

AMALGAMATION TRANSACTIONS OF CORPORATE LESSEES AS BREACHES OF NONASSIGNMENT COVENANTS: ANOTHER PLEA FOR SUBSTANCE OVER FORM

WHEN the lessee of real estate is a corporation, a provision making assignment of the lease or subletting of the premises without the lessor's written approval a ground for forfeiture¹ constitutes an uncertain shield for a landlord seeking protection from changes in the tenant's ability to comply with various other lease covenants, notably that establishing the duty to pay rent, since whether various devices of corporate amalgamation, which effect substantial changes in the lessee's ownership, management, and business, will or will not breach the nonassignment clause is judicially determined according to the form of the transaction, rather than on the basis of its economic effects upon the lessor. Transactions which may accomplish amalgamation—sales of stock or of assets, management contracts, and mergers or consolidations pursuant to state statute—may have no effect on the lessor's interests, as when assets are sold to a newly formed corporation in order to change the state in which the lessee business is incorporated² and may actually increase the assets³ or improve the management of the corporate lessee. But in many cases amalgamation transactions will eliminate those personnel upon whose competence lessor relied, substitute a lessee with fewer net assets or a more speculative business, or change the use of the premises in a manner detrimental to lessor. In deciding whether a particular type of amalgamation transaction breaches a nonassignment clause, courts have asked first, has an "assignment" been made, and second, is it within the scope of the nonassignment clause.⁴

1. Nonassignment clauses are frequently used and take a variety of forms. For examples, see BERGERMAN & ROTH, *NEW YORK REAL PROPERTY FORMS* 512-14 (2d ed. 1959); FRIEDMAN, *REAL ESTATE FORMS* 164 (1957); FRIEDMAN, *PREPARATION OF LEASES* 102 (1955).

2. See *H. P. Hood & Sons v. Perry*, 248 Mass. 350, 142 N.E. 794 (1924).

3. Cf. *Peacock v. Feltman*, 243 Ill. App. 236 (1927), where the entire assets of an Indiana corporation were transferred to a newly formed Delaware corporation having a substantially larger capital stock and which expressly assumed the liabilities of the transferor corporation. The transferor corporation was dissolved and the enterprise was carried on without interruption by the same personnel and under the same management.

4. Amalgamation may also be accomplished, of course, through *acquisition* by a lessee corporation of stock or assets of another corporation, a technique which may also advance, be a detriment to, or have no effect upon the interests of the landlord. But no case has been found in which a landlord claimed that such an acquisition by a lessee constituted a breach of a nonassignment clause, probably because of the courts' insistence upon some change in legal entity as a necessary condition to finding an assignment. Compare *Burrows Motor Co. v. Davis*, 76 A.2d 163 (D.C. Munic. Ct. App. 1950) (sale of stock effects no change in corporate entity), with *Lord Baltimore Filling Stations v. Hoffman*, 117 A.2d 397, 398 (D.C. Munic. Ct. App. 1955) ("One corporation, Lord Baltimore, assigned

Sales by shareholders of stock in the lessee corporation, even sales of all the stock or of a controlling interest—which may result in amalgamation—are not held to constitute assignments.⁵ Two rationales have been offered for this result. One court has said that since a corporation is an entity separate from its shareholders and since it is that entity which is lessee, a change in shareholders nonetheless leaves the same tenant and thus does not constitute an assignment of the lease.⁶ Other courts have reached the same conclusion by finding that the parties could hardly have contemplated that the sale of stock by a shareholder would give the lessor the option of claiming a forfeiture since the lessor must have known when he entered the lease that corporate stock is traded in the ordinary course of business. These courts reason that if the lessor had really intended to bar transfers of stock, he would have expressly so provided.⁷ If possible, however, landlords would consider sales of stock within the scope of the prohibition, since they would foresee the substantial changes which could be effected in the character of their corporate lessees by stock transfers. But most corporate managers would never agree to such a construction of the clause, which would severely restrict the transferability of outstanding stock.⁸ Thus, even discarding the fiction of contemplation, exclusion of sales of stock from the operation of a nonassignment clause seems the result which would have obtained had the parties actually bargained over the proper interpretation of the provision.

Nor are nonassignment clauses generally breached when lessee enters a contract providing that a third party shall exercise substantial managerial powers over lessee's business,⁹ a device which may be used to accomplish temporary

the lease to another corporation, American Oil, and the fact that the one was the wholly owned subsidiary of the other did not prevent the transaction from being a true assignment." Such acquisitions will not be treated separately in this Note.

5. See, e.g., *Alabama Vermiculite Corp. v. Patterson*, 124 F. Supp. 441, 445 (D.S.C. 1954) (collecting cases). The first time a lessor claimed that the sale by a shareholder of all the stock of a corporate lessee constituted an assignment, the argument was dismissed as "frivolous." *Rivoli Holding Co. v. Ulichy*, 109 N.J. Eq. 54, 56, 156 Atl. 369, 370 (Ch. 1931).

6. *Posner v. Air Brakes & Equip. Corp.*, 62 A.2d 711 (N.J. Super. Ct. Ch. 1948). The court taking this approach indicated, however, that if it found fraud, deception, or injustice, it might "pierce the corporate veil" to find an assignment. *Id.* at 713.

7. *Burrows Motor Co. v. Davis*, 76 A.2d 163 (D.C. Munic. Ct. App. 1950); *Ser-Bye Corp. v. C.P. & G. Markets, Inc.*, 78 Cal. App. 2d 915, 179 P.2d 342 (1947).

8. See notes 42-43 *infra* and accompanying text.

9. *Markowitz v. Greenwall Theatrical Cir. Co.*, 75 S.W. 74, 76 (Tex. Civ. App.), *rev'd on other grounds*, 97 Tex. 479, 79 S.W. 1069 (1903); see *City of Waterville v. Kelleher*, 127 Me. 32, 141 Atl. 70 (1928) (individual lessee); *Whitmeyer v. Poche*, 49 So. 2d 69, 71 (La. Ct. App. 1950) (individual lessee); *cf.* *Bond & Mortgage Corp. v. Pulley*, 95 Mont. 337, 26 P.2d 645 (1933) (individual lessee, sharecrop agreement); *Stoner v. Markey*, 63 Ohio App. 459, 27 N.E.2d 176 (1940) (individual lessee, sharecropping on percentage basis neither an assignment nor a subletting); *Vincent v. Crane*, 134 Mich. 700, 97 N.W. 34 (1903) (dictum) (individual lessee). *But cf.* *Sherwin v.*

amalgamation. One route to this result has been a purely semantic distinction between contracts of employment and assignments, with management contracts falling into the former category.¹⁰ A second argument is that since the lease taken as a whole contained no intimation that the lessee's current managers are obligated personally to manage the business, it is not reasonable to read such an obligation into a vague nonassignment clause.¹¹ Third, when the manager's compensation is computed as a percentage of the profits, the hiring of the manager has been likened to the formation of a partnership¹² which, in turn, is held not to be an assignment.¹³ Finally, if the court can find both that the manager receives compensation for his services and that the lessee retains a substantial interest in the business, the manager may be termed "an agent of the lessee," and therefore not an assignee or sublessee.¹⁴ When the only interest retained by the corporate lessee in the premises is the right to receive an absolute monthly sum, however, the "manager's" obligation to pay all expenses and bear all the losses of the enterprise and his right to receive all the income in excess of a "rental payment" to the lessee may be held inconsistent with his being a "mere servant" of the lessee.¹⁵ And when indicated by the practical construction the parties to a management agreement place upon it and the terms of the agreement itself, "management contracts" have been held to constitute breaches.¹⁶

In the one reported appellate case directly on point, *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club*,¹⁷ a corporate amalgamation by statutory merger, though considered an assignment, was held not to violate a non-

Bogosian, 112 Cal. App. 359, 296 Pac. 641 (1931) (individual lessee's covenant not to sublet breached by percentage sharecropping "lease"). See also note 14 *infra*.

10. *Markowitz v. Greenwall Theatrical Cir. Co.*, 75 S.W. 74 (Tex. Civ. App. 1903).

