CORRECTLY INTERPRETING LONG-TERM LEASES
PURSUANT TO MODERN CONTRACT LAW: TOWARD
A THEORY OF RELATIONAL LEASES

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MOST jurisdictions have long viewed residential or commercial
leases of real property as regulated solely by traditional prop-
erty law. By calling something “a lease,” as opposed to “a contract,”
these jurisdictions have reflexively applied certain rules to the transac-
tion. Hence, the form of the transaction, not its substance, has dic-
tated the applicable legal rules. The fact that a lease represents an
agreement between two parties regarding the use of something is often
overlooked, when that “something” is land—real property—which
has mystical connotations in our legal system. Due to land’s impor-
tance and immobility, a whole body and history of law have devel-
oped concerning this type of asset.

The nature of a lease as both a conveyance of real property and a
contract has led to the development of the rules that are the focus of
this Article. Traditional property rules dictate that a lessee may
alienate a leasehold, absent a specific lease provision restricting the
assignability or subleasing of the demised premises.1 Until recently,

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1 For the sake of brevity and consistency, “alienate” or “voluntarily transfer” will be used
in this Article to refer to either an assignment or a sublease of leasehold premises, or both. If
the need for differentiation arises, only the appropriate term will be used. An assignment
occurs when the lessee transfers his entire interest in the premises to another. A sublease
occurs when the lessee retains a reversionary interest in the property, thereby transferring
something less than the entire interest in the premises. For a comprehensive discussion of the
differences between assignments and subleases, see Curtis, Assignments and Subleases: An

This Article is limited to a discussion of the rules concerning alienability that apply to what
traditionally have been termed voluntary transfers: sales and gifts. It does not address
alienability rules that apply to other categories of separability: “involuntary extinguishment
(cancellation, forfeiture of civil rights); voluntary extinguishment (waiver, abandonment);
the vast majority of courts in the United States routinely have resorted to traditional property law principles to uphold and enforce clauses that restrict a lessee's right to alienate his interest in the premises. Consequently, parties commonly insert into commercial leases clauses that require the lessee to obtain the lessor's consent prior to alienating the leasehold. Historically, the lessor used such a clause to ensure that the proposed assignment to a second assignee-lessee ("T2") would not have a detrimental effect on the lessor's reversionary interest or, for that matter, on the lessor's present interest in the premises.

Typically, courts have resolved disputes between lessors and lessees regarding the alienability of all or a portion of the leasehold by interpreting the provisions of the lease. If the lease contains no restriction on the alienability of the leasehold, the lessee may alienate his interest to any person or entity. If, however, the lessor's consent is required to approve an assignment, the lessee must obtain the lessor's consent prior to making a valid transfer. More importantly, courts traditionally have construed clauses that forbid the lessee from freely exercising his right to alienate as granting the lessor the absolute right to refuse consent to the alienation of the leasehold—even if the stated reason for refusal to consent is unreasonable, arbitrary, capricious, or made in bad faith. In this situation, a transfer that occurs without the lessor's consent is a ground for terminating the lease.

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2 Due to a historical oddity, an absolute restraint on the alienability of a leasehold is not viewed as impermissible. See infra notes 12-20 and accompanying text.

3 Such refusals will be referred to collectively as "arbitrary" for the remainder of this Article.

4 See J. Dukeminier & J. Krier, Property 229-31 (1981). On the other hand, a lessor waives the right to terminate if he fails to make a timely objection to the transfer and accepts rent
Correctly Interpreting Long-Term Leases

It has long been an axiom of property law that courts will enforce clauses in leases allowing the lessor to withhold consent arbitrarily. In the last decade, however, a number of state courts have applied contract law principles in construing these clauses. Such a move may presage a more widespread abandonment of the common law property rules governing the alienability of commercially leased premises. The recent cases do not make this fundamental doctrinal change expressly; nevertheless, their common strand is the clear repudiation of the common law property rules and the adoption of contract rules.

