#H-111 ns33f
02/22/88

Memorandum 88-14

Subject: Study H-111 - Commercial Lease Law (Assignment and Sublease--background study)

The Commission in 1984 decided to activate its study of commercial lease law in response to a request from the Executive Committee of the State Bar Real Property Law Section. The Commission decided to hire a consultant to prepare a background study on this subject, but due to funding limitations and other problems a consultant contract was not authorized until 1986.

The Commission's consultant is Professor William G. Coskran of Loyola of Los Angeles Law School. Professor Coskran met with the Commission in July of 1986, at which time he reviewed the status of the lease law study and the Commission gave him direction concerning the scope of the study. Professor Coskran noted that issues surrounding assignment and sublease would be the major and most important part of the study, which is due March 1.

Attached to this memorandum is the portion of the study dealing with assignment and sublease, delivered somewhat ahead of schedule. We are sending out the text of the study now, without footnotes, so that the Commission and interested persons will have as much time as possible before the March meeting to review the study. Professor Coskran is putting the footnotes (which are merely citation of authority and not textual) in proper form, and we will send them out separately when received. Professor Coskran will also address lesser unrelated and procedural lease law issues in a separate report.

The assignment and sublease issue is precipitated by a 1985 California Supreme Court case, Kendall v. Ernest Pestana, Inc., 40 Cal.3d 488, 220 Cal.Rptr. 818, 709 P.2d 837 (1985). As Professor Coskran's study notes, that case held that a lease clause prohibiting assignment or sublease without the landlord's consent must be read to include a limitation that consent may not be unreasonably withheld. The issues that holding generates include:

(1) Should the case be overruled by legislation?

(2) If not, should the rule of the case be applied to leases executed before the ruling on the case was announced?

(3) Should parties to a lease be able to negotiate a provision that a lessor may unreasonably withhold consent to an assignment or sublease, or even that assignment or sublease is absolutely prohibited?

(4) If a requirement of reasonableness is to be read into landlord consent provisions, shouldn't statutory breach-of-lease remedies be redrafted to recognize this?

Professor Coskran will be present at the March meeting to review with the Commission the background study and the issues presented. We hope to be able to begin making some initial policy decisions with the objective of developing a tentative recommendation to send out for comment over the summer, leading to a final recommendation for the 1989 legislative session.

Respectfully submitted,

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RESTRICTIONS ON LEASE TRANSFERS: VALIDITY AND RELATED REMEDIES ISSUES (Must Consenting Adults be Reasonable?)*

by

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FEBRUARY 1988

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The Commission assumes no responsibility for any statement made in this study, and no statement in this study is to be attributed to the Commission. The Commission's action will be reflected in its own recommendation which will be separate and distinct from this study. The Commission should not be considered as having made a recommendation on a particular subject until the final recommendation of the Commission on that subject has been submitted to the Legislature.

Copies of this study are furnished to interested persons solely for the purpose of giving the Commission the benefit of the views of such persons, and the study should not be used for any other purpose at this time.

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CLRC/1

COMMENT DRAFT 2/10/88
Study for California Law
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NOTE: The views expressed in this study are those of the author and should not be taken to reflect any opinion of the Commission or its members or staff.

RESTRICTIONS ON LEASE TRANSFERS: VALIDITY & RELATED REMEDIES ISSUES. (Must Consenting Adults be Reasonable?)

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I. SCOPE OF STUDY.

Assume that a lessor leases commercial property to a tenant. Later, the tenant transfers or attempts to transfer all or part of the leasehold to a third party. The transfer will be in the form of either an assignment to an assignee, or a sublease to a subtenant. A clause in the lease between the lessor and tenant restricts the tenant's ability to transfer to a third party. The lessor refuses to allow the transfer. The tenant and the third party complete the transfer despite the lessor's objections, or the deal between the tenant and the third party is ended due to the lessor's objections. A dispute between the lessor and the tenant ensues. The third party also will be involved in the dispute if the transfer was completed, and perhaps be involved even if it was not completed.

This is the basic factual situation which triggers the issues involved in the study. The same issues are involved when the transfer restrictions are contained in a sublease from the tenant to a subtenant, and it is the subtenant who wishes to transfer to a third party over the tenant/sublessor's objections.

The restrictions on transfer can take a variety of forms, discussed in detail below. In general they come in two forms. First, there are direct restrictions, such as a prohibition against transfer without the lessor's consent. Second, there are

indirect restrictions, such as a lessor's option to recover possession of the premises if a transfer is proposed, or right to participate in profits from the third party if a transfer is completed. There are other factual variations which will be discussed where appropriate. The study is limited to non-residential leases and the word "commercial" will be used in the broad sense to include all types of non-residential leases. There is, however, a limited discussion of the distinct factors present in a residential transaction.

The study examines the existing California law, and in some instances proposes clarifications or modifications of the law, dealing with the following general issues:

1. What are the limitations, if any, on a lessor's ability to restrict a transfer by a tenant?

2. Suppose the restriction provisions are silent about the standard governing the lessor's right to object to a transfer. What standard will be used--reasonableness or sole discretion?

3. Suppose the parties agree on provisions that expressly provide for a standard of sole discretion for the lessor's right to object to transfer. Will that provision be enforceable, or will a mandatory reasonableness standard be imposed?

4. What are the limitations, if any, on a lessor's ability to provide for an option to recover the premises when a transfer is proposed?

5. What are the limitations, if any, on a lessor's ability to provide for a right to part or all of the profits from the third party if a transfer is completed?

6. What is the relationship between transfer restrictions and a lessor's remedies for breach and abandonment by a tenant?

II. INTRODUCTION

In 1983, a relatively dormant area of California lease law was reexamined and thrust into the limelight. In Cohen v. Ratinoff[1], a California court of appeal reviewed and rejected a portion of the common law and majority view about lease transfer restraints. In 1985, the California Supreme Court did the same thing in Kendall v. Ernest Pestana, Inc..[2]

There are three basic components to the common law and majority view. First, the tenant's leasehold interest is freely transferable, unless the parties agree to a restriction. Second, the parties are free to absolutely prohibit transfer or to condition transfer upon obtaining the lessor's consent, which may be withheld in lessor's sole discretion. Third, if the parties agree that lessor's consent is required for a transfer, but fail to expressly provide for a reasonableness standard, the lessor can withhold consent in his sole discretion. The holdings in Cohen and Kendall are limited to changing the third component by

imposing a reasonableness standard when the clause does not express a standard. This change should be examined. If the change is a good one, we should examine the propriety of applying the change to leases finalized prior Cohen and Kendall.

Although not part of the holding, there is broad language in Kendall which gives mixed signals about the continued validity of clauses which absolutely prohibit transfer or expressly give the lessor sole discretion to withhold consent. Also, there are unresolved issues concerning the lessor's right to enforce a clause providing for capture of possession or profit when a transfer comes up. Despite the solace some find in supreme court footnotes, there are issues which should be resolved to provide certainty in drafting and enforcement of leases. These issues present an important confrontation between freedom of contract and public policy. The uncertainties can be resolved by legislation or litigation. It would be wasteful of time and money to leave these issues to piecemeal resolution by litigation. The history of the enforceability of a "due on transfer" loan clause in California is a good example of the long time span which can be involved in clarifying restraint issues.[3] The "due on transfer" issues spawned a long term growth industry for litigators and seminar producers.

In 1970, at the urging of the California Law Revision Commission, the legislature adopted Cal. Civ. Code section 1951.4 as part a comprehensive codification of lease remedies.[4] That section allows the lessor to keep the lease in effect and enforce

its provisions after the tenant has breached the lease and abandoned the property. This remedy is available only "if the lease permits" the tenant to transfer, subject only to reasonable restrictions. The code section should be reexamined to make sure it takes into consideration the recent developments in the law and the various types of direct and indirect transfer restrictions.

III. ASSIGNMENT & SUBLEASE OVERVIEW

Before looking specifically at transfer restrictions, it will be helpful to take a brief overview of the nature and effect of assignments and subleases.

If a tenant transfers the entire balance of the lease term to a third party, it results in an assignment; if a tenant transfers less, it results in a sublease.[5] If a tenant transfers the entire balance of the lease term, but retains a contingent right to recover possession, there is a jurisdictional split on the result. In California, the result is a sublease.[6]

The tenant remains liable to the lessor for breaches of the lease which occur after either an assignment or a sublease.[7] This is based on their privity of contract which continues unless the lessor releases the tenant. Consent to an assignment or sublease does not in and of itself release the tenant from liability to the lessor.[8]

An assignee and the lessor become liable to one another for breaches of their respective real covenant obligations which occur during the period that the assignee has the leasehold.[9] This is based on privity of estate between the lessor and assignee which arises when the assignee takes over the tenant's estate. Absent an assumption, the assignee is not liable for breaches which occurred before the assignment or which occur after a reassignment.[10]

Generally, a subtenant is not directly liable to the lessor.[11] Absent an assumption by the subtenant, there is no privity of contract or estate between the lessor and subtenant. However, if the lease obligations are not performed, the lessor can terminate the lease and recover possession from the tenant and the subtenant.[12] Generally, the lessor is not directly liable to the subtenant for breaches of the prime lease obligations. However, this direct liability might arise in situations where the lessor consents to a sublease and the subtenant assumes the obligations of the prime lease.[13]

There are significant differences in the relationship between a tenant/assignor and an assignee on the one hand, and a tenant/sublessor and a subtenant on the other. A sublease creates an new tenancy relationship and privity of estate, as well as contract, between the tenant as sublessor and the third party as subtenant. An assignment leaves the tenant/assignor with no further interest in the property. The relationship between the tenant/assignor and the assignee is purely contractual.[14]

Examples of important ramifications of this distinction are the right to bring an unlawful detainer action and the right to exercise purchase or renewal options contained in the lease. The tenant/sublessor has a right to bring an unlawful detainer action against the subtenant to recover possession of the property if the subtenant breaches obligations to the tenant/sublessor. The tenant/assignor cannot bring an unlawful detainer action against the assignee.[15] When a sublease occurs, generally the tenant/sublessor retains the right to exercise purchase or renewal options contained in the prime lease. When an assignment occurs, the option rights generally pass to the assignee.[16]

There are important differences in the nature and effect of an assignment and a sublease. The lessor, tenant and third party may have important reasons to prefer one form of transfer over the other, and these preferences may conflict. However, for the purpose of testing the standard which should apply to a restriction on transfer, an assignment and sublease are generally treated the same.[17]

IV. TYPES OF RESTRICTION CLAUSES

There are several types of clauses which restrict, directly or indirectly, a transfer of all or part of the leasehold by the tenant. They typically fall into one or more of the following categories.

1. **SILENT CONSENT STANDARD**. The tenant must obtain the lessor's consent to a transfer, but there is no express standard governing the lessor. The clause does not expressly require the lessor to be reasonable, nor does it expressly permit the lessor to refuse consent in his sole discretion. The Cohen and Kendall cases involve this type of clause.[18]

2. **EXPRESS REASONABLE CONSENT STANDARD**. The tenant must obtain the lessor's consent to a transfer, and a reasonableness standard is expressly imposed upon the lessor. The common phrase that "consent shall not be unreasonably withheld" is an example.

3. **EXPRESS SOLE DISCRETION CONSENT STANDARD**. The tenant must obtain the lessor's consent to a transfer, and the lessor is expressly given sole discretion to grant or withhold consent. For example, the clause might provide that "consent may be withheld in the sole and absolute subjective discretion of the lessor."

4. **EXPRESS SPECIFIC REQUIREMENTS**. The tenant's right to transfer, and the lessor's consent, are conditioned upon express specific requirements being met. The requirements will vary depending upon the facts of the particular lease transaction. For example, the tenant and third party may be required to furnish evidence that the third party meets certain minimum credit or operational experience requirements.

5. **CONSENT REQUIRED BUT EXCEPTIONS**. The lessor's consent is required per one of the above alternatives, but specific types of transactions are exempted from the future consent requirements. For example, an exemption for subleases to

the tenant's franchisees or an exemption for transfers among related corporate entities may be appropriate in some situations.

6. **ABSOLUTE PROHIBITION**. Transfer is prohibited. There is no mention of consent or compliance with requirements.

7. **POSSESSION RECOVERY**. If the tenant wishes to transfer, the lessor may elect to recover possession of the property. The tenant is free to transfer to the third party only if the lessor chooses not to exercise that option.

8. **PROFIT SHIFT**. The lessor is entitled to receive part or all of the profit generated by the transfer transaction.

There are sophisticated variations of the "Possession Recovery" and the "Profit Shift" types of clauses. Also, these two types can be combined with other types of clauses. For example, the "Express Reasonable Consent Standard" clause and the "Profit Shift" clause could readily be combined. The lessor would have the right to impose reasonable objections, and if the transfer goes through, the lessor shares in the profit from the third party. There are variations of the other clauses as well. For example, there may be a provision allowing the tenant an option to terminate the lease if the lessor refuses consent for a reason not set forth in the lease, or one which does not meet the test of commercial reasonableness.[19]

V. MOTIVES OF THE PARTIES

The tenant's desire for free transferability, and the lessor's desire for restrictions on transferability, involve a large variety of motivations. These motivations show that the transferability issue is an important one for the parties to a commercial lease. Several of these motives are mentioned below.

A. Tenant Motives

The tenant may wish freedom to transfer when he wishes to retire from the business operated on the premises, or move to another location. The need to transfer may be unanticipated due to illness of the tenant or the business. If the business conducted on the premises is healthy, the proposed leasehold transfer may also involve a sale of the business. If a sale of the tenant's business is involved, the location may be so important to the particular business that it is difficult to separate a sale of the business from a transfer of the leasehold.

The tenant's space needs may create the desire for freedom to transfer. A tenant may anticipate a need to expand in the future and lease more space than initially needed. Until the expansion occurs, the tenant would like to defray the rental cost of the additional space by subletting. On the other hand, the tenant may initially use all of the space rented but later have reduced needs. A reduction in business or changes in the business technology may eliminate the need for some of the leased

premises. Rather than negotiate a termination of the existing lease and move to a different location, the tenant may wish to remain and rent the excess space.

Corporate family events may create the need for a leasehold transfer. For example, there may be an assignment of the lease involved in a merger of the corporate tenant or a sublease involved in the creation of a subsidiary. A partnership tenant may wish to incorporate and transfer to the new entity. Personal family events may also create a transfer incentive. For example, a parent may wish to transfer the leasehold and family business to a child. This might occur as part of a retirement plan or as part of an estate plan.

The tenant may wish to use the leasehold as security for a loan. This could involve three separate steps of transfer. First, there is the transfer of a security interest in the leasehold. Second, there is the potential foreclosure or trustee's sale transfer. Third, there is the retransfer by the lender if it acquired the leasehold at the foreclosure or trustee's sale.

There can be a variety of other motives arising out of the many types of commercial lease transactions.

B. Lessor Motives

The lessor's motives are the ones which are called into question by the cases involving leasehold transfer restrictions.

At this point, avoid placing a value judgment of reasonable or unreasonable on any particular motive. It is important to note that transfer restrictions are not the only way a lessor can protect some of these motivations. For example, the lessor might rely on a clause compelling, preventing or regulating certain uses on or alterations of the premises. When the profit motive is involved, there are several alternatives available, as discussed below.

The lessor is virtually unrestricted, except for prohibitions against discrimination,[20] in evaluating and choosing a tenant in the first instance. The lessor would like the same freedom to evaluate and choose any new occupant, or to retain the original tenant. The tenant is a known and chosen quantity and the lessor may prefer not to deal with a virtually unknown quantity chosen by the tenant.

Various facets of income protection concern lessors. Creditworthiness of the new occupant is a typical concern. If the rent is based on a percentage of profits, the ability to generate profits is a major consideration. This involves factors such as management ability, business experience, and type of business. A loss of percentage rentals was involved in one of the post-Kendall cases discussed below.[21] The particular agreed percentage set forth in the lease is generally based on the tenant's particular type of business. There is a wide variation among rates based on the type of business, and a change of tenant and business can significantly affect percentage rental income.[22] The

lessor may want to protect the drawing power of a certain tenant in a shopping center. That drawing power brings people to the center and generates profits for other tenants who are paying percentage rentals. The drawing power also helps to maintain the overall economic health of the center and facilitates renting space in the center.

The variety and balance of tenants is another important consideration to a shopping center lessor. Control over the mix of uses is important to the lessor for two reasons. The mix can have an important effect on the degree of economic success of the center. Also, the lessor wants to avoid violating any exclusive rights or non-competition protection given to other tenants. The lessor may wish to avoid competition from a new occupant to protect the lessor's business whether in a shopping center situation or not. In addition to mix, the lessor may want to maintain a certain image for a center or a building. This involves more than just a control over the general type of business. It can involve factors such as name recognition, quality of goods and services, ethnic character of goods and services, or reputation for unique goods or services.

A different occupant may increase the burden on the building, common areas or demand for lessor services. For example, the new occupant may require use of heavy equipment which causes noise and vibrations which disturb other tenants. The new occupant's business may require a forklift which causes extreme bearing weight on small areas and accelerates

deterioration of paving and floors. There may be a substantial increase in use of parking areas, elevators and other common areas and facilities. There may be an increased demand for lessor furnished services such as electricity, water, trash pick-up, etc. Insurance costs and availability may change. Use by a new occupant may involve alterations to the building such as partition walls and signs.

