting assignment"); Associated Cotton Shops, Inc. v. Evergreen Park Shopping Plaza of Del., Inc., 170 N.E.2d 35, 38 (Ill. App. Ct. 1960) ("the ordinary provisions in a lease prohibiting assignments or subletting will not apply in a case where the shareholders of the corporate lessee dispose of all their stock"); Citizens Bank & Trust Co. v. Barlow Corp., 456 A.2d 1283, 1289 n.6 (Md. 1983) (citations omitted) ("generally the sale of stock is held not to be within a non-assignment clause"); Segal v. Greater Valley Terminal Corp., 199 A.2d 48, 50 (N.J. Super. App. Div. 1964) ("the sale of the shares of stock of a lessee corporation to another company, resulting in the relationship of parent and wholly-owned subsidiary, does not constitute an assignment of the lease").

45. *Branmar Theater Co.*, 264 A.2d at 529.

46. *E.g.*, *Associated Cotton Shops, Inc.*, 170 N.E.2d at 38.

47. *E.g.*, Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, 238 S.W.2d 321, 325 (Mo. 1951); Segal v. Greater Valley Terminal Corp., 199 A.2d 48, 50 (N.J. Super. App. Div. 1964). *But see* Feeley v. Harwood Elec. Co., 22 Luzerne Leg. Reg. 314, 317–18 (Pa. C.P. 1923) (merger is a voluntary transfer).

48. *Segal*, 199 A.2d at 50.

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

50. *Segal*, 199 A.2d at 51–52.

Additionally, some courts have noted that the statutory mechanism for merger creates a transfer by operation of law, not a voluntary transfer, which is not covered under the basic assignment prohibition.[51] They have also noted that the basic lease assignment prohibition, without more, is intended only to prohibit voluntary assignments, and that mergers create assignments automatically by operation of the corporate statutes.[52]

B. Restrictions against Assignments by Operation of Law

Regarding leases that also specifically prohibit transfers "by operation of law," there is a split of authority as to whether a merger violates such clause. It is true that courts will generally enforce restrictions against transfers by operation of law.[53] However, reported decisions are fairly evenly split on whether a merger even constitutes a transfer by operation of law. Opinions that find mergers not to violate transfer by operation of law clauses tend to stress the rule of strict construction of lease assignment restrictions;[54] that finding a merger to violate the assignment clause could result in a forfeiture of the leasehold estate, which is disfavored;[55] and that if the landlord wanted to prevent mergers it could specifically have stated so in the lease.[56] The Missouri Supreme Court has also voiced a policy rationale that holding a merger to be a violation of a prohibition against assignments by operation of law would give the landlord a distinct advantage over the tenant, forcing renegotiations of the lease over threat of termination.[57] Additionally, there seems to be a sense in some courts that prohibiting assignments due to mergers would run contrary to the merger statutes.[58] Even these jurisdictions, however, indicate that an express provision stating that a merger requires landlord approval would be effective.[59]

In contrast, cases finding mergers to constitute violations of transfers by operation of law apply the principle of strict construction less tightly.[60] Cases finding mergers to be prohibited transactions view the operation of the statutory merger provisions as a true transfer of rights from one party to another,[61] not really distinguishable from transfers such as involuntary bankruptcy or execution[62] despite the fact that the tenant voluntarily initiates the merger process. The statute itself

51. *Dodier Realty & Inv. Co.*, 238 S.W.2d at 325).
52. *Segal*, 199 A.2d at 50.
53. *See, e.g.*, Standard Operations, Inc. v. Montague, 758 S.W.2d 442 (Mo. 1988).
54. *Segal*, 199 A.2d at 50.
55. *Standard Operations, Inc.*, 758 S.W.2d at 444.
56. *Id.* at 445.
57. *Id.* at 444.
58. *Segal*, 199 A.2d at 51 ("To deny the benefit of a merging corporation's nonassignable contracts to the surviving corporation in a merger authorized by statute would sharply limit the utility of such statutes.").
59. *Id.* at 52.
60. *E.g.*, Citizens Bank & Trust Co. v. Barlow Corp., 456 A.2d 1283, 1288 (Md. 1983).
61. *E.g.*, Pac. First Bank v. New Morgan Park Corp., 876 P.2d 761, 765 (Or. 1994).
62. *Citizens Bank & Trust Co.*, 456 A.2d at 1288.