For example, in Kendall v. Ernest Pestana, Inc.,\(^5\) the California Supreme Court joined the rapidly expanding list of state courts that have rejected the property rules on alienability of leaseholds and, by applying contract principles, have limited the lessor's right to restrict alienation arbitrarily. The Kendall court concluded that the traditional property right impermissibly impedes the alienability of land, and conflicts with the contract principles of good faith and fair dealing applicable to leases.\(^6\) Kendall and the other recent cases raise the significant question of when, if ever, the lessor may expressly or impliedly retain the right to refuse consent arbitrarily to the transfer of the leasehold by the lessee.\(^7\)

This Article analyzes the emerging case law restricting a lessor's right to limit the alienability of leased premises. This development in landlord-tenant law is laudable in the sense that leases, as consensual agreements, should be governed by contract rules, except when circumstances lead courts to make a special exception for a relatively unique aspect of an asset.\(^8\) But long-term commercial leases require special rules; the courts that ignore their unique characteristics may

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\(^{5}\) 40 Cal. 3d 488, 709 P.2d 837, 220 Cal. Rptr. 818 (1985).

\(^{6}\) Id. at 506, 709 P.2d at 849, 220 Cal. Rptr. at 830.

\(^{7}\) Interestingly, these cases have all involved long-term commercial leases, instead of short-term residential leases. Most of the decisions that, using implied contract principles, have expanded the lessee's rights vis-a-vis the lessor have considered cases from residential settings. See Cunningham, The New Implied and Statutory Warranties of Habitability in Residential Leases: From Contract to Status, 16 Urb. L. Ann. 3, 7-8 & n.14 (1979).

\(^{8}\) Specialized rules or laws are sometimes needed to accommodate the unique nature of the asset or item being regulated. Laws that regulate the priority of mortgages are excellent examples of rules that work effectively primarily because the asset is real property — immobile and permanent. For an analysis of the unique nature of real property as a security interest, see Johnson, Adding Another Piece to The Financing Puzzle: The Role of Real Property Secured

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improperly apply contract principles and, as a result, give rise to unintended, detrimental consequences.

The courts tend to look at the commercial lessor-lessee relationship as a short-term, complete contingent contract. Using this approach, they have restricted the lessor's options and increased his transaction costs, thereby forcing the parties into a bargaining position that requires the lessee to make important concessions to obtain a long-term lease. The lessor must demand such concessions because he is unable to restrain the alienability of the premises through contractual provisions. Courts should assist parties in reducing transaction costs by rejecting the approach used in *Kendall*. Instead, they should recognize that long-term leases are a species of relational contracts and should be governed by the rules concerning such specialized agreements and relationships.⁹

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⁹ A relational contract is defined as follows:

A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of inability to identify uncertain future conditions or because of inability to characterize complex adaptations adequately even when the contingencies themselves can be identified in advance. . . . Long-term contracts are more likely than short-term agreements to fit this conceptualization, but temporal extension per se is not the defining characteristic.

Goetz & Scott, Principles of Relational Contracts, 67 Va. L. Rev. 1089, 1091 (1981) [hereinafter Goetz & Scott, Relational Contracts]. Relational contracts differ from standard or complete contingent contracts because the complete contingent contract assumes complete risk allocation ex ante; in other words, performance standards are reduced to specific obligations. In the complete contingent contract, parties are assumed to be able to allocate all the risks ex ante, because they are presumed to have access to complete information about all the future contingencies and the relevant legal rules that could affect their relationship. See Goetz & Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 Va. L. Rev. 967, 971 n. 11 (1983) [hereinafter Goetz & Scott, Toward A General Theory of Contractual Obligations].

Professors Goetz and Scott explain that parties are prevented from forming complete contingent contracts—allocating all the risks in the document—only by the costs of negotiating and actually writing the terms. As Professor Narasimhan has adeptly summarized: "Under this view, while the contract is incomplete, the contract as supplemented with the underlying contract rules represents a complete allocation made by the parties." Narasimhan, Of Expectations, Incomplete Contracting, and the Bargain Principle, 74 Calif. L. Rev. 1123, 1129-30 n. 24 (1986). Thus, although parties to a complete contingent contract may choose to assume certain risks, those risks are foreseeable and allocated by the parties in the agreement. Goetz & Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 Calif. L. Rev. 261, 267 & n. 10 (1985) [hereinafter Goetz & Scott,
Part I briefly summarizes the common law rules on the alienability of leasehold estates. Historically, the common law courts, preferring form over function (as in much of property law), have not viewed the lease as a freehold estate, and have allowed absolute restrictions on the alienability of a lease. Such restraints, however, are viewed with disfavor. From this "rule of construction," certain boilerplate clauses or particularized formulations have emerged that clearly delimit the parties' rights and responsibilities with respect to alienability.