The transaction itself may cause an unwanted increase in the lessor's real property tax burden. Certain assignments and subleases can cause an increase in assessed valuation and thus an increase in property taxes.[23]

The lessor may wish to avoid a transfer of a security interest in the leasehold, which could lead to a transfer upon foreclosure or trustee's sale, and a retransfer by a lender who acquired the leasehold at the foreclosure or trustee's sale. The lessor may be concerned about having the leasehold involved in an involuntary forced sale and ending up with an unknown new tenant at the end of the process. Also, the lessor may be concerned about certain requirements the lender has for making the loan. This latter concern was involved in one of the post-Kendall cases discussed below.[24]

A sublease reduces the lessor's ability to clear the lease from title and recover possession before expiration of the term. Even though the tenant/sublessor is willing to voluntarily surrender his leasehold, the subtenant can block recovery of the premises.[25]

A tenant who subleases and becomes a sublessor may want to restrict transfer by the subtenant for many of the same motives discussed above. In addition, the tenant/sublessor will be concerned that the new occupant chosen by the subtenant may do something which creates a breach of the prime lease and jeopardizes the tenant's position under the prime lease.

C. Profit Motive

The tenant and lessor share the motive to profit from an appreciation in the rental value of the premises. When the rental value increases above the agreed rent in the lease, the difference creates a leasehold bonus value. So long as there is no transfer, the tenant indirectly enjoys the benefit by occupying property which is worth more rent than he is obligated to pay. However, when a transfer occurs, both the landlord and the tenant would like the profit generated from the third party who comes into the premises with a higher rental value. It is at that point that a dispute is likely to occur, and questions of express language and reasonableness become involved.

VI. STANDARDS GOVERNING RESTRICTIONS

A. Types of Standards in General

In theory, leasehold transfer restrictions could be banned altogether if there were some compelling public policy to be served. This draconian approach has not been taken in the past and it is not likely to occur in the future. Since transfer restrictions are not prohibited, the question is the type of standard to apply to them. There are two basic standards involved in the clauses and discussed by the courts: reasonableness and sole discretion. The reasonableness standard requires the lessor to conform to objective commercial reasonableness. The sole discretion standard allows the lessor to have subjective personal reasons which do not have to meet an objective test of commercial reasonableness.

The sole discretion standard does not allow the lessor total freedom. For example, he cannot engage in prohibited discrimination.[26] California recognizes that a power which may be exercised without reason cannot be exercised for a bad reason.[27]

B. Sole Discretion Standard Perhaps Not An Unreasonable Choice

The words "arbitrary" or "capricious" are sometimes used instead of "sole discretion".[28] These words seem to involve an unnecessary negative prejudgment. The phrase "sole discretion" is

a more impartial and descriptive name for the subjective standard involved.

Does a lessor who chooses and negotiates for a sole discretion standard do so in order to be unreasonable? It is simplistic to believe that all lessors who want a clause without a reasonableness standard wish to be unreasonable. For example, a lessor with a small transaction and a short term lease may simply wish to avoid the expense and time involved in evaluating new parties during the lease term, or he may wish to avoid litigation over reasonableness.

The ultimate decision of reasonableness rests with a judge or jury. There may be two distinct questions in litigation concerning compliance with the reasonableness standard. First, is the specific requirement reasonable? Second, have the third party and the tenant reasonably complied with the requirement? For example, suppose a lessor requires the third party to have good credit and sufficient experience to operate a particular business on the premises. Are credit and experience reasonable requirements? What is "good" credit and "sufficient" experience? What credit and experience does the proposed third party have?

Some requirements are vague and perhaps somewhat personal at times. For example, lessor may wish to create and maintain a certain "image" for his shopping center or building. This appears perfectly reasonable and necessary to a lessor. However, the prospect of having a jury of people with no interest in the

property evaluate the reasonableness of his image and its enforcement may not be appealing.

Even specific requirements which seem to clearly meet a requirement of reasonableness may be subject to attack. For example, consider the requirement that the third party have good credit. There is a comment in the Kendall case that commercially reasonable grounds for refusing consent include objections to the financial stability of the third party.[29] This seems obvious and beyond challenge, leaving only the factual question of the particular financial stability required of the third party open for dispute and litigation. However, the tenant and third party might still mount an attack on the financial stability requirement itself. The tenant remains liable to the lessor after the transfer occurs, so the tenant's financial stability remains accessible to the lessor.[30] Could the tenant and third party argue that since lessor will continue to have the same financial protection from the tenant after the transfer, it is unreasonable to insist that the third party independently have financial stability? Would this be requiring greater protection for the lessor than he would have had in the absence of a transfer?[31] The lessor is legitimately interested in performance by the party in possession, not collection litigation against an absentee party. Even though the lessor can mount arguments to counter an attack on the apparent reasonableness of the requirement, he might still end up having to litigate the issue. It may be reasonable for a

lessor to wish to avoid doing so by expressly providing for a sole discretion standard.

Another example of apparently clear reasonableness is the lessor's desire to protect percentage rentals. A California court of appeal has held that the lessor who objects to an assignment which will result in a loss of percentage rentals is reasonable as a matter of law.[32] Suppose that a lease provides for percentage rentals, but it does not contain a clause limiting use of the premises to any specific business or it contains a clause allowing the tenant to conduct any lawful business on the premises. Or, suppose there is a restriction against use for other than a specific business, but there is no clause compelling the tenant to continue in business on the property. Also, suppose that there is a substantial minimum rent so that it is unlikely a court will impose an implied obligation to operate a particular business, or to operate at all.[33] A change in the type of business by the tenant could result in a drop in or loss of percentage rentals. A cessation of business would result in a loss of percentage rentals. Does the lessor have a legally enforceable expectation to rent over and above the agreed minimum rent? Could the tenant and third party argue that the lessor is unreasonable to insist that he receive more protection upon transfer than he would have had without one? This is not just an example of a potential attack on an apparently reasonable requirement. It is also an example of the need to consider other clauses when drafting or applying a transfer restriction clause.

A clause limiting use to a specific business and compelling continuous operation would go a long way toward protection upon transfer.

There is a large variety of transactions that fall into the commercial lease category. There may be a short term lease used to provide a small shop for a sole proprietor or a long term lease used as a financing tool for a major project developer. There may be periodic heavy use such as seasonal income tax assistance or steady and intense use such as an industrial factory. The goals of the parties, and the lease provisions as the bargained compromises of those goals, are also varied and often complex. No one size fits all.

The California Supreme Court has recognized the difficulties of applying a reasonableness standard to commercial leases. In Mattei v. Hopper,[34] a seller attempted to get out of a real property sale contract on the grounds that the buyer's obligation was subject to the broker being able to arrange satisfactory leases of shopping center buildings. The seller claimed that this made the buyer's promise illusory and that the contract failed for lack of consideration. The court mentioned the "multiplicity of factors" involved in a commercial lease and declined to apply a "reasonable person" standard to the satisfaction clause. The court pointed out that "it would seem that the factors involved in determining whether a lessee is satisfactory are too numerous and varied to permit the application of a reasonable man standard...."[35] The court went on to uphold the contract since

the buyer, although not held to a reasonable person standard, was obligated to exercise honest judgment.

A dissenting opinion in a 1981 Idaho Supreme Court decision points out some of the practical problems that result from a reasonableness standard.[36] The case involved a "Silent Consent Standard" type clause. The clause required the tenant to obtain the lessor's consent to a leasehold transfer, but it did not contain an express standard of either reasonableness or sole discretion. The majority implied a reasonableness standard. The dissent pointed out that:

> "(T)he effect of the decision is to potentially subject every denial of consent to litigation and approval by a judge. Rather than the lessor being sure of his right to control his property by retaining an unrestricted right to deny consent to assign or sublease, by its decision today this Court has destroyed that right and vested in the courts the power to determine what the lessor should have intended and award control of the property based upon that determination. Certainly, as evidenced by this case, the parties will rarely agree on what is reasonable under particular circumstances. Is there any assurance that judges will be unified in their opinions on what is reasonable. The only assurance to be gained by the rule adopted by the

majority today is that the parties' attempt to write their lease to avoid litigation will be frustrated."[37]

A lessor may want to avoid the expense, delay and uncertainty of litigation. He may want to avoid having his judgment second-guessed in a trial, perhaps years after exercising his judgment, by persons with no interest in the property.

See the Kreisher case at the end of Sec. XIII for another reason the Lessor may wish to avoid a reasonableness standard.

C. Basic Issues in Choice of Standards

Freedom of contract vs. public policy is a core issue running through transfer restriction questions. Beyond that, there are two basic questions generally involved.

1. If a clause prohibits transfer of the leasehold without the lessor's consent, but does not expressly provide for a standard, is a reasonableness or a sole discretion standard applicable? A "Silent Consent Standard" type clause is the most common example. The tenant is prohibited from assigning or subletting "without the lessor's prior written consent." In addition to the freedom of contract vs. public policy issue, there is an interpretation question involved. Have the parties clearly agreed to one standard or the other by not saying more,

or have they left an omission which must be construed and furnished?

2. Can the parties expressly negotiate and provide for a sole discretion standard, or are there compelling public policy reasons to take away the freedom to contract and mandate a reasonableness standard? The "Express Sole Discretion Consent Standard" type clause and the "Absolute Prohibition" type clause are the most common examples.[38]

VII. VIEWS OUTSIDE CALIFORNIA

A. Common Law and Majority View

The common law and majority rule can be simply summarized. Leasehold transfers are freely allowed unless restricted; restrictions are permitted, but strictly construed.

The leasehold is a transferable property interest. Absent a valid restriction in the lease, the tenant may assign or sublease without the lessor's consent and without compliance with any particular standards or restrictions. In a rare situation, a restriction might be implied.[39] The lessor is permitted to negotiate an agreement that restricts transfer of the leasehold. Although the common law prohibition against restraints on fee

transfers is virtually absolute,[40] restrictions on leasehold transfers are allowed because of the lessor's continuing interest in the property during and after the term of the lease.

The scope of a restriction clause is strictly construed in order to allow maximum freedom to the tenant.[41] Thus, a particular transaction will generally escape the restriction unless the clause expressly takes it into consideration. For example, a simple prohibition against assignment or subleasing does not take into consideration the type of entity (e.g. a corporate tenant which continues to hold the lease while its stock is transferred[42]), the type of interest transferred (e.g. a license or easement) or the type of transfer (e.g. an involuntary transfer by death[43]). A restriction on one type of transfer does not lead to an inferred restriction on other types of transfer.

The basic issues involved in the choice of standards are resolved in the following manner:

1. If a clause prohibits transfer of the leasehold without the lessor's consent, but does not expressly provide for a reasonableness standard, the lessor is bound only by the sole discretion standard.[44]

2. The parties may expressly provide for a sole discretion standard and this will be enforceable.[45]

B. Minority View

Some jurisdictions have reconsidered the common law and majority view and rejected it in part. The court in Kendall comments that "(t)he traditional majority rule has come under steady attack in recent years."[46] The opinion goes on to state: "A growing minority of jurisdictions now hold that where a lease provides for assignment only with the prior consent of the lessor, such consent may be withheld only where the lessor has a commercially reasonable objection to the assignment, even in the absence of a provision in the lease stating that consent to assignment will not be unreasonably withheld."[47] The following states are referred to as being in this minority: Alabama (Homa-Goff Interiors, Inc. v. Cowden in 1977[48]); Alaska (Hendrickson v. Freericks in 1980[49]); Arkansas (Warmack v. Merchants Nat'l Bank of Fort Smith in 1981[50]); Florida (Fernandez v. Vazquez in 1981[51]); Idaho (Funk v. Funk in 1981[52]); Illinois (Jack Frost Sales v. Harris Trust & Sav. Bank in 1982[53]); New Mexico (Boss Barbara, Inc. v. Newbill in 1982[54]); and, Ohio (Shaker Bldg. Co. v. Federal Lime and Stone Co. in 1971[55]). Three other states are mentioned for conflicting or uncertain authority (Louisianna, Massachusetts and North Carolina).[56] The Shaker case, cited for the Ohio position, was reversed in a subsequent appeal.[57] Also, a later Ohio case (F & L Center Co. v. Cunningham Drug Stores in 1984[58]) supports the common law and majority view. However, there have been cases in additional states supporting the minority position: Arizona (Campbell v. Westdahl[59] and Tucson Medical Center v Zoslow[60] in 1985); and, Colorado (Basnett v. Vista

Village Mobile Home Park in 1984[61]). Recent cases considering the issue have not been universal in adopting the minority view[62], and the ones adopting the minority view are not all without dissent.[63] However, this is not due necessarily to a disagreement with the merits of the minority view. It may be due to the belief that the legislature, rather than the court, should make the change.[64] There may also be a belief that the minority is the better view, but that the change to it should not be adopted retroactively. An exact count of states is much less important than determining exactly what the minority cases do and what they do not do.

Each of the cases mentioned above involved a "Silent Consent Standard" type clause which prohibited transfer without the lessor's consent, but did not expressly state either a reasonableness or a sole discretion standard. None of those cases involved a clause expressly providing for a sole discretion standard. None of those cases hold that an express sole discretion standard would be unenforceable. Thus, the attack of the minority upon the traditional common law and majority view has been aimed at only one of the two major components of that rule.

The minority cases stand for the proposition that a reasonableness standard will be implied to govern the lessor in the absence of an express standard. The cases change the effect of a "Silent Consent Standard" type clause. The common law and majority allows the lessor to have sole discretion. The minority

requires the lessor to meet an objective standard of commercial reasonableness. A major argument for the common law and majority treatment of this type of clause is that the language is clear so there is no basis for implying a reasonableness standard. The clause does not expressly mention sole discretion or reasonableness. The tenant could have bargained for a reasonableness standard, in which case it would be expressed in the lease. Since it is not in the lease, it was not bargained for, and the lessor is left with a sole discretion standard.[65] The minority does not find the "Silent Consent Standard" unambiguous regarding the governing standard.[66] If the clause is considered unclear, two basic policies lead to a reasonableness standard. One is the implied covenant of good faith and fair dealing.[67] The other is the dislike and strict construction of restrictions on transfer.[68]

Many of the minority view cases use strong language to criticize the sole discretion standard. However, the cases do not directly hold that the parties cannot bargain and expressly provide for such a standard. There is no trend of holdings abolishing the part of the common law and majority rule which leaves the sole discretion standard to the agreement of the parties.

The minority view is directed at avoiding unpleasant surprises for the tenant at the time of transfer--the "Silent Consent Standard" surprise. It is directed at encouraging disclosures and clarifying expectations. It does not override the

freedom of contract of the parties, nor prohibit a negotiated express sole discretion standard.

VIII. RESTATEMENT POSITION

The Restatement Second of Property adopts the following approach to leasehold transfers and restrictions:

> The interests ...of the tenant in the leased property are freely transferable, unless...the parties to the lease validly agree otherwise.[69]

> A restraint on alienation without the consent of the landlord of the tenant's interest in the leased property is valid, but the landlord's consent to an alienation by the tenant cannot be withheld unreasonably, unless a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent.[70]

The strict construction approach of the common law and majority is continued in the Restatement.[71] Thus, the language will be construed in favor of the tenant and transferability absent clear words of restriction.

The Restatement distinguishes between three types of restraints, categorized by the remedies available to the lessor.[72] If a prohibited transfer is made, the "forfeiture restraint" allows the lessor either to terminate the lease or to forego his objections to the transfer and enforce the lease provisions. The "disabling restraint" allows the lessor to keep the lease in effect and prevent the transfer from taking place. The "promissory restraint" ends up almost as one of the other two types, depending on the remedy available and chosen for breach of the promise. If the lessor can and does terminate the lease, the effect is the same as a forfeiture restraint, but with the additional right to damages. If the lessor can and does seek specific performance of the promise, the effect is the same as a disabling restraint. Although the lessor may prefer to have the option to negate the transfer, the disabling restraint is more disliked than a forfeiture restraint. The disabling restraint prevents transfer while the forfeiture restraint involves either a transfer back to the lessor or a permitted transfer to the third party. California appears to adopt the forfeiture restraint remedy, despite clause language indicating either a disabling or a promissory restraint.[73]

Kendall and several of the other minority view cases refer to the Restatement and use it to support their use of the reasonableness standard. The Restatement reflects the minority view by imposing a reasonableness standard on the "Silent Consent Standard" type clause. It leaves the common law and majority view

intact where the parties have agreed to and expressly provided for a sole discretion standard.

The Restatement position allows the lessor to have a provision for "an absolute right to withhold consent" if it is "freely negotiated." If the tenant has "no significant bargaining power in relation to the terms of the lease", it is not freely negotiated.[74] A clause which lacks free negotiation is not totally void. Transfer is still restricted but a reasonableness standard applies.[75]

The policy toward recovery of the premises by the lessor, triggered by an attempted transfer, depends on the manner in which recovery is accomplished. There might be a provision allowing the tenant to terminate the lease (as an exclusive remedy) if the lessor unreasonably withholds consent. This is sufficiently close to a sole discretion standard to require that the clause be freely negotiated. A Restatement comment distinguishes this from a lessor's right of first refusal to acquire the tenant's interest on the same terms offered by a third party. "Such right of first refusal is valid though its exercise will prevent the transfer by the tenant to another."[76] Since the tenant will receive basically the same deal from the lessor or the third party, there is no significant damper on transferability.

The Restatement position, like the minority view, is directed at avoiding unpleasant surprises for the tenant at the time of transfer--the "Silent Consent Standard" surprise. It is

directed at encouraging disclosures and clarifying expectations. It does not override the freedom of contract of the parties, nor prohibit a negotiated express sole discretion standard.

IX. CALIFORNIA PRIOR TO THE KENDALL CASE

A. Statutes

Cal. Civ. Code Sec. 711 provides that: "Conditions restraining alienation, when repugnant to the interest created, are void."[77] There is nothing in this statute, enacted in 1872, to indicate that anything but the common law rule was being adopted.[78] Restraints on alienation were considered repugnant to a fee simple interest.[79] They were not considered repugnant to a leasehold interest.[80]

Cal. Civ. Code Sec. 820 provides in pertinent part that: A tenant for years or at will has no other rights to the property than such as are given to him by the agreement or instrument by which his tenancy is acquired..."[81] This statute, enacted in 1872, emphasizes the lease as the source of the tenant's rights.

