New York Law Journal
Real Estate Trends
WWW.NYLJ.COM
An ALM Publication
VOLUME 264—NO. 30
WEDNESDAY, AUGUST 12, 2020

TRANSACTIONAL REAL ESTATE

Anti-Assignment Provisions in Leases


By **Allen M. Wieder**
And **Salvatore Gogliormella**

Real estate practitioners are frequently asked to opine on whether particular corporate transactions violate lease provisions that are intended to restrict assignments and changes in control of the tenant. Typically, parties are permitted to freely transfer contractual rights without obtaining permission from their counterparties. However, leases commonly contain provisions restricting assignment, subletting and changes in control. These restrictions will be enforced, but will be construed as restraints on alienation which are to be narrowly construed.

Absent specific provisions restricting stock transactions or mergers, courts generally will not interpret common anti-assignment provisions as prohibiting the transfer of equity interests in either the entity burdened by the provision or any parent entities.

Similarly, restrictions on transfers of interests in the tenant that do not expressly cover a so-called "upper tier" transfer of interests in parent or ancestor entities above the level of the tenant are typically not read to restrict the upper tier transfers. Where the transaction consists of equity transfers, applicable anti-assignment covenants like other restraints on alienation will be construed strictly against the restriction.

In a 2019 decision in *Triple R Associates v. Checkers Drive-In Restaurants*, No. CV 17 888561 (Ohio Ct. of Claims 2019), a state trial court judge in Ohio found that transfers involving a tenant's corporate great-grandparent and great-great-great-grandparent violated the applicable anti-assignment covenant.

While the judge did not explain in her order why she believed that the transactions at issue constituted prohibited assignments under the lease, this decision raised questions about whether there has been an evolution in the way courts are interpreting and enforcing anti-assignment provisions.

> While the result reached by the court raised some questions, 'Checkers' may not really be inconsistent with traditional approaches to interpreting anti-assignment provisions.

The clause being construed in *Checkers* restricted the transfer of any membership interest or effective control of the Tenant. The clause included both specific and broad catch-all terms that the plaintiff landlord argued were clearly and unambiguously meant to cover the kinds of corporate transfers at issue in the case.

Specifically, the clause required landlord consent to the transfer by "sale, assignment, bequest, inheritance, operation of law or other dispositions" that result in "a change in the present effective control of Tenant." The plaintiff maintained that, regardless of how distant the relevant transactions appeared on an organizational chart of the tenant, the effective control of tenant was directly implicated by the transfers because the transactions led to an overhaul of the tenant's entire ownership structure and board.

On the basis of the facts so presented, the court determined that "reasonable minds can come but to one conclusion" and entered judgment for the plaintiff on this claim. The judgment was never appealed—the parties ultimately settled the lawsuit after mediation.

While the result reached by the court raised some questions, *Checkers* may not really be inconsistent with traditional approaches to interpreting anti-assignment provisions. The court may have concluded that, even if the clause at issue were strictly construed, its broad language ("effective control")

ALLEN M. WIEDER *is a counsel and* SALVATORE GOGLIORMELLA *is a partner at Paul, Weiss, Rifkind, Wharton & Garrison LLP. Partner* PETER E. FISCH *and summer associates* CHAD HUGHES *and* YIHAN ZHUANG *assisted in the preparation of this article.*

explicitly covered the particular transactions that occurred (which did in fact result in changes to the tenant's board) and that judgment for the plaintiff was therefore warranted.

Indeed, a review we conducted of the case law in a sampling of states (New York, California, Texas and Illinois) shows that each state continues to take a variation of the approach described above, narrowly interpreting anti-assignment provisions.

New York

While the Court of Appeals has not directly decided this issue, the Appellate Division, trial courts, and the Southern District of New York (applying New York law) have consistently taken a strict approach to construing anti-assignment provisions.