Part II discusses and analyzes the burgeoning minority position by focusing on the approach taken by the *Restatement (Second) of Property*\(^ {10}\) (the "Restatement") and the cases that have followed it. This Part illustrates the modernization of property law as, in some contexts, courts apply contract principles to cases previously thought to be within the exclusive domain of property law. Part II concludes by evaluating this development in California through an examination of *Kendall v. Ernest Pestana, Inc.*\(^ {11}\) In that case, the California Supreme Court wholeheartedly embraced the minority position and applied contract law principles to the alienability of leaseholds.

Part III analyzes the lessor's right to restrict alienability for arbitrary reasons, and concludes that this is an expressly retained economic right, which improves the alienability of leaseholds. By comparing the alienability of leaseholds with the alienability of mortgages, I predict that the judicial decisions restricting the alienability of leaseholds may create unfortunate economic consequences—consequences that have not been recognized by the courts. In fact, valid commercial reasons justify the use of a clause that allows the lessor to restrict alienability arbitrarily. Eliminating such a purposeful clause forces the parties to use less efficient substitutes.

Part IV proposes a solution to the issues raised by the recent decisions. Residential form leases of limited duration (three years or less, for example) should be treated as complete contingent contracts primarily comprised of terms that, except for the provisions concerning the amount of rent, are seldom the products of arms-length bargaining. Courts should treat commercial leases and leases of more than three years, but less than fifty years, as relational contracts, and

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10 Restatement (Second) of Property § 15.2(2) (1976).
should presume that a freely negotiated clause restricting the alienability of the leasehold by the lessee is effective and enforceable.

I. THE ALIENABILITY OF COMMERCIAL LEASES AT COMMON LAW

In the absence of either a statutory restriction or a provision in the lease, the lessee can alienate his interest in the leasehold freely. Because the lessor normally retains a valuable and significant reversionary interest in the leasehold, the prudent lessor will insert a clause in the lease that curtails the lessee's right to alienate the leasehold at will. The lessor is thus allowed to restrain the alienability of the leasehold, which is not a freehold estate, without running afoul of the ancient maxim that an absolute restraint on alienation is repugnant to the grant of a freehold estate. Thus, by using a clearly worded clause (an "approval clause"), the lessor effectively can control the alienability of the leased premises.

To prevent alienation without the lessor's consent, an approval clause should be worded as an absolute prohibition of any transfer by the lessee. Parties often use rhetoric similar to the following to achieve this result: "Lessee shall not sell, sublet, or assign the premises or any part thereof without the prior written consent of lessor." The law does not favor restraints on alienation; thus, clauses restricting the alienability of a leasehold are strictly scrutinized. As a result, black letter law holds that a clause prohibiting or restricting an assignment does not prohibit a sublease, and vice versa.

A. Formulations That Permit the Lessor to Restrict Alienability Arbitrarily

Notwithstanding the strict interpretation given lease clauses restraining alienability, property law has developed certain off-the-rack formulations that grant to the lessor the power to forbid absolutely the alienation of the premises. As long as the lessor has used the

12 See J. Dukeminier & J. Krier, supra note 4, at 131-33.
13 Curtis, supra note 1, at 1254.
14 A typical, more lengthy provision prohibiting transfers (both voluntary and involuntary), absent the lessor's consent, appears in Goldstein, Provisions for Subletting or Assigning a Commercial Lease (with Form), Prac. Law., Apr. 15, 1982, at 31, 35.
15 See J. Dukeminier & J. Krier, supra note 4, at 192.
16 Professors Goetz and Scott explain the purpose of off-the-rack rules as follows:
appropriate off-the-rack formulation, most courts will allow him to prohibit the alienation of the leasehold for no reason or for any reason, including an arbitrary one.\textsuperscript{17}

California, for example, embraced the majority view in \textit{Richard v. Degen & Brody, Inc.}\textsuperscript{18} and rejected the lessee's contention that the landlord may not arbitrarily withhold consent to alienation. The court stated that the great weight of authority permits the lessor to "withhold his assent arbitrarily and without regard to the qualifications of the proposed assignee."\textsuperscript{19} This approach represents the traditional property law view and, until recently, was the overwhelming majority view in the United States. Citing the paramount importance of the lessor's ability to control the selection of his tenants so as to protect the value of his reversionary interest, most courts have summarized rejected lessees' claims that the use of this theory impermissibly restrains alienability.\textsuperscript{20}