B. Cases Prior to Kendall

DeAngeles v. Cotta[82] is a 1923 case which has been cited as an early suggestion that restrictions must relate to the lessor's legitimate interests.[83] The lessor brought an Unlawful Detainer action based on the alleged breach of a "Silent Consent Standard" type clause which prohibited transfer without the lessor's consent. The four original tenants, through a series of individual assignments, had transferred to two new parties. The trial court found that the original tenants did not jointly assign the leasehold and the clause did not prohibit assignment of their individual interests.

The court of appeal reversed and interpreted the clause as a joint and several covenant not to assign. The court stated that "(o)wners of property are justly solicitous as to the character of its occupants and restrictions upon the right of a lessee to substitute another tenant without the lessor's consent are reasonable covenants which ought to be rationally construed."[84] It referred to the California statute that requires strict construction of a condition involving forfeiture,[85] but went on to say that "(t)his does not mean that courts must resort to scholastic subtleties to save tenants from the consequences of their deliberate breach of their covenants."[86] The court approves the view that courts should not make a different contract for the parties or defeat their clear intent by resorting to strained and unnatural construction.[87] A petition for hearing in the California Supreme Court was denied.[88]

This case does not involve a court imposed reasonableness standard. It does not analyze and express a preference against a sole discretion standard. The case merely shows that strict construction of a restriction on transfer does not prevent a common sense interpretation of the purpose of the clause to protect a lessor.

Kendis v. Cohn, a 1928 court of appeal case, involved a clause which prohibited assignment or subletting without the lessor's consent. The clause provided that "lessees may, with the written consent of...lessors, assign...to any person or persons of good character and repute and satisfactory to the lessors...."[89] The court pointed out that a reasonableness standard was not expressed and it would not be implied. The lessor "is the sole judge of his own satisfaction, subject only to the limitation that he must act in good faith."[90] The lessor was the sole judge of good character and repute, without testing that judgment against the ordinary reasonable person. However, if he were in fact satisfied, he could not act in bad faith by deceitfully denying satisfaction.

The Kendis opinion states that a lessor is still bound by a requirement of good faith even though he does not have to be judged by an objective reasonableness standard.[91] A person may be unreasonable but still acting in good faith. Reasonableness is an objective test based on common experience of the ordinary reasonable person. "Good faith, in contrast, suggests a moral

quality; its absence is equated with dishonesty, deceit or unfaithfulness to duty."[92]

The clause in the 1960 case of Richard v. Degen & Brody, Inc.[93] prohibited assignment or subleasing without the lessor's written consent, and it did not expressly provide a consent standard. The tenant contended that the lessor could not "arbitrarily" refuse consent to a sublease. The court rejected the contention with the comment that it was "untenable" and followed the traditional majority view. The "Silent Consent Standard" type clause is governed by a sole discretion, not a reasonableness, standard. There was no discussion of the merits of that view, nor the reasons that might support a contrary view.

In 1981, a court of appeal imposed a reasonableness standard on a condominium association. In Laguna Royale Owners Association v. Darger[94], a condominium association attempted to block a mini-time-share division by one of the condominium owners. The association asserted the absolute right to withhold consent and the unit owner asserted the absolute right to transfer. The court rejected both absolutes and allowed transfer restrictions subject to a reasonableness standard. The association argued that the traditional rule allowing absolute restrictions on a tenant applied because the unit owner was technically a sublessee. The condominium was developed pursuant to a 99 year ground lease, and the unit buyers received an undivided interest in the leasehold. The court took a passing shot at the traditional rule when it said: "Even assuming the continued vitality of the rule that a

lessor may arbitrarily withhold consent to a sublease . . . there is little or no similarity in the relationship between a condominium owner and his fellow owners and that between lessor and lessee or sublessor and sublessee." The common law has long recognized a distinction between a leasehold interest upon which restrictions are clearly allowed, and a fee ownership interest upon which restrictions are virtually prohibited.[95] Since the court distinguished the condominium unit interest from the typical leasehold interest, the rule in the Richard case was also distinguished.

A court of appeal squarely faced and rejected the traditional rule in Cohen v. Ratinoff, decided in 1983.[96] A commercial lease clause prevented assignment or subleasing without the lessor's prior written consent, and there was no express consent standard--A "Silent Consent Standard" type clause. The court ruled that a lessor may refuse consent only where he has an objectively reasonable objection. After several requests by the tenant for consent to an assignment, the lessor's attorney informed the tenant that the lessor could be "as arbitrary as he chooses." This colorful framing of the issue may have encouraged reevaluation of the traditional rule.

The Cohen case was followed in quick succession by four cases dealing with the same issue: Schweiso v. Williams[97] in 1984; Prestin v. Mobil Oil Co.[98] in 1984 (applying a federal court's perception of California law); Sade Shoe Co. v. Oschin & Snyder[99] in 1984; Hamilton v. Dixon[100] in 1985; and, Thrifty Oil

Co. v. Batarse[101] in 1985. All five cases involved commercial leases. All five involved clauses restricting transfer without the lessor's consent, but with no express consent standard--a "Silent Consent Standard" type clause.

Schweiso and Prestin imposed a reasonableness standard on the lessor. In Schweiso, the lessors referred to the restriction clause as a "license to steal" and they demanded a "transfer fee" as "blood money." Some might consider this subtle choice of words used to frame the issue as the verbal equivalent of an obscene gesture.

The Sade Shoe Co. decision seems to hold that a sole discretion refusal is permitted, but that it may constitute tortiuous interference with prospective economic advantage.[102] This prompted the Hamilton court to comment that it was "bemused" by that apparently "incongruous" result.

The lease in Hamilton was executed in 1970. The court expressed the view that Richard v. Degen & Brody was "clearly the law" at that time, and it would be improper to rewrite the bargained rights and reasonable expectations fifteen years later.[103] The court also commented that the abrogation of the freedom to bargain for a sole discretion standard should come from the legislature, not the courts.[104] It should be noted that the facts in Hamilton show that it is improper to always characterize the tenant as riding the white horse of virtue in a joust with a greedy lessor. Picture the lessor as a sixty-seven year old widow living alone in a mobile home. Her income came

from social security and rent from the leased property. Her fixed rent had become a "pittance" due to "shocking double-digit inflation" during the fifteen years since the lease was executed.

The dispute in the Thrifty Oil case involved a "Silent Consent Standard" type clause in a sublease. The subtenant subleased to third parties without even asking for the sublessor's consent. The sublessor brought an unlawful detainer action against the subtenant and third parties to recover possession. After a hearing which took place about three months before the Cohen decision, the trial court ruled in favor of the sublessor based on the Richard case. After the Cohen decision, the subtenant and third parties cited it in a petition to be relieved from forfeiture under Cal Civ. Proc. Code Section 1179. This section allows relief from forfeiture in limited hardship situations. The trial court denied the petition because the subtenant had not requested consent. The court of appeal found it unnecessary to decide whether Richard or Cohen applied to interpretation of the "Silent Consent Standard" clause, because no consent had been sought. Regardless of which case applied, the court of appeal stated, the subtenant and third parties "properly could not prevail in the unlawful detainer action because of the fact there was a failure to seek consent for the assignment...."[105] However, the court held that the failure to seek consent was not an absolute bar to relief against forfeiture under Section 1179. The matter was remanded to the trial court to weigh the facts for forfeiture relief. The court gave examples

of factors to consider. One example was the fact that consent was not sought and the reasons for such failure. Another example was the degree of arbitrariness or unreasonableness, if any, of the sublessor.[106] It seems strange that the failure to ask for consent on the one hand would block the subtenant and third parties from winning the unlawful detainer, but on the other hand not block them from relief against forfeiture. Comments in the case indicate that the court might have been giving the subtenant and third parties the opportunity the prove that asking for consent would have been a futile gesture.

Don Rose Oil Co., Inc. v. Lindsley, a 1984 court of appeal decision, cited Cohen and Prestin with approval, and commented that "(t)he trend in the law is toward assignability of contract rights."[107] However, this case involved a dispute concerning the right to assign a petroleum franchise. The characteristics of a business franchise and a commercial lease are sufficiently different that the case did nothing to resolve leasehold transfer issues.

This was the variegated background faced by California Supreme Court when the Kendall case was decided.

X. KENDELL V. ERNEST PESTANA, INC.[108]

A. Facts

There were four transactions leading up to the suit in Kendall. The following outline may help to identify the transactions and parties discussed below:

1. Lessor(City)---------lease----------Tenant(Perlitchs).
2. Tenant (Perlitchs)----sublease----------Subtenant (Bixler).
3. Tenant (Perlitchs)----assignment----------Assignee (Pestana).
4. Subtenant (Bixler)---proposed assignment--Kendall & O'Haras.

5. Proposed assignees of the sublease, Kendall and O'Haras

vs.

Assignee of the prime lease, Pestana.

First, the City of San Jose (lessor), leased airport hanger space to the Perlitchs (prime tenants). Second, the Perlitchs (prime tenants) sublet to Bixler (sublessee). Third, the Perlitchs (prime tenants/sublessors) assigned all interest in the prime lease to the Pestana corporation (assignee of the prime lease and successor sublessor). Fourth, Bixler (subtenant) proposed to assign his interests in the sublease, as part of a sale of his business, to Kendall and the O'Haras (proposed assignees of the sublease). Kendall and the O'Haras had a stronger financial position than Bixler (subtenant). Bixler (sublessee) requested consent to the proposed assignment from Pestana (assignee of the prime lease and successor sublessor).

Consent was denied, and Pestana allegedly demanded increased rent and other deal sweeteners as a condition of consent.

Kendall and the O'Haras (proposed assignees of the sublease) brought action against Pestana (assignee of the prime lease and successor sublessor) for declaratory and injunctive relief and damages. They contended in effect that Pestana was bound by a reasonableness standard and that it had unreasonably withheld and conditioned consent. The trial court sustained a demurrer to the complaint without leave to amend and, on appeal, this was deemed to include a judgment of dismissal of the action. The California Supreme Court reversed.

The plaintiffs, Kendall and the O'Haras, were the proposed assignees of a sublease. The defendant, Pestana, was the assignee of the prime lease and a successor sublessor. The disputed clause was contained in the sublease. It prohibited assignment, sublease or other specific actions without prior written consent of the sublessor. It was a "Silent Consent Standard" type clause, and did not expressly provide for a reasonableness or a sole discretion standard. Other clauses provided for: a five year term with options for four additional five year terms; a rent escalation every ten years proportionate to the prime lease rent increase; and, a use as an aircraft maintenance business. The sublease was apparently drafted and executed in 1969 (with a term to commence January 1, 1970).

The dispute concerned a successor sublessor's refusal to consent to assignment of the subleasehold by a subtenant. It will

be easier to deal with the issues in the more common context of a lessor, tenant and third party dispute. We will assume that the lessor of a commercial lease uses a "Silent Consent Standard" type clause to refuse or condition consent to a proposed transfer by the tenant to a third party. The court in Kendall uses this context in its discussion. The issues and their resolution will be the same. Also, although the parties in the case were fighting over a proposed assignment, the court expressly extended its holding to subleases.[109]

B. KENDALL RULE & REASONS

The facts involve a "Silent Consent Standard" type clause. The tenant was required to get the Lessor's consent for a transfer of the leasehold. The clause did not expressly provide for a reasonableness standard nor a sole discretion standard. Faced with the narrow issue of which standard to use, the majority of the court in Kendall adopted the minority view that a reasonableness standard should be implied. The decision imposes a reasonableness consent standard on the lessor of a commercial lease containing a clause that restricts assignment or subleasing without lessor's consent, and that has no express consent standard. The lessor in that situation must have a commercially reasonable objection to justify refusal to consent.

There are dual bases for the result, flowing from the dual nature of a lease as a conveyance and a contract.[110]

1. Property Policy Against Restraints on Alienation. The court states that in California, unreasonable restraints on alienation are prohibited.[111] The court borrowed from the "due on transfer" loan security situation in Wellenkamp v. Bank of America[112] to support and amplify this proposition. You compare the justification for the restriction with the quantum of restraint in order to determine reasonableness.[113] The court saw no modern justification for allowing leases to be exempt from the general policy.

2. Contract Policy of Good Faith and Fair Dealing. The duty of good faith and fair dealing is implied into contracts in California.[114] The contractual nature of a lease brings that duty into the lease. The court concluded that where the lessor retains the discretionary power to grant or withhold consent to an assignment or sublease, the power should be exercised in accordance with commercially reasonable standards.

C. Common Law Rule Arguments Rejected.

When a clause requires the lessor's consent, the common law and majority view would allow the lessor to have sole discretion in the absence of an express reasonableness standard. The court addressed arguments supporting the traditional common law rule.

1. Freedom of Personal Choice.[115] The traditional rule emphasizes the lessor's freedom of personal choice in selecting the tenant. The unconsenting lessor is not obligated to look to someone else for performance. The court said that the values used in personal selection are preserved by the commercially reasonable grounds used for withholding consent. Also, the original tenant remains liable to the lessor despite the assignment or sublease. The court also pointed to certain lease breach remedy legislation, discussed below in subsection E, as support for limits on the lessor's freedom of choice.

2. Unambiguous Reservation of Sole Discretion.[116] Another justification for the traditional rule is that the absence of an express reasonableness standard results in an unambiguous reservation of sole discretion. The tenant failed to bargain for a reasonableness standard, so the law should not rewrite the contract. The court concluded that the clause is not unambiguous. Also, it pointed out that recognition of the implied duty of good faith and fair dealing is not a rewriting of the contract. It is important to keep in mind the type of clause that the court was dealing with when considering the ambiguity argument. The clause did not expressly provide any consent standard.

D. Use of "Silent Consent Standard" Clause to Increase Profit is Improper.

Sometimes the rental value of property increases beyond the agreed rent.[117] Sometimes a lessor uses a proposed assignment or sublease as a device to demand increased rent as a condition of consent. This was apparently the situation in Kendall. The court rejected the argument that the lessor has the right to the increase in rental value in this situation.[118] The lessor made his bargain and was not automatically entitled to the benefit of increased value during the lease term. It is important to keep the court's criticism of the lessor's profit motive in the perspective of the facts. The lessor apparently surprised the tenant with a demand for money that it was not otherwise entitled to under the terms of the lease. It was attempting to improve, not just maintain, its economic position without the benefit of an express clause allowing it to do so. The lessor could have bargained for and expressly included frequent periodic rent increases in the lease. It could have used other express clauses to increase its return. In Kendall, there was a provision for rent escalation every ten years. However, there was no express provision for a rent increase upon assignment or subleasing; nor was there any provision for the lessor to receive part or all of the profit derived by the tenant from the transaction.

E. Inferences from Remedy Legislation.

In 1970, the legislature adopted a comprehensive revision of the lessor's remedies upon termination of a lease.[119] Both the Kendall majority and dissent use parts of that legislation for support. Cal. Civ. Code Section 1951.2 provides that, except as provided in section 1951.4, a lease terminates if either of two situations occur. First, the tenant breaches and abandons. Second, the tenant breaches and the lessor terminates the tenant's right to possession.[120] Section 1951.2 further provides in part that the lessor may recover the excess of the post termination unpaid rent over the amount of rental loss the tenant proves could be reasonably avoided. Thus, the tenant may reduce or avoid these damages by proving what the lessor could receive by reletting to another tenant. The majority opinion comments that this "duty to mitigate" undermines the lessor's freedom to look exclusively to the tenant for performance.[121]

Cal. Civ. Code Section 1951.4 permits the lessor to keep the lease in effect and to continue enforcing its terms against the tenant.[122] This lock-in remedy must be included in the lease. Also, it is available only "if the lease permits" the tenant to sublet, assign, or both, subject only to reasonable limitations. If the lessor's consent is required, the lease must provide that consent "shall not be unreasonably withheld." The remedy is available only if the lessor expressly subjects himself to a reasonableness standard. The dissent argued that the legislature

provided the remedy as an incentive to forgo the right to withhold consent unreasonably. It follows, the dissent argued, that the legislature must have recognized the contractual right to withhold consent unreasonably.[123] The majority called this speculation. The majority stated that implied statutory recognition of a common law rule that is not the subject of the statute does not codify the rule. Also, such implied recognition does not prevent a court from reexamining the rule.[124]

The majority and dissent positions can be reconciled. The dissent argues that the legislature provided the lock-in remedy, in part, as an incentive for a lessor to forego the right to withhold consent in his sole discretion. The majority did not prohibit an express sole discretion standard. It implied a reasonableness standard where there was no express contrary language. Thus, the lessor has the incentive to give up a sole discretion standard in order to obtain the lock-in remedy, but if the lessor does not wish to forego the sole discretion standard, he must expressly provide for it.

There is another argument based on section 1951.4, one that was not specifically mentioned by the dissent. In order for the lock-in remedy to be available, the lease must permit the tenant to sublet, assign, "or both." The statute clearly requires that the lessor allow either a sublease or an assignment or both, without restriction or with reasonable restrictions. It just as clearly allows the lessor to prevent either a sublease or an assignment without the reasonableness standard limitation.

This argument can also be reconciled with the majority position by emphasizing the narrow holding of the majority. In the absence of an express standard, reasonableness will be implied.

The remedy legislation package adopted in 1970 was the product of an extensive review by the California Law Revision Commission.[125] It seems that the Commission and the legislature assumed the existence of the traditional rule in California, but did not specifically consider whether it should be followed or rejected. The remedies revision was a major undertaking and understandably occupied their attention. Now that issues concerning restraints on leasehold transfers have become more pronounced, Cal. Civ. Code Section 1951.4 should be re-examined. This will be done below.

F. Guidelines For Reasonableness.

The Kendall decision points out some factors that may be considered in applying the reasonableness standard. They are: financial responsibility of the new party; legality and suitability of the use; need for alterations of the premises; and, nature of occupancy.[126] The court mentions other situations where a court has considered the lessor's objection as reasonable. They are: the desire to have one lead tenant in order to preserve the building image; the desire to preserve tenant mix

in a shopping center; and, the belief that a proposed specialty restaurant would not succeed at the location.[127] The court considers it unreasonable to deny consent solely on the basis of personal taste, convenience or sensibility, or for the purpose of charging more rent than originally agreed.[128] Other examples can be found in cases involving clauses that contain an express reasonableness standard.