11. See *City of Waterville v. Kelleher*, 127 Me. 32, 141 Atl. 70 (1928) (individual lessee).

12. See *id.* at 36, 141 Atl. at 72 (dictum).

13. See note 31 *infra*.

14. Cf. *Boston Elevated Ry. v. Grace & Hyde Co.*, 112 Fed. 279 (1st Cir. 1901), where a creditor in possession was deemed an "agent" of corporate lessee even though the lessee did not retain any right to income from the premises or to regain possession at any fixed future date. *But cf.* *Cockrell v. Houston Packing Co.*, 105 Tex. 283, 295, 147 S.W. 1145, 1151 (1912) (where a creditor in possession was held an assignee of an individual lessee).

15. *Boston, C. & M.R.R. v. Boston & L.R.R.*, 65 N.H. 393, 448, 23 Atl. 529, 535 (1888) (corporate lessee); see *Frasier v. Witt*, 62 Cal. App. 309, 217 Pac. 114 (1923) (individual lessee); *Bedgisoff v. Morgan*, 23 Wash. 2d 737, 745, 162 P.2d 238, 242, *modified*, 24 Wash. 2d 781, 167 P.2d 422 (1945).

16. See *Lemons v. Knox*, 72 Ariz. 177, 232 P.2d 383 (1951). In *Lemons*, as in the cases cited in note 15 *supra*, the only interest retained by the lessee was the right to receive an absolute monthly sum. Thus *Lemons* may be regarded as a variant rationale for the result reached by those cases in the same fact situation, rather than as the statement of a wholly independent proposition of law.

17. 361 Mo. 981, 238 S.W.2d 321 (1951).

assignment clause.¹⁸ Since the lessee corporation ceased to exist and its entire interest in the lease was thus terminated and since under the Missouri merger statute¹⁹ the leasehold was vested in the surviving corporation, the lessee was held to have assigned the lease. But because the statute provided that all assets of the constituent companies to a merger are transferred without any further act of the parties,²⁰ the merger was classified as coming within the well established category of "transfers by operation of law," assignments which are not considered breaches of nonassignment covenants.²¹ A lower Pennsylvania court, faced with a similar case, saw no distinction between a statutory transfer by merger and a voluntary transfer, since each was a voluntary act of the lessee.²² But the *Dodier* court, while admitting that a voluntary act brought about the merger and that but for this voluntary act the lease would not have been transferred, argued that all instances of transfer by operation of law involve voluntary act of the lessee which is causally related to the transfer of the lease. Thus, the Missouri court reasoned, if the doctrine of transfer by operation of law is to have any significance when the mechanism of transfer

18. In *Pittsburgh Terminal Coal Corp. v. Potts*, 92 Pa. Super. 1, 13 (1927), the court reasoned that since it was not by an act of the constituent corporations that the surviving corporation acquired their rights and property, acquisition would be better regarded as a "succession" rather than as an assignment. But in *Potts* the lessor, not the lessee, was the merging party; the lessee had claimed that the surviving corporation could not exercise a warrant of attorney in favor of the lessor. No indication exists that the lease contained a covenant against the lessor's assignment of *his* rights or property. See Note, 38 VA. L. REV. 496, 502 (1952). But see *Fuld, Some Practical Aspects of a Merger*, 60 HARV. L. REV. 1092, 1102 (1947).

19. MO. ANN. STAT. §§ 351.410-455 (1952).

20. MO. ANN. STAT. § 351.450(4) (1952).

21. In *Proprietors of Locks & Canals v. Boston & M.R.R.*, 245 Mass. 52, 139 N.E. 839 (1923), a lease covenant whereby the corporate lessee agreed to surrender the premises when it shall cease to be "the owners and proprietors of said road" was similarly held not to be breached by consolidation with another corporation.

22. *Feeley v. Harwood Elec. Co.*, 22 Luz. Leg. Reg. 314 (Pa. C.P. 1923). The non-assignment covenant in *Feeley* specified that transfers by "every . . . legal process" were within its scope; therefore, the case is not a holding directly contrary to *Dodier*. The *Feeley* opinion is unclear. Language at the beginning of the court's decision that "it is perfectly clear that by the express terms of the Act, the agreement based thereon, and the lease, a voluntary transfer, synonymous with assignment, resulted," *id.* at 317, indicates the court's rationale to be that because the merger agreement is voluntary the transfer of assets thereunder is likewise voluntary. Later in its discussion, however, the court argues as follows:

We discover no distinction in principle or authority between the statutory transfer effected by merger and any other mode of transfer through the voluntary act of the lessee, because that mode, like any other, would thrust upon the lessor a tenant whom, with or without reason, he might not desire to recognize as such.

Id. at 318. The court could not have meant by this that any transfer which has the effect of imposing an unwanted tenant on the lessor is a breach, for a transfer on death may equally impose an unwanted tenant on the lessor though it is well accepted—probably since the sixteenth century—that the transfer on death to the lessee's executor does not breach a covenant not to assign. *Squire v. Learned*, 196 Mass. 134, 81 N.E. 880 (1907); see note 25 *infra*.

is a statute, that doctrine will prevent such transfers from being held within the ban of nonassignment clauses.²³

When originally developed the operation-of-law doctrine was based on the theories that nonassignment clauses are intended only to reach voluntary acts of the lessee, and that "transfers by operation of law" are always involuntary.²⁴ But the models before the courts formulating the restriction—death, levy on execution, and involuntary bankruptcy—were transactions in which lessee took no action to bring about a transfer of the lease,²⁵ while an agreement to merge is calculated to transfer all of the corporate assets to another corporation. In spite of its origin in a false analogy to genuinely involuntary transfers, however, the extension of the operation-of-law doctrine to merger is not unreasonable. Merger legislation commonly provides that the surviving corporation, in addition to possessing all the assets, rights, and privileges of

23. *Dodier Realty & Inv. Co. v. St. Louis Nat'l Baseball Club*, 361 Mo. 981, 988, 238 S.W.2d 321, 323 (1951).

24. *Doe ex dem. Goodbehere v. Bevan*, 3 M. & S. 353, 105 Eng. Rep. 644 (K.B. 1815); *Doe ex dem. Mitchinson v. Carter*, 8 T.R. 57, 101 Eng. Rep. 1264 (K.B. 1798).

25. From the sixteenth century the English courts have ruled that a transfer to lessee's executors upon his death is not violative of a covenant not to assign unless such a transfer is expressly prohibited. See *Moor & Ferrands Case*, 1 Leo. 3, 74 Eng. Rep. 3 (C.P. 1581) (by implication); *Squire v. Learned*, 196 Mass. 134, 81 N.E. 880 (1907); *Parry v. Harbert*, 1 Dyer 45b, 73 Eng. Rep. 98 (K.B. 1540) (dictum) (although an executor would breach such a clause by assigning). When lessee devised his leasehold to one other than his executors, the early cases split. Compare *Fox & Swan*, Style 483, 82 Eng. Rep. 881 (1655) (devise not a breach) and *Doe ex dem. Goodbehere v. Bevan*, 3 M. & S. 353, 105 Eng. Rep. 644 (K.B. 1815) (dictum), with *Barry v. Stanton*, Cro. Eliz. 330, 78 Eng. Rep. 580 (K.B. circa 1590) (devise breached condition against assignment). During the eighteenth century the category of assignments by operation of law was expanded to include assignments in involuntary bankruptcy, *Demn d. Lord Stanhope v. Skeggs*, 21 Geo. 3 B.R., cited at 8 T.R. 59, 101 Eng. Rep. 1266 (K.B. 1798) (*semble*); *Goring v. Warner*, 2 Eq. Cas. Abr. 100, 22 Eng. Rep. 86 (Ch. 1724), and transfers upon a levy of execution upon an insolvent's property, *Doe ex dem. Mitchinson v. Carter*, 8 T.R. 57, 101 Eng. Rep. 1264 (K.B. 1798). The further extension of the doctrine to permit the assignee in bankruptcy to dispose of a nonassignable lease, *Doe ex dem. Goodbehere v. Bevan*, 3 M. & S. 353, 105 Eng. Rep. 644 (K.B. 1815), was a natural and predictable outgrowth of permitting the transfer to the assignee since it would be inequitable to encumber him with operating the bankrupt's business or estate under threat of forfeiture should the lease be sold. Subsequently the doctrine has been used to avoid finding a breach where the leasehold is sold in satisfaction of a mortgage, see, e.g., *Riggs v. Pursell*, 66 N.Y. 193, 201 (1876), where the lease is assigned in a proceeding in voluntary bankruptcy, *Bemis v. Wilder*, 100 Mass. 446 (1868) (alternate holding), where the lease is transferred to a trustee in bankruptcy in a voluntary reorganization proceeding under chapter X of the Bankruptcy Act, *In re Childs Co.*, 64 F. Supp. 282, 284 (S.D.N.Y. 1944) (corporate lessee), and where the lease is sold by a trustee in bankruptcy, *In re Prudential Lithograph Co.*, 270 Fed. 469 (2d Cir. 1920) (same). *But cf. In re Farrow's Bank, Ltd.*, [1921] 2 Ch. 164 (compulsory liquidation) (corporate lessee). The doctrine has also been used where there had been a transfer of the lease to a trustee upon voluntary dissolution and the transfer by the trustee of the total corporate assets—including the lease—to a partnership. *Chestnut v. Master Labs.*, 148 Neb. 378, 390, 27 N.W.2d 541, 548 (1947) (alternative holding).

