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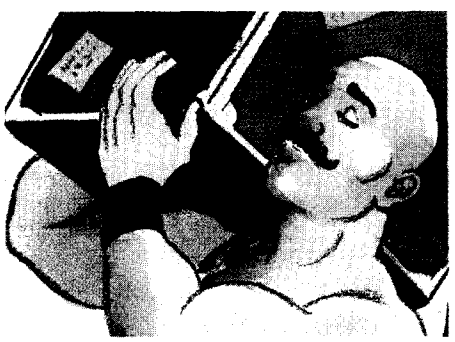

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Probate and Property is aimed at lawyers who devote a large part of their practice to two major areas: real estate law or laws dealing with wills, trusts, and estates. The articles, other editorial matter, and advertisements are intended to provide lawyers with up-to-date, practical information that they can apply to legal questions raised by their clients in these areas of law. The goal of the editors is to print relevant articles and columns that are written in a readable and informative style and that will aid lawyers in giving their clients accurate, prompt, and efficient service.

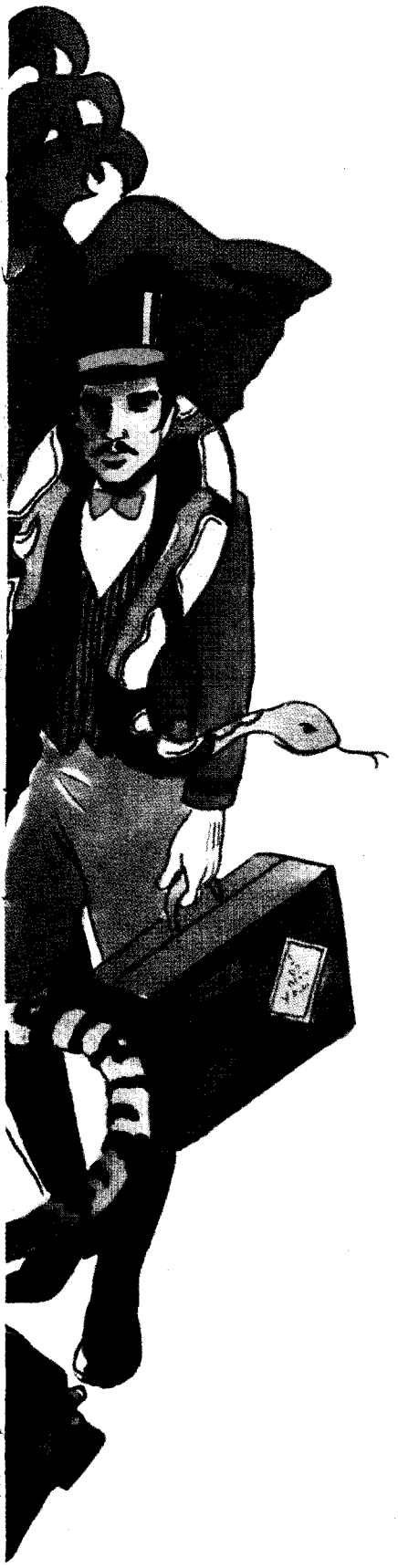

Illustration by PATRICK DILLEY

Commercial Leasing Forum

Lease Assignment and Subletting — Can the Landlord Say No?

By Emanuel B. Halper

The question and answer format of this article takes a different approach to a real property question. Three members of the Section's Real Property Division Commercial Leasing Committee were asked to respond to a series of questions on assignment and subletting of commercial leases in order to bring out the way courts are dealing with the issue in various parts of the country.

A recent California decision held that, when a tenant requests that a landlord consent to a proposed assignment of the leasehold estate, the landlord may not withhold consent unreasonably. We reviewed the case law of many states to see whether the doctrine spread. Three committee members—James W. Creamer Jr., Englewood, California; Eugene L. Grant, Portland, Oregon; and T. Edmund Rast, Charlotte, North Carolina—were asked to answer a series of relevant questions, as follows:

1. If a lease prohibits assignment or subletting completely and the tenant asks the landlord for permission to assign or sublet, is the landlord obliged to be reasonable?

Creamer: Probably no. The law appears to be in Colorado that a prohibition against assignment or subletting will be upheld. In *dictum* the Colorado Court of Appeals stated in *Carleno v. Vollmert Tire Co.*, 540 P.2d 1149 (Colo. 1975) that:

> where a lease requires the consent of the lessor to an assignment or sublease but places no qualification on the right of the lessor to withhold consent, such right is absolute and consent may be withheld arbitrarily by the lessor without creating a breach of the lease.