Once a reasonableness standard has been negotiated or imposed, the question of what is reasonable is generally one of fact.[129] This study is concerned with the more basic question of when a reasonableness standard will be imposed. Therefore, there will not be an extensive discussion of cases applying the reasonableness standard.

G. Application to Types of Restriction Clauses.

Section IV of this study describes eight different types of transfer restriction clauses.

The Kendall case involved the "Silent Consent Standard" type clause. The clause did not contain any express standard for consent. The court only had to decide whether to imply a reasonableness or a sole discretion consent standard in the absence of any express standard. It implied a reasonableness standard and thus departed from the common law and majority view on this particular issue.

The case has no impact on the "Express Reasonable Consent Standard" type clause, except for language in the case discussing what may or may not be considered reasonable.

The "Express Sole Discretion Consent Standard", "Absolute Prohibition" & "Possession Recovery" type clauses are not expressly involved in the case. It is dangerous to draw inferences from language used to resolve the narrow issue actually involved in the case. There may be clues in the case to predict the attitude of the court members who decided Kendall. However, such crystal balling must take into consideration that four out of five in the majority are no longer on the court[130] and both of the dissenters are still sitting.[131] Some feel that the change in court personnel will favor lessors, at least where questions of reasonableness arise.

The court used broad general language to both criticize the traditional common law rule and to support a reasonableness standard.[132] Much of that language could be applied to an express sole discretion standard clause. On the other hand, the court referred to the Restatement as support for modern rejection of the traditional common law rule.[133] The Restatement implies a reasonableness standard in a "Silent Consent Standard" type of clause, but it also allows a freely negotiated "absolute right to withhold consent.[134] The court clearly recognized the impact of the Restatement position. It commented in footnote 14 that the Restatement rule would validate a clause giving the lessor "absolute discretion" or "absolutely prohibiting" an assignment

(or sublease). However, the court added, the case does not involve the question of the validity of those clause types.

Kendall did not deal directly with the "Express Specific Requirements" type clause. If there is a question about the reasonableness of a specific requirement, the general discussion of reasonable objections will be of help. If there is a question whether the parties can expressly agree to a specific requirement which does not meet a reasonableness test, the clue search mentioned above is involved again.

The case applies directly to the "Consent Required But Exemptions" type clause if the clause is silent on the consent standard. If there is an express reasonableness standard, the case has no impact except for language discussing the meaning of reasonableness. If there is an express sole discretion standard, there is no direct answer in the case.

Footnote 17 appears to show approval of a "Profit Shift" type clause which gives the lessor the right to profit from the assignment or sublease transaction. It provides:

> Amicus Pillsbury, Madison & Sutro request that we make clear that, "whatever principle governs in the absence of express lease provisions, nothing bars the parties to commercial lease transactions from making their own arrangements respecting the allocation of appreciated rentals if there is a transfer of the leasehold." This

principle we affirm; we merely hold that the clause in the instant lease established no such arrangement.

This footnote also indicates that the court was aiming its broad criticism of the common law rule at the clauses which do not contain express language, not the clauses which clearly put the tenant on notice of what to expect.

XI. CALIFORNIA AFTER THE KENDALL CASE.

John Hogan Enterprises, Inc. v. Kellogg,[135] a 1986 court of appeal decision, involved a percentage rent lease with a clause which limited use to a women's ready-to-wear shop. The tenant had been operating at a stable profit for several years and producing percentage rentals above the minimum rent. The tenant entered escrow to assign the lease to a third party who proposed to operate an antique store as a hobby. There would not be sufficient revenue to produce percentage rentals, so only the minimum rent would be paid by the third party for the remaining 9 years of the term. The third party agreed to pay the tenant $150,000.00. This amount was "equivalent to the difference over the remaining nine years of the lease between the minimum rent and the actual rents the Lessor had actually received." [136] The lessor used a "Silent Consent Standard" type clause in the lease to object to the transfer.

The court applied Kendall and subjected the lessor to a reasonableness standard. It made an irrefutable comment in holding, as a matter of law, that the lessor met the reasonableness standard. "Refusing to consent to highway robbery cannot be deemed commercially unjustified."[137] The court made an important distinction. A lessor's refusal to consent in order to increase his return above that provided in the lease is generally considered unreasonable. However, it is reasonable to object to a transfer that would place the lessor in a worse financial position that it bargained for and could expect to continue under a percentage lease.

The Hogan court did not appear to directly deal with the use clause. The clause limited use to a women's ready-to-wear shop. The third party intended to use the premises as an antique shop. Probably the court considered the proposed change of use issue as included in, and overpowered by, the loss of rent issue. There does not seem to be a legitimate basis in the case to speculate that the court would have allowed the change in use if there had not been a drop in rent.

Northridge Hospital Foundation v. Pic 'N' Save No. 9, a 1986 court of appeal decision, cited Kendall for the proposition that a lease is a contract and the duty of good faith and fair dealing is implied in contracts.[138] However, the case does not deal with the issue of transfer restrictions. It deals with a lessor and tenant attempting to eliminate a sublease by a voluntary surrender of the prime lease.

Airport Plaza, Inc. v. Blanchard, a 1987 court of appeal decision, is another case involving the question of reasonableness.[139] Blanchard was the lessor of a seventy-five year ground lease. Airport Plaza, a corporation with two shareholders, was the successor tenant of a seventy-five year ground lease. The lease called for a shopping center to be built by the tenant and the center was completed. Airport wanted to borrow money to get back some of its investment in the property. It proposed to hypothecate its leasehold as security for the loan. The loan money was not going to be reinvested in the center. Airport also proposed to dissolve the corporation and distribute it assets, including the hypothecated leasehold, to its two shareholders. The lessor objected to the hypothecation and the dissolution.

A lease clause stated that the tenant could not transfer in whole or part without the lessor's consent, except as otherwise provided in the lease. This is a "Silent Consent Standard" type clause governed by the Kendall requirement of reasonableness.[140] The lease provided that the tenant could hypothecate for purposes of improving the premises. It also provided that the tenant could assign the entire leasehold without the lessor's consent if Airport Plaza remained liable until all the encumbrances against the property had been paid off.

The Airport Plaza court held that the lessor was reasonable in objecting to the hypothecation because the lender would require terms that constituted a substantial variation of the

lease. The court also held that the lessor was reasonable in objecting to the dissolution of the corporation and assignment to the shareholders. The lessor's security would be impaired. The corporate assets would become personal assets of the shareholders and used for purposes other than the shopping center. The court recognized that, generally, a technical change of ownership or legal form is not a violation of a transfer restriction. However, this is true only when change does not affect the rights of the landlord.

Multiplex Ins. Agency, Inc. v. California Life Ins. Co.[141], a 1987 court of appeal case, involved an action by a general insurance agent against an insurance company for failure to pay commissions. It cites Kendall on the propriety of bringing a tort action for breach of contract. The Cohn case, by reversing a judgment on the pleadings and remanding, allowed the tenant to proceed with a bad faith breach of contract cause of action and claim for punitive damages. A footnote in Kendall pointed this out, expressed no view on the merits of the punitive damages claim in Cohn and noted that not every breach of the good faith and fair dealing covenant results in a tort action.[142]

Golden State Transit Corp. v. City of Los Angeles[143] is a 1987 decision by a United Stated District Court. An applicant for a taxicab franchise renewal sought an order that the franchise could be transferred without City restriction, other than good moral character of the transferee. The court refused to eliminate all restrictions and pointed out that the franchisee was

adequately protected by the Kendall requirement of reasonableness.

Superior Motels v. Rinn Motor Hotels,[144] a 1987 court of appeal decision, involved the issue of whether an antireceivership provision in a lease was an invalid restraint on alienation. The disputed lease clause provided that the appointment of a receiver to take possession of the tenant's assets would constitute a breach of the lease. The clause was attacked as an unreasonable restraint on alienation. Cal. Civ. Code Section 711 provides: "Conditions restraining alienation, when repugnant to the interest created, are void."[145] The court said that it only prohibits restraints that are unreasonable, those not necessary to protect, or prevent impairment of, a security. The court cited Kendall and two secured loan transaction cases[146] as authority for this proposition. The court goes on to say that it cannot resolve the validity of the clause in the abstract and there was no evidence regarding the necessity of the provision to protect security interests.

See also the Kreisher case at the end of Section XIII.

XII. PUBLIC POLICIES.

The Kendall case uses two distinct policies to support the implication of a reasonableness standard. They are the contract policy of implying a covenant of good faith and fair dealing, and the real property policy against restraints on alienation.

A. Rule Against Restraints on Alienation.

1. Common Law Background & Development.

The real property rule against restraints on alienation has ancient origins in the law of England. It is older than the perennial favorite of property historians, the rule against perpetuities.[147] It is possible that the policy of free alienability developed as a side effect of rules which were developed for quite different purposes.[148] The first major statute dealing with the subject was a product of the feudal system in early England. It was Quia Emptores, adopted in 1290, which provided that:

> (I)t shall be lawful to every freeman to sell at his own pleasure his lands or tenements or part of them, so that the feoffee shall hold the same lands or tenements

> of the chief lord of the same fee, by such service and custom as his feoffor held before.[149]

This statute was aimed at freeing fee simple estates from the early English practice of subinfeudation. Subinfeudation involved the creation of layered continuing obligations to successive grantors.[150]

Examination of the historical origins of the rule in early England does little to explain its vitality in the modern United States. An early rationale, which was codified in California,[151] is the "repugnancy" argument. Since a fee simple property interest is transferable, it is repugnant to the nature of the fee simple interest to restrain transfer.[152] One major commentator has found this rationale to be less than persuasive. He argues that if the interest is created subject to an express provision for forfeiture upon alienation, the nature of the interests includes its inalienability. Thus, he argues, the repugnancy rationale is only a poor expression of a policy of opposition to the restraint.[153]

Another rationale for the rule against restraints is that there are only a certain number of recognized estates in real property. If the grantor of a fee simple could eliminate its characteristic of alienability, he would be able to create a new type of estate.[154] This is not very satisfying as a basic modern reason to follow the rule.

Several social and economic policy reasons have been given to justify a rule against restraints on fee alienation. For example: 1. the market price of property may be increased; 2. wealth may be increasingly concentrated if an owner is unable to alienate his property; 3. improvement of property will be discouraged if the owner cannot realize the increased value by a sale; and, 4. creditors will be treated unfairly if they cannot reach the asset.[155] Another reason given is that alienability increases productivity. If an owner is unable to make land productive, he will usually sell it to someone who can. If he cannot transfer to a more productive user, and if he is reluctant to make improvements, the property will not be devoted to its highest and best use.[156]

Some courts and commentators have recognized that restraints on alienation are not necessarily all bad. In some cases they may actually facilitate development or have some other legitimate purpose which outweighs the impact of the restraint.[157] For example, a restraint imposed on all purchasers of property in a residential development or interests in a condominium or cooperative may secure mutual protection of their investments and common expectations.[158] This recognition of legitimate uses for restraints leads one away from an absolute prohibition of restraints. It results in a balancing of the negative impact of the restraint against the positive purpose of the restriction.[159]

The duration of the restraint and the effect of violation are also factors to consider. A restraint on a fee simple for a

limited period may be viewed more favorably than a perpetual restraint. A forfeiture type restraint results in either a waiver of objection to the transfer or forfeiture resulting in re-transfer. The forfeiture restraint is viewed more favorably than a disabling restraint, which negates the restricted transfer.[160] Although a perpetual restraint on a fee simple is void,[161] Kentucky, and perhaps other states, would allow a forfeiture restraint of limited duration on a fee simple.[162]

The principal target of the rule against restraints on alienation has been the fee simple estate. In contrast, most courts uphold forfeiture restraints on life estates.[163] The life estate is not as alienable as the fee simple even absent restriction, and there are more reasons why a grantor may want to restrict transfer of a life estate.[164]

The rule against restraints on alienation was not directed against restrictions on transfer of leasehold estates, except with respect to the strict construction of restriction language. "The common-law hostility to restraints on alienation had a large exception with respect to estates for years. A lessor could prohibit the lessee from transferring the estate to whatever extent he might desire."[165] The lessor's continuing interest in the property, both during and after the lease term, is a major interest and a strong incentive for control. A more complete discussion of the common law and majority rule with respect to leaseholds is contained in Section VII.A above.

2. California Rule Against Restraints.

In 1872, California adopted Cal. Civ. Code Section 711 which states: "Conditions restraining alienation, when repugnant to the interest created, are void." The common law rule against restraints, discussed above, considered restraints repugnant to a fee simple interest, but not repugnant to a leasehold interest. There is nothing in the statute to indicate it was doing something other than adopting the common law. Thus, it must be construed as a continuation of the common law, not as a new enactment.[166]

In 1978, the California Supreme Court in Wellenkamp v. Bank of America clearly adopted a balancing test for the validity of restraints affecting alienation of fee simple estates.[167] The Wellenkamp family of cases involved secured credit transactions with restrictions on the encumbrance, installment sale and conveyance of a fee simple estate.[168] The cases involved deeds of trust securing loans and creating security interests in fee simple estates. Clauses in the deeds of trust permitted the lenders to accelerate the due date and call the loans upon transfer (or encumbrance) of an interest in the property. The Wellenkamp court held that Section 711 does not prohibit all restraints, only unreasonable ones. A balancing test is applied to determine reasonableness. You compare the justification for the restriction with the quantum of restraint in order to determine reasonableness.[169] Although Wellenkamp applied the rule

against restraints to transactions apparently not contemplated by the common law rule, loan security interests, the case can be viewed as liberalizing the common law rule against restraints on fee simple estates. The restraints are not automatically void. They are subject to a balancing test.

Cohen v. Ratinoff, in 1983, was the first California appellate decision to apply Section 711 to a leasehold.[170] The court stated that only unreasonable restraints are invalid and cited the Laguna Royale case. That case involved basically a condominium transaction, not a typical leasehold transaction.[171] The court concluded that the "Silent Consent Standard" type of clause was not inherently repugnant to the leasehold interest because the lessor has an interest in the character of the proposed transferee. However, it held that there is an unreasonable restraint if the clause is implemented in a manner that "its underlying purpose is perverted by the arbitrary or unreasonable withholding of consent...."[172] In a footnote, the court commented that the tenant contended the reasoning of Wellenkamp should apply to leases. The court went on to say: "Since Wellenkamp did not involve a leasehold interest, it is distinguishable from the instant case."[173] However, the court did not explain its extension of the common law rule against restraints, and Section 711, to leaseholds. Note that the court used the implied covenant of good faith and fair dealing, discussed below, as an independent basis for imposing a reasonableness standard on the lessor.

The court in the Kendall case saw no modern justification for allowing leases to be exempt from a general policy prohibiting unreasonable restraints on alienation. It borrowed the balancing test from Wellenkamp and stated: "Reasonableness is determined by comparing the justification for a particular restraint on alienation with the quantum of restraint actually imposed on it."[174] The court quoted a commentator's doubts about the continued vitality of the common law treatment of leaseholds:

> A lessor could prohibit the lessee from transferring the estate for years to whatever extent he might desire. It was believed that the objectives served by allowing such restraints outweighed the social evils implicit in the restraints, in that they gave to the lessor a needed control over the person entrusted with the lessor's property and to whom he must look for the performance of the covenants contained in the lease. Whether this reasoning retains full validity can well be doubted. Relationships between lessor and lessee have tended to become more and more impersonal. Courts have considerably lessened the effectiveness of restraint clauses by strict construction and liberal applications of the doctrine of waiver.[175]

The court also cites with approval the Restatement proposition that the lessor's consent to transfer by the tenant cannot be

withheld unreasonably, unless a freely negotiated lease provision gives the lessor the absolute right to withhold consent.[176]

There is no question that the Kendall decision uses strong language to criticize the common law and majority rule which allows the lessor to retain sole discretion over a leasehold transfer. Likewise, there is no question that the result in Kendall can be accomplished without completely overturning the common law and majority rule. The case involved a "Silent Consent Standard" type clause, one which did not expressly state that consent could be withheld in the lessor's sole discretion. An application of strict construction of restriction clauses and fair disclosure to the tenant would justify imposition of a reasonableness standard, absent an express provision to the contrary. This would satisfy the legitimate concerns expressed in Kendall, but leave the parties free to bargain and expressly provide for a sole discretion standard, or for other clauses which expressly exempt the lessor from the scrutiny of a reasonableness standard. Such a result would be consistent with the developing minority view and the Restatement position cited in Kendall.[177] It may also be possible to conclude that it is "reasonable" to allow the parties to bargain and expressly provide for a sole discretion standard or specific requirements that are not subject to litigation over compliance with a reasonableness standard. See Section VI.B above.

The imposition of a reasonableness standard in the absence of an express sole discretion standard or specific set of

requirements seems to be a fair and logical extension of the strict construction of restraints on leasehold transfers. This would reduce the chances of unpleasant surprises for the tenant at the time of transfer, and it would encourage lessors to bargain for an express clause if they want to avoid the reasonableness standard. There is some question concerning the fairness of retroactivity, but otherwise this development in Kendall seems justified. However, it seems unnecessary and undesirable to extend beyond the facts of Kendall to a mandatory reasonableness standard test for all types of leasehold transfer restrictions, regardless of express contrary language in the lease. Such an extension is not supported by the holdings in the developing minority view cases, and it is not supported by the Restatement position.

One of the reasons mentioned for curtailing restrictions is the shortage of vacancies. Vacancies fluctuate with time and place, and there are major factors at work in producing or reducing them. An economic outlook report in early 1988 was entitled "Slow growth, higher vacancies cast ominous shadows over commercial real estate in '88".[178] The report mentions several factors contributing to vacancies reaching up to 40% in some areas of Los Angeles County, but does not mention free transferability of leaseholds as one of them.