the constituent corporations,²⁶ remains subject to their duties and obligations.²⁷ Further, application of nonassignment clauses to mergers would, by preventing the surviving corporation from taking over the lease, run counter to the specific provisions in many statutes that no interest in property shall be in any way impaired by reason of merger and that the interest shall be as effectually the property of the surviving corporation as it was of the constituent corporations.²⁸ Since the comprehensive merger statutes evidence a legislative disposi-

26. See, *e.g.*, ALASKA COMP. LAWS ANN. § 36-2A-95 (Supp. 1958) (vest without further act or deed); CONN. GEN. STAT. § 33-113 (1958) (all property shall be vested in); DEL. CODE ANN. tit. 8, § 259 (1953) (all property shall be vested in); FLA. STAT. ANN. § 608.22 (1943) (all property shall be vested in); HAWAII REV. LAWS § 173-13 (1955) (vest without further act or deed); ILL. REV. STAT. ch. 32, § 157.69 (1957) (vest without further act or deed); KAN. GEN. STAT. ANN. § 17-3706 (1949) (all property shall be vested in); KY. REV. STAT. § 271.485 (1953) (vest without further act or deed); ME. REV. STAT. ANN. ch. 53, § 84(VII) (Supp. 1959) (all property shall be vested in); MD. ANN. CODE art. 23, § 71 (1957) (vest without further act or deed); MO. ANN. STAT. § 351.450 (1952) (vest without further act or deed); N.J. STAT. ANN. § 14:12-5 (1939) (all property shall vest in); N.Y. STOCK CORP. LAW § 89 (all property shall be vested in and shall vest without further act or deed); PA. STAT. ANN. tit. 15, § 2852-907 (1958) (vest without further act or deed); UTAH CODE ANN. § 16-5-6 (1953) (vest without further act or deed); VA. CODE ANN. § 13.1-74 (1956) (vest without further act or deed).

27. See, *e.g.*, ALASKA COMP. LAWS ANN. § 36-2A-95 (Supp. 1958); CONN. GEN. STAT. § 33-113 (1958); DEL. CODE ANN. tit. 8, § 259 (1953); HAWAII REV. LAWS § 173-13 (1955); ILL. REV. STAT. ch. 32, § 157.69 (1957); ME. REV. STAT. ANN. ch. 53, § 84 (VII) (Supp. 1959); MD. ANN. CODE art. 23, § 71 (1957); MO. ANN. STAT. § 351.450 (1952); N.J. STAT. ANN. § 14:12-5 (1939); N.Y. STOCK CORP. LAW § 90; PA. STAT. ANN. tit. 15, § 2852-907 (1958); UTAH CODE ANN. § 16-5-6 (1953); VT. STAT. ANN. tit. 11, § 166 (1959); VA. CODE ANN. § 13.1-74 (1956).

28. See, *e.g.*, ALASKA COMP. LAWS ANN. § 36-2A-95 (Supp. 1958) (shall not revert or be in any way impaired); ARK. STAT. ANN. § 64-702 (1957) (shall be as effectually the property of the surviving corporation as of its constituents); DEL. CODE ANN. tit. 8, § 259 (1953) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); HAWAII REV. LAWS § 173-13 (1955) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); ILL. REV. STAT. ch. 32, § 157.69 (1957) (shall not revert or be in any way impaired); KAN. GEN. STAT. ANN. § 17-3706 (1949) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); ME. REV. STAT. ANN. ch. 53, § 84 (VII) (Supp. 1959) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); MICH. STAT. ANN. § 21.53 (1935) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); MO. ANN. STAT. § 351.450 (1952) (shall not revert or be in any way impaired); N.J. STAT. ANN. § 14:12-5 (1939) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); N.Y. STOCK CORP. LAW § 89 (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); VT. STAT. ANN. tit. 11, § 165 (1959) (shall not revert or be in any way impaired and shall be as effectually the property of the surviving as of the constituent corporations); VA. CODE ANN. § 13.1-74 (1956) (shall not revert or be in any way impaired); WIS. STAT. ANN. § 180.67 (1957) (shall not revert or be in any way impaired).

tion to facilitate corporate merger, application of the operation-of-law doctrine to statutory mergers is justifiable.²⁹ Moreover, to the extent that the development of the operation-of-law doctrine in involuntary bankruptcy and creditor levy cases is grounded on protecting the interests of parties outside the lessor-lessee relationship,³⁰ the same reasoning would militate in favor of the doctrine's availability in merger situations, since the interests of shareholders and creditors are indirectly protected by treating the surviving corporation as a continuation of its constituents.³¹

Transfer of all the lessee's assets to another corporation, a fourth technique of corporate amalgamation has traditionally been held a voluntary assignment of the lease resulting in a breach of the covenant not to assign.³² Even when

29. A court-ordered transfer of "all the property, rights, and powers" of the transferor companies "without further act or deed" has been held to transfer a personal services contract although such contracts are in English law generally nonassignable. *Nokes v. Doncaster Amalgamated Collieries, Ltd.*, [1938] 4 All E.R. 6 (K.B.). The court order was made under § 154 of the Companies Act of 1929 which authorizes a court to make provision for "the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company . . ." Companies Act, 1929, 19 & 20 Geo. 5, c. 23, § 154 (repealed). In finding the contract to have been transferred by the court order, Lord Hewart, L.C.J., said: "[W]e are dealing with provisions for facilitating—not for hindering, not for frustrating, not for bewildering, but for facilitating—the reconstruction and amalgamation of companies. . ." *Nokes v. Doncaster Amalgamated Collieries, Ltd.*, *supra* at 10.

30. See *Doe ex dem. Goodbehere v. Bevan*, 3 M. & S. 353, 105 Eng. Rep. 644 (K.B. 1815); *Goring v. Warner*, 2 Eq. Cas. Abr. 100, 22 Eng. Rep. 86 (Ch. 1724); *Pappas v. Broad & East Jersey Realty Co.*, 103 N.J.L. 704, 137 Atl. 417 (C.P. 1927) (dictum).

