#H-111 ns33f
07/08/88

Second Supplement to Memorandum 88-44

Subject: Study H-111 - Commercial Lease Law (Assignment and Sublease--comments of Ronald P. Dentiz)

Attached to this supplementary memorandum are comments of Ronald P. Denitz on the staff draft assignment and sublease provisions attached to Memorandum 88-44. In brief, Mr. Denitz' comments are:

(1) He agrees with the staff's selection of the date of the Kendall case as the cutoff date for retroactivity of the Kendall codification.

(2) He disagrees with the staff's proposal to apply the Kendall rule in cases where the lease was executed before Kendall but a successor of the original landlord assumed rights under the lease after Kendall. This proposal "would diminish the rights of landlord by for the first time imposing upon landlord the obligation to be commercially reasonable in withholding landlord's consent"; moreover, "a purchaser acquiring ground floor commercial space in an office building or acquiring a shopping center would be reluctant or, worse, driven off if the assignment clauses of the pre-Kendall stores therein have been drawn with only the restriction that assignment could be had only with the landlord's prior written consent."

(3) He believes the Comment that elaborates the concept of the landlord's reasonableness should be expanded to cover a number of situations frequently encountered in practice. Specifically, he is concerned that a change in use by the new tenant could be incompatible with other uses in the building or in the area, could negatively impact service elements in the building such as air-conditioning and elevators, could increase insurance rates or create a fire safety hazard, or could increase noise. He would add to the Comment that these matters might properly affect the reasonableness of the landlord's refusal to consent to an assignment or sublease. He would

also mention the possible impact of the proposed use on any percentage rent, and that the landlord should be able to condition consent on change or imposition of a percentage rent in an appropriate case.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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July 7, 1988

BY AIRBORNE EXPRESS

California Law Revision Commission
4000 Middlefield Road
Suite D-II
Palo Alto, California 94303-4739

Attention: Nathaniel Sterling, Esq.
Assistant Executive Secretary

Re: Study H-111: Commercial Lease Law (Assignment and Sublease) - Staff Draft a/o 5/31/88 (Memorandum 88-44)

Dear Nate:

I have carefully reviewed the Staff Draft of the Tentative Recommendation in the captioned matter and the proposed Comments with respect thereto.

In order to assist the Commission in reviewing the Staff Draft, herewith are respectfully submitted my comments concerning the same:

1. The tentative selection by the Staff of the date of the decision in Kendall vs. Pestana, Inc. (hereinafter for convenience merely "Kendall"), that is, December 5, 1985, is both fair and realistic inasmuch as those of us in the actual day-to-day draftsmanship and negotiation of commercial lease documents (which often resembles the "trenches" in the light of most good-sized tenants being represented by informed and often aggressive legal counsel) used forms and conducted negotiations prior to mid-December, 1985 based upon the theory that the earlier law (prior to Kendall) governed and would continue to govern interpretation of lease documents until and unless the California Supreme Court ruled otherwise: although the Cohen vs. Ratinoff (hereinafter "Cohen") case and its "progeny" ruled on the District Court of Appeals level that landlord's consent could not be unreasonably withheld if the language of the lease required landlord's consent but was in the nature of a "silent standard", most lawyers and, more important, another District Court of Appeal case in California decided

otherwise even after Cohen but before the Supreme Court handed down Kendall.

2. Nothwithstanding the commercially enlightened selection by the Staff of the December 5, 1985 decision date of Kendall as the cutoff date of retroactivity, the Staff tentatively has provided that the sale or other transfer of landlord's ownership (assumably by way of deed or devise or descent or even ground lease) would diminish the rights of landlord by for the first time imposing upon landlord the obligation to be commercially reasonable in withholding landlord's consent in a lease which, prior to the transfer, gave Landlord the right to remain unreasonable (which often times can be for perfectly understandable reasons).

3. The scope of the Comment as to what is or is not (at least tentatively) "reasonable" should be augmented and, in fact, expanded to expressly cover situations that we in the "trenches" come up against on a weekly if not daily basis:

   (a) The proposed use by tenant must be compatible with the other uses in the building or in the area;

   (b) The proposed use by tenant should not negatively impact or "surcharge" any service elements in the building such as air-conditioning (e.g., assignment by drugstore to a commercial baker), elevators (e.g., increase foot traffic or elevator traffic due to the proposed assignee wishing to use demised premises for any of the diverse purposes contained in Exhibit "A" hereto [which Exhibit "A" contents constantly have been used by us as our well-accepted "Rule and Regulation No. 14"];

   (c) Uses which would increase the insurance rates or create a fire safety hazard;

(d) Any use which would provide any noise or "shake, rattle and roll" (e.g., an assignment by a law firm to a record company or recording studio or other facilities to be used for rehearsal or auditioning of bands and rock and roll groups); or

(e) In shopping centers or other store-type buildings and parking structure leases, where uses are directly related to and consistently and commercially determine what percentage rent (if any) should be imposed and the level of that percentage rent, the reasonableness of landlord's consent should not be negatively affected by the language of the Comment that "...denial [may not be imposed by landlord]...in order that the landlord may charge a higher rent that originally contracted for".

Similarly, in office buildings where ground floor space can readily be adapted to either office or bank uses (no percentage rent) or retail stores or shops (which do customarily pay percentage rent), landlord needs to reserve the right to impose a percentage rent for the first time or modify any preceeding percentage rent clause (see Exhibit "B" hereto).

Surely the Court in Kendall did not have in mind the fine line of differential between one type of shopping center tenant and another type of shopping store tenant (and between a ground floor lawyer's office or bank in an office as original tenant and a restaurant or drugstore being proposed by the assignor as the use to be made of demised premises by the assignee). Hopefully the Commission will.