It is possible to hypothesize public ills resulting from restraints on leasehold transfers, or to encounter anecdotal incidents of individual problems. However, I have not been able

to find any empirical study showing that the common law and majority view, or the Restatement modified common law view, in fact cause problems serious enough to warrant taking away the freedom of contract. The California Supreme Court has recognized that intellectual criticism of a rule may not accurately reflect an actual problem. Keys v. Romley involved an action for damages caused by surface water run-off. The court pointed out that the rule followed in California since 1873 had been criticized as inhibiting improvement of land. The court responded:

> (N)o documentation has been produced to establish that the rule has in fact impeded urban development in the state. A number of highly urbanized states follow the rule, and California's phenomenal growth rate, to which no one can be oblivious and of which this court may take judicial notice, appears unstunted by the existence and application of the civil law rule since 1873.[179]

This comment in the Keys unanimous opinion was made by Justice Mosk, who was one of the two dissenters in Kendall.

It is naive to assume that all lessors would win a negotiation for a clause lacking a reasonableness standard. Even if one were to assume that lessors would win such a negotiation, California already has a built in statutory protection against lessors making massive use of clauses taking away the

reasonableness standard. Cal. Civ. Code Section 1951.4 allows the lessor to use the important lock-in remedy upon breach and abandonment by the tenant only if the lease permits the tenant to transfer, subject only to limits that meet a reasonableness standard. This section is discussed below. Some lawyers feel that this remedy is so important that it makes any discussion of Kendall and sole discretion standards moot.

Another factor to consider is the remedy of a lessor for violation of the restraint by a tenant. California appears to limit the lessor to a forfeiture remedy.[180] This is traditionally viewed more favorably than a disabling restrain which would nullify an attempted transfer.[181]

There appears to be good reason to impose a reasonableness standard in the absence of an express contrary agreement of the parties. There does not appear to be a compelling reason to change the rule against restraints on alienation and take away freedom of contract by prohibiting an express provision for sole discretion.[182] The Restatement position reflects these conclusions.[183]

The maximum duration allowed for a lease in California is ninety-nine years, and there are some shorter limits for certain types of leases.[184] An argument could be made that extremely long term leases approach the practical duration of a fee simple, and should be subject to the same strict prohibition against restraints. It seems that long term leases tend to be complex, highly negotiated, transactions and best left to the agreement of

the parties. However, if there is a realistic compelling reason to impose a mandatory reasonableness standard on long term leases, the problem could be solved by a time limit after which a mandatory reasonableness standard would govern. A time limit would be a more direct solution than an absolute rule applicable to all leases regardless of duration. However, the exact time picked for a time limit appears to be a rather arbitrary choice.

Before leaving the alienability issue, it is interesting to note that a strong and enforceable leasehold transfer restriction clause will probably enhance the alienability of the lessor's reversion.

B. Implied Covenant of Good Faith & Fair Dealing.

The Kendall case used the implied covenant of good faith and fair dealing as a basis for implying a reasonableness standard into the "Silent Consent Standard" type clause.[185] The covenant of good faith and fair dealing is implied into every contract in California.[186] A lease is considered to be a contract, as well as a conveyance.[187] Basically, the covenant requires that neither party do anything to deprive the other of the contemplated benefits of the agreement.[188]

The covenant of good faith and fair dealing focuses on the bargain of the parties and their expectations flowing from that bargain. It has been said that:

> Good faith performance...occurs when a party's discretion is exercised for any purpose within the reasonable contemplation of the parties at the time of formation--to capture opportunities that were preserved upon entering the contract, interpreted objectively.[189]

If the clause imposes a consent requirement, but does not expressly state a reasonableness standard or a sole discretion standard, Kendall would find a reasonableness standard contemplated by the tenant and imply that standard based on good faith and fair dealing.

It is rather easy to use good faith and fair dealing to imply a reasonableness standard in the absence of an express agreement to the contrary. This is what Kendall did, and it did no more. It would be quite a different matter to use good faith and fair dealing to mandate a reasonableness standard in the face of express language to the contrary.

Generally, a covenant will not be implied where the subject is completely covered by the contract.[190] In the Commercial Union case, the California Supreme Court declared that what the duty of good faith and fair dealing embraces depends upon the nature of the bargain struck and the legitimate expectations of the parties arising from the contract.[191] In the Seaman's case, the California Supreme Court stated that although the parties may not be permitted to disclaim the covenant of good faith, they are

free, within reasonable limits, to agree upon the standards by which application of the covenant is to be measured.[192]

A 1933 New York decision has been credited with first stating the now standard doctrine of good faith and fair dealing.[193] A more current decision by a federal district court in New York refers to general contract principles in Corbin's treatise on contracts to make very specific comments on the relationship between the covenant of good faith and fair dealing and express provisions in the contract. In VTR, Incorporated v. Goodyear Tire & Rubber Company,[194] the court made the following comments:

> The general rule (regarding the covenant of good faith and fair dealing)... is plainly subject to the exception that the parties may, by express provisions of the contract, grant the right to engage in the very acts and conduct which would otherwise have been forbidden by an implied covenant of good faith and fair dealing.
>
> No case has been cited and I know of none which holds that there is a breach of an implied covenant of good faith and fair dealing where a party to a contract has done what the provisions of the contract expressly give him the right to do...As to acts and conduct authorized by the express provisions of the contract,

> no covenant of good faith and fair dealing can be implied which forbids such acts and conduct.
>
> The allegations that the defendants acted in bad faith are mere characterizations by the plaintiffs and add nothing to their claim for relief. Whether or not the acts and conduct of the defendants are in bad faith is to be determined here by whether or not they had the right to engage in them under the contract. Since they had such right, defendants cannot be said to have acted in bad faith.[195]

The court also mentioned that the fact the party agreed to a bad bargain does not change the result.

If the lessor bargains for and gets an express clause negating the reasonableness standard on a transfer restriction, the tenant is put on notice that the reasonableness standard is not one of his contractual expectations. It may be considered reasonable for a lessor to want such a provision.[196] A later claim by the tenant that the lessor should be subject to a reasonableness standard despite express contrary language would be an attempt to deny the lessor of the benefit of his bargained contractual expectations.

There appears to be good reason, based on the implied covenant of good faith and fair dealing, to impose a reasonableness standard in the absence of an express contrary agreement of the parties. However, if there is an express

agreement to the contrary, there does not appear to be a compelling reason to take away the freedom of contract by mandating a reasonableness standard. The Restatement position reflects these conclusions.[197]

C. The Restatement Compromise.

The Restatement position, explained in Section VIII above, seems to be the best compromise between freedom of contract and the public policies. It imposes a reasonableness standard unless the parties freely negotiate and expressly provide to the contrary.[198] It places the emphasis on reasonable expectations and disclosure, rather than on mandating a reasonableness standard in the face of contrary language.

This position is a carefully considered solution to the criticisms leveled against the traditional common law rule. The Restatement is the most common source referred to by courts that move away from the traditional rule. If the traditional rule is considered inadequate in some respects by more states, the Restatement position will have an advantage over other possible solutions. It will develop a national body of interpretations.

There is a phrase in the Restatement position which can use some clarification. The Restatement requires that a clause providing for the absolute right of the lessor to withhold consent be "freely negotiated." It is clear that total equality

of bargaining power is not required. The Restatement does not consider a clause freely negotiated if the tenant has "no significant bargaining power in relation to the terms of the lease."[199] The relationship between the phrase "freely negotiated" in the Restatement and the adhesion doctrine in California is unclear. California has a well developed body of law defining the parameters of the adhesion doctrine as a means of protecting one contracting party from overreaching by the other.[200] Stability and predictability in contractual relationships are important, especially when dealing with real property interests. If the Restatement position is adopted in California, consideration should be given to clarifying the requirements of "freely negotiated". One way of doing so would be to adopt the adhesion doctrine as the test. Since this doctrine is already an integral part of California law, there would be no problem of unfairness created by retroactive application.

Another factor involved in the stability and predictability of contracts is the burden of proof. Contracts and contract provisions should not be easily set aside. The tenant should have the burden of establishing the lack of free negotiation which would result in the invalidity of the express language. This approach to valuing contract stability has been taken in other legislation crafted by the California Law Revision Commission.[201]

XIII. RETROACTIVITY.

The document containing the disputed "Silent Consent Standard" clause in Kendall was drafted and executed in 1969 (with a term commencing January 1, 1970). At that time, the most current California case dealing specifically with the consent standard issue was Richard v. Degen & Brody.[202] That case also involved the "Silent Consent Standard" clause. It clearly followed the common law and majority rule that the lessor was not bound by a reasonableness standard if the clause did not express one. There were no California cases adopting a different view at the time. It was about fourteen years after the disputed document in Kendall was executed before a California court squarely faced and rejected the common law and majority rule. This was done in the Cohen v. Ratinoff[203] case in 1983.

The Kendall dissent argued that the lessor's counsel was entitled to rely on the traditional rule as the state of the law in California when the document was executed, and it was unfair to reject the common law retroactively. The dissent expressed the view that the contract was being rewritten by a retroactive rejection of the traditional rule. Also, it suggested that if a change is warranted, it should be made by the legislature.[204]

The majority responded that the traditional rule has not been universally followed and that it has never been adopted by the California Supreme Court. The court commented that "the trend in favor of the minority rule should come as no surprise to observers of the changing state of real property law in the 20th

century." This is a noble thought, but can it be applied realistically to a lawyer drafting a lease in 1969?

Prior to the Cohen case, the "due on" transfer or encumbrance clause in a loan security document was the transfer issue receiving attention in California. The Wellenkamp decision in 1978 is relied upon heavily in Kendall.[205] It was certainly possible to draw analogies from the "due on" transfer or encumbrance cases. However, it does not seem unreasonable that an attorney would conclude that a clause in a deed of trust restraining alienation of a fee simple interest would be distinguished from a lease clause restraining assignment and subletting of a leasehold. Indeed, the Cohen court made such a distinction.[206] Also, it seems that the California Supreme Court did not clearly start its journey toward Wellenkamp until 1971 when it decided the La Sala case.[207] This was after the Kendall document had been executed.

An article in the January, 1970 issue of the Hastings Law Journal criticized the application of the traditional rule to residential leases and argued for change. However, it pointed out that "(e)xcept for dictum in a Massachusetts district court case, and an apparently controlling decision in Louisiana, this harsh rule is accepted everywhere."[208] There was a particularly perceptive prediction in a 1980 article in the California State Bar Journal.[209] The article reviewed the cases and concluded that the principles in the Wellenkamp loan security case should govern leasehold transfer restrictions. Both of these articles

criticizing the traditional rule were published after the document in Kendall was executed.

It is clear that some lawyers believed California followed the traditional rule. The lawyers on the court in the unanimous, but vacated, court of appeal decision in Kendall expressed no doubts. The opinion, referring to the "Silent Consent Standard" clause, states:

> (I)t is obvious that the attorney for the lessor agreeing to such a term was entitled to rely upon the state of the law then existing in California. And at such time (Dec. 12, 1969) it is clear that California followed the "weight of authority" in these United States and allowed such consent to be arbitrarily or unreasonably withheld absent a provision to the contrary.[210]

That court expressed the view that it would be rewriting the contract of the parties to apply the minority view to the lease. It suggested that if California is going to adopt the minority view, it should be done by legislation. The unanimous court of appeal in the now disapproved decision in Hamilton was of the opinion that the Richard case (following the traditional rule) was "clearly the law" at the time a lease was signed in 1970, and it would be improper to rewrite the bargained rights and reasonable expectations of the parties.[211] The unanimous opinion

of the court of appeal in the Thrifty Oil Co. case referred to a trial court hearing that took place in July, 1983,(about three months before the Cohen decision) and commented: "At that time the law was clearly in accord with Richard v. Degen & Brody, Inc. ... ."[212]

A practice handbook published by the California Continuing Education of the Bar in 1975 contains a sample of a "Silent Consent Standard" clause with the following comment: "A tenant should insist that the landlord agree not to unreasonably withhold its consent to a proposed assignment, encumbrance, or subletting, and most landlords agree to give such a clause. Without such an agreement the landlord can arbitrarily withhold its consent or attach conditions to the granting of its consent, and the tenant is without recourse."[213] Up until the time that the Cohen case was decided in 1983, major treatises expressed the view that California followed the common law and majority view.[214]

It seems realistic to recognize that a change in the law regarding leasehold restraints developed in the 1980s. A change based, at least in part, on good faith and fair dealing should give careful consideration to the reasonable expectations of the parties at the time the bargain was struck.

See supplemental pages 76A-76D.

XIV. THE SURPRISE PROFIT DEMAND.

SUPPLEMENT TO SECTION XIII ON RETROACTIVITY:

On February 6, 1988, a California Court of Appeal (First Appellate District, Division Four) filed its decision in Kreisher v. Mobil Oil Corporation (88 Daily Journal D.A.R. 1566; Note that this decision is not final). The unanimous decision contains a strong and thorough argument against retroactive application of Kendall.

In Kreisher, the trial court entered judgment against lessor Mobil, based on a jury verdict, for $214,000 compensatory damages and $2,002,500 punitive damages. The tenant, a Mobil station franchisee, based his causes of action on the lessor's failure to comply with a reasonableness standard when refusing consent to a transfer of the tenant's leasehold and gasoline service station franchise. The lease and franchise agreements both contained a "Silent Consent Standard" clause. One third party offered the tenant $28,000 for the transfer and another offered $31,000.

The relationship between the parties was based on two related documents: a franchise agreement and a station lease. The relationship continued through a series of three year term contracts going back to 1971. The sequence of events leading to litigation started with a notice of default from the lessor to the tenant. The notice referred to the tenant's breach of a continuous operation clause and stated the lessor's intention to

terminate if the default was not cured. The tenant responded with a notice of a third party's offer of $28,000 for a transfer and required for the lessor's consent. The lessor refused without stating a reason, other than the lessor's intention to terminate the lease and franchise. The lessor then learned of an additional breach, the failure to maintain insurance, and of revocation of the tenant's resale permit by the State Board of Equalization. After giving an additional notice of termination for default, the lessor served tenant with a three-day notice to quit. The tenant then notified the lessor of the second third party offer, this one for $31,000, and asked if the lessor wished to either meet that offer or consent to the transfer. The lessor rejected both proposals and commenced an unlawful detainer action. The tenant vacated prior to any further judicial action.

The tenant then filed an action against the lessor for compensatory and punitive damages based on eight causes of action. The three causes of action which ultimately went to the jury and led to the judgment were: breach of contract and the implied covenant of good faith and fair dealing; intentional interference with prospective economic advantage; and, intentional infliction of emotional distress.

The Kreisher court points out that contract execution, consent refusal and jury verdict all occurred before the Kendall decision was filed on December 5, 1985. That case subjected the

lessor to a reasonableness standard, implied into a "Silent Consent Standard" clause. The court reviewed the principles involved in retroactivity, including foreseeability, reliance, public policy and fairness. It then concluded as follows:

> Our weighing of the relevant considerations comes down to this. At all relevant times, the prevailing rule of law was that a lessor could withhold assent to a proposed assignment for any reason whatsoever. Mobil displayed considerable and justifiable reliance on that rule...The strength and extent of that reliance is only partially offset by Mobil's inability to foresee the nonjudicial portents of a change in the rule. By contract, there is no evidence that plaintiff had any inkling of a judicial change of the rule...Public policy supporting the change will not be advanced by applying the change to completed contractual arrangements involving the stability of real property titles. As regards the fairness factor, we perceive no satisfying basis for making plaintiff the windfall beneficiary of a change he did not foresee or help bring about. Conversely, it is patently unfair to penalize Mobil for its nonconformity with standards which took effect only after it conscientiously determined the state of the law and relied upon it in reasonable good faith.

The court reversed the judgment because the refusal to give consent was at the heart of all the causes of action leading to it.

Since this case involved a petroleum dealer franchise, as well as a lease, the court also discusses Cal. Bus. & Prof. Code Section 21148. This section prohibits the franchisor from withholding consent to a transfer of the franchise unless certain requirements are met. The section became effective on January 1, 1981, and expressly made prospective in operation. The statute does not apply to the pre-statute franchise in the case.

In the Kendall case, it is obvious that the lease, refusal to consent and trial took place before the Supreme Court opinion was filed. However, the tenant in that case did help bring about the change.

Section VI.B of this study mentions some of the reasons a lessor may have for wishing to avoid application of a reasonableness standard. Another reason might be the desire to avoid the potential of punitive damage jury award. Note that the highest price offered for a transfer in Kreisher was $31,000. The punitive damage award was $2,002,500.

RETURN TO SECTION XIV. THE SURPRISE DEMAND, commencing p.77.

Unanticipated demands by lessors for profit from a transfer seem to stir the passions and cause a strong motivation to reject the common law and majority view. The Cohen, and Kendall cases are good examples. The same is true in other states.[215] It is the fact that the demand is unsupported by express lease provisions and comes as a surprise to the tenant that creates the problem. It is not created by the fact that the lessor seeks to benefit from an appreciation in the value of his property. If some lessors had not asked for more money than was specifically provided for in their leases, sometimes with colorful ambush language,[216] probably little judicial attention would have been given to this area of the law.

There seems to be agreement that it meets the reasonableness standard for the lessor to protect his expectations for the agreed rental return.[217] When he goes beyond protecting the agreed rent and seeks to sweeten the deal without benefit of an express clause, problems develop. The profit involved in the dispute typically has arisen because of an increase in the rental value of the property in excess of the amount of the agreed rent. The tenant indirectly enjoys the benefit of this bonus value while occupying premises worth more than he is paying. At the time of transfer, the tenant wants to profit directly from the bonus value by charging consideration for an assignment or higher rent for a sublease. The lessor wants to use the transfer as an event which brings the profit from the increased value to him.

