#H-112

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Third Supplement to Memorandum 90-50

Subject: Study H-112 - Commercial Lease Law: Use Restrictions (Comments on Tentative Recommendation--revised comments of Professor Coskran)

Attached to this memorandum are revised comments of our consultant, Professor Bill Coskran, concerning the issues raised in Memorandum 90-50 and the first two supplements to it.

Respectfully submitted,

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RE USE RESTRICTIONS IN COMMERCIAL LEASES; Study #H-12.

Attached are my revised comments concerning the the staff tentative recommendations and the letters from interested parties.

Respectfully submitted,

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USE RESTRICTIONS

1. CHARGE OF LANDLORD BIAS.

Mr. Johnson's charge of bias in favor of landlords has been raised and discussed previously, so I will not repeat my comments here. However, there is an additional factor to consider with respect to use restrictions. What is the tenant's present position, absent the Commission's proposals?

Existing statutes provide for the enforcement of a use restriction according to its terms. If property is leased for a "particular purpose" the tenant must not use it for "any other purpose," and if the tenant does so, the tenant is liable to the lessor for all damages resulting from such use, or the lessor may treat the lease as rescinded (C.C. 1930). The lessor may terminate the lease and recover possession when the tenant uses or permits use of the property "in a manner contrary to the agreement of the parties." (C.C. 1931(1))

Existing California case law does not inhibit the lessor's ability to restrict changes in use. Even in the Kendall type situation, where a clause requires the lessor's consent to change but does not express the applicable standard, the tenant is not assured of the protection of an implied reasonableness standard. Although I personally favor application of the Kendall result to such a silent consent clause, an opinion that the present

California Supreme Court would do so is quite speculative. I have heard experienced real property lawyers express the view that the tenant would not receive such judicial protection. The proposed legislation expressly extends this protection to tenants.

The Kendall holding applies only to clauses which require consent but fail to express the standard governing consent. Thus, even if the Kendall result is judicially extended to a use restriction clause, this would not prevent use of an express "absolute prohibition of change" clause or other express restrictions.

In order to prevent changes in use, the Lessor must include an express clause in the lease. The proposed legislations makes it clear that the tenant's rights include any reasonable use unless there is an express restriction. Also, the tenant is given the benefit of ambiguities by a construction in favor of unrestricted use.

2. BASIC PRINCIPLES.

Mr. Johnson argues that the lessor should be subject to a mandatory reasonableness standard, and that the lessor should not be able to deviate from this by contract provisions.

This position was considered extensively in the discussions leading to the legislation on Assignment/Sublease restrictions. That legislation reflects the basic principle that freedom of contract is allowed unless there is a compelling contrary public

policy. The legislation also adopts a principle requiring express language to create an enforceable restriction. This enhances the prospects that the restriction will become a known part of the negotiations, or that it will at least be a known part of the deal.

Since there is a close relationship between transfer restrictions and use restrictions, it seems that the same general principles should govern unless there is a compelling reason for different treatment. No compelling reason has been presented.

I am not against providing relief to parties who have made a bad deal. There are certain base level protections in existing doctrines, e.g. adhesion. I agree with Mr. Johnson that such doctrines do not provide complete relief from a bad deal. However, further relief requires a change in existing doctrines, or the development of a new one. In either event, if the Commission decides that a bad deal is going to be sufficient justification to allow a judicial modification of express contract terms, it is essential that the Commission develop clear and consistent requirements for application of the new policy. It is also important to consider the ramifications of such a new policy on contracts generally.

Neither the policy against restraints on alienation nor the implied covenant of good faith and fair dealing prevents the enforcement of an express use restriction in accordance with its terms. Neither one supports the imposition of a mandatory reasonableness standard in the face of express contrary language

in the contract. A mandatory reasonableness standard would require a change in California law.

A. RESTRAINTS ON ALIENATION.

It has long been recognized that the policy against restraints on alienation is not applicable to use restrictions. This is true even though the restricted party owns a much larger interest than a tenant's leasehold. Most of the cases distinguishing transfer restrictions from use restrictions, and upholding use restrictions, involve a restriction on a fee simple interest.