31. See MO. ANN. STAT. § 351.410 editorial comment (1952). The *Dodier* result coincides with the longstanding rule that at least so long as an original lessee partner remains active, compare *Dingley v. Sales*, 1 M. & S. 297, 105 Eng. Rep. 111 (1813), with *Hunter v. Johns*, 275 Pa. 532, 119 Atl. 605 (1923), the addition of a partner does not breach a nonassignment covenant, see, e.g., *Miller v. Pond*, 214 Mich. 186, 183 N.W. 24 (1921); *Hunt v. Shell Oil Co.*, 116 F.2d 598, 600 (10th Cir. 1941) (dictum); cf. *Liberty Nat'l Bank v. Pollack*, 337 Ill. App. 385, 85 N.E.2d 855 (1949) (transfer by partnership to a corporation not a breach). *But cf.* *Emery v. Hill*, 67 N.H. 330, 39 Atl. 266 (1893) (transfer by partnership to corporation a breach). Although the cases lack articulated rationales, the courts have apparently felt that so long as one of the original lessees remains a partner, the partnership had not changed sufficiently to constitute an assignment, since to be so characterized a transaction must result in the transfer of lessee's entire interest in the premises. *Miller v. Pond*, 214 Mich. 186, 183 N.W. 24 (1921). Thus, even where the original partnership was dissolved and the business carried on under the management of one partner, a court has held that no assignment or subletting had occurred. *Roosevelt v. Hopkins*, 33 N.Y. 81 (1865).

32. *Lord Baltimore Filling Stations, Inc. v. Hoffman*, 117 A.2d 397 (D.C. Munic. Ct. 1955); *H. P. Hood & Sons v. Perry*, 248 Mass. 350, 142 N.E. 794 (1924); *White v. Huber Drug Co.*, 190 Mich. 212, 157 N.W. 60 (1916). An attempt to defeat the rule by lessee's retaining the lease for the statutory period for winding up its affairs, while permitting its formal successor to use the leasehold to carry on the business, was held to be a breach on the theory that having transferred all its other assets and having no debts, the lease is of no value to it and cannot be conserved. *Plotkin v. Milwaukee Metal Working Co.*, 255 Wis. 456, 39 N.W.2d 439 (1949). New Mexico is the only state with a stat-

a transfer of all the assets has been made to a corporation which was specifically established to continue the same business at the same location under the same firm name and with the same management, but when most of the shareholders of the original corporation were eliminated, a breach was found.³³ Had the old shareholders simply sold their stock, there would have been no breach.³⁴ The court, however, reasoned that the two corporations could not be said to be substantially identical since a change was made not only in the shareholders but also in the legal entity which held title to the assets.³⁵ Other courts have required a change in legal entity only. Thus, nonassignment covenants have been breached even when the transferor is a wholly owned subsidiary of the transferee³⁶ and when the transferee is a corporation reincorporated in another state expressly to continue the transferor's business and carries on that business without interruption or substantial change in management.³⁷ This line of authority was rejected, however, when the trustees of a dissolved corporation transferred its entire assets to a partnership composed of the former shareholders, apparently on the ground that transfer to a partnership was different from a transfer to a corporation.³⁸ Why a different result should be reached where the transfer is to another corporation is unclear, since in either instance the same enterprise is continued uninterrupted under the same management. And transfers of assets may not be breaches of nonassignment clauses in those states whose statutes explicitly provide that the assets of the transferor corporation shall vest in the transferee "without fur-

ute which explicitly provides for forfeiture. N.M. STAT. § 51-2-29 (1953) ("[N]o corporation shall have the right to sell, transfer, or exchange any contract, or property, or rights derived therefrom or thereunder, not assignable by its terms.")

33. *White v. Huber Drug Co.*, 190 Mich. 212, 157 N.W. 60 (1916).

34. See notes 5-7 *supra* and accompanying text.

35. 190 Mich. at 220, 157 N.W. at 63.

36. *Lord Baltimore Filling Stations, Inc. v. Hoffman*, 117 A.2d 397 (D.C. Munic. Ct. 1955).

37. *H. P. Hood & Sons v. Perry*, 248 Mass. 350, 142 N.E. 794 (1924); *Peacock v. Feltman*, 243 Ill. App. 236 (1927) (dictum). But a dictum in *White v. Huber Drug Co.*, 190 Mich. 212, 219, 157 N.W. 60, 62 (1916), indicated that it would reach the opposite result in the context of reincorporation, since the actual owners remained the same. The *White* court relied on *New York Bank Note Co. v. Hamilton Bank Note Engraving & Printing Co.*, 28 App. Div. 411, 423, 50 N.Y. Supp. 1093, 1099 (1898) (reincorporation in a different state does not bar "assignee" from enforcing contract), and *Reynolds v. Myers*, 51 Vt. 444, 455 (1879) (by implication) (contract enforceable against enterprise reincorporated in a different state).

38. *Chestnut v. Master Labs.*, 148 Neb. 378, 390, 27 N.W.2d 541, 548 (1947) (alternative holding). The Nebraska court expressly distinguished both *H. P. Hood & Sons v. Perry* and *White v. Huber Drug Co.* because "the two cases do not involve circumstances where there had been a dissolution and a continuation of the same business and parties by a partnership." *Id.* at 390, 27 N.W.2d at 549. The Wisconsin Supreme Court has interpreted the *Chestnut* decision as based entirely upon waiver. *Plotkin v. Milwaukee Metal Working Co.*, 255 Wis. 456, 459, 39 N.W.2d 439, 441 (1949). But if *Plotkin* is correct, it seems unlikely that the *Chestnut* court would have bothered to distinguish *Hood* and *White*.

ther act or deed" upon approval of the transfer by the transferor's shareholders³⁹ or that the assets shall belong as effectually to the successor corporation as they did to the original corporation.⁴⁰ Transfers pursuant to these statutes may be interpreted as transfers by operation of law, since legislatures have used substantially the same language in providing for the effect of mergers and sales of assets.

Thus, it is easily seen that the judicial construction of nonassignment clauses has been unsatisfactory. In the present context as in some others, it can make no difference to a lessor which technique—merger, sale of assets, sale of stock, management contracts—his lessee uses to achieve amalgamation.⁴¹ For example, merger with, and transfer of assets to, a debt-ridden corporation which then becomes the "new lessee" may equally impair the ability of the lessee enterprise to pay rent. Since the lessor's interests may be equally harmed by merger, sale of assets, management contracts, and sale of stock, the use of one form rather than another should not of itself govern the applicability of covenants against assignment.

And the most desirable uniform treatment of the described amalgamation transactions may be simply stated: they should not be held to breach covenants not to assign. First, to subject such normal corporate activities to nonassignment clauses, which are fairly commonplace, seems such a haphazard mode of lessor protection as to allow landlords to declare forfeitures whenever such an "assignment" occurs for a variety of other grounds. Second, holding nonassignment covenants breached by amalgamation transactions would severely reduce the advantages of the corporate form of doing business. Should the acquisition of controlling blocks of stock by outsiders be held breaches, for example, management would be compelled to impose restrictions on the transferability of all shares to prevent such acquisitions and thus to save the corporation's leases from forfeiture. But whether courts would uphold such restrictions in the case of publicly held corporations is, to say the least, rather doubtful.⁴² If they would not, the lessee's managers would be placed in the

39. UTAH CODE ANN. § 16-5-6 (1953). The Utah code provides for the effect to be given the sale of assets and the effect to be given merger by the same provision. Section 16-5-1 concerns "consolidation by merger." Section 16-5-2 describes the procedure for consolidation by purchase. Section 16-5-6 provides for the transfer of property upon both forms of consolidation.

40. ME. REV. STAT. ANN. ch. 53, § 51-2-29 (1953); MD. ANN. CODE art. 23, § 72(1) (1957); VT. STAT. ANN. tit. 11, § 165 (1959).

41. See FTC, REPORT ON CORPORATE MERGERS AND ACQUISITIONS 8-10, 69-70, 85-101 (1955); BALLANTINE, CORPORATIONS §§ 182, 279-80 (rev. ed. 1946).