The desire to profit from an appreciation in property is not intrinsically evil or lacking in good faith. Both the lessor and the tenant have a motive to profit from the appreciation. The lessor may make arguments for it. For example, that the tenant should look to his business, not the property, for profit. The tenant may make arguments for it. For example, that the tenant bears the risk of a decrease in rental value so he should have the benefit of an increase. Neither party is intrinsically entitled to that appreciation profit. The benefit of that profit is one to be derived from the bargain made between them.

A lessor who desires the rent to keep pace with the value of the property has always had more effective ways of doing so than to use withholding consent under a "Silent Consent Standard" clause. Rent escalation based on periodic re-appraisals is one way. Rent escalation based on a formula or one of the consumer price indices, although not directly tied to market value of the premises, is another way. A short term lease, either with or without a right of first refusal, will keep bringing the rent up to a market rate. These methods are bargained for and expressly set forth in the lease. The increase in rent and the tenant's loss of bonus value resulting from these methods comes as no surprise to the tenant.

The "Silent Consent Standard" type of clause does not have this characteristic of express disclosure to the tenant. Preventing its use for unanticipated exaction of a profit which has not been bargained for is understandable. It is the surprise

factor, imposed on the tenant's deal without prior negotiation and warning that creates the problem. It is not the profit motive itself that causes the problem.

The cases designed to avoid the silent consent standard surprise should not be extended to prevent the parties from expressly agreeing on a profit to the lessor triggered by a transfer. Such an extension would be economic policy making, i.e., a mandatory transfer of value from the lessor to the tenant at the time of transfer despite an express contrary agreement. It would also lead to incongruous results. The policy would be adopted to protect the profit of tenants. Lessors would probably place more reliance on drafting perfectly acceptable devices to raise the rent more effectively and more frequently. At least with a clause providing for a lessor profit upon transfer, the tenant can control the time when that additional profit to the lessor arises. Also, a tenant may want a "sweetheart" lease with initial rent below market for a particular tenant, but increasing to market upon transfer.[218]

At one extreme is the "Silent Consent Standard" clause involved in the cases which reject the common law and majority view and impose a reasonableness standard. After imposing the reasonableness standard, cases such as Cohen and Kendall typically hold that it is unreasonable to use the clause to extract additional profit. At the other extreme is the "Profit Shift" clause which expressly allows the lessor to participate in profit generated at the time of transfer. This profit is part of

the original bargain. It does not come as a late surprise hit on the tenant. Somewhat in between is the "Express Sole Discretion Consent Standard" type clause. This type of clause does not mislead the tenant into believing that the lessor is subject to a reasonableness standard. It has been held that a lessor can seek to improve, rather than just maintain, his position with this type of clause.[219] However, maybe the "Express Sole Discretion Consent Standard" would be less objectionable to some, and be less subject to litigation, if it could not be used to exact additional profit. This would leave the clause free from the demands and litigation of a reasonableness standard governing other decisions by the lessor. It would leave the parties free to negotiate and expressly provide for lessor profit upon transfer. Such a compromise rule would merely require fair disclosure of future profit entitlements.

XV. THE LOCK-IN REMEDY: C.C. 1951.4.

A. The Remedy Legislation in General.

Section X.E above mentioned certain remedy legislation, adopted in 1970, and discussed the conflicting conclusions the Kendall majority and dissent drew from it. The California Law Revision Commission went through a lengthy and comprehensive

process of reviewing and proposing modifications to common law remedies for tenant breaches.[220] The resulting legislation, with a few changes, is contained in Cal. Civ. Code Sections 1951 through 1951.6.[221] It attempts to eliminate some of the problems with the common law and create remedies which are essentially fair to both the lessor and the defaulting tenant.

The basic plan of the legislation, contained in Section 1951.2, is to have an immediate termination of the lease and an immediate cause of action for damages, including prospective rental loss damages. The contract rule of mitigation of damages is built in by allowing the tenant to prove post-termination rental loss that could have been reasonably avoided by the lessor. The termination of the lease is triggered by either of two situations: (1) the tenant breaches and abandons the premises; or, (2) the tenant breaches and the lessor terminates the tenant's right to possession of the premises.[222]

According to the basic remedy, the tenant can unilaterally trigger a termination of the lease by breach and abandonment. The lessor is given the opportunity to prevent this termination and provide for a lock-in remedy by Section 1951.4. If the lease specifically provides for the remedy and this section is complied with, the lessor can lock-in the lease, that is, keep the lease in effect and continue to enforce its provisions. Relief is provided to the locked-in tenant by requiring that the lease permit the tenant to assign or sublet (or both), subject only to reasonable restrictions.

Certain agreements which are often called leases, but which have unique characteristics, are exempt from the application of the remedies legislation.[223] For example, an agreement for exploration for or removal of natural resources is more in the nature of a profit a prendre than a lease and is exempt. There does not appear to be a strong reason to remove the exemption and subject those transactions to the recommendations below.

B. Effect of C.C. 1951.4 on Bargaining Over Leasehold Transfer Restriction.

One of the concerns expressed over allowing an "Express Sole Discretion Consent Standard" or an "Absolute Prohibition" type of clause is the lessor's bargaining power. Section 1951.4 gives the tenant a built-in edge with leasehold transfer restrictions. The lock-in remedy is a valuable option for the lessor, and he can have it only if the lessor subjects himself to the reasonableness standard. Neither the "Express Sole Discretion Consent Standard" nor the "Absolute Prohibition" clause would qualify for the lock-in remedy.

C. Specific Applications of C.C. 1951.4.

The lock-in is available under section 1951.4(b) only "if the lease permits" the tenant to do any of the following:

(1) Sublet, assign, or both.

(2) Sublet, assign, or both, subject to "standards or conditions", and the lessor does "not require compliance with" any "unreasonable" standard or condition.

(3) Sublet, assign, or both, "with the consent of the lessor", and "the lease provides" that consent "shall not unreasonably be withheld."

Suppose a lease does not restrict the tenant's right to assign or sublet. The tenant is automatically allowed to assign or sublet, without restriction and without obtaining the lessor's consent. Thus, if nothing is said one way or the other about leasehold transfers in the lease, the tenant is permitted to assign or sublet. Does the phrase "if the lease permits" in the introductory language of section 1951.4(b) indicate that the permission must be stated in the lease? Logically, express language of permission should not be required since the tenant receives the intended freedom to transfer whether an express clause is present or not. It can be argued that the "lease permits" if it does not prohibit. However, it would be helpful to clarify the language.

Suppose a lease contains a "Silent Consent Standard" clause which requires the lessor's consent but does not expressly state a standard governing consent. Application of the Kendall decision will impose a reasonableness standard on the lessor, even though one is not expressed in the lease. Subsection (3) of 1951.4(b) is satisfied only if "the lease provides" that consent shall not be

unreasonably withheld. Under the Kendall rule, the lessor cannot unreasonably withhold consent even if the lease does not so provide. The tenant receives the benefit of the required transfer freedom whether the reasonableness standard is express or implied. Since the purpose of the statute is satisfied in either case, the lessor should have the benefit of the lock-in remedy in either case.

Suppose a lease contains specific requirements or conditions that must be met for a permissible transfer, for example, the "Express Specific Requirements" type clause. Subsection (2) of 1951.4(b) mandates that the lessor "not require compliance" with any "unreasonable" standard or condition. The tenant should have the burden of proving that the particular requirement is unreasonable at the time and in the manner it is applied. This would be consistent with cases involving the reasonableness standard generally.[224] It would be consistent with the placement of the burden of proving reasonably avoidable rent loss on the tenant by section 1951.2. It would also be a realistic recognition of the fact that it is the tenant's fault, a breach of the lease, that sets the whole process in motion.

Suppose a lease contains specific requirements which are reasonable at the time they are included in the lease, but later circumstances make application of one or more of the requirements unreasonable. The fact that a standard or condition becomes unreasonable after execution of the lease should not prevent the lessor from using the lock-in remedy if he does not require

compliance with the unreasonable requirement. This position is expressed in the California Law Revision Commission comment on section 1951.4. The language of subsection (2) to 1951.4 can be construed to adopt this position. It requires that the lessor "not require compliance with" any unreasonable standard or condition. However, the language could more clearly express that position.

Suppose that one clause or part of a clause allows the tenant to transfer subject only to reasonable limitations if, but only if, the lessor is exercising the lock-in remedy in section 1951.4. Suppose further that another clause or part of a clause contains an expressly agreed provision which either absolutely prohibits transfer or gives the lessor the sole discretion to consent or object to transfer in all other circumstances. A form of clause presented in a lease practice book published by the California Continuing Education of the Bar appears to be setting up this type of combination. One of the remedy provisions states: "After Tenant's default and for as long as Landlord does not terminate Tenant's right to possession of the premises, if Tenant obtains Landlord's consent Tenant shall have the right to assign or sublet its interest in this lease...Landlord's consent to a proposed assignment or subletting shall not be unreasonably withheld."[225] The comment to the clause mentions that it is unclear whether this clause in combination with an "Absolute Prohibition" will work to preserve the lock-in remedy, but opines that "such an arrangement probably is permitted."[226]

Does this type of combination, which allows transfer under the reasonableness standard only if and when the lock-in is exercised, comply with section 1951.4? The statute is unclear on this point. On the one hand, it can be argued that the purpose of the statute is satisfied by the combination. The tenant is given the freedom to transfer when he needs it, at the time of the lock-in. On the other hand, allowing such a provision eliminates any benefit the section would give a tenant in bargaining for a reasonableness standard governing all transfers.

Suppose a lease contains a "Possession Recovery" clause. It gives the lessor the option to recover possession of the property if the tenant wishes to transfer. If the tenant has breached the lease, the exercise of such a right would terminate the tenant's right to possession and result in termination of the lease.[227] Thus, the actual exercise of such a provision lets the tenant out from under the lock-in remedy. The unexercised existence of such a clause in the lease does not prejudice the tenant's relief under section 1951.4, so it should not prejudice the lessor's remedy under that section.

Suppose a lease contains a "Profit Shift" clause. It allows the lessor to receive part or all of the profit generated by the tenant's leasehold transfer. The tenant's relief provided in section 1951.4 is designed to minimize the tenant's losses after a breach and abandonment. It is not designed to assure that the tenant will profit from appreciated value of the leasehold. The

existence or exercise of such a clause should not prevent the lessor from exercising the lock-in remedy.

XVI. RESIDENTIAL LEASES.

This study is limited to commercial leases. However, certain general observations can be made.

The Kendall decision specifically refrained from deciding whether its opinion extended to residential leases.[228] It is interesting to note that of the four statutes referred to by the court as imposing a reasonableness standard on lessors, three apply to residential only and the fourth applies to residential and other types of leases.[229] Kendall relied heavily on the Wellenkamp loan security case in reaching its conclusion, and that case involved residential property. The typical duration characteristics of a residential loan and a residential lease are, however, quite different.

None of the California cases has dealt specifically with a residential lease. However, the court in the Schweiso case while using good faith and fair dealing to impose a reasonableness standard on a commercial lessor, commented that "(a)pplying the covenant of good faith and fair dealing to residential leases appears to be both logical and inevitable."[230] There is no clearcut pattern in the out of state cases since most of them involve commercial leases. The attitude of courts is probably

best summed up by this comment in a Florida case: "Although we see no significant difference between a residential lease and a commercial lease as to the obligations of good faith and commercial reasonableness, we are presented only with a business lease and, therefore, adopt the narrow holding."[231]

There are clearly strong consumer protections involved when dealing with housing.[232] It has been argued that the common law and majority rule operates unfairly on residential tenants when there is a housing shortage, and that implication of a sole discretion standard into the "Silent Consent Standard" clause does not meet the reasonable expectations of a residential tenant.[233] However, a residential tenant does not typically expect to reap a benefit from an increase in the rental value of the premises. Transferability of the leasehold is an important economic factor to a commercial tenant, and one that is usually considered at the time of entering a commercial lease. A residential tenant is not typically concerned about transfer restrictions at the time of entering into a lease, and thus does not actively bargain over them.[234] In addition, residential tenants seldom retain counsel to advise and negotiated for them.

Residential leases are typically short or monthly tenancies. The tenant has a shorter term and less reason to be concerned about needing to transfer a significant leasehold. A residential restraint is usually of a shorter duration than a commercial one. On the other hand, it might be argued that the lessor can recover the premises in a short time so he does not need as much control

in the interim. A rent control jurisdiction which strictly limits the lessor's ability to terminate a tenancy, or ability to decline to renew it, dramatically changes the potential term of a residential lease.

There seems little reason not to imply a reasonableness standard into a "Silent Consent Standard" clause. This would probably conform to the expectations of most residential tenants. It would require an express agreement in the lease if the lessor wants to depart from that standard. The tougher question is whether to allow an expressly agreed departure from the reasonableness standard in residential leases.

One's attitude toward transfer restrictions in a residential lease can shift dramatically depending on the nature of the transaction. Suppose you have a nice single family residence which has served as your family nest since you personally designed and built it. It is filled with unique furnishings collected over the years. You have been temporarily transferred or you are planning an extended trip and need to rent your home, furnished, to provide income for loan payments, taxes, insurance and maintenance. You select your tenant according to your own personal standards, preferences and instincts. Should you be required to have a "commercially reasonable objection" to prevent a transfer by this tenant? On the other hand, suppose that a major apartment development and management company owns hundreds of virtually identical apartment units throughout the state, with

professional on-site management and security. Do you mind imposing a reasonableness standard on that lessor?

The Restatement recognizes the distinction between these two situations when applying a reasonableness standard,[235] Perhaps more flexibility in discretion than that provided by the reasonableness standard is needed in some residential situations. In some situations the lessor, as well as the tenant, may be considered to be in need of consumer protection. There are a variety of situations where legislation has made a distinction between one to four unit residential transactions and other residential transactions. This would cover the hypotheticals posed above, and it might be a reasonable compromise distinction.

XVII. SUMMARY OF CONCLUSIONS.

A. Relating to Commercial Lease Transfer Restrictions.

The following conclusions are based on the assumption that, although they are not necessarily equal in bargaining power, the parties are not involved in a contract which would be invalidated in whole or part under the adhesion doctrine in California.

1. The freedom of the parties to negotiate and contract concerning restrictions on leasehold transfers should be

preserved unless there is a compelling public policy reason to interfere.

2. Disclosure of restrictions by express provisions should be encouraged in order to provide clear expectations for the parties.

3. A tenant may freely transfer unless the lease imposes a restriction.

4. Restrictions on leasehold transfers are permitted but strictly construed. Ambiguities are construed in favor of transferability.

5. A "Silent Consent Standard" clause is one which requires the lessor's consent to a leasehold transfer by a tenant, but which does not contain an express standard governing the lessor's consent. The clause does not expressly state that the lessor is subject to a reasonableness standard nor does it expressly state that the lessor has the freedom of a sole discretion standard.

The traditional common law and majority view holds that the lessor is free to use subjective sole discretion in withholding consent. There are several recent out of state cases which imply into this type of clause a reasonableness standard to govern the lessor. These cases still represent a minority view but might be considered to indicate a trend. However, there are

also some recent cases which decline to adopt the minority view. The Restatement of Property, Second, implies a reasonableness standard into this type of clause. The California Supreme Court, in Kendall v. Pestana, adopted the minority view and implied a reasonableness standard into this type of clause.

The implication of a reasonableness standard into the "Silent Consent Standard" clause is justified by public policy. However, careful consideration should be given to the possibility of unfairness resulting from the retroactive application of this rule.

6. An "Express Reasonableness Standard" clause is one which requires the lessor's consent to a leasehold transfer by the tenant, and which by express agreement of the parties imposes a standard of reasonableness on the lessor.

The common law and majority view, the minority view, and the Restatement of Property, Second, consider this type of clause valid.

If the reasonableness standard is complied with, this clause does not violate the covenant of good faith and fair dealing and it does not violate the rule against restraints on alienation.

7. An "Express Sole Discretion Standard" clause is one which requires the lessor's consent to a leasehold transfer by the tenant, and which by express agreement of the parties gives the

lessor the sole discretion to refuse consent. An "Absolute Prohibition" type clause is one in which express agreement of the parties absolutely prohibits leasehold transfers by the tenant.

The common law and majority view consider these types of clauses valid. There is no trend of holdings in out of state cases rejecting this view. The clauses are valid according to the Restatement of Property, Second, if "freely negotiated." Although there is some language in Kendall criticizing the common law and majority view in general, the holding of that case does not prevent the use of such clauses.

Public policies do not justify prohibiting the freedom to contract for these types of clauses. The Restatement position presents a fair balance between policy and freedom of contract. However, the phrase "freely negotiated" should be clarified.

It is unlikely that a tenant in a freely negotiated long term lease would agree to this type of restriction for the full term. Thus, negotiations usually take care of avoiding such a long term sole discretion or absolute prohibition restriction. However, there may be concern that such restrictions on a lease term approaching fee simple characteristics could cause substantial adverse consequences. If this is a realistic concern, it could be solved by a time limit after which a mandatory reasonableness standard would govern the lessor. A time limit would be a more direct solution than an absolute prohibition of such clauses in all leases, regardless of term. The particular time chosen for the limit would, however, be largely arbitrary.

Note: the "Sole Discretion Standard" and "Absolute Prohibition" type clauses do not comply with Cal. Civ.Code Section 1951.4, so the lessor would not be able to use the lock-in remedy provided in that section.

8. The recent litigation over this area of the law has been generated in large measure by lessors' attempts to "sweeten," rather than preserve, the deal made in the lease. The lessor's demand comes as an apparent surprise at the time of the proposed transfer. Consideration should be given to requiring an express lease clause to support a lessor's demand for participation in bonus value profit by increase in rent or otherwise. If the express provision is present, it has been negotiated and provided for at the time the lease is entered into. The express provision converts the demand from a surprise into one of the reasonable expectations of the parties

9. Specific standards or conditions for a leasehold transfer by the tenant, expressly agreed to by the parties in the lease, should be presumed to be reasonable. If there is a later dispute over reasonableness, the tenant should have the burden of proving that the challenged standard or condition is unreasonable at the time and in the manner it is applied.