\textsuperscript{17} "'Arbitrary' means '[d]epending on will or discretion,' [and] not governed by any fixed rules or standards." Paul v. Board of Zoning Appeals, 142 Conn. 40, 44, 110 A.2d 619, 621 (1955) (quoting Webster's New International Dictionary (2d ed. 1942)). The use of a vague term like "arbitrary" is typical in a long-term contract, because the parties are unable to anticipate with particularity the facts that may give rise to a dispute. Thus, they prefer to leave the resolution of the meaning of the term to the court when the dispute arises.


\textsuperscript{19} Id. at 299, 5 Cal. Rptr. at 269 (quoting 51 C.J.S. Landlord and Tenant § 36 (1967)).

\textsuperscript{20} In addition, courts also justify the restraint by stating formalistically that a leasehold estate is a nonfreehold estate; hence, the quantum of restraint is limited. This sort of argument based on labelling the type of interest being restrained (as opposed to examining the nature of
The lessee can protect his interest in the alienability of the demised premises by refusing to agree to an approval clause that absolutely restricts his right to alienate. In this context, the parties can agree to a court-approved clause that limits the lessee's right to alienate, but does not prevent it absolutely. For example, many leases today contain approval clauses providing that the lessor may not unreasonably withhold consent to a transfer. If the lessor does withhold consent, he must demonstrate to the court's satisfaction that he has not done so unreasonably, meaning that he has acted as a prudent lessor would, given the facts of the case.

To determine reasonableness, the courts typically use a two-pronged test. The first prong tests whether the lessor's reason for denying consent would be unreasonable per se. For example, conditioning consent to a transfer on a change in the terms and conditions of the original lease is unreasonable per se. Moreover, a lessor cannot "reasonably" refuse consent where the ultimate reason for the refusal is that the lessee will make a profit from the transfer, nor can he insist on a share in that profit.

In interpreting what is reasonable behavior under the first prong of the test, the courts have developed inflexible criteria that do not vary with the identity of the lessor or with the situation. The courts have created a hypothetical lessor against whom they test the particular...
Correctly Interpreting Long-Term Leases

lessor's judgment. Thus, the original lease agreement controls the respective rights of the parties, and the lessor must base his objection to the proposed assignee, T2, on the terms of the lease, rather than on any exogenous or idiosyncratic facts that were not conveyed to the lessee ex ante and that would not concern the "reasonable lessor." 

The problem with mandating this approach in every commercial lease is that the lessor may be unable to define ex ante which future facts will affect his decision to consent to a transfer to some hypothetical and unknown assignee. This creates significant problems that may force the lessor to retain the right to restrain alienability arbitrarily. Often the parties are unable to specify at the time of contracting which factors might cause the lessee to request to transfer the premises to T2. In addition, it is unlikely that the parties would be able to identify T2 at the time of the initial lease agreement.

Requiring a lessor to act "reasonably" in deciding whether to consent to a transfer does not alleviate his concerns for several important reasons. Reasonableness, as currently defined by the courts, is both a vague and extremely narrow standard that imposes certain duties, or costs, on a lessor that he may be unwilling to bear ex ante. For example, when a lessor's decision to withhold consent is measured by "reasonableness," he runs some risk, however slight, that a court acting with hindsight will determine that his actions unreasonable. A logical corollary to this risk is the fact that a lessor, who is found to be in breach because he refused to consent to a "reasonable" transfer, runs the risk of acquiring a tarnished reputation. This threat of reduced reputational capital results in considerable pressure to consent to the transfer.

A lessor may have idiosyncratic reasons for refusing consent to a "reasonable" transfer. Because a hypothetical "reasonable lessor" would not have individualized, subjective concerns, the court might hold that a lessor's idiosyncratic refusal to consent to a transfer was unreasonable, notwithstanding his particular motivation. When a lessor agrees to act reasonably in a decision to withhold consent, he must convey at the time of the agreement any idiosyncratic facts that might cause him to reject an otherwise "suitable" or "reasonable" substitute tenant. The problem here is the same that caused the lessor to refuse

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26 This rule efficiently allocates to the lessor the duty to convey any relevant information about his preferences. See supra notes 17-20.
consent to the assignment to a hypothetical T2 at the time he contracted with the original lessee: the lessor may not be able to predict and convey ex ante any future idiosyncratic reasons to the lessee. Thus, by tying himself to a "reasonable lessor" standard, a lessor limits his range of future options.