However, see the discussion at Question 3 below as to whether the Court of Appeals has indicated a potential modification of this doctrine.

Grant: The Oregon Supreme Court has not been called on recently to decide the enforceability of a provision in a commercial lease which would absolutely prohibit assignment or subletting of the tenant's leasehold estate. In the early Oregon case of *Abrahamson v. Brett*, 21 P.2d 229 (OR 1933), the Oregon Supreme Court in *dictum* stated that, where the landlord's consent to assignment is required, it may be arbitrarily withheld at the landlord's discretion. Since that time, a line of cases has developed where a portion of the holding was that a commercial lease is a contract and should be construed according to contract principles including an implied covenant of good faith and fair dealing. See *Wright v. Bauman*, 398 P.2d 119 (OR 1965); *Kulm v. Coast to Coast Stores*, 432 P.2d

1006 (OR 1967); *U.S. National Bank v. Homeland*, 631 P.2d 761 (OR 1981). In each of these cases, the tenant had abandoned the premises and the courts held that the implied covenant of good faith and fair dealing creates an obligation on the part of the landlord to mitigate the damages by using reasonable efforts to relet the premises.

These cases suggest the Oregon Supreme Court would require the landlord to be reasonable in response to a tenant request to assign or sublet a lease even if the lease prohibited assignment and subletting. Under these cases, if, after abandoning the premises, a tenant produced a suitable replacement tenant, the landlord would be required to accept what would be essentially an assignment of the lease to the replacement tenant. It would not make any sense to allow the landlord to unreasonably reject a tendered assignee in a non-default situation when the Oregon law requires the landlord to not unreasonably reject a tendered assignee after a default has occurred by virtue of an abandonment of the premises.

Rast: If a lease prohibits assignment or subletting completely and the tenant asks the landlord for permission to assign or sublet, the North Carolina Court of Appeals (the intermediate appellate court) has held that the tenant is barred from such a transfer if the landlord withholds consent, whether or not the landlord acts reasonably. *Isbey v. Crews*, 284 S.E.2d 534 (NC 1981).

2. Is the rule for assignment and subletting the same?

Creamer: Yes. However, a prohibition against either assignment or subletting, but not both, will not prohibit what is omitted from the lease. *Gordon Investment Co. v. Jones*, 227 P.2d 336 (Colo. 1951) held that the terms "assignment" and "sublease" are not synonymous and the landlord's permission to assign does not include the right to sublease.

Grant: I am unable to find any Oregon cases that make any distinction between assignment and subletting in the question of a landlord obligation to act reasonably.

Rast: The Court of Appeals in *Isbey* indicated, although without discussion, that the above rule would apply both to assignment and subletting restrictions.

3. Would the answer change if the language of the lease is that assignment and subletting is permitted *only if the landlord consents*?

Creamer: Probably. The Colorado Court of Appeals was faced with this issue in *Basnett v. Vista Village Mobile Home Park*, 699 P.2d 1343 (Colo. App. 1984). Assignment of mobile home space without the landlord's consent was prohibited. The court adopted a middle-ground position contained in § 15.2(2) of the Restatement (Second) of Property which states that consent to assignment or subletting cannot be unreasonably withheld unless the lease contains an express statement, freely negotiated between the parties, to that effect.

However, the Colorado Supreme Court reversed the Court of Appeals on other grounds. *Vista Village Mobile Home Park v. Basnett*, 731 P.2d 700 (Colo. 1987). The court found no evidentiary support for a trial court finding that there was unreasonably withheld consent.The court stated specifically that it was not passing on whether the Court of Appeals was correct in adopting the Restatement (Second) of Property position. So we are left with *Carleno* as the only definitive case on the issue where the court fashioned a reasonableness standard out of the facts of that case where consent by the landlord to assignment was required.

Grant: In *Comini v. Union Oil*, 562 P.2d 175 (OR 1977), the Oregon Supreme Court approved the defendant oil company's refusal to consent to the sale by a distributor to a third party of the distributorship agreement. The oil company's consent was expressly required for any sale, but there was no statement in the agreement that consent could not be unreasonably withheld. The court said:

> ... This does not necessarily mean that defendant can arbitrarily refuse to approve a sale ... where no legitimate business interests of consequence to defendant are to be served by such refusal. In every contract there is an implied covenant of good faith and fair dealing.

The court then found the existence of such good reasons. Based on the abandonment cases discussed under the first question and the *Comini* case, my answer to the first question would not change if the lease provided that assignment or subletting is permitted only if the landlord consents.