42. Although early dicta suggest a contrary result, *In re Klaus*, 67 Wis. 401, 405, 29 N.W. 582, 583 (1886) (Wisconsin statutes "are inconsistent with the exercise of a prohibitory power of the corporation, by by-laws or the articles of incorporation, to prevent the entry of transfers of stock in the books actually made and which are valid between the parties"), where such a restriction was contained in the *articles of incorporation* courts have enforced it, *Mason v. Mallard Tel. Co.*, 213 Iowa 1076, 240 N.W. 671 (1932); *68 Beacon St., Inc. v. Sohler*, 289 Mass. 354, 194 N.E. 303 (1935); *Wright v. Iredell Tel. Co.*, 182 N.C. 308, 108 S.E. 744 (1921) (distinguishing by-law imposed restrictions); see

untenable position of being unable to prevent breaches of the nonassignment clause. Even when the managers of the lessee corporation could restrict the sale of stock by requiring lessor's approval whenever stock was to be transferred—as in close corporations—such a restriction would impair their ability to attract new personnel,⁴³ who, even if able to invest in lessee's stock, would probably not be willing to do so where they not free to withdraw. Thus equity financing would be curtailed. In sum, sales of stock should not be considered breaches,⁴⁴ and no rational basis would then exist for holding equivalent transactions violative of the nonassignment clause. In addition, the erection of a legal barrier restricting amalgamation will arguably prevent free market forces from determining who shall control the nation's economic resources,⁴⁵ and may impede the revitalization of unhealthy enterprises by skilled managers.⁴⁶

O'Neal, *Restrictions on Transfer of Stock in Closely Held Corporations: Planning and Drafting*, 65 HARV. L. REV. 773, 780 (1952). *But see* Hornstein, *Stockholders Agreements in the Closely Held Corporation*, 59 YALE L.J. 1040, 1049 (1950). Restrictions requiring consent when the restriction is found only in the by-laws have almost without exception been held invalid. *E.g.*, *People ex rel. Malcom v. Lake Sand Corp.*, 251 Ill. App. 499 (1929); *Miller v. Farmers Milling & Elevator Co.*, 78 Neb. 441, 110 N.W. 995 (1907); *State ex rel. Howland v. Olympia Veneer Co.*, 138 Wash. 144, 244 Pac. 261 (1926). *But cf.* *Longyear v. Hardman*, 219 Mass. 405, 106 N.E. 1012 (1914) (relying on statute). But with one possible exception, *Wright v. Iredell Tel. Co.*, *supra*, whenever the restriction in question has been upheld, the corporation was considered closely held, see *Mason v. Mallard Tel. Co.*, *supra* at 1087, 240 N.W. at 675 ("It is apparent from the record that it is a small corporation . . . Those who created the corporation manifestly intended that the stock should be closely held . . ."); *Longyear v. Hardman*, *supra* at 408, 106 N.E. at 1013 ("The motives . . . [for the imposition of such a restriction] in a small business corporation, where substantial changes in ownership of stock well might be accompanied by a change of managing officers, are obvious."); *cf.* *Penthouse Properties, Inc. v. 1158 Fifth Ave., Inc.*, 256 App. Div. 685, 11 N.Y.S.2d 417 (1939) (restriction contained in lease of co-op apartment).

43. Restrictions on the free transferability of stock are frequently imposed as a means of protecting the managers of a closely held corporation against the possibility of outsiders entering the business. See O'NEAL, *CLOSE CORPORATIONS* § 7.02 (1958). See also *Barrett v. King*, 181 Mass. 476, 479, 63 N.E. 934, 935 (1902) (Holmes, J.) ("[T]here seems to be no greater objection to retaining the right of choosing one's associates in a corporation than in a firm"). The usual restriction does not hinder the readjustment of control, since when the board wishes to take in a new manager it is free to consent to the transfer of stock to him. But when the restriction is imposed as a means of safeguarding a lessee against a forfeiture of a lease, the lessor and not the existing managers determines whether a new "partner" may be taken into the business. Whereas in the former case the restricted character of the stock may prove an attraction to a capable individual, in the latter case the managers may be prevented by the lessor's objection from offering such an individual stock in the company.

44. For a discussion of the analogous requirements of economic flexibility which prompted the provision prohibiting covenants not to assign accounts receivable, see *UNIFORM COMMERCIAL CODE* § 9-318, comment.

45. Of course, sound reasons exist for limiting corporate amalgamations in some instances. See *FTC, REPORT ON CORPORATE MERGERS AND ACQUISITIONS* (1955); Comment, 68 YALE L.J. 1627 (1959).

46. For an example of revitalization through merger, see *Saunders, The Stormiest Merger Yet*, *Fortune*, April 1955, p. 136.

But if nonassignment clauses are held not breached by amalgamation transactions entered by lessees, some alternative means of landlord protection, consonant with tenant interests, must be sought. One approach is represented by the English Landlord and Tenants Act of 1927⁴⁷ which provides that a lessor may not unreasonably withhold his consent to an assignment of the lease,⁴⁸ and allows a lessee to secure a judgment determining his right to transfer in order that he not be forced to transfer at his peril.⁴⁹ The act does little, however, to meet the problems raised by the American cases. By its terms, the act is inapplicable unless the transaction is declared to be an assignment. Thus, neither management contracts nor transfers of stock would come within its purview.⁵⁰ And while merger is considered an assignment,⁵¹ it probably would not be within the scope of the statute on the following reasoning. The statute, which does not obligate the lessee to obtain lessor's consent, applies only where the lessee has covenanted in the lease not to assign without lessor's consent. Since the act thus applies only to transactions within the scope of nonassignment clauses,⁵² and since mergers have been held beyond the scope of such clauses,⁵³ the act would not reach mergers. Even where the act applies, minimal protection is given the tenant who must prove that the lessor's denial of consent was unreasonable.⁵⁴ Almost any ground that might be advanced will probably be held to constitute a reasonable basis for lessor's withholding con-

47. In all leases whether made before or after the commencement of this Act containing a covenant, condition or agreement against assigning, underletting, charging or parting with the possession of demised premises or any part thereof without license or consent, such covenant, condition or agreement shall, notwithstanding any express provision to the contrary, be deemed to be subject

(a) to a proviso to the effect that such license or consent is not to be unreasonably withheld, but this proviso does not preclude the right of the landlord to require payment of a reasonable sum in respect of any legal or other expenses incurred in connection with such license or consent.

Landlord & Tenant Act, 1927, 17 & 18 Geo. 5, c. 36, § 19(1).

48. Under the act, if a lessor unreasonably withholds consent, lessee may nevertheless assign. See *Lewis & Allenby (1909), Ltd. v. Pegge*, [1914] 1 Ch. 782; *Ideal Film Renting Co. v. Nielson*, [1921] 1 Ch. 575 (dictum); *Sear v. House Property & Inv. Soc'y*, 16 Ch. D. 387 (1880) (dictum). Of course, the statutory standard could be included in the lease.

49. *Evans v. Levy*, [1910] 1 Ch. 452; *cf. West v. Gwynne*, [1911] 2 Ch. 1 (C.A.); *Young v. Ashley Gardens Properties, Ltd.*, [1903] 2 Ch. 112 (C.A.).

50. See notes 5-7, 9-14 *supra* and accompanying text.

51. See note 18 *supra* and accompanying text.

52. "[S]uch *covenant, condition or agreement* shall . . . be deemed to be subject . . . to a proviso . . ." Landlord & Tenant Act, 1927, 17 & 18 Geo. 5, c. 36, § 19(1). (Emphasis added.)

53. See note 18 *supra* and accompanying text.

54. See, *e.g.*, *Shanly v. Ward*, 29 T.L.R. 714 (C.A. 1913); *Mills v. Cannon Brewery Co.*, [1920] 2 Ch. 38, 46 (dictum). Furthermore, the lessor need not give reasons for refusing consent. *Goldstein v. Sanders*, [1915] 1 Ch. 549; *Young v. Ashley Gardens Properties, Ltd.*, [1903] 2 Ch. 112, 115 (C.A.) (dictum).

sent: the financial ability,⁵⁵ the personality,⁵⁶ the stability of,⁵⁷ and the use by⁵⁸ the proposed assignee. In addition, when the landlord has refused consent on the advice of experts, it has been concluded that lessor's refusal must have been reasonable.⁵⁹ Only when the lessor's sole motive in refusing consent was to free the premises⁶⁰ to charge higher rent,⁶¹ or to avoid losing the assignee as a tenant of other premises⁶² would a court find the lessor's refusal unreasonable.