Some might argue that a new doctrine should be established, extending the policy against restraints on alienation to use restrictions. Even such an extension would not result in a mandatory reasonableness standard contrary to express language of the contract. The policy against restraints on alienation does not prohibit freedom to contract for an express absolute restriction or other express restrictions. The policy does not make a reasonableness standard mandatory. This part of the common-law view has not been changed by Kendall or the cases relied upon in Kendall. The holding in Kendall only applies to a clause which requires the lessor's consent but which does not expressly state a standard. In that case, a reasonableness standard will be implied.

B. GOOD FAITH & FAIR DEALING.

The policy behind the implied covenant of good faith and fair dealing focuses on the bargain of the parties and their expectations flowing from that bargain. Basically, the covenant requires that neither party do anything to deprive the other of the contemplated benefits of the agreement. The policy does not prevent enforcement of express contractual provisions, and it does not compel a party to perform something that is in direct conflict with an express provision. It protects reasonable expectations; it does not compel reformation.

The background study (pages 459-461) refers to statements which support the view that the covenant of good faith and fair dealing does not prevent enforcement of an express provision in accordance with its terms. "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." (Burton, Breach of Contract and the Common Law Duty to Perform in Good Faith, 94 Harv. L. Rev. 369, 373 [1980].) The extent of the duty of good faith and fair dealing depends upon the nature of the bargain struck and the legitimate expectations of the parties arising from the contract. (Commercial Union Assurance Companies v. Safeway Stores, Inc., 26 Cal.3d 912, 164 Cal.Rptr. 709 [1980].) A very clear explanation of the relationship between the covenant of good faith and fair dealing and express provisions is

contained in VTR, Inc. v. Goodyear Tire & Rubber Co., 303 F. Supp. 773 (S.D.N.Y. 1969). The court stated:

> 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.
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> ....
>
> 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.

The court also said that merely because a party agreed to a bad bargain does not change the result.

If the lessor bargains for and gets an express absolute prohibition clause, the tenant is put on notice that a standard of reasonableness is not one of the tenant's contractual expectations.

Neither Kendall nor the cases relied upon in Kendall require a mandatory reasonableness standard or prevent enforcement of an express clause in accordance with its terms. The holding in Kendall only applies to a transfer restriction which requires the lessor's consent but which does not expressly state a standard. In that case, a reasonableness standard will be implied.

C. EXPANSION OF GOOD FAITH & FAIR DEALING.

It is certainly tempting to adopt a view that parties to a contract should "do the right (and reasonable) thing" despite the express terms of the contract. The result might be to leave the parties to litigation, and leave it to the court to determine the right and reasonable thing and modify the contract accordingly. There would also be a major change in basic contract law. Presently, each party to a contract has the absolute right to refuse an amendment proposed by the other party.

If the policy of good faith and fair dealing is to be expanded beyond protection of reasonable contractual expectations, the requirements and ramifications of the expansion should be considered. Would it be expanded to a policy of modifying express terms, and a policy of prohibiting certain express terms? If so, when and under what conditions would it be applied?

If the policy is changed to allow modifications of express provisions, why should the modifications be limited to a use clause? For example, suppose the lease has a fixed term which is about to expire and the tenant wants a two year extension. If the lessor refuses to amend the lease, can the tenant force the two year extension by showing that it is commercially reasonable to do so? Suppose due to various circumstances, the agreed rent is higher than the fair market rental. Can the tenant force an amendment of the rent clause by showing that a lower amount is commercially reasonable? Consider the resulting litigation over the issue of "commercially reasonable."

Since the covenant of good faith and fair dealing is implied in every contract in California, a change should not be limited to situations where it is raised by a tenant.