10. A lessor's right to elect to recover possession of the premises when a tenant proposes a leasehold transfer, expressly

agreed to by the parties in the lease, should not be considered an unreasonable restraint on alienation nor a violation of the covenant of good faith and fair dealing.

11. A lessor's right to receive part or all of the profit generated by a leasehold transfer by a tenant, expressly agreed to by the parties in the lease, should not considered an unreasonable restraint on alienation nor a violation of the covenant of good faith and fair dealing.

B. Relating to the Lock-In Remedy in C.C. 1951.4

Cal. Civ. Code Section 1951.4 allows the lessor to keep the lease in effect and enforce its terms after the tenant has breached the lease and abandoned the premises. However, this remedy is available only "if the lease permits" the tenant to make a leasehold transfer subject only to reasonable limitations. The following conclusions relate to that code section.

1. If a lease does not restrict transfer, the tenant is automatically free to assign or sublet without the lessor's consent. It should not be necessary to expressly grant the right to assign or sublet in order to comply with section 1951.4.

2. If a lessor's consent is subject to an implied reasonableness standard (e.g. a "Silent Consent Standard" clause

above), it should be considered in compliance with the requirements of section 1951.4. It should not be necessary to have the reasonableness standard expressed in the lease.

3. For purposes of compliance with section 1951.4, specific requirements or conditions for a leasehold transfer by the tenant, expressly agreed to by the parties in the lease, should be presumed to be reasonable. An example is the "Express Specific Requirements" type of clause. If there is a later dispute over reasonableness, the tenant should have the burden of proving that a particular standard or condition is unreasonable at the time and in the manner it is applied.

4. It is possible that a particular requirement or condition, although reasonable at the time of entering the lease, becomes unreasonable due to changed circumstances. As long as the lessor does not require compliance with the unreasonable standard or condition, the existence of an unreasonable requirement or condition in the lease should not prevent the lessor from using the remedy in section 1951.4.

5. A lease might provide that the tenant can transfer subject only to reasonable restrictions if, but only if, the lessor is exercising the remedy provided in section 1951.4. In all other respects, the lease provides for a sole discretion standard or an absolute prohibition against transfer. It is not

clear whether this combination is permissible under the present statute. There are competing considerations in resolving the issue, but it should be resolved and clarified.

6. The remedy in section 1951.4 should not be denied to a lessor just because of the presence in the lease of an expressly agreed provision giving the lessor the right to elect to recover possession of the premises when a tenant proposes a leasehold transfer. Note, however, that the exercise of this right would terminate the lease and deny the lessor the lock-in remedy.

7. The remedy in section 1951.4 should not be denied to a lessor just because of the presence in the lease, or the exercise, of an expressly agreed provision giving the lessor the right to receive part or all of the profit generated by a leasehold transfer by a tenant.

1 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 195 Cal. Rptr. 84 (1983).
2 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P.2d 837 (1985).
3 See e.g.: *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505 (1964); *LaSala v. American Sav. & Loan Ass'n.*, 5 Cal. 3d 864, 97 Cal. Rptr. 849 (1971); *Tucker v. Lassen Sav. & Loan Ass'n.*, 12 Cal. 3d 629, 116 Cal. Rptr. 633 (1974); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978); and, *Dawn Investment Co. v. Superior Court*, 30 Cal. 3d 695, 180 Cal. Rptr. 332 (1982).
4 Cal. Civ. Code Secs. 1951-1952.6, except 1951.3 (West 1985); 9 Cal. L. Rev. Comm. Reports 153 (1969).
5 Moynihan, *Introduction to the Law of Real Property* (2d. ed. 1988); 2 *Powell on Real Property*, Sec. 246[1] at 372.92-372.93 (Patrick J. Rohan rev'n. ed. 1986); Rohan, 7 *Current Leasing Law & Techniques*, Sec. 5.01 at 5-4 & 5-5 (1987).
6 *Hartman Ranch Co. v. Associated Oil Co.*, 10 Cal. 2d 232, 73 P.2d 1163 (1937); *Reed v. South Shore Foods, Inc.*, 229 Cal. App. 2d 705, 40 Cal. Rptr. 575 (1964).
7 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 500, 220 Cal. Rptr. 818, 825 (1985); 2 *Powell on Real Property*, Sec. 246[1] at 372.112 (1986).
8 *Peiser v. Mettler*, 50 Cal. 2d 594, 328 P.2d 953 (1958); 2 *Powell on Real Property*, Sec. 246[1] at 372.112 (1986).
9 Cal. Civ. Code Sec. 822 West 1982); 2 *Powell on Real Property*, Sec. 246[1] at 372.94-372.96 (Patrick J. Rohan rev'n. ed. 1986); Rohan, 7 *Current Leasing Law & Techniques*, Sec. 5.01 at 5-5 & 5-6 (1987).
10 Cal. Civ. Code Sec. 1466 (West 1982).
11 *Erickson v. Rhee*, 181 C. 562, 185 P.847 (1919); Moynihan, *Introduction to the Law of Real Property*, 96 (2d. ed. 1988); Rohan, 7 *Current Leasing Law & Techniques*, Sec. 5.01 at 5-5 & 5-6 (1987).
12 Cal. Civ. Code Secs. 1161, 1164 (West 1982) and 1174 (West Supp. 1988).
13 *Cordonier v. Central Shopping Plaza Assocs.*, 82 Cal. App. 3d 991, 147 Cal. Rptr. 558 (1978); *Marchese v. Standard Realty & Development Co.*, 74 Cal. App. 3d 142, 141 Cal. Rptr. 370 (1977).
14 The tenant's interest in the property, which is necessary for privity of estate, ceases upon assignment. Rohan, 7 *Current Leasing Law & Techniques*, Sec. 5.01 at p. 5-4 & 5-5 (1987).
15 *Reed v. South Shore Foods, Inc.*, 229 Cal. App. 2d 705, 40 Cal. Rptr. 575 (1964).
16 *Gilman v. Nemetz*, 203 Cal. App. 2d 81, 21 Cal. Rptr. 317 (1962).
17 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, fn. 2 at 492, 220 Cal. Rptr. 818, fn. 2 at 820 (1985).
18 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 325, 195 Cal. Rptr. 84, 85-86 (1983); *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, fn. 5 at 494, 220 Cal. Rptr. 818, fn. 5 at 821 (1985).
19 *F & L Center Co. v. Cunningham Drug Stores*, 19 Ohio App. 3d 72, 19 Ohio B.R. 156, 482 N.E.2d 1296 (1984).
20 See e.g. Cal. Civ. Code Sec. 51 (West Supp. 1988).
21 *John Hogan Enterprises, Inc. v. Kellogg*, 187 Cal. App. 3d 589, 231 Cal. Rptr. 711 (1986).
22 *1987 Percentage Lease Rates*, The Mortgage and Real Estate Executives Report, Vol. 20, No. 1, p. 8 (March 1, 1987).
23 Cal Rev. & T. Code Sec. 61 (b) & (c) (West Supp. 1988).
24 *Airport Plaza, Inc. v. Blanchard*, 188 Cal. App. 3d 1594, 234 Cal. Rptr. 198 (1987).
25 *Bailey v. Richardson*, 66 Cal. 416 (1885); *Buttner v. Kasser*, 19 Cal. App. 755, 127 P. 811 (1912).
26 Cal. Civ. Code. Sec. 51 (West Supp. 1988).
27 *Schweiger v. Superior Court*, 3 Cal. 3d 507, 516-517, 90 Cal. Rptr. 729, 734-735

(1970).

28 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 494, 220 Cal. Rptr. 818, 822 (1985); Annot., 21 A.L.R.4th 188, 191 (1983).

29 *Id.* 40 Cal. 3d 488, at 502, 220 Cal. Rptr. 818, at 826 (1985).

30 *Id.* 40 Cal. 3d 488, at 500, 220 Cal. Rptr. 818, at 825 (1985).

31 A lessor's refusal based on financial stability of the third party has been held unreasonable when the original tenant offers to act as guarantor. *Adams, Harkness & Hill, Inc. v. North East Realty Corp.*, 361 Mass. 552, 281 N.E.2d 262, 54 A.L.R.3d 673 (Mass. 1972).

32 *John Hogan Enterprises, Inc. v. Kellogg*, 187 Cal. App. 3d 589, 231 Cal. Rptr. 711 (1986).

33 *Lippman v. Sears, Roebuck & Co.*, 44 Cal. 2d 136, 280 P.2d 775 (1955).

34 *Mattei v. Hopper*, 51 Cal. 2d 119, 330 P.2d 625 (1958).

35 *Id.* 51 Cal. 2d 119, at 123.

36 *Funk v. Funk*, 102 Idaho 521, 633 P.2d 586 (1981).

37 *Id.* 633 P.2d 586, at 591.

38 See Study Section IV.

39 *Rowe v. Great Atlantic & Pacific Tea Company*, 46 N.Y. 2d 62, 412 N.Y.S. 2d 827, 385 N.E. 2d 566 (1978).

40 Moynihan, *Introduction to the Law of Real Property*, p. 32 (2d. ed. 1988); 2 *Powell on Real Property*, Sec. 246[1] at p. 372.97 (Patrick J. Rohan rev'n. ed 1986).

41 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 494, 220 Cal. Rptr. 818, 821 (1985); 2 *Powell on Real Property*, Sec. 246[1] at 372.100-372.104 (Patrick J. Rohan rev'n. ed. 1986).

42 *Richardson v. La Rancherita*, 98 Cal. App. 3d 73, 159 Cal. Rptr. 285 (1979); *Ser-Bye Corp. v. C.P. & G. Markets* 78 Cal. App. 2d 915, 179 P.2d 342 (1947).

43 *Stratford Co. v. Continental Mortgage Co.*, 74 Cal. App. 551, 241 P. 429 (1925).

44 Annot., 21 A.L.R.4th 188, Secs. 2 & 3 (1983).

45 2 *Powell on Real Property*, Sec. 246[1] at 372.97 (Patrick J. Rohan rev'n. ed. 1986).

46 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 496, 220 Cal. Rptr. 818, 822 (1985).

47 *Id.* 40 Cal. 3d 488, at 496, 220 Cal. Rptr. 818, at 822.

48 *Homa-Goff Interiors, Inc. v. Cowden*, 350 So. 2d 1035 (Alabama 1977).

49 *Hendrickson v. Freericks*, 620 P.2d 205 (Alaska 1981).

50 *Warmack v. Merchants Nat'l Bank of Fort Smith*, 272 Ark. 166, 612 S.W.2d 733 (1981).

51 *Fernandez v. Vazquez*, 397 So. 2d 1171 (Fla. 1981).

52 *Funk v. Funk*, 102 Idaho 521, 633 P.2d 586 (1981).

53 *Jack Frost Sales v. Harris Trust & Sav. Bank*, 104 Ill. App. 3d 933, 433 N.E.2d 941 (1982).

54 *Boss Barbara, Inc. v. Newbill*, 97 N.M. 239, 638 P.2d 1084 (1982).

55 *Shaker Bldg. Co. v. Federal Lime and Stone Co.*, 28 Ohio Misc. 246, 57 Ohio Ops. 2d 486, 277 N.E.2d 584 (1971).

56 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, fn. 9 at 496, 220 Cal. Rptr. 818, fn. 9 at 822-823 (1985).

57 Unreported decision of Court of Appeals of Ohio, Cuyahoga County, App. No. 31451, March 2, 1972. Mentioned in *F & L Center Co. v. Cunningham Drug Stores*, 19 Ohio App.3d 72, 19 Ohio B.R. 156, 482 N.E.2d 1296, 1299 (1984).

58 *F & L Center Co. v. Cunningham Drug Stores*, 19 Ohio App.3d 72, 19 Ohio B.R. 156, 482 N.E.2d 1296 (1984).

59 *Campbell v. Westdahl*, 148 Ariz. 432, 715 P.2d 288 (1985).

60 *Tucson Medical Center v. Zoslow*, 147 Ariz. 612, 712 P.2d 459 (1985).

61 *Basnett v. Vista Village Mobile Home Park*, 699 P.2d 1343 (Colo. App. 1984).

62 See e.g.: *B & R Oil Co. v. Ray's Mobile Homes, Inc.* 139 Vt. 122, 422 A.2d 1267 (1980); *Danpar Associates v. Somersville Mills Sales Room, Inc.*, 182 Conn. 444, 438 A.2d 708 (1980); *Isbey v. Crews*, 55 N.C. App. 47, 284 S.E.2d 534 (1981); *Mann*

Theaters v. Mid-Island Shopping Plaza Co., 94 App. Div. 466, 464 N.Y.S. 2d 793 (1983); *Snortland v. Larson*, 364 N.W.2d 67 (N.D. 1985).

63 See e.g.: *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P.2d 837 (1985); *Funk v. Funk*, 102 Idaho 521, 633 P.2d 586 (1981); *Homa-Goff Interiors, Inc. v. Cowden*, 350 So. 2d 1035 (Alabama 1977).

64 See e.g. *Homa-Goff Interiors, Inc. v. Cowden*, 350 So. 2d 1035, 1041 (Alabama 1977).

65 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 502, 220 Cal. Rptr. 818, 827 (1985).

66 *Id.* 40 Cal. 3d 488, at 502-503, 220 Cal. Rptr. 818, at 827.

67 *Id.* 40 Cal. 3d 488, at 500, 220 Cal. Rptr. 818, at 825-826.

68 *Id.* 40 Cal. 3d 488, at 498-499, 220 Cal. Rptr. 818, 824-825.

69 Restatement Second Property, (*Landlord and Tenant*) Sec. 15.1 (1977).

70 *Id.* Sec. 15.2.

71 *Id.* Comment e. at 102-103.

72 *Id.* Comments b., c. & d. at 101-102.

73 *Chapman v. Great Western Gypsum Co.*, 216 Cal. 420, 14 P.2d 758 (1932); *People v. Klopstock*, 24 Cal. 2d 897, 151 P.2d 641 (1944); *Weisman v. Clark*, 232 Cal. App. 2d 764, 43 Cal. Rptr. 108 (1965).

74 Restatement Second Property, (*Landlord and Tenant*) Sec. 15.2, comment i. at 106 (1977).

75 *Id.* Comment i. at 106.

76 *Id.* Comment i. at 106-107.

77 (West 1982).

78 Cal. Civ. Code Section 5 (West 1982).

79 Moynihan, *Introduction to the Law of Real Property*, 32 (2d. ed. 1988).

80 2 *Powell on Real Property*, Sec. 246[1] at 372.97 (Patrick J. Rohan rev'n. ed 1986).

81 (West 1982).

82 *DeAngeles v. Cotta*, 62 Cal. App. 691 (1923).

83 Kehr, *Lease Assignments: The Landlord's Consent*, 55 Calif. S.B.J. 108, 111 (January, 1980).

84 *DeAngeles v. Cotta*, 62 Cal. App. 691, 695 (1923).

85 Cal. Civ. Code. Sec. 1442 (West 1982).

86 *DeAngeles v. Cotta*, 62 Cal. App. 691, 695 (1923).

87 *Id.* at 695-696.

88 *Id.* at 696.

89 *Kendis v. Cohn*, 90 Cal. App. 41, 265 P. 844 (1928).

90 *Id.* at 66.

91 *Id.* at 66.

92 *Guntert v. City of Stockton*, 43 Cal. App.3d 203, 210-211, 117 Cal. Rptr. 601, 606; Zankel, *Commercial Lease Assignments and the Age of Reason: Cohen v. Ratinoff*, 7 CEB Real Prop. L. Rep. 29 (1984).

93 *Richard v. Degen & Brody, Inc.*, 181 Cal. App. 2d 289, 5 Cal. Rptr. 263 (1960).

94 *Laguna Royale Owners Assn. v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981).

95 Moynihan, *Introduction to the Law of Real Property*, 32 (2d. ed. 1988); 2 *Powell on Real Property*, Sec. 246[1] at 372.97 (Patrick J. Rohan rev'n. ed. 1986).

96 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 195 Cal. Rptr. 84 (1983).

97 *Schweiso v. Williams*, 150 Cal. App. 3d 883, 198 Cal. Rptr. 238 (1984), modified at 151 Cal. App. 3d 776c.

98 *Prestin v. Mobil Oil Corp.*, 741 Fed. 2d 268 (9th Cir., 1984).

99 *Sade Shoe Co. v. Oschin & Snyder*, 162 Cal. App. 3d 1174, 209 Cal. Rptr. 124 (1984).

100 *Hamilton v. Dixon*, 168 Cal. App. 3d 1004, 214 Cal. Rptr. 639 (1985).

101 *Thrifty Oil Co. v. Batarse*, 174 Cal. App. 3d 770, 220 Cal. Rptr. 285 (1985).

102 *Sade Shoe Co. v. Oschin & Snyder*, 162 Cal. App. 3d 1174, 1179, 209 Cal. Rptr. 124, 126 (1984).

103 *Hamilton v. Dixon*, 168 Cal. App. 3d 1004, 1009, 214 Cal. Rptr. 639, 642 (1985).