Even a statute designed to meet the major difficulties of the English statute, and focused specifically on amalgamation transactions, would be subject to severe objections. Such a statute might provide that if a corporate lessee enters a management contract, transfers all or almost all of its assets, merges or consolidates or is the surviving corporation in a merger, or if a substantial portion of stock in the lessee corporation is transferred by any means whatever,⁶³ and if the lessor has not given written consent to such transaction whether or not such consent is required by the lease, and if the lessor can prove lessee to be a poorer business risk subsequent to the transaction or to be likely to use the property in a manner detrimental to the lessor's other holdings, the court shall declare a forfeiture or an increase in the rental, whichever is more equitable. This statute has the advantage of encompassing all economically equivalent amalgamation transactions which are likely to prejudice the lessor. In addition, the grounds specified by the statute as detrimental to the lessor afford less possibility of arbitrary refusal of consent than the reasonableness formula of the English act. But whenever an amalgamation was contemplated, the corporate lessee might first be required to obtain a declaratory judgment that the proposed change would not prejudice the lessor. In view of crowded court

55. Cf. *Shanly v. Ward*, 29 T.L.R. 714 (C.A. 1913); *In re Town Invs., Ltd.*, [1954] 1 Ch. 301.

56. Cf. *Governors of Bridewell Hosp. v. Fawkner*, 8 T.L.R. 637 (Ch. 1892) (refusal of consent to assignment to Salvation Army general). *In re Gibbs & Houlder Bros. & Co.'s Lease*, [1925] Ch. 575 (C.A.) (dictum).

57. Cf. *Shanly v. Ward*, 29 T.L.R. 714 (C.A. 1913).

58. See *Wilson v. Flynn*, [1948] 2 All E.R. 40 (K.B.). When the use to which the premises would be put might, by competing, injure the earning power of his nearby tenants, the lessor's refusal to consent has been held reasonable. See *Premier Confectionery (London) Co. v. London Commercial Sale Rooms, Ltd.*, [1933] 1 Ch. 904.

59. See *Governors of Bridewell Hosp. v. Fawkner*, 8 T.L.R. 637 (Ch. 1892).

60. See *Bates v. Donaldson*, [1896] 2 Q.B. 241 (C.A.) (freeing premises for occupancy); *In re Winfrey & Chatterton's Agreement*, [1921] 2 Ch. 7 (freeing premises for occupancy).

61. See *Ideal Film Renting Co. v. Nielsen*, [1921] 1 Ch. 575. Compare *H. P. Hood & Sons v. Perry*, 248 Mass. 350, 142 N.E. 794 (1924).

62. See *In re Gibbs & Houlder Bros. & Co.'s Lease*, [1925] Ch. 575 (C.A.), criticized in *Tredeggar v. Harwood*, [1929] A.C. 72, 81 (dictum).

63. A pledge of stock securing a loan has been held to be an involuntary transfer of stock and not a breach of a covenant not to transfer stock. See *Lipsker v. Billings Boot Shop*, 129 Mont. 420, 431, 288 P.2d 660, 666 (1955). Thus, to be fully effective, it is necessary so to word the statute, if transfers of this nature are to be included within its scope.

dockets in many jurisdictions, a suit for a declaratory judgment might entail years of delay⁶⁴ with the probable result of cancelling the amalgamation. As an alternative the lessee might proceed with amalgamation and face the possibility of forfeiture after a subsequent suit. The lessee's only escape from this dilemma would be to accede to lessor's demands, presumably for increased rent, whenever it proposes to merge.⁶⁵

Examination of the interests of the lessor and the corporate lessee in the lease transaction is a prerequisite to discussing nonstatutory methods of solving the problem of lessee amalgamation. The lessor's underlying interest is in

64. "The nation-wide 1956 average for jury cases is 12.1 months from 'first filing' to trial in the 71 jurisdictions reporting thereon. . . . The 1956 reports for non-jury cases show an average of 6.5 months from 'first filing' to trial in the 70 jurisdictions reporting thereon. . . ." INSTITUTE OF JUDICIAL ADMINISTRATION, STATE TRIAL COURTS OF GENERAL JURISDICTION CALENDAR STATUS STUDY 1956 CIVIL CASES (JURY AND NON-JURY) I (1956). In countries having a population of more than 750,000 the average delay in jury cases was 22 months in jurisdictions reporting. *Id.* at II. In the federal courts the median time interval from filing to final disposition of civil cases in which a trial was held was 15.4 months for the same year. 1957 JUDICIAL CONFERENCE OF THE UNITED STATES ANN. REP. 4. Attorney General Brownell informed the conference that "in some areas it still takes 2½, 3 and even more than 3 years from issue for a civil case to be tried." *Id.* at 50. Since these figures were released, some improvement in court calendars has, however, occurred. See KARLEN, ATTITUDES OF THE BENCH AND BAR TOWARD THE LAW'S DELAYS (1958).

Jury trial is generally available in those declaratory judgment actions which are substitutes for actions in which either party has the right to a jury. Note, 59 YALE L.J. 168 (1949). Thus if a lessee's declaratory judgment action on the harm of a proposed amalgamation to lessor is regarded as a substitute for an ejectment action by lessor, trial by jury would be possible.

65. A statute requiring a claim by lessor that an amalgamation transaction was prejudicial to his interests to be submitted to arbitration would meet these objections in part at least. Arbitration is usually speedier and less expensive than litigation and may be more private. See 2 O'NEAL, CLOSE CORPORATIONS § 9.11 (1958). Arbitrators would be likely to adjust the rent as an alternative to forfeiture unless they found the amalgamated enterprise to be a considerably poorer risk or to have plans for the property's use seriously detrimental to lessor's other holdings.

A provision for compulsory arbitration would, however, be subject to constitutional objections. In the 1920's the Supreme Court invalidated the Kansas Industrial Court Act which provided for the compulsory fixing of wages and hours as depriving property without due process of law. *Chas. Wolff Packing Co. v. Court of Industrial Relations*, 267 U.S. 552 (1925). Since that decision appears to have been based in part upon the philosophy that the state was precluded by the fourteenth amendment from restricting the freedom of contract of employers and employees, more recent decisions upholding wage and hour legislation would seem to undercut its basis. Schwartz, *The Constitutionality of Compulsory Arbitration*, 38 KY. L.J. 361, 367 (1950); see Stanford, *Compulsory Arbitration—A Solution For Industrial Decay?*, 13 U. PITT. L. REV. 462, 464-74 (1952). This change in attitude is accented by two New Jersey decisions. *New Jersey Bell Tel. Co. v. Communications Workers*, 5 N.J. 354, 365, 75 A.2d 721, 726 (1950) (upholding compulsory arbitration of labor disputes in public utilities); *Van Riper v. Traffic Tel. Workers*, 2 N.J. 335, 347, 66 A.2d 616, 622 (1949) (dictum). Further, the willingness of the Court to uphold the provision for the arbitration of damages required by the legislatively-standardized fire policy suggests that the Court might not have invalidated statutes requir-

receipt of his rent. He is interested in his tenant's assets as a source of income and as a fund which he may look to for his rental payments and in the competency of the lessee's managers, perhaps the most important determinant of the prosperity of the business.⁶⁶ The lessor may also be interested in preventing a change in the property's use, either on grounds of personal taste or because he seeks to guard against decreasing the value of his other property located nearby. The lessee, on the other hand, will at the very minimum require assurance that its lease does not provide for forfeiture in frequently occurring circumstances—as might a broadly construed nonassignment clause—so that opportunities for bad-faith declarations of forfeiture by the lessor whenever rental values increase will be prevented. The lessee will also want to retain a maximum of control in running its business, including freedom from any restraints on financing, expansion, or amalgamation.

Another prerequisite to the satisfactory solution of the amalgamation-lease problem is a recognition of the similarities that the lessor bears to an ordinary creditor. The lessor in risking loss of the rental for which he has bargained when rental values decline and the creditor by risking the loss of the assets he has contributed to his debtor's business, have substantially identical problems in protecting themselves against the eventuality of the other party's failure. For example, by placing such reasonable restraints on his borrower as will preserve his income and asset position, the commercial lender seeks to ensure the full repayment of his loan.⁶⁷ Since the lessor has a similar interest in the financial status of his tenant, he might profitably consider the means by which lenders have sought to protect themselves.