Assuming that the lessor does agree to a reasonableness restriction on his right to object to any transfer, if the lessor has not acted unreasonably per se, the courts use the second prong of the test: the lessor must prove that the reason given for his refusal to consent is "objectively reasonable" in light of the facts of the case. Although the phrase "objectively reasonable" seems refractory at first glance, a review of the authorities reveals that acceptable objective reasons for a refusal to consent fall into two distinct categories: (1) objections concerning the financial condition of the proposed transferee (including objections concerning the financial reputation or true identity of the transferee); and (2) objections concerning the proposed use or occupancy of the premises.27

A review of the relevant case law also indicates that no court has held to be reasonable a lessor's objection to a transfer if the purpose of the objection is to extract a higher rent from the assignee-lessee. The lessor might try to justify his refusal on the ground that any transfer represents an opportunity to renegotiate the lease to reflect the unanticipated (and therefore unaddressed) changed conditions that have occurred since the lease was executed. Nonetheless, the lessor's desire to renegotiate the lease to capture part of the appreciation of the premises is not regarded as reasonable. Instead, the courts focus on various factors endogenous to the lease to ascertain what is reasonable.

In sum, the common law permits the lessor to restrict alienability arbitrarily, unless language in the lease requires the lessor to act reasonably. When language is inserted in the lease requiring the lessor to act reasonably, the lessor must show that his refusal to consent to a

27 In interpreting the term "reasonable," courts tend to take the view that the lessor can consider only a few relevant factors (receipt of the rent reserved in the lease, the terms of the lease, the financial condition of assignee, etc.) in determining whether to give consent to an assignment. To this extent, the word "reasonable" is strictly interpreted. Note, Effect of Leasehold Provisions Requiring the Lessor's Consent to Assignment, 21 Hastings L.J. 516, 517-18 (1970); accord Fernandez v. Vazquez, 397 So. 2d 1171 (Fla. Dist. Ct. App. 1981); American Book Co. v. Yeshiva Univ. Dev. Found., 59 Misc. 2d 31, 297 N.Y.S.2d 156 (1969).
transfer was justifiably based on objective standards applied to the hypothetical "reasonable" lessor. Unique facts or reasons that might cause the lessor to refuse consent, but that are not conveyed ex ante by the lessor to the lessee, may not be relied on ex post by the lessor.

II. THE MINORITY POSITION: THE INFLUENCE OF CONTRACT LAW

A. The Genesis of the Minority Rule and the Influence of the Restatement (Second) of Property

As one might expect, the common law rule has not been accepted in all jurisdictions. As early as 1943, a federal district court stated:

It would seem to be the better law that when a lease restricts a lessee's rights [to alienate the premises] by requiring [a lessor's] consent before these rights can be exercised, it must have been in the contemplation of the parties that the lessor be required to give some reason for withholding consent. Text books and digests state the law otherwise.\(^{28}\)

In 1963 Louisiana became the first state to adopt the minority position on alienability by holding in *Gamble v. New Orleans Housing Mart, Inc.*\(^{29}\) that lessors must act reasonably in situations requiring the lessor's consent to a transfer.\(^{30}\)

Following Louisiana's lead, two common law jurisdictions, Ohio\(^{31}\)


\(^{30}\) The court explained its holding as follows:

Here the lessee is simply not permitted to sublet without the written consent of the lessor. This does not prohibit or interdict subleasing. . . . It suggests or connotes . . . that he may sublet. At the time the lease was entered into the lessee had every reason to believe that he could sublet upon producing a proper subtenant.