Lessors can also be the victims of bad bargains. For example, assume the following situation. A group of small investors pool their resources to own and operate a neighborhood shopping center. A major grocery store tenant in the center, with several years to go on its lease, elects to move to a different

location in a new shopping center nearby, and to transfer its premises to a third party. The grocery store tenant is making a good profit at its present location, but it wants to make an even greater profit at the new center. The transferee admittedly will not produce the same percentage rentals for the lessor, and more importantly, will not be a drawing power for other businesses in the center. Also, the departing tenant will be relocating close enough to the old center to draw customers from the old center. After the move, the small businesses in the center start having troubles because of the lack of drawing power and a domino effect of failures starts to occur. Unless the departing tenant's lease has express clauses preventing what has occurred, or has "no substantial minimum" rent, the lessor is unable to prevent the move or collect damages from the departing tenant. Assume further that the tenant's negotiating power as a major tenant prevented the lessor from obtaining protective clauses in the bargain. The present operation of the implied covenant of good faith and fair dealing does not aid the lessor because the lessor did not have the reasonable contractual expectation of a compulsory operations clause or a strict limitation on transfer and use. Suppose in another situation that the lessor is able to show that it would be "commercially reasonable" to charge a higher rent than agreed, or to force the tenant to change the tenant's present use to one which will produce a greater percentage rent for the lessor, and the same or greater profit for the tenant. Can the lessor force an amendment?

If the doctrine is to be expanded, there is no logical reason to limit the expansion to leases. If expansion is warranted there, it would be logical to apply the extension to all contracts which contain the implied covenant--i.e. all contracts.

In Mr. Zankel's letter, he points out this problem of using the covenant of good faith and fair dealing to change an express provision. He notes that it would be commanding the lessor to amend the lease. In an earlier article written by Mr. Zankel, he pointed out that "(if the lessor) simply states that the sole purpose will be as specified in the lease, then arguably there can be no change without an actual amendment of the lease. To argue otherwise would be to say that the tenant could change any lease provision by simply requiring the landlord to be 'reasonable.' Why not, for example, change the rent?" (M. Zankel, Commercial Lease Assignments and the Age of Reason: Cohen v. Ratinoff, 7 Real Prop. L. Rep. 29, 36 [1984].)

If the Commission decides to expand the covenant of good faith and fair dealing into modification of contract terms, it should also consider the ramifications of using the litigation process to renegotiate the terms of contracts. It will be a growth industry for lawyers earning a living by litigation. The Commission should also define how this extension relates to formation doctrines such as adhesion, and to existing law relating to reformation of contracts and relief from forfeiture. The change will also have an effect on the contract negotiating

process. If, at a later date, a court can ignore an express provision and impose a "commercial reasonableness" standard on the facts at the time of litigation, there is less incentive to spend time, money and effort negotiating and reducing the bargain to writing. For example, why should a tenant bargain for an express reasonableness standard, and perhaps have to give up something in exchange, if the court will provide it later anyway?

D. RELATIVE BARGAINING POWER.

There are many contractual situations where an exact equality of bargaining positions does not exist. There are doctrines such as the adhesion doctrine which have developed to provide a base line protection in contract formation. There are certainly situations where a party has made a bad bargain and the adhesion doctrine does not provide relief. If a test of the relative bargaining power of the parties is adopted for the enforceability of contract provisions, what are the components of that test and how is it to be applied? Additionally, it would be naive to adopt a policy based on the assumption that all lessors have greater bargaining power than all tenants.

3. DAMAGES UPON TENANT BREACH & LEASE TERMINATION; C.C. 1997.040(a).

Existing law provides that if the tenant breaches the lease and abandons the premises, or the lessor terminates the lease based on the tenant's breach, certain damages are recoverable

(C.C. 1951.2). The major component of recoverable damages is the excess of the agreed rent over the reasonably avoidable rent loss.

Suppose in a particular case there will be a deficiency and damages if the lessor relets for the use specified in the lease. Suppose further that the lessor could get more rent by leasing for a different use and thus reduce or eliminate the deficiency. How does a use restriction in the breached lease affect the tenant's offset for reasonably avoidable rent loss?