Through the use of clauses tailored to the specific needs of the parties, lessors may be given the greatest measure of protection consistent with giving reasonable recognition to the interest of lessees.⁶⁸ To protect his interest in

ing arbitration of other questions than wages and hours of employment. See *Hardware Dealers Mut. Fire Ins. Co. v. Glidden Co.*, 284 U.S. 151 (1931).

More compelling is the claim that a compulsory arbitration statute is unconstitutional as dispensing with jury trials guaranteed in actions at law by state constitutions. The Pennsylvania Supreme Court in upholding Pennsylvania's compulsory arbitration statute—which provides for the right of appeal to a jury trial *de novo*—said that any statute making the decision of the arbitrators final would be unconstitutional. *Application of Smith*, 381 Pa. 223, 112 A.2d 625 (1955) (dictum). But the denial of trial by jury does not invalidate compulsory workmen's compensation statutes. *Branch v. Indemnity Ins. Co.*, 156 Md. 482, 144 Atl. 696 (1929); *State ex rel. Davis-Smith Co. v. Clausen*, 65 Wash. 156, 117 Pac. 1101 (1911); *Brady v. Place*, 41 Idaho 747, 242 Pac. 314 (1925) (alternative holding).

66. See 2 DEWING, *THE FINANCIAL POLICY OF CORPORATIONS* 1216 (5th ed. 1953).

67. See Gardner, *Unsecured Note Issues*, 44 ILL. B.J. 458, 462 (1956).

68. Traditionally, landlords have responded to case law developments by broadening their nonassignment clauses. The most frequently used variant of the nonassignment clause stipulates "nor shall any subletting or assignment hereof be effected by operation of law or otherwise than by the written consent of the lessor." *Burrows Motor Co. v. Davis*, 76 A.2d 163, 164 (D.C. Munic. Ct. App. 1950). Such a clause would effectively prevent a transfer of the lease by merger, *cf. Feeley v. Harwood Elec. Co.*, 22 Luz. Leg. Reg.,

his tenant's asset position, a lessor might include in the lease covenants by which the lessee agrees, at all times during the life of the lease, to limit his expenditures, liabilities, and investments to stated sums or percentages.⁶⁹ At a minimum, the landlord will want to ensure that his tenant has sufficient free assets to satisfy damages in the event of a breach. To implement this objective the lease would provide that failure of the tenant to maintain a stated ratio of current assets to current liabilities will constitute a breach.⁷⁰ Since rapid increase in current liabilities is a major cause of business failure, a similar clause requiring a stated ratio of total assets to total liabilities would be an inadequate substitute for a current assets clause.⁷¹ But a total assets clause would nonetheless perform an essential function by insuring against lessee insolvency in the bankruptcy sense.⁷² Absent such insurance, lessee may go into bankruptcy, where the amount of damages lessor may recover is severely restricted.⁷³ And the price of avoiding lessee bankruptcy is equally

314 (C.P. Pa. 1923), by devise on death, *Kiernan v. Keeney*, 62 Pa. D. & C. 469 (C.P. 1947), or by delivery of the premises to a receiver in bankruptcy, *Parks v. Union Mfg. Co.*, 14 Ky. L. Rep. 206 (Super. Ct. 1892), but has been held ineffective to block amalgamation by the purchase of a controlling share of the voting stock of the corporate lessee, *Burrows Motor Co. v. Davis*, 76 A.2d 163 (D.C. Munic. Ct. App. 1950). When a shareholder sells his share, the lessee corporation may accomplish a result which an individual could accomplish only by assignment. But unless corporate form is disregarded, the sale of stock by a shareholder is not an assignment of the lease. *Id.* at 164.

Thus a nonassignment covenant capable of fully protecting lessor's interests should provide that "an assignment within the meaning of the lease shall be construed to include (1) the transfer of the lease pursuant to (i) the merger of lessee with or consolidation in any other corporation, (ii) the merger of any other corporation with the lessee, or (iii) the transfer whether voluntary or involuntary of any or all of lessee's assets; (2) the transfer, voluntary or involuntary, by any shareholder of voting stock in lessee corporation; (3) the contracting of lessee with another to manage lessee's affairs, in consideration of a percentage of the profits or all but a stated amount of the profits." But this is unfeasible. See note 43 *supra* and accompanying text.

69. All covenants should, of course, be so written as to apply both to parent and to any subsidiary companies. Gardner, *Unsecured Note Issues*, 44 ILL. B.J. 458, 462 (1956); see BAKER & CARY, *CASES ON CORPORATIONS* 1009 (3d ed. 1958); Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 CALIF. L. REV. 243, 257 (1954).

70. For examples of current asset-liabilities restrictions see COOK, *LEGAL DRAFTING* 476 (rev. ed. 1951) [hereinafter cited as COOK]; FOULKE & PROCHNOW, *PRACTICAL BANK CREDIT* 461 (2d ed. 1950) [hereinafter cited as FOULKE & PROCHNOW]; KOLLE, *MODERN BANKING FORMS* 1210 (1958) [hereinafter cited as KOLLE].

71. 1 DEWING, *THE FINANCIAL POLICY OF CORPORATIONS* 158-59 (5th ed. 1953); see 2 *id.* at 1213-27.

72. "A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debt. . . ." Bankruptcy Act § 1(19), 52 Stat. 840 (1938), 11 U.S.C. § 1(19) (1958).

73. In bankruptcy lessor's damages are limited to one year's rent from the date of entry. Bankruptcy Act § 63(a)(9), 52 Stat. 573 (1938), 11 U.S.C. § 103 (1958); see 3 COLLIER, *BANKRUPTCY* ¶ 63.33, at 1904-09 (14th ed. 1941).

unattractive to the lessor; he may be forced to modify the lease provisions, especially the rental. An alternative approach to preserving assets would limit either severally or in aggregate the total direct and contingent liabilities that could be outstanding at any time,⁷⁴ the total annual distributions to shareholders,⁷⁵ and the amount of compensation that might be paid to executives in any given year.⁷⁶ Should the lessor conceive his interest to extend to attempting to ensure that his tenant stay in business, he may utilize the total asset and current asset restrictions as well as these more particular covenants. No matter which approach the lessor takes, he may also find it wise to limit the change of quick assets into assets of decreased liquidity by placing a limit on the amount of loans and investments, particularly the amount of loans and advances to officers, shareholders and employees,⁷⁷ and the amount of capital expenditures⁷⁸ that may be made without his consent. Finally, to keep the lessor informed of his tenant's asset position, he should require that he be furnished, monthly or annually, with the lessee's income statement and balance sheet and, in addition, should reserve the right to inspect the lessee's books.⁷⁹ To protect his interests, however, the lessee should insist on the freedom to make, without consent, such capital expenditures as he would need to expand the business or to replace existing equipment. Since long-term market trends are difficult to predict, any lessee whose business would require substantial capital investments to expand may find a capital expenditures restriction particularly objectionable. Indeed, only a lessee whose principal business is conducted on the leasehold in question would agree to most of these suggested provisions.

A more direct approach to assuring that assets will be available to compensate the lessor for damages arising from a breach would be to require the deposit at the commencement of the lease of cash or liquid securities.⁸⁰ A security deposit would allow lessee's managers a maximum of flexibility in running the business in contrast with the battery of limitations imposed by the covenants suggested in the preceding paragraph. And security deposits

74. See COOK 476 (forms); FOULKE & PROCHNOW 463; KOLLE 1209, 1223, 1224 (forms).

75. If the lessor is to receive adequate protection, not only dividends but all forms of distribution to shareholders must be limited. See BAKER & CARY, CASES ON CORPORATIONS 1009 (3d ed. 1958). The covenant should limit the payment of any dividends other than dividends in stock, and should limit the payment for the purchase, redemption, or retirement of any of lessee's stock by lessee or any of lessee's subsidiaries. *Id.* at 1010; see COOK 477; KOLLE 1209, 1224.