104 *Id.* 168 Cal. App. 3d 1004, at 1010, 214 Cal. Rptr. 639, at 643.
105 *Thrifty Oil Co. v. Batarse*, 174 Cal. App. 3d 770, 776, 220 Cal. Rptr. 285, 289 (1985).
106 *Id.* 174 Cal. App. 3d 770, at 778, 220 Cal. Rptr. 285, at 291.
107 *Don Rose Oil Co., Inc.*, 160 Cal. App. 3d 752, 760, 206 Cal. Rptr. 670, 674 (1984).
108 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P.2d 837 (1985).
109 *Id.* 40 Cal. 3d 488, fn. 2 at 492, 220 Cal. Rptr. 818, fn. 2 at 820.
110 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824; Cal. Civ. Code Sec. 1925 (West 1985).
111 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824; Cal. Civ. Code Sec. 711 (West 1982).
112 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824; *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978).
113 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824.
114 *Id.* 40 Cal. 3d 488, at 500, 220 Cal. Rptr. 818, at 825.
115 *Id.* 40 Cal. 3d 488, at 501-502, 220 Cal. Rptr. 818, at 826-827.
116 *Id.* 40 Cal. 3d 488, at 502-503, 220 Cal. Rptr. 818, at 827-828.
117 This accounts for the profit motive shared by both lessor and tenant. See Study Section V.C.
118 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 501 & 504-504, 220 Cal. Rptr. 818, 826 & 829 (1985).
119 Cal. Civ. Code Secs. 1951-1952.6, except 1951.3 (eff. July 1, 1971) (West 1985).
120 (West 1985).
121 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 502, 220 Cal. Rptr. 818, 827 (1985).
122 (West 1985).
123 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 510, 220 Cal. Rptr. 818, 832-833 (1985).
124 *Id.* 40 Cal. 3d 488, at 506, 220 Cal. Rptr. 818, at 830.
125 9 Cal. L. Rev. Comm. Reports 153 (1969).
126 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 501, 220 Cal. Rptr. 818, 826 (1985).
127 *Id.* 40 Cal. 3d 488, at 502, 220 Cal. Rptr. 818, at 827.
128 *Id.* 40 Cal. 3d 488, at 501, 220 Cal. Rptr. 818, 827.
129 *Id.* 40 Cal. 3d 488, at 501, 220 Cal. Rptr. 818, at 826.
130 Justices Bird, Grodin, Kaus and Reynoso.
131 Justices Lucas and Mosk.
132 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 501-505, 220 Cal. Rptr. 818, 826-829 (1985).
133 *Id.* 40 Cal. 3d 488, at 499-500, 220 Cal. Rptr. 818, at 825.
134 Restatement Second Property, (*Landlord and Tenant*) Sec. 15.2(2) (1977).
135 *John Hogan Enterprises, Inc. v. Kellogg*, 187 Cal. App. 3d 589, 231 Cal. Rptr. 711 (1986).
136 *Id.* 187 Cal. App. 3d 589, fn. 2 at 592, 231 Cal. Rptr. 711, fn. 2 at 713.
137 *Id.* 187 Cal. App. 3d 589, at 594, 231 Cal. Rptr. 711, at 714.
138 *Northridge Hospital Foundation v. Pic 'N' Save No. 9*, 187 Cal. App. 3d 1088, 1100, 232 Cal. Rptr. 329, 337 (1986).
139 *Airport Plaza, Inc. v. Blanchard*, 188 Cal. App. 3d 1594, 234 Cal. Rptr. 198 (1987).
140 *Id.* 188 Cal. App. 3d 1594, at 1599-1600, 234 Cal. Rptr. 198, at 200-201.
141 *Multiplex Ins. Agency, Inc. v. California Life Ins. Co.*, 189 Cal. App. 3d 925, 235 Cal. Rptr. 12 (1987).
142 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, fn. 11 at 497, 220 Cal. Rptr. 818, fn. 11 at 823 (1985).
143 *Golden State Transit Corp. v. City of Los Angeles*, 660 F.Supp. 571 (C.D. Cal. 1987).
144 *Superior Motels v. Rinn Motor Hotels*, 195 Cal. App. 3d 1032, 241 Cal. Rptr. 487 (1987).
145 (West 1982).

146 *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978); *Tucker v. Lassen Sav. & Loan Ass'n.*, 12 Cal. 3d 629, 116 Cal. Rptr. 633 (1974).
147 Restatement Second Property, (*Donative Transfers*) Intro. note to Part II, p.142 (1983).
148 *Id.* at 142.
149 18 Edw. I, ch. I (1290).
150 For a general discussion of the common law background, see Moynihan, *Introduction to the Law of Real Property*, 1-24 (2d. ed. 1988).
151 Cal. Civ. Code Section 711 (West, 1982).
152 Moynihan, *Introduction to the Law of Real Property* Intro. note to Part II, p.143. See e.g., *Bonnell v. McClaughlin*, 173 Cal. 213, 159 P. 590 (1916); *McCleary v. Ellis*, 54 Iowa 311, 6 N.W. 571 (1880); *Pattin v. Scott*, 270 Pa. 49, 112 A. 519 (1922).
153 6 *American Law of Property*, Sec. 26.19, at p.439 (A. J. Casner ed. 1952).
154 3 Simes & Smith, *The Law of Future Interests*, Sec. 1134 (2d ed. 1956).
155 6 *American Law of Property*, Sec.26.3, at p.413-14 (A. J. Casner ed. 1952)
156 3 Simes & Smith, *The Law of Future Interests*, Sec. 1117 (2d ed. 1956); 6 *American Law of Property*, Sec. 26.3, at p.413 (A. J. Casner ed. 1952). See *Mandelbaum v. McDonell*, 29 Mich. 78, 107 (1874); *Morse v. Blood*, 68 Minn. 442, 443, 71 N.W. 682 (1897). See generally Maudsley, *Escaping the Tyranny of Common Law Estates*, 42 Mo. L. Rev. 355 (1977).
157 *Northwestern Real Estate Co. v. Serio*, 156 Md. 229, 144 A. 245 (1929) (Bond, C. J., dissenting); 3 Simes & Smith, *The Law of Future Interests*, Sec. 1115, at p.8 (2d ed. 1956).
158 Restatement Second Property, (*Donative Transfers*) Intro. note to Chap. 4, at p.158-9 (1983).
159 3 Simes & Smith, *The Law of Future Interests*, Sec. 1115, at p.8. (2d ed. 1956); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978).
160 6 *American Law of Property*, Sec. 26.9, at p.419 (A. J. Casner ed. 1952).
161 6 *American Law of Property*, Sec. 26.15, at p.430 (A.J. Casner ed. 1952). See, e.g., *Cushing v. Spalding*, 164 Mass. 287, 41 N.E. 297 (1895); *Stansbury v. Hubner*, 73 Md. 288, 20 A. 904 (1890).
162 *Robertson v. Simmons*, 322 S.W.2d 476 (Ky. 1959); *Cammack v. Allen*, 199 Ky. 268, 250 S.W. 963 (1963); *Francis v. Big Sandy Co.*, 171 Ky. 209, 188 S.W. 345 (1916).
163 See e.g. *Conger v. Lowe*, 124 Ind. 368, 24 N.E. 889 (1890); *Ford v. Ford*, 230 Ky. 56, 18 S.W.2d 859 (1929); *Lariverre v. Rains*, 112 Mich. 276, 70 N.W. 583. (1897).
164 6 *American Law of Property*, Sec. 26.48, at p.485 (A. J. Casner ed. 1952).
165 Powell, *The Law of Real Property*, Sec. 246(1) at p.372.97 (Patrick J. Rohan rev'n. ed. 1986).
166 Cal. Civ. Code Sec. 5 (West 1982).
167 *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978).
168 See e.g.: *Tucker v. Lassen Sav. & Loan Ass'n.*, 12 Cal. 3d 629, 116 Cal. Rptr. 633 (1974); *LaSala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 97 Cal. Rptr. 849 (1971).
169 *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 949. 148 Cal. Rptr. 379, 382 (1978).
170 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 195 Cal. Rptr. 84 (1983). An earlier case is distinguishable because it involved a condominium development. See Study Section IX.B for a discussion of *Laguna Royale Owners Assn. v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981).
171 *Laguna Royale Owners Assn. v. Darger*, 119 Cal. App. 3d 670, 174 Cal. Rptr. 136 (1981). See Study Sec. IX.B.
172 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 329, 195 Cal. Rptr. 84, 88 (1983).
173 *Id.* 147 Cal. App. 3d 321, fn. 2 at 329, 195 Cal. Rptr. 84, fn. 2 at p.88.

174 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 498, 220 Cal. Rptr. 818, 824 (1985).
175 *Id.* 40 Cal. 3d 488, at 499, 220 Cal. Rptr. 818, at 825.
176 *Id.* 40 Cal. 3d 488, at 499-500, 220 Cal. Rptr. 818, at 825. See the discussion of the Restatement position in Study Section VIII.
177 See Study Sections VII.B & VIII.
178 *The Los Angeles Business Journal*, January 11, 1988, at p.15.
179 *Keys v. Romley*, 64 Cal. 2d 396, 406-407, 50 Cal. Rptr. 273, 279 (1966).
180 *Chapman v. Great Western Gypsum Co.*, 216 Cal. 420, 14 P.2d 758 (1932); *People v. Klopstock*, 24 Cal. 2d 897, 151 P.2d 641 (1944); *Weisman v. Clark*, 232 Cal. App. 2d 764, 43 Cal. Rptr. 108 (1965).
181 6 *American Law of Property*, Sec. 26.9, at 419 (A.J. Casner ed. 1952); Restatement Second Property, (*Landlord and Tenant*) Sec. 15.2, comments b., c. & d. and note 4 (1977).
182 "If it ain't broke, don't fix it." Source unknown.
183 See Study Section VIII.
184 Cal. Civ. Code Secs. 717-719 (West 1982).
185 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 500, 220 Cal. Rptr. 818, 825 (1985).
186 *Id.* 40 Cal. 3d 488, at 500, 220 Cal. Rptr. 818, at 825. See also: *Seaman's Direct Buying Services, Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 206 Cal. Rptr. 354 (1984); Restatement Second Contracts, Sec. 205 (1982).
187 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824; Cal. Civ. Code. Sec. 1925 (West 1985).
188 *Id.* 40 Cal. 3d 488, at 500, 220 Cal. Rptr. 818, at 825. See also *Seaman's Direct Buying Services, Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 206 Cal. Rptr. 354 (1984).
189 Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, 373 (1980).
190 *Lippman v. Sears, Roebuck & Co.*, 44 Cal. 2d 136, 280 P.2d 775 (1955). *Cousins Inv. Co. v. Hastings Clothing Co.*, 45 C.A. 2d 141, 149, 113 P.2d 878. See also *First American Bank & Trust v. Safeway Stores, Inc.*, 729 P.2d 938 (Ariz. 1986).
191 *Commercial Union Assurance Companies v. Safeway Stores, Inc.*, 26 Cal. 3d 912, 918, 164 Cal. Rptr. 709, 712 (1980).
192 *Seaman's Direct Buying Services, Inc. v. Standard Oil Co.*, 36 Cal. 3d 752, 769, 206 Cal. Rptr. 354, 363 (1984).
193 Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 Harv. L. Rev. 369, at 379 (1980). *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 188 N.E. 163 (1933).
194 *VTR v. Goodyear*, 303 F. Supp. 773 (S.D. New York, 1969).
195 *Id.* at 777-780.
196 See Study Section VI.B.
197 See Study Section VIII.
198 Restatement Second Property (*Landlord and Tenant*) Sec. 15.2 (1977).
199 *Id.* Comment i. at p. 106.
200 See e.g.: Witkin, *Summary of California Law, Contracts*, Contracts §§ 23-36 & 743-752 (9th edition, 1987).
201 Cal. Civ. Code Section 1671(b) (West 1985).
202 *Richard v. Degen & Brody, Inc.*, 181 Cal. App. 2d 289, 5 Cal. Rptr. 263 (1960).
203 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, 195 Cal. Rptr. 84 (1983).
204 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 511, 220 Cal. Rptr. 818, 833 (1985).
205 *Id.* 40 Cal. 3d 488, at 498, 220 Cal. Rptr. 818, at 824; *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978). *Wellenkamp* was given only limited retroactivity. It was not applied when, prior to the date the decision became final, the lender had enforced the clause by forclosure, or waived enforcement in return for a modification agreement.
206 *Cohen v. Ratinoff*, 147 Cal. App. 3d 321, fn. 2 at 329, 195 Cal. Rptr. 84, fn. 2 at 88 (1983). When dealing with deeds of trust, distinctions are important. A trustee

under a deed of trust has been distinguished from an ordinary bear. See *Stephens, Partain & Cunningham v. Hollis*, 196 Cal. App. 3d 948, 955 (particularly fn. 4), 242 Cal. Rptr. 251, 255 (1987).

207 *LaSala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 97 Cal. Rptr. 849 (1971).

208 Note, *Effect of Leasehold Provisions Requiring The Lessor's Consent to Assignment*, 21 Hastings L.J. 516, 519 (1970).

209 Kehr, *Lease Assignments: The Landlord's Consent*, 55 Calif. S.B.J. 108 (January, 1980).

210 *Kendall v. Ernest Pestana, Inc.*, 209 Cal. Rptr. 135, 136 (1984). (Note that this decision was vacated by the California Supreme Court: 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P.2d 837 (1985).)

211 *Hamilton v. Dixon*, 168 Cal. App. 3d 1004, 214 Cal. Rptr. 639 (1985). (Note that this case has been disapproved by the California Supreme Court: *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, 220 Cal. Rptr. 818, 709 P.2d 837 (1985).)

212 *Thrifty Oil Co. v. Batarse*, 174 Cal. App. 3d 770, 220 Cal. Rptr. 285 (1985).

213 *Commercial Real Property Lease Practice*, Section 3.110, at p. 159 (CEB, 1975).

214 See e.g.: 42 Cal. Jur. 3d, *Landlord and Tenant*, § 202 (1978); Miller & Starr, 4 *Current Law of California Real Estate*, Sec. 27:92 at p. 416.

215 *B & R Oil Co. v. Ray's Mobile Homes, Inc.* 139 Vt. 122, 422 A.2d 1267 (1980); *Campbell v. Westdahl*, 148 Ariz. 432, 715 P.2d 288 (1985); *Fernandez v. Vazquez*, 397 So. 2d 1171 (Fla, 1981); *Funk v. Funk*, 102 Idaho 521, 633 P.2d 586 (1981); *Herlou Card Shop, Inc. v. The Prudential Insurance Company of America*, 73 App. Div. 2d 562, 422 N.Y.S.2d 708 (1979); *Illinois C.G.R. Co. v. International Harvester Co.*, 368 So. 2d 1009 (La., 1979); *Ringwood Asso., Ltd. v. Jack's of Route 23, Inc.*, 153 N.J. Super. 294, 379 A.2d 508 (1977), *aff'd*, 166 N.J. Super. 36, 398 A.2d 1315 (1978).

216 Lessors have referred to the transfer restriction as a "license to steal" and to a demanded transfer fee as "blood money." *Schweiso v. Williams*, 150 Cal. App. 3d 883, 198 Cal. Rptr. 238 (1984), modified at 151 Cal. App. 3d 776c.

217 *John Hogan Enterprises, Inc. v. Kellogg*, 187 Cal. App. 3d 589, 231 Cal. Rptr. 711 (1986).

218 *In Re J.F. Hink & Son (Cukierman v. Mechanic's Bank)*, 815 F.2d 1313 (9th Cir. 1987).

219 *Illinois C.G.R. Co. v. International Harvester Co.*, 368 So. 2d 1009, 1015 (La., 1979); *B & R Oil Co. v. Ray's Mobile Homes, Inc.* 139 Vt. 122, 422 A.2d 1267 (1980); *Herlou Card Shop, Inc. v. The Prudential Insurance Company of America*, 73 App. Div. 2d 562, 422 N.Y.S.2d 708 (1979).

220 8 Cal. L. Rev. Comm. Reports 701 (1967); 9 Cal. L. Rev. Comm. Reports 153 (1969).

221 (West 1985.) Present Cal. Civ. Code Sec. 1951.3 was not part of the original legislation.

222 Cal Civ. Code Sec. 1951.2(a).

223 Cal. Civ. Code Sections 1952.4 (natural resource removal) & 1952.6 (public entity bond projects) (West 1985).

224 See e.g.: *Funk v. Funk*, 102 Idaho 521, 633 P.2d 586 (1981); Restatement Second Property (*Landlord and Tenant*) Sec. 15.2, Comment G at p. 105; Miller & Starr, 4 *Current Law of California Real Estate*, Sec. 27:92 at p. 416-417 (1977) and fn. 17 at p. 439 of 1987 supp.

225 *Commercial Real Property Lease Practice*, Sec. 3.117, at p. 164 (Cal CEB, 1975).

226 *Id.* at 165. For a contrary view see Zankel, Commercial Lease Assignments and the Age of Reason: Cohen v. Ratinoff, 7 CEB Real Prop. L. Rep. 29, 34 (1984)

227 Cal Civ. Code Sec. 1951.2 (a) (West 1985).

228 *Kendall v. Ernest Pestana, Inc.*, 40 Cal. 3d 488, fn. 1 at p. 492, 220 Cal. Rptr. 818, fn. 1 at p. 820.

229 *Id.* 40 Cal. 3d 488, fn. 13, at p. 499, 220 Cal. Rptr. 818, fn. 13, at p. 825.

230 *Schweiso v. Williams*, 150 Cal. App. 3d 883, fn. 3, at p. 886, 198 Cal. Rptr. 238, fn. 3,

at p. 840 (1984), modified at 151 Cal. App. 3d 776c.

231 *Fernandez v. Vazquez*, 397 So. 2d 1171, fn. 8, at p. 1174 (Fla, 1981).

232 For example, see the distinction between a commercial and a residential transaction with respect to a liquidated damages clause in Cal. Civ. Code Sec. 1671 (West 1985).

233 Note, *Effect of Leasehold Provisions Requiring The Lessor's Consent to Assignment*, 21 Hastings L.J. 516 (1970).

234 Rohan, 7 *Current Leasing Law & Techniques*, Sec. 5.01 at p. 5-10.1 (1987).

235 Restatement Second Property (*Landlord and Tenant*) Sec. 15.2, comment g. & illus. 8 at p. 105-106 (1977).