First, assume that under the terms of the breached lease, the tenant could have changed the use without the lessor's consent, or limited only by a requirement for the lessor's reasonable consent. It seems clear that the tenant should be entitled to have a reasonable change in use considered in avoiding damages. Subsection (a) of proposed C.C. 1997.040 provides for this result.

Second, assume that under the terms of the breached lease the tenant could not have changed the use because the terminated lease contained an express absolute restriction or a sole discretion standard for consent. Can the tenant avoid the express restriction by having a reasonable change in use considered in avoiding damages? The present wording of subsection (a) would prevent that change from being considered.

Mr. Carbone raises an important objection to the result in this second situation. His letter argues persuasively that once the lease is terminated and the issue is damages, a reasonable

change in use should be considered for purposes of mitigation. This position has considerable merit. It should be weighed against the factors that were discussed in leading to the present wording of subsection (a).

As I recall, the main reason in support of the present wording was that the lessor should not be required to give up a bargained benefit expressed in the lease in order to reduce damages to a breaching tenant. Also, if a tenant is allowed to base offsets on a modification of the terms of the use clause, why should the modifications be limited to the use clause?

If the legislation is changed in accordance with Mr. Carbone's proposal, there is another possible consideration. Would there be a potential for the tenant to indulge in tactical avoidance of the express terms of the lease? Suppose the following sequence:

1. Execution of a lease containing an express clause specifying the use and absolutely prohibiting a change.

2. Tenant proposes a change in use and the lessor refuses to amend the lease.

3. Tenant breaches the lease and abandons the premises, triggering a termination of the lease pursuant to C.C. 1951.2.

4. Lessor sues the tenant for damages and the tenant offsets based on the rental value for a different use of the premises.

It seems that the tenant has imposed an amendment of the lease terms by breaching the lease and abandoning the premises. If this is going to be the result, could the tenant then threaten

the lessor with this result when proposing an amendment to the lease?

I asked Mr. Carbone if he considers this to be a problem. His response by letter of May 25th points out the conflict between two public policies: (1) freedom of contract; and, (2) mitigation of damages. He discusses the importance of mitigation in this situation. He makes it clear that he does not suggest that the use clause be ignored in determining damages. Mr. Carbone accepts the proposal, mentioned in Mr. Denitz's letter of May 11th, that would give the tenant the opportunity to prove that facts and circumstances no longer justify continued enforcement of the use restriction. Mr. Carbone recommends that the language of 1997.040 be changed as follows:

Delete the phrase "except to the extent the lease includes a restriction on use that is enforceable under this chapter."

Insert instead the phrase "and any enforceable use restriction unless the tenant proves that under the circumstances it would be unreasonable to enforce the restriction." This seems to be consistent with Mr. Denitz's proposal.

Since the basic issue here is one of mitigation of damages, it seems the Commission has a great deal of flexibility in determining policy, and I think Mr. Carbone's point deserves careful consideration.

4. LOCK-IN REMEDY UPON TENANT BREACH & ABANDONMENT; C.C. 1997.040(b).

Existing law provides that if the tenant breaches the lease and abandons the premises, the lessor can elect to keep the lease in effect and enforce the lease terms against the breaching tenant. The remedy is available only if the tenant is permitted to assign or sublet, subject only to reasonable restrictions.

Suppose in a particular case the tenant wants to transfer to a third party who will use the property for a different use. How does a use restriction in the breached lease affect the tenant's ability to transfer for a different use?

First, assume that, under the terms of the breached lease, the tenant could have changed the use without the lessor's consent, or limited only by a requirement for the lessor's reasonable consent. It seems clear that the tenant should be entitled to transfer to a third party who will be making a reasonable change in use. Subsection (b) of proposed C.C. 1997.040 allows this result.

Second, assume that under the terms of the breached lease the tenant could not have changed the use because the lease contains an express absolute restriction or a sole discretion standard for consent. Can the tenant avoid the express restriction by making a transfer to a third party? The present wording of subsection (b) would prevent such a change in use even if the change would not be unreasonable.