Id. at 627. The court went on to set out the following standards:

The lessor cannot unreasonably, arbitrarily, or capriciously withhold his consent. . . . Where the provision, as here, was simply a reservation for the consent of the lessor *he did not have the right arbitrarily to refuse the sublessee tendered to him when such person was solvent, honorable, and fulfilled the same conditions as the original lessee.*

Id. (emphasis added). Under French or civil law, which greatly influences Louisiana law, a lessor who wishes to retain an arbitrary right to withhold consent must expressly reserve that right in the lease. The mere assertion that the lessor retains the right to consent to a voluntary transfer requires the lessor to act reasonably.

and Illinois, 32 rejected the common law view and adopted the holding and rationale in Gamble. In 1977 the Alabama Supreme Court addressed the lessee's right to withhold consent unreasonably in a frequently cited opinion, Homa-Goff Interiors, Inc. v. Cowden, 33 and concluded that the common law view was archaic in today's urban society. 34 The Alabama court was the first to base its decision on the policy of alienability. The court balanced the right of the lessor to withhold consent unreasonably against society's interest in the alienability of commercial leaseholds, 35 concluding that the "reasonable" alienation of commercial leasing space is paramount and predominates over any attempt by the lessor to restrict alienability arbitrarily. 36

Since Homa-Goff, fourteen states have reexamined their law on this issue. Six states have adopted or reaffirmed their adoption of the common law view, 37 while eight states have rejected the common law view and restricted, either in whole or in part, the lessor's right to restrain alienability arbitrarily. 38 The eight states that have adopted the

v. Cunningham Drug Stores, 19 Ohio App. 3d 72, 482 N.E.2d 1296 (1984) (discussing the reversal of Shaker).


33 350 So. 2d 1035 (Ala. 1977).

34 According to the court, "[e]ven where the lease provides an approval clause, a [lessor] may not unreasonably and capriciously withhold his consent to a sublease agreement. The [lessor's] rejection should be judged under a test applying a reasonable commercial standard." Id. at 1038.

35 Id. at 1037.

36 Id.


In F & L Center Co., for example, the lessee argued that the lessor can refuse consent to a voluntary transfer only on reasonable grounds. The court rejected the argument, holding instead that consent may be withheld for any reason, absent express language to the contrary in the lease. 19 Ohio App. 3d at 75-76; 482 N.E.2d at 1299-1300. The court stated that the parties easily could have inserted a reasonableness clause into the lease, as they had done in another paragraph. Id. at 75, 482 N.E.2d at 1300.

38 See Hendrickson v. Freericks, 620 P.2d 205 (Alaska 1980) (construing a twenty-year commercial lease, court held that lessor may withhold his consent only when he has reasonable grounds to do so); Tucson Medical Center v. Zoslow, 712 P.2d 459 (Ariz. Ct. App. 1985) (holding that a lease is a contract governed by the contract principles of good faith and
minority position were influenced by the position taken recently by the American Law Institute (ALI).

The ALI endorses the minority position that a lessor must act reasonably when withholding consent to alienate the lease, absent express terms to the contrary. In 1977 the ALI approved Section 15.2(2) of the Restatement, which states: "A restraint on alienation without the consent of the landlord of the tenant’s interest in the leased property is valid, but the landlord’s consent to an alienation by the tenant cannot be withheld unreasonably, unless a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent."39

The Restatement’s position expressly rejects the common law property position that gives a lessor the right to restrain alienability arbitrarily through the use of a standardized lease clause, even one that might not expressly state that the lessor has the "absolute right to withhold consent arbitrarily." Instead, the Restatement, no doubt influenced by contract law, adopted the position that a lessor’s retention of the right to restrain alienability arbitrarily through the use of the standard clause surprises the lessee and thwarts the lessee’s expectations that he may transfer to a reasonably acceptable tenant.40 Accordingly, the Restatement posits that the lessor’s interest is protected adequately by the right to object to a proposed assignee on what it deems reasonable commercial grounds—the lessee’s ability or inability to pay the rent and perform the other obligations contained

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39 Restatement (Second) of Property § 15.2(2) (1976) (emphasis added).
40 For a discussion of the merits of this argument, see infra notes 135-41 and accompanying text.
in the lease. The Restatement would prohibit the lessor from objecting to a transfer in order to extract higher rental payments or to obtain a portion of the increased value of the leasehold unless a freely negotiated provision expressly grants to the lessor the right to withhold consent to a transfer arbitrarily. The Restatement's adoption of the minority rule has caused many courts to reconsider their rules on this issue.