In *Brentsun Realty Corp. v. D'Urso Supermarkets, Inc*., 182 A.D.2d 604, 582 N.Y.S.2d 216 (N.Y. App. Div. 1992), the Second Department interpreted an anti-assignment covenant in a lease that prohibited the assignment of the lease or the disposition or sale of 50 percent or more of the stock of the tenant without written consent.

The court found that the merger of the subsidiary tenant into its parent did *not* violate the covenant because "[t]he merger did not change the beneficial ownership, possession, or control of [tenant's] property or leasehold estate. Only [tenant's] corporate form was affected, not the corporate property. Therefore no assignment or similar transfer of the lease occurred."

In *Cellular Tel. v. 210 East 86th Street Corp.*, 44 A.D.3d 77, 839 N.Y.S.2d 476 (N.Y. App. Div. 2007), the First Department interpreted a clause that prohibited the transfer or other disposition of more than 25 percent of the issued and outstanding capital stock of the tenant. The court found that the acquisition of the tenant's parent company did *not* constitute an assignment for purposes of the clause. "Given the vast web of interlocking ownership between many corporations, it would be unreasonable to read the lease provision as effecting an assignment or transfer whenever some far removed corporate parent is sold, especially when the lease expressly limits the prohibition to capital stock of tenant."

The *Cellular Tel.* court did, however, find that a separate anti-assignment provision was triggered by two mergers—the parent entity's merger with the subsidiary tenant, which resulted in the parent becoming the tenant, and the tenant's follow-on merger with another entity, which was determined to effect an assignment under the lease.

California

California courts have similarly strictly interpreted lease assignment restrictions involving a corporate tenant.

A landlord that has knowledge of a tenant's corporate identity but does not specifically restrict stock transfers in the lease cannot claim that the corporate tenant's stock transaction breached the anti-assignment clause.

In *Ser-Bye Corp. v. C.P. & G. Markets,* Inc., 78 Cal. App.2d 915, 179 P.2d 342 (Cal. App. 1947), a corporate tenant held a lease that contained a restriction against assignment of the lease without landlord's consent. The shares of the tenant corporation were sold and the landlord sued. After acknowledging the equitable rule against forfeitures, the court ruled that the anti-assignment clause was not violated because that clause prohibited only a transfer of the leasehold interest and not a transfer of the ownership of the corporation. In the absence of language in the lease showing "the clear and manifest intention of the parties" to treat the transfer of stock as an assignment, the anti-assignment clause was not violated.

The court in *Richardson v. La Rancherita of La Jolla*, 98 Cal. App. 3d 73, 159 Cal Rptr. 285 (Cal. App. 1979), similarly held that a lease to a corporate tenant restricting assignment, either voluntarily or by operation of law, was not violated by the sale of the corporation's stock. The court of appeals reasoned that there was no violation in the absence of language reflecting an intent to prohibit a change in stock ownership without landlord's consent.

The California courts do not yet seem to have decided any lease assignment restriction cases where changes in control are prohibited but a transfer was made through an indirect or upper-tier entity.

Illinois

Illinois also strictly interprets anti-assignment provisions. Under Illinois law, the general rule is that absent special circumstances, a "change in corporate ownership does not effectuate an assignment of rights." *Ineos Polymers Inc. v. BASF Catalysts*, 553 F.3d 491, 499 (7th Cir. 2009).

In *Transamerica Commercial Finance Corp. v. Stockholder Systems, Inc.,* 1990 U.S. Dist. LEXIS 15275, 1990 WL 186088 (N.D. Il. 1990), a U.S. district court found that a licensee had not violated an anti-assignment provision after a series of mergers and upper-tier transfers. While plaintiffs argued that the transactions violated the transfer restriction, the court held that the anti-assignment provision was not implicated because the agreement "does not prohibit even the licensee (much less the parent … which owns all of the stock of the licensee) from selling its stock".

In *Tyco Lab., Inc. v. Dasi Indus., Inc.,* 1993 U.S. Dist. LEXIS 12654, 1993 WL 356929 (N.D. Ill. 1993), the court held that while a change in control may in certain circumstances violate an anti-assignment provision, a change in control of an upper-tier holding company would not: "The License Agreement provided that a change in controlling ownership of a party to the contract would be considered an assignment, not that a change in controlling ownership of the owner of the party would be so considered."