Mr. Zankel raises an important objection to the result in this second situation. His letter argues persuasively that once the lessor chooses this remedy, the reasonableness standard should govern the use of the premises as well. This position has considerable merit. The tenant must be allowed a reasonable right to transfer, and the type of use is closely related to the practical ability to find a transferee. Thus, strict adherence to the existing use could make it quite difficult or impossible for the tenant to get a transferee. This is particularly true, as Mr. Zankel points out, if the tenant has already failed at the business specified in the lease.

Mr. Zankel's position should be weighed against the factors discussed in leading to the present wording of subsection (b). As I recall, the main reason in support of the present wording of subsection (b) was that the use clause is an integral part of the continuing lease which remains enforceable according to its terms against the tenant and third party. The present wording of C.C. 1951.4 provides that "the lease continues in effect" and "the lessor may enforce all the lessor's rights and remedies under the lease." Also, if a tenant who breaches and abandons is entitled to a modification of the use clause, what other clauses could be modified to make it easier for the tenant to transfer? For example, suppose the tenant wants an extension of the lease term to make it more attractive to a third party. Perhaps these factors in support of subsection (b) can be eliminated by

treating the use clause as uniquely related to the right to transfer.

If the legislation is changed in accordance with Mr. Zankel's proposal, there is another possible consideration. Would there be a potential for the tenant to engage in tactical avoidance of the express terms of the lease? Suppose the following sequence:

1. Execution of a lease containing an express clause specifying the use and absolutely prohibiting a change.

2. Tenant proposes an assignment to a third party who will change the use, and the lessor refuses to amend the lease.

3. Tenant breaches the lease and abandons the premises.

4. Lessor elects to use the lock-in remedy and keep the lease in effect despite the tenant's breach and abandonment. (Assume the lease is properly drafted to allow the 1951.4 remedy.)

5. Tenant assigns to the third party who will change the use of the premises.

It seems that the tenant has imposed an amendment of the lease terms by breaching the lease and abandoning the premises. If this is going to be the result, could the tenant then threaten the lessor with this result when proposing an amendment to the lease? I have asked Mr. Zankel to review this point and see if he considers it to be a problem.

5. APPLICATION OF POLICY AGAINST RESTRAINTS ON ALIENATION AND COVENANT OF GOOD FAITH AND FAIR DEALING; C.C. 1997.210.

An express restriction on use does not violate the policy against restraints on alienation. This is discussed at length in the background study and summarized above in Section 2.A.

Enforcement of an express restriction on use in accordance with the terms of that restriction does not violate the covenant of good faith and fair dealing. This is discussed at length in the background study, and summarized above in Section 2.B.

The present proposal reflects the validity and enforceability of express restrictions according to their terms. As discussed above in Section 2.C&D, if the Commission is going to expand the concept of good faith and fair dealing, there are several factors that must be considered and expressed.

6. ABSOLUTE PROHIBITION AGAINST CHANGE; C.C. 1997.230.

I agree with Mr. Carbone's view that the statement in the comment about good faith and fair dealing should apply to enforcement rather than the mere existence of the absolute prohibition clause. That part of the comment could be corrected by changing the statement to "The covenant of good faith and fair dealing does not prevent enforcement of an express lease provision absolutely prohibiting use, in accordance with its express terms."

Mr. Johnson argues for a mandatory reasonableness standard. This has been addressed above in Section 2.

Mr. Carbone would revise the comment to provide that enforcement of the restriction would be subject to the implied covenant of good faith and fair dealing, to be decided on the facts of each case. I lean towards Mr. Zankel's view that it requires an amendment to the lease to avoid enforcement of the express terms of a clause. The question of extending the covenant of good faith and fair dealing is discussed above in Section 2.B.,C & D. If the Commission adopts the Mr. Carbone's revision, just what does it mean in this context to say that the express contract provision is subject to the covenant of good faith and fair dealing?

