FEATURE
REAL ESTATE

WHOSE LEASE IS IT ANYWAY?

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An assignment provision is undoubtedly one of the most important clauses in a commercial lease agreement. These agreements can last anywhere from three to five years — or even ten or more, with renewal options — and they are signed with no idea as to the future success, failure, or ownership of the tenant. If that tenant's ownership changes, will their lease remain the same?

Those considering whether to acquire or merge with a business with an existing lease agreement must consider existing assignment provisions as a factor. The sale of a tenant's business could trigger various options, which are typically at the landlord's election. The most extreme option would be the option to terminate the lease upon notice of the sale. Therefore, it is vital to carefully scrutinize and negotiate assignment provisions when entering into a commercial lease agreement.

If an assignment provision is unclear as to when the tenant can or cannot assign the lease, it can wreak havoc for commercial landlords and tenants alike. A specific question that arises in the context of an assignment is whether a sale or transfer of the ownership of the tenant's business constitutes an assignment of the lease agreement. For example, if the lease states that the tenant cannot assign the lease, is it considered an assignment if the tenant sells their business through a stock sale, and the new owner operates under the same name? Technically, the tenant remains the same, but the ownership of the tenant's entity has changed. If the lease does not address what happens in this type of situation, the court will have to interpret whether or not an assignment was made. Clear assignment language is rendered even more important by Ohio's lack of legal guidance on the enforcement of anti-assignment clauses in commercial leases when a tenant transfers ownership or control of their business.

Ohio courts generally consider an assignment as a full and complete transfer of all the interest of the assignor in and to the thing assigned. *See City Of Cincinnati ex rel. Ritter v. Cincinnati Reds*, 782 N.E.2d 1225 (2002).

Typically, parties are permitted to freely transfer contractual rights without obtaining permission from their counterparties. In Ohio, a commercial lease for real property is a contract as well as a conveyance of an interest in that property. Consequently, the Ohio courts will look to the principles of construction applicable to contracts and apply those principles to leases.

If a lease requires that the landlord consent to an assignment of a commercial lease, the prevailing view in Ohio is that a landlord's consent may be withheld for any reason, absent express language in the lease that consent not be unreasonably withheld. *See F & L Center Co. v. Cunningham Drug Stores, Inc.*, 482 N.E.2d 1296 (1984).

However, Ohio courts also view restrictions against the assignment of leases as a restraint upon the alienation of property, which are not looked upon with favor and are strictly construed. *See Fairbanks v. Power Oil Co.*, 77 N.E.2d 499 (1945); *see also Littlejohn v. Parrish*, 163 Ohio App.3d 456, 2005-Ohio-4850, 839 N.E.2d 49 (1st Dist.).

This means that, absent specific language restricting ownership transactions or mergers, courts generally will not interpret common anti-assignment clauses as prohibiting the transfer of equity interests in either the entity burdened by the provision or any parent entities.

The dearth of case law on this subject leaves some question as to the specificity required for courts to interpret an anti-assignment provision to prohibit a change in tenant ownership.

Illustrative of the uncertainty is *Triple R Associates v. Checkers Drive-In Restaurants*, Cuyahoga C.P., No. CV 17 888561 (October 15, 2019).

The trial court, in ruling on cross-motions for summary judgment, ruled in favor of the landlord, finding that transfers involving a tenant's corporate great-grandparent and great-great-great-grandparent companies violated the applicable anti-assignment clause in the lease.

The anti-assignment clause being construed in *Checkers* restricted the transfer of any membership interest or effective control of the tenant. It included both specific and broad catch-all terms that the landlord argued clearly and unambiguously covered the kinds of corporate transfers at issue in the case.

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

Before these transfers, the landlord had agreed to provide the tenant with below-market rent due to the tenant's underperforming business. In negotiating the lease terms, the landlord insisted on very broad restrictions on assignment to prevent being stuck with below-market rent long term.

The court found that the landlord was entitled to judgment in its favor as a matter of law on its breach of lease claim against the tenant. The judgment was never appealed, and the parties eventually settled.

While the trial court did not explain its decision in its order, it likely concluded that even strictly construing the clause at issue, its broad language ("effective control") explicitly covered the particular transactions that occurred (which did result in changes to the

tenant's ownership structure and board), and the landlord was entitled to judgment in its favor as a result.

On the other hand, some may view the *Checkers* decision as inconsistent with the traditional approach of strictly interpreting anti-assignment provisions.

In the end, *Checkers* highlights the importance of clarity in negotiating anti-assignment clauses to leave as little as possible for the courts to interpret in the event of a later conflict.

The best way to provide clarity in an anti-assignment provision is to negotiate and define what type of sale or transfer constitutes a change in control of the tenant's business; this is commonly referred to as a change in control clause. A change in control clause identifies the percentage of the tenant's business that must be sold or transferred before an effective assignment has been made. The threshold in a change in control clause should be negotiated but typically falls around 30% to 51%.

Clarity in the assignment provision benefits landlords and tenants alike. An assignment of the lease typically requires written notice and the landlord's consent. If the tenant does not know when to provide notice of an assignment because the lease lacks a threshold, the tenant could be in default. The landlord, on the other hand, benefits by knowing who their tenant is and how the operation of the tenant's business may affect the overall success of the landlord's real estate.

Should your client find itself in a situation where it believes a tenant has assigned its lease in violation of an anti-assignment provision, it should thoroughly consider the practical ramifications of lease termination, in addition to the legal issues and consequences.

In addition to the time and expense of going to court, terminating a lease requires finding new tenants, cleaning the premises, removing abandoned property, and potentially renovating the property in preparation for a new tenant.

If possible, consider engaging with the entity to whom the lease has been assigned to explore the possibility of negotiating a new lease or a lease amendment with more favorable terms, with the idea that both parties would be saving the time and expense of protracted litigation.

With the uncertainty as to how an Ohio court would interpret an anti-assignment provision, plus the cost of litigation, landlords and tenants alike can benefit from negotiating a change in control clause. Remember: an ounce of negotiation prevents a pound of costly litigation.

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