However, the court in another case, *Pioneer Trust & Sav. Bank v. Zayre Corp.*, 1989 U.S. Dist. LEXIS 10832, 1989 WL 106669 (N.D. Ill. 1989), showed a willingness to collapse multiple steps in a transaction in order to give effect to an anti-assignment clause. The court found that a tenant violated an anti-assignment clause in transferring its lease to a subsidiary and then selling that subsidiary to another company.

The clause in question clearly granted the tenant the right to transfer its lease to a subsidiary, but prohibited the lease from being assigned to unrelated entities. The court found that once the subsidiary was sold to a third party, the original tenant no longer had an interest in the lease in violation of the restriction. The court expressly distinguished language in Section 7:3.3[C][1] of Friedman on Leases stating that a two-step process, like that utilized by Zayre, could be used to circumvent an anti-assignment provision and concluded that the specific language of the lease required a different result.

Texas

Texas courts have recognized the strong policy against forfeiture in the lease context, and have held generally that the sale or transfer of the stock of a corporation does not constitute an assignment, in the absence of express change of control restrictions. Texas courts appear to follow the general approach of strictly construing anti-assignment restrictions.

In *Tenneco, Inc. v. Enterprise Productions Co.,* 925 S.W.2d 640, 39 Tex. Sup. J. 907 (Tex.1996), the Supreme Court of Texas narrowly construed assignment restrictions in the context of a preferential right to purchase. The original owners of a plant had an agreement that provided the owners with a right of first refusal if "any Owner should desire to sell, transfer or assign" its ownership interest.

The defendant purchased all the equity in one of the owners, and the other owners sued to exercise their right of first refusal. In granting summary judgment to the defendant, the Court distinguished a sale of equity from a sale or assignment of assets and noted that the right of first refusal would have been triggered had the parties included a change-of-control provision in the agreement.

In *TXO Prod. Co. v. M.D. Mark, Inc.*, 999 S.W.2d 137, 1999 Tex. App. LEXIS 5581 (Tex. App. 1999), the court cited other jurisdictions' disfavor towards forfeiture in leases, expressed a similar unwillingness to find that a merger breaches a non-assignment clause, and held that a parent-subsidiary merger did not violate an agreement which provided that certain data "shall not be sold, traded, disposed of, or otherwise made available to third parties."

The court cited favorably to *Dodier Realty & Inv. Co. v. St. Louis National Baseball Club, Inc.,* 361 Mo. 981, 238 S.W.2d 321 (Mo. 1951), where the merger of a contractual party into its controlling shareholder was held to not violate the anti-assignment clause in a lease. The court also cited to cases where courts in other jurisdictions were unwilling to find that a merger violated anti-assignment provisions in circumstances including insurance policies, trackage rights, construction contracts, printing contracts, arbitration clauses, non-compete covenants, and employee compensation contracts.

Finally, the court noted that the parties could have easily specified that the non-disclosure provision was implicated by a statutory merger, and the court refused to imply a violation in the absence of that agreement.

As in California, courts in Texas do not yet seem to have decided whether a lease restriction on changes in control of a tenant would be violated by the transfer of an upper-tier entity.

Conclusion

These cases suggest that courts in New York, California, Texas, and Illinois intend to continue to carefully consider and narrowly construe anti-assignment provisions in leases and other corporate transactional documents. The *Checkers* case may have turned on the "effective control" formulation and the fact that the transfer in question resulted in significant changes to board composition.

A lease without this formulation or a transaction without such changes could yield a different result. In addition, not all jurisdictions have determined how to treat upper-tier transfers when not expressly restricted, and individual judges may arrive at seemingly inconsistent conclusions based upon the facts before them. Clarity in negotiating these provisions is paramount in order to leave as little as possible for the courts to interpret in the event of a later conflict.