7. SOLE DISCRETION CONSENT STANDARD; C.C. 1997.250(c).

Mr. Johnson again argues for a mandatory reasonableness standard. This has been addressed above in Section 2.

Mr. Williams raises an issue of clarity. Is a clause clear when it states that the lessor's consent is required to change, and that the consent is governed by the sole and absolute discretion of the lessor? Does the mention of the possibility of consent lead the tenant to believe that the lessor will be reasonable in granting or refusing consent, or that the lessor will have to show some objectively legitimate reason for refusal? This concern arose with the assignment/sublease legislation and it continues to bother some people. It should be addressed.

The matter was made moot in the assignment/sublease legislation by eliminating the section providing for sole discretion consent.

8. EFFECTIVE DATE; C.C. 1997.270.

A. RETROACTIVITY--IN GENERAL.

The proposed legislation imposes an implied reasonableness standard on the lessor where the restriction requires consent but fails to state an express standard. Subsection (a) of C.C. 1997.270 limits this rule to leases executed after the effective date of the legislation.

Existing statutes provide for the enforcement of a use restriction according to its terms. If property is leased for a "particular purpose" the tenant must not use it for "any other purpose," and if the tenant does so, the tenant is liable to the lessor for all damages resulting from such use, or the lessor may treat the lease as rescinded (C.C. 1930). The lessor may terminate the lease and recover possession when the tenant uses or permits use of the property "in a manner contrary to the agreement of the parties." (C.C. 1931(1)).

Mr. Johnson believes that the new statutory imposition of the implied reasonableness standard should receive full retroactivity. He bases this, I believe, on the argument that this has been the law in California for quite some time, and that it can be discerned from the Kendall case and certain pre-Kendall cases.

The question of retroactivity was discussed at length in connection with the related issue of assignment/sublease

restrictions. Kendall, and the cases cited by Mr. Johnson, deal with a restriction on transfer, not a restriction on use. The policy against restraints on alienation, used as one of the key bases for limiting the transfer restrictions in those cases, has traditionally been held inapplicable to use restrictions. The application of the principles in the cases to a use restriction is speculative even after the Kendall case. There is no doubt that one can speculate on the extension of the Kendall good faith and fair dealing reasoning to a use clause, although there are many who believe that the current California Supreme Court will not make such an extension. However, I have looked in vain for cases imposing that implied standard of reasonableness to a use restriction.

B. RETROACTIVITY--THE "TRANSFER" CASES.

When a clause requiring the lessor's consent to a transfer is silent on the standard to be applied, there are two views. The common-law (and apparently still majority) view implies a standard of subjective sole discretion. The minority view (and Kendall case) implies a standard of objective reasonableness. The Commission adopted the minority and Kendall view that a reasonableness standard should be implied when the transfer consent clause is silent on the standard to be applied.

Views on the effective date of the implied reasonableness standard included the 1990 effective date of the legislation, the 1985 date of Kendall, the 1983 date of Cohen,

the 1978 date of Wellenkamp, and total retroactivity. Although the California Supreme Court did not decide the Kendall case until 1985, an effective date of Sept. 23, 1983 was chosen for implementation of the implied reasonableness standard on transfer restrictions. The reason for choosing the earlier date was the belief that practitioners in general would have been alerted to the transfer restriction issue by the Cohen case in 1983. This was considered to be a fair compromise for the change of law in California.

Until the Court of Appeal decision in Cohen v. Ratinoff in 1983, it seems clear that a careful and competent lawyer could reasonably conclude that California followed the common-law and still majority view that a sole discretion standard would apply to a transfer restriction absent an express agreement to not unreasonably withhold consent. Prior to Cohen, an attorney doing research on this specific issue would have found agreement in major treatises and the Continuing Education of the Bar practice handbook on commercial leases. They would lead the attorney to the conclusion that a tenant who wants a reasonableness standard to apply must negotiate and expressly provide for it. I find it hard to believe that a tenant's attorney involved in negotiating a pre-Cohen lease would rely on speculation that the minority view and an implied reasonableness standard would be implied. Express reasonableness standard clauses were a matter of negotiation and bargain. If the implied reasonableness standard

had been applied to pre-Cohen leases, it would have provided an unbargained windfall.