B. California and the Kendall Decision

No state has struggled with the issue of the validity of the standard approval clause more than California. Historically, California appellate courts recognized the right of commercial lessors to restrain alienability arbitrarily through the use of appropriate language in the lease. In 1983 the California Court of Appeal, in Cohen v. Ratnoff, rejected the rationale for the majority rule, focusing on the contractual nature of the lease. The court stated:

Since Richard v. Degen & Brody, Inc. was decided, however, there has been an increased recognition of and emphasis on the duty of good faith and fair dealing inherent in every contract. A lease constitutes both a conveyance of a leasehold interest and a contract. . . . The duty of good faith and fair dealing, which is implicit in the lease entered into between plaintiff and defendant, therefore, militates against the arbitrary or unreasonable withholding of consent to an assignment. A breach by the lessor of his duty constitutes a breach of the lease agreement.

The holding in Cohen was bolstered by the opinion in Schweiso v.

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41 Restatement (Second) of Property § 15.2 reporter's note 7 (1976).
42 For a discussion of California case law in this area, see Note, Kendall v. Ernest Pestana, Inc.: Landlords May Not Unreasonably Withhold Consent to Commercial Lease Assignments, 14 Pepperdine L. Rev. 81 (1986). Although I focus primarily on the California cases that have addressed the issues discussed herein, the issues are national in scope. California cases are highlighted because that jurisdiction has so many cases on the issue, and because California is one of the most influential jurisdictions in the United States. The fact that fourteen additional states recently have addressed this issue, see supra notes 37-38 and accompanying text, is evidence of its widespread scope and the trend toward applying contract principles to traditional property law questions.
45 Id. at 329, 330, 195 Cal. Rptr. at 88, 89.
The Schweiso court noted: "We are no longer in the days of caveat emptor even as to commercial leases. In recent times the necessity of permitting reasonable alienation of commercial space has become paramount in our increasingly urban society." The court held that the lessor may refuse consent only where he has a good faith, reasonable objection to the transfer.

Perhaps the most significant aspect of the Cohen and Schweiso decisions is that in both cases the court was interpreting standard lease clauses. Similar clauses had been interpreted previously, pursuant to traditional property law, as allowing the lessor to withhold consent to alienation arbitrarily. No party in either case alleged that the admittedly boilerplate language granting the lessor this broad right was ambiguous or inadequate for this purpose.

As recently as May 1985, in Hamilton v. Dixon, a California appellate court again confronted the "clash between the contractual right of a landlord to arbitrarily withhold consent to a sublease of commercial premises and the emerging [contracts] concept of the implied covenant of good faith and fair dealing." In Hamilton, the lessor refused consent to the sublease of a long-term commercial lease, because the lessor claimed she had the right to receive the increased rent to which the proposed sublessor and the proposed sublessee had agreed. Unlike the Cohen and Schweiso courts, this court upheld the

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47 Id. at 887, 198 Cal. Rptr. at 240.
48 See Schweiso, 150 Cal. App. 3d at 883, 198 Cal. Rptr. at 239; Cohen, 147 Cal. App. 3d at 321, 195 Cal. Rptr. at 85.
49 I contend that, given these decisions, no language will grant the lessor the right to withhold consent to an assignment arbitrarily in this situation. The court is mandating that the lessor have a "reasonable" basis for refusing to consent to a transfer, notwithstanding any express agreement to the contrary to which the parties freely assent for good faith, valid reasons. See infra notes 58-67 and accompanying text.
51 Id. at 1006, 214 Cal. Rptr. at 640.
52 This case illustrates the effect of "fortuitous inflation" on a long-term commercial lease and the interests at stake regarding the alienability of long-term commercial leases. In Hamilton, the parties entered into a long-term lease in 1970 (the length of term was 23 years and eight months) for a monthly rental of $375, plus the lessee's covenant to pay all utilities. In 1974, the original lessee (defendant) subleased the premises to a transeree for the balance of the term; the sublessee agreed to pay $750 a month for five years (a 100% increase in the rent realized by the sublessor) and $1500 a month in 1979 and thereafter (a 200% increase). The lessor consented to this transfer, but properly reserved the right to withhold consent to future transfers. In 1982, the sublessee requested the lessor's consent to another transfer. The
lessor's actions. The court stated that it was inappropriate to question the lessor's refusal to consent, because the boilerplate clause used in the lease granted the lessor the right to withhold consent to a transfer arbitrarily. According to the court, any attempt to change this rule by imposing a "reasonableness standard" would interfere with the freedom of lessors and lessees to negotiate the terms of commercial leases.\(^5\)

California's conflicting decisions were resolved in the landmark decision, *Kendall v. Ernest Pestana, Inc.*\(^4\) In *Kendall*, the Supreme Court of California reversed the Court of Appeal and embraced the minority position, lending its considerable weight and influence to the growing list of states that had rejected the traditional property law treatment of alienation of leases. The court acknowledged that it was departing from an established rule that had been in effect for many

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53 Id. at 1009, 214 Cal. Rptr. at 642.