4. Last, but certainly not least, additional thought should be given to the economic implications of the Commission possibly accepting the Staff recommendation that the transfer or other

disposition of landlord's fee or other ownership interest might subject a pre-December 5, 1985 lease to the "reasonableness" obligations of Kendall: when approaching the purchase of an already-existing office building with ground floor space (or, even more so, a shopping center) a purchaser examines the leases already in place as well as the dollar costs of operation (which dollar cost of operation include, of course, the amount of taxes payable per annum); a purchaser will have his eyes wide open as to the increase in taxes resulting from the application of Prop. 13 and will know exactly where he stands with regard to taxes, but a purchaser acquiring ground floor commercial space in an office building or acquiring a shopping center would be reluctant or, worse, driven off if the assignment clauses of the pre-Kendall stores therein have been drawn with only the restriction that assignment could be had only with the landlord's prior written consent (i.e., - the "silent standard"). "Tenant mix" in shopping centers and high-class commercial uses in the ground floor portion of office buildings (i.e., - not "adult book stores" or any other trashy use) could very well determine whether or not the project could be sold or not sold.

Thank you for the opportunity to present these items of our commercial experience and we hope that the balance of Professor Coskran's Summary of Conclusions will be the basis for additional Draft-elements of the eventual Tentative Recommendation.

With best personal regards I am

Cordially,

RONALD P. DENITZ
CORPORATE COUNSEL

Enclosures
cc: John De Moully, Esq.
Executive Secretary (w/encl.)

RPD/law

RULES AND REGULATIONS

14. Tenant shall not occupy or permit any portion of demised premises to be occupied as an office that is not generally consistent with the character and nature of all other tenancies in the Building, or is (a) for an employment agency, a public stenographer or typist, a labor union office, a physician's or dentist's office, a dance or music studio, a school, a beauty salon or barber shop, the business of photographic or multilith or multigraph reproductions or offset printing (not precluding using any part of demised premises for photographic, multilith or multigraph reproductions solely in connection with Tenant's own business and/or activities), a restaurant or bar, an establishement for the sale of confectionary or soda or beverages or sandwiches or ice cream or baked goods, an establishment for the preparation or dispensing or consumption of food or beverages (of any kind) in any manner whatsoever, or as a news or cigar stand, or as a radio or television or recording studio, theater or exhibition-hall, for manufacturing, for the storage of merchandise or for the sale of merchandise, goods or property of any kind at auction, or for lodging, sleeping or for any immoral purpose, or for any business which would tend to generate a large amount of foot traffic in or about the Building or the land upon which it is located, or any of the areas used in the operation of the Building, including but not limited to any use (i) for a banking, trust company, depository, guarantee, or safe deposit business, (ii) as a savings bank, or as savings and loan association, or as a loan company, (iii) for the sale of travelers checks, money orders, drafts, foreign exchange or letters of credit or for the receipt of money for transmission, (iv) as a stock broker's or dealer's office or for the underwriting of securities, or (v) a government office or foreign embassy or consulate, or (vi) tourist or travel bureau, or (b) a use which conflicts with any so-called "exclusive" then in favor of, or is for any use the same as that stated in any percentage lease to, another tenant of the Building or any of Landlord's then buildings which are in the same complex as the Building, or (c) a use which would be prohibited by any other portion of this lease (including but not limited to any Rules and Regulations then in effect) or in violation of law. Tenant shall not engage or pay any employees on demised premises, except those actually working for Tenant on demised premises nor shall Tenant advertise for laborers giving an address at demised premises.

PERCENTAGE RENTALS

49. Further supplementing Subdivision A of Article 3, Tenant acknowledges that Landlord normally requires that ground floor shop or store tenants (as opposed to normal office tenants) pay percentage rentals and consequently Tenant agrees that if the proposed assignee is to operate a shop or store in demised premises it shall be reasonable for Landlord to withhold Landlord's consent to any assignment of this lease unless the proposed assignee consents to an amendment of this lease adding thereto Landlord's then standard Rent Rider and providing for Tenant to pay, in addition to the base annual rent reserved on the first page of this lease, additional rent in the sum of a reasonable percentage of Tenant's gross sales at or from or on behalf of the demised premises; said percentage rent shall be payable upon the terms and at the times set forth in said Rent Rider.

Landlord acknowledges that Tenant, in its operation of a * office, is a normal "office" tenant and therefore an assignment of this lease for the same use would not entitle Landlord to require percentage rent as a condition of Landlord consenting to such an assignment.

OR

PERCENTAGE RENTALS

* The percentage rental set forth in the Rent Rider attached to this lease was a material and major inducement to Landlord to enter into this lease, the percentage of Gross Income to be paid as percentage rent and the amount of Gross Income in excess of which percentage rent is payable each being related directly to the type of business conducted or to be conducted by Tenant within demised premises and the amount which Tenant has represented to Landlord as Tenant's probable minimum annual dollar-volume of business. Accordingly, Landlord shall have the further reasonable right to withhold its consent to such proposed assignment unless Tenant and said proposed assignee agree to a proposal by Landlord to:

(i) increase the level of fixed minimum rent,

(ii) increase the percentage of Gross Income to be paid as percentage rent, and

(iii) decrease the amount of Gross Income in excess of which percentage rent is payable,

to reflect the proposed change in [a] the type of business or [b] the reasonably estimated minimum annual dollar-volume of business to be done in demised premises or [c] the financial strength of the occupant of demised premises or [d] any combination of the foregoing. Such adjustment shall be contained in an amendment of lease to be executed by Landlord, Tenant, and the proposed assignee concurrently with the execution of the Assignment, Assumption and Consent.