Rast: The lease at issue in *Isbey* in fact provided that assignment or subletting was permitted only if the landlord consented (i.e., providing for the possibility of landlord consent but not specifically stating such consent might be unreasonably withheld). The court in *Isbey* stated that since the general rule in North Carolina would support a complete prohibition of assignment or subletting, the addition of a provision allowing for landlord consent would not have the effect of imposing a burden of reasonableness on the landlord. The decision in *Isbey* was founded on the long-standing principle in North Carolina that "a court does not insert terms into a contract when the parties have elected to omit such terms." *Isbey*, 284 S.E.2d 534, 537 [citing *Taylor v. Gibbs*, 150 S.E.2d 506 (NC 1966)].

4. Assuming that the landlord is required to be reasonable by virtue of a covenant to be reasonable in the lease or by virtue of statutory or case law, have the cases established criteria to determine what constitutes being reasonable? If so, please indicate the criteria.

Creamer: Yes. Colorado has adopted the prudent man standard. In *List v. Dahnke*, 638 P.2d 824 (Colo. App. 1981) the lease of a retail store prohibited assignment without the landlord's consent. When the primary tenant failed, it sought to assign the lease to a proposed tenant who wanted to operate a Thai food restaurant. The landlord refused to consent to the assignment. Later the landlord sued the original tenant for the unpaid rent under the balance of the lease. That party defended, claiming that the landlord unreasonably refused to consent to the proposed assignment for racial reasons. The trial court held for the landlord, finding the refusal was not unreasonable.

On appeal, the Court of Appeals

adopted the prudent man standard and stated that under the test arbitrary considerations of personal bias, prejudice, taste, convenience or sensibility cannot support a landlord's refusal to consent. However, it upheld the trial court's finding that the landlord's refusal in this case was based upon a belief that a Thai food specialty restaurant would not be successful in a shopping center location.

Grant: One case dealing with abandonment of the premises by the tenant and the landlord's obligation to mitigate damages addressed the criteria governing who the landlord must accept in order to have reasonably mitigated the damages. In my opinion, the criteria applicable in the mitigation of damages context will be equally applicable in the assignment and subletting context. In *Foggia v. Dix*, 509 P.2d 412 (OR 1973), dental offices were vacated by the lessee. The offices were part of a larger dental clinic occupied by two other dentists and designed for that special use. The court held that the lessor was not required to rent the premises to persons not working in dentistry or related fields or at a rent less than the fair rental value for the premises. The court said:

> In order to mitigate the damages occasioned by a lessee's breach of a lease, the landlord should not be required to substantially alter his obligations as established in the preexisting lease.

This holding suggests that in Oregon a landlord reasonably could withhold consent to a proposed assignment or subletting if any change of use is involved.

The court may have overstated its holding to some extent. If the tenant had procured a replacement tenant such as an orthodontist or perhaps an optometrist who could use the premises in their original condition without major alteration, the court might have reached a different result. The key word here is "substantially" alter the lessor's obligations. The court said, "Thus in the present case plaintiff was not required to rent the premises to persons not working in dentistry or related fields, since the offices were part of a dental clinic occupied by two other dentists and were designed for that special use." It is possible in the future that the Oregon Supreme Court might interpret "related fields" quite broadly. For the present, however, the *Foggia* case gives strong support for the position that a landlord can withhold consent to an assignment or subletting that would involve a change of use which the landlord in good faith believes would be detrimental to its property.

Rast: If the landlord is required to be reasonable by virtue of a covenant to that effect in the lease, the North Carolina rule is that the standard is the action of a reasonable man in the landlord's position, and "arbitrary considerations of personal taste, sensibility or convenience" or "mere whim or caprice" will not suffice. *Jones v. Andy Griffith Products, Inc.*, 241 S.E.2d 140, 244 S.E.2d 258 (NC 1978). The four objective criteria which may be used in evaluating the reasonableness of the landlord's conduct are:

1. Financial responsibility of the subtenant;
2. Identity or business character of the subtenant—his or her suitability for the particular building;
3. Legality of the proposed use of the premises; and
4. Nature of the occupancy, such as office, factory, clinic, etc.

Jones, at 143, citing *American Book Co. v. Yeshiva University Ct. Development Foundation, Inc.*, 297 N.Y.S.2d 156 (Sup. Ct. 1969).

In applying these guidelines, each case is determined on its own facts, but the burden of proof of unreasonableness rests on the party challenging the landlord's conduct. *Jones*, at 144, citing *Broad & Branford Place Corp. v. J.J. Hockenjos Co.*, 30 A.2d 80, 82 (N.J.L. 1944).

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