54 40 Cal. 3d 488, 709 P.2d 837, 220 Cal. Rptr. 818 (1985). Factually, *Kendall* is an odd case involving a fight between a sublessor tenant and a prospective sublessee. Briefly, the owner, a municipality, entered into a long-term lease with the Perlitches (T1). T1 sublet the premises to Bixler (T2). T1 then transferred its interest in the premises as sublessor to defendant Ernest Pestana, Inc. (defendant). When T2 sought to transfer his interest in the premises to plaintiffs Jack Kendall, Grady O'Hara, and Vicki O'Hara, the defendant objected. The defendant refused to consent to the assignment because the plaintiffs rejected his demand for increased rent and other changes in lease terms as a condition for his consent to the assignment. Id. at 493-94, 709 P.2d at 839-40, 220 Cal. Rptr. at 820-21. Paragraph 13 of the sublease between T1 and T2 provided:

Lessee shall not assign this lease, or any interest therein, and shall not sublet the said premises or any part thereof, or any right or privilege appurtenant thereto, or suffer any other person (the agents and servants of Lessee excepted) to occupy or use said premises, or any portion thereof, without written consent of Lessor first had and obtained, and a consent to one assignment, subletting, occupation or use by any other person, shall not be deemed to be a consent to any subsequent assignment, subletting, occupation or use by another person. Any such assignment or subletting without this consent shall be void, and shall, at the option of Lessor, terminate this lease. This lease shall not, nor shall any interest therein, be assignable, as to the interest of lessee, by operation of law [sic], without the written consent of Lessor.

Id. at 494 n.5, 709 P.2d at 840 n.5, 220 Cal. Rptr. at 821 n.5. Although the facts are unusual, the issue before the court was identical to the issue raised in other cases regarding alienability. For further background to the case see Note, supra note 42, at 88-89.
years in California, but decided that its holding was necessary in light of two developments in California law: (1) the treatment of commercial leases as conveyances subject to the policy against restraints on alienation; and (2) the treatment of leases as contracts with the concomitant requirements of good faith and fair dealing implied by law in every contract (and therefore in every lease). Thus, California became the eighth—and arguably the most important—jurisdiction to adopt the minority position.

III. A CRITICAL APPRAISAL OF THE MINORITY POSITION: THE IMPACT OF ECONOMIC REALITIES AND INAPPROPRIATE CONTRACT PRINCIPLES

The cases that have adopted the minority position contain serious flaws in reasoning and analysis. Two key suppositions underlie the notion that a lessor should not be allowed to restrict the alienability of commercial leaseholds arbitrarily. First, these courts accept the notion that leases with unrestricted approval clauses somehow impede the alienability of property (that is, property might not be transferred to the higher value user). Second, they operate under the theory that, pursuant to contract principles, allowing a lessor to restrict alienability merely because the lessor wishes to extract higher rental payments is "unfair" and economically wrong. Because the Kendall decision is better reasoned than most of the other decisions, I will critique the minority position by focusing on that case.

A. Defining The Minority Position

One issue needs to be addressed at the outset: if the courts simply have construed ambiguous clauses in lease agreements and advocated certain constructional preferences in situations requiring judicial interpretation, then perhaps much ado is being made about very little. None of the courts adopting the minority position has squarely addressed the issue of arbitrary refusal of consent in a case involving an express and unequivocal lease term stating that the lessor has the right to restrain alienability arbitrarily by unreasonably withholding

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55 Nevertheless, the court was not bound to follow the rule or to overrule it prospectively. See infra notes 66-67 and accompanying text.
56 Kendall, 40 Cal. 3d at 498, 709 P.2d at 843, 220 Cal. Rptr. at 824.
57 Id. at 500, 709 P.2d at 844, 220 Cal. Rptr. at 825.
consent to a voluntary transfer. Instead, the cases have involved lease provisions stating simply that the lessor has the right to withhold his consent to a transfer.\footnote{58}{See supra note 38.}

In Kendall, the court noted that the case did not present the question of the validity of a clause expressly granting a