76. See KOLLE 1210.

77. See COOK 476 (limiting loans and advances); KOLLE 1209-10, 1224 (limiting investments, loans and advances).

78. See KOLLE 1209 (form).

79. See FRIEDMAN, REAL ESTATE FORMS 153 (1957) (form); KOLLE 1033, 1203, 1210 (forms).

80. Examples of security deposit provisions may be found in BERGERMAN & ROTH, NEW YORK REAL PROPERTY FORMS 469-72 (2d ed. 1959); COOK 446-47; FRIEDMAN, PREPARATION OF LEASES 109-10 (1955).

assure lessors of a recovery of at least part of the damages from a breach.⁸¹ Further, lessors are frequently able to resort to the security deposit without litigation.⁸² Manifestly, effectiveness of a security deposit will vary with the size and quality of collateral.⁸³ But the size and quality of the deposit also are determining factors in its acceptability to lessee. Most lessees would balk at tying up a substantial portion of their assets which they could otherwise use in their businesses.⁸⁴ That portion of their assets which lessees could afford to tie up would in most cases be too small to give the lessor any real protection.⁸⁵ For those lessees who normally maintain large blocks of securities, a deposit requirement would not, however, present a burden if the clause contained provisions allowing the lessee to substitute collateral and reserving to him the income.⁸⁶ Only in this rare instance will a meaningful security deposit be feasible.⁸⁷

A covenant requiring the lessor's written approval of the appointment of designated corporate officers and of any other person employed to manage the affairs of the business would ensure that those on whose financial judgment and integrity lessor relied could not be replaced by persons in whom he had no confidence. If the tenant is a "one man" corporation, the lease may provide for a breach if

_____ shall cease to be the chief executive officer of the company, but if such event results from his death, disability, or resignation then the company shall have sixty (60) days thereafter to employ in like capacity a person satisfactory to the holder.⁸⁸

When the corporate tenant is larger, several important managers may be included in such a clause. Alternatively, a covenant might provide for breach if

81. See Wilson, *Lease Security Deposits*, 34 COLUM. L. REV. 426, 432 (1934).

82. See *id.* at 437, 448-49.

83. *Id.* at 433.

84. Although he nowhere expressly so states in text, in his appendix Friedman indicates that security deposits are among those clauses most objectionable to lessees. FRIEDMAN, *PREPARATION OF LEASES* 96, 109 (1955). It is rare for the amount of the security deposit to exceed one year's rent. See *Oldden v. Tonto Realty Corp.*, 143 F.2d 916, 921 (2d Cir. 1944). Wilson believes this amount to be inadequate to safeguard lessor against a decline in rental values. See Wilson, *Lease Security Deposits*, 34 COLUM. L. REV. 426, 434-35 (1934).

85. The exception is the short term lease where significantly smaller deposits would give reasonable security. See *id.* at 433-35. But though complete security is unavailable, Wilson observes that any security is better than none. *Id.* at 433.

86. See FRIEDMAN, *PREPARATION OF LEASES* 48 (1955); Wilson, *Lease Security Deposits*, 34 COLUM. L. REV. 426, 446 (1934).

87. Even here the security deposit does not provide complete security against lessee's bankruptcy. Section 63(a) (9) of the Bankruptcy Act, 52 Stat. 873 (1938), 11 U.S.C. § 103 (1958), has been construed to require lessee to return to the trustee that portion of the security deposit in excess of one year's rent from the date of lessor's entry. *Oldden v. Tonto Realty Corp.*, 143 F.2d 916 (2d Cir. 1944).

88. KOLLE 1209.

the composition of the board of directors is changed.⁸⁹ But a restriction would doubtless be unsatisfactory to a large corporate lessee. And, even in a small corporation, managers die and retire with sufficient frequency to create some objection to such a provision. Such fortuitous events may serve only to provide the landlord with an opportunity to compel the lessee to pay increased rentals where the leasehold is valuable.

The landlord may also seek to limit the use to which his premises may be put. For example, the lessor of office spaces may fear the use of the leased premises for manufacturing because the noise which accompanies such operation would disturb his other tenants.⁹⁰ By restrictive covenants⁹¹ the lessor may either exclude any businesses he considers undesirable or restrict the property to certain specified uses.⁹² The value of covenants prohibiting named uses is limited because of the unforeseeability of those uses which will become objectionable at some future time. And a covenant permitting the premises to be used only for specified purposes may be too restrictive to prove acceptable to the lessee.⁹³

An alternative to specific covenants protecting the lessor would be for the lease to provide for arbitration if the lessor claims his interests have been prejudiced because lessee has entered an amalgamation transaction giving rise to a change in management, policies, or personnel.⁹⁴ The covenant should provide that if the arbitrators find lessor's interests to have been prejudiced by the transaction they may either adjust the rent or declare a forfeiture. While a court under existing law would be limited to a consideration of whether the form of the amalgamation gave rise to a breach, arbitrators would be free to consider whether the amalgamated enterprise would be as good a financial risk as the lessee was prior to the amalgamation.⁹⁵ Arbitrators would

89. For example, the lease might prohibit a change in a majority of the board for the first quarter of the lease term except in the case of death or disability.

90. See FRIEDMAN, PREPARATION OF LEASES 60 (1955).

91. See BERGERMAN & ROTH, NEW YORK REAL PROPERTY FORMS 295, 527 (2d ed. 1959) (forms).

92. See *id.* at 527-28 (forms); FRIEDMAN, PREPARATION OF LEASES 100 (1955). For a concise discussion of some of the problems in drafting use clauses see *id.* at 59-63, 86.

93. "If the lease contains any restrictions on the tenant's use, the tenant's lawyer should obtain express authority to conduct the business currently contemplated and to expand into such fields as his client is likely to desire during the term." *Id.* at 86.

94. Broadly drawn arbitration clauses are sometimes included in commercial leases. See BERGERMAN & ROTH, NEW YORK REAL PROPERTY FORMS 290, 518 (2d ed. 1959).

The most important commercial jurisdictions have statutes expressly making future dispute provisions specifically enforceable. See 2 O'NEAL, CLOSE CORPORATIONS § 9.14 at n.74 (1958). Elsewhere, both at common law and under the earlier statutes which made no reference to agreements to arbitrate future disputes, courts have traditionally permitted either party to revoke such an agreement. See, *e.g.*, Prader v. National Masonic Acc. Ass'n, 95 Iowa 149, 161, 63 N.W. 601, 605 (1895); Skinner v. Gaither Corp., 234 N.C. 385, 67 S.E.2d 267 (1951).

95. "Judges and juries must find for one litigant or the other, but arbitrators can mold their decision to fit the needs of the particular business problem." 2 O'NEAL, CLOSE CORPORATIONS § 9.11 (1958).

consider the changes in corporate policy and in the use of premises that the amalgamation made probable, taking into consideration the extent to which the managers of the lessee would manage the amalgamated concern. Arbitration would safeguard the lessee against an arbitrary increase in rent which might follow a breach found because the lessee used the "wrong" form of corporate amalgamation, while giving lessor protection against the substitution of a financially unreliable tenant. But arbitration will occasionally be unacceptable to the parties.

Because judicial interpretations of nonassignment clauses have varied depending on the form of corporate amalgamations, such clauses offer little protection for lessors and have created a trap for the corporate lessee. Since corporate amalgamations producing identical results may be effected in a number of ways, and since all forms of corporate amalgamation cannot feasibly be brought within the reaches of a nonassignment clause, courts should decline to hold any corporate amalgamation a breach of a nonassignment clause. If the lessor seeks protection against prejudicial changes in the identity of his corporate lessee, he should insert in the lease specific provisions which will protect him against specific dangers, rather than rely upon the catchall protection furnished by nonassignment clauses. Alternatively, he may agree with the lessee to provide for arbitration to determine whether a corporate change has so injured the lessor that a breach of the lease should be found. If the lessor fails to take these steps to protect himself, the courts should decline to interpret the nonassignment clause to provide him with an undeserved windfall.