automatically executes the transfer.[63] These decisions focus on the language in the merger statutes stating that one of the merging entities ceases to exist, downplaying the self-contradictory language in many merger statutes that also says that the successor corporation shall be considered the same corporate entity as the merging corporation.[64]

V. NONMERGER CHANGES IN ENTITIES AS ASSIGNMENTS

There are very few cases specifically dealing with changes in tenant entities other than those effectuated by corporate mergers. At least one case has found that the dissolution of a corporation does not violate a clause that simply stated that the tenant "will not sell, assign, underlet or relinquish said premises without the written consent of the lessor," since the dissolution is a "technical transfer that is not fairly and substantially an assignment."[65] The case stressed that under Nebraska's dissolution statutes, the corporation still existed in the sense that it had five years to dispose of its property, defend and prosecute suits, and otherwise wind down its affairs.[66] The same decision also found that the second step of the transaction, under which the principals of the corporation formed a partnership to essentially continue the corporation's operations, also did not violate the assignment clause, since the assignment clause did not contain a restriction against transfers by operation of law, and such clause is to be strictly construed against the lessor.[67]

As discussed above, at this time it is necessary to predict results regarding other changes in form of business entities based on the well-established general concepts regarding assignment clauses. Although the merger cases may be helpful in situations such as conversions of a partnership to a limited liability corporation, even in jurisdictions that find such mergers to violate "assignment by operation of law" prohibitions should be extended to new situations with caution. Maryland's highest court has noted that in a merger there is a necessary corresponding change in ownership of stock, and therefore "there has been a change in ownership, and not merely a change in the legal form of ownership."[68] For instance, the operation of a statute allowing conversion into a limited liability company could still be viewed as only a "technical" legal change.

VI. CONSEQUENCES OF CHANGES IN FORM OF TENANT ENTITY

A. Liability of Entities and Principals

It is clear that an individual or entity that has existing liability exposure under a lease cannot escape liability due to a restructuring of the tenant entity or a transfer

63. Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club, 238 S.W.2d 321, 325 (Mo. 1951).
64. *E.g.*, *Citizens Bank & Trust Co.*, 456 A.2d at 1284–85.
65. Chesnut v. Master Labs., 27 N.W.2d 541, 548–49 (Neb. 1947) (citation omitted).
66. *Id.* at 549.
67. *Id.* at 548.
68. *Citizens Bank & Trust Co.*, 456 A.2d at 1287.

of the lease to a new entity in the absence of an intention of landlord to release that entity.[69] This is explicitly clear in most state statutes allowing entity conversions.[70] With consolidations or mergers, the situation is a bit more complex. Although an existing party is most likely not released, the liability of the successor entity on personal covenants may be determined by the factors discussed earlier in this article.

B. Control of Tenant Business

Since different forms of business entities are governed differently under state business entity statutes, the landlord cannot assume that the control structure will be the same after conversion to a new entity. Although there is little authority on the continued effectiveness of "change of control" language after changes in form of the tenant entity, it would seem that such clauses need to focus on functional or practical control tests, as opposed to references to such things as percentage of stock ownership or partnership interest holdings. For example, a majority stockholder may have the right to dictate control of the tenant (by the ability to vote into office the directors of the corporation), but could lose that right if the corporation converts to a limited liability company subject to an operating agreement that contractually provides that the manager is to be elected by majority vote of three management committee members of the company, each such member to have an equal vote. Whether such a new control structure is likely or not, it certainly would be possible under the ultraflexible limited liability corporation statutes in many states.

VII. CONCLUSION

A few lessons for dealing with tenant restructurings can be learned from reviewing the cases discussed above. From the landlord's perspective, perhaps the overriding lesson is that a landlord that truly desires to restrict changes in tenant entities, prevent changes in control, and prevent mergers or spin-offs to subsidiaries runs a risk in relying on general assignment prohibition language, even language that prohibits assignments by operation of law. The landlord not only has to overcome the propensity of courts to very strictly construe lease assignment limitations, but in many jurisdictions also needs to use language to protect itself against tenant claims that it has unreasonably withheld consent in connection with a tenant restructuring. Even if a landlord uses language in its lease that clearly defines changes in the form of the tenant entity, tenant mergers, and so forth as specifically prohibited acts of assignment, the landlord may have to go one step further in preventing tenant "end runs" around assignment prohibitions by structures such

69. *See, e.g.*, Moneywatch Cos. v. Wilbers, 665 N.E.2d 689, 691 (Ohio Ct. App. 1995) (individual who signed lease not released from liability when tenant name in lease changed to that of newly formed corporation).

70. *E.g.*, Del. Code Ann. tit. 6, § 17-217(e) (Supp. 2012) ("[t]he conversion of any other entity into a domestic limited partnership (including a limited liability limited partnership) shall not be deemed to affect any obligations or liabilities of the other entity incurred prior to its conversion to a domestic limited partnership, or the personal liability of any person incurred prior to such conversion").

as licenses or operating agreements.[71] The "strict construction" vein that runs deep through assignment opinions also indicates that a specific assignment prohibition, if not worded to apply to the exact situation at hand, is not likely to be extended by "analogy" to the new situation. For example, one would envision a provision that declares an assignment to have occurred upon a conversion of a general partnership to a limited partnership would not apply upon a conversion of the general partnership to a limited liability company.

If a landlord agrees to an express or implied provision to the effect that landlord's consent to an assignment cannot be unreasonably withheld, the landlord may want to enumerate in the lease examples of considerations that the parties agree the landlord can "reasonably" use in deciding whether to grant consent. The landlord will be better off if these considerations are truly factors that go to the essence of what the landlord is concerned about. The most solid footing of all for landlords in this area would be to enumerate considerations that the courts have already recognized as legitimate, being primarily the financial responsibility of the tenant, the legality of the tenant's proposed use, and the nature of the proposed tenant's occupancy. Because tenant restructurings are unlikely to affect any of these recognized areas, other than possibly financial responsibility in a subsidiary spin-off or downstream merger, it may be useful for the truly concerned landlord to state that its enumerated prohibition against restructuring applies regardless of the reason for such restructuring or the financial impact of the restructuring on the landlord's tenant. Of course, if the transferee affirmatively assumes personal covenants in the lease, it is doubtful whether the landlord has a legitimate concern if there is no financial impact.

The landlord also ought to specify in the assignment clause specific rights to receive certain information in advance of tenant restructuring, so that the landlord can truly evaluate any assignment from such restructuring on objective factors. Although the landlord is certainly under no duty to seek out information about a proposed assignee,[72] the landlord is better off making sure it gets the information it really needs, so that a court does not second-guess it if the tenant instead provides other information that the landlord thinks is insufficient. Such an information requirement would also benefit the tenant, since landlords are justified in withholding consent if they have insufficient information to evaluate the assignment.[73] The landlord should also seek some type of "reporting" covenant in the lease so that a tenant cannot prevent discovery of an assignment by merging into a new entity, then changing the new entity's name back to the name of the "old" entity. Finally, due to the surprising new case law coming out of New York, landlords may want to consider incorporating the lease's use or purpose clause by reference specifically into the list of factors for landlord's consent.

From a tenant's perspective, given the somewhat inconsistent results in the existing merger cases and the paucity of cases involving restructurings into newer

71. *See* Mann Theaters v. Mid-Island Shopping Plaza, 464 N.Y.S.2d 793, 796 (N.Y. App. Div. 1983), *aff'd*, 468 N.E.2d 51 (N.Y. 1984) (lease restricted "use of the property by others" as well as "assignments").

72. *E.g.*, Rowley v. City of Mobile, 676 So. 2d 316, 320 (Ala. Civ. App. 1995).

73. *Id.*

entities such as limited liability companies, the tenant should not simply rely on the fact that assignment prohibitions are narrowly construed. If a tenant wants the flexibility to engage in transfers to subsidiaries, conversion of its legal form, or mergers, the tenant should negotiate into the lease specific language permitting such changes. Tenants under existing leases may have a few new opportunities to effectively get around assignment prohibitions. Although the lack of case law and inconsistent results discussed above create a somewhat risky environment in which to operate, tenants may be able to effectuate mergers in the absence of specific prohibitions, in some states even if the assignment clause prevents assignments by operation of law.

Tenants may be able to get around existing assignment or change in control prohibitions by entering into operating agreements or licensing agreements that give the former tenant some continuing control rights under, or some remaining interest in, the lease. Finally, tenants have an opportunity to try to use the "strict construction" doctrine to avoid overly specific change of control prohibitions by stated transactions in which, for example, they convert from a corporation to a limited liability partnership and then switch members.