The Richard case in 1960 involved a "Silent Consent Standard" clause restricting transfer. The court 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. This was not directly challenged until the Cohen case in 1983.

Mr. Johnson refers primarily to three cases in support his argument for retroactivity prior to Cohen. They are Wellenkamp v. Bank of America in 1978, Richardson v. La Rancherita in 1979, and Laguna Royale Owners Association v. Darger in 1981.

Wellenkamp involved a "due on transfer" clause in a deed of trust. It was certainly possible to speculate on further ramifications of this decision. However, it seems reasonable that an attorney could conclude that a clause in a deed of trust restraining alienation of a fee simple interest would be distinguishable from a lease clause restraining assignment and subletting of a leasehold. Indeed, the Cohen court which adopted the implied reasonableness standard made such a distinction. The court expressly rejected the tenant's contention that the Wellenkamp reasoning should be applied to leases. It would be even more likely to conclude that it would not be applied to a use restriction.

Richardson involved a sale of stock by a corporate tenant. The assignment/sublease restriction clause did not restrict a sale of stock, so the restriction clause did not even

apply to the transaction. Despite this fact (and a case decision clearly supporting the right to transfer the stock), the lessor insisted on the right to consent and delayed the closing of the stock sale. The court upheld a judgment against the lessor based on tort interference with contract. This case did not predict Kendall since it involved a transaction which was not even covered by the restriction and which did not require the lessor's consent at all. An attempt to apply the case to a use restriction would be even more remote.

Laguna Royale involved the attempt by a condominium association to block a mini-time share division by one of the condominium owners. Although the condominium was developed on a 99 year ground lease, the court viewed the condominium relationship as more of a fee ownership than a lessor/tenant relationship. The common-law has long recognized a distinction between a leasehold interest upon which restrictions are allowed, and a fee ownership interest upon which restrictions are virtually prohibited. The court recognized the distinction when it stated: "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 court had no occasion to apply or reject the arbitrary discretion rule of the Richard case because it was distinguishable on the facts. A use restriction was not involved.

Mr. Johnson refers to by Robert Kerr's 1980 article in the California State Bar Journal. Mr. Kerr's prediction of the Kendall result on transfer restrictions was thoughtful and accurate. I continue to be impressed by the article. However, I would have a hard time holding a lawyer to speculation (though well reasoned) in a bar journal when it is contrary to more traditional research sources. Even if a tenant's lawyer read and believed the article, I would expect the attorney to bargain for an express reasonableness standard rather than rely on the prospect of a future court decision to give it without bargaining. It would be even more difficult to hold a lawyer to further speculation that Mr. Kerr's prediction will be extended to use restrictions.

I am not saying that an experienced real property lawyer could not have predicted the 1985 Kendall result. I am not saying that it is unreasonable to speculate that the Kendall reasoning might, in the future, be extended to use restrictions. However, I believe it would be placing too much of a premium on expertise and speculation to expect that prescience from the general bar and the busy practitioners who have drafted past leases. Full retroactivity based on the asserted predictability of Kendall, and speculation that it will be extended to use restrictions by a future California Supreme Court decision, would raise an interesting malpractice issue for attorneys who relied on basic research tools.

C. OPTIONS.

Mr. Johnson questions the language of subsection (b) of 1997.270. He refers to the language dealing with execution of an option. I believe it is intended to apply to the situation where a binding option to lease is entered into. The option fixes the terms of the lease which will go into effect when the option is exercised. Since the parties are bound by the lease terms fixed by the option, that date controls rather than the later date of exercise of the option. This parallels the approach taken by C.C. 1952.2 when the basic remedies legislation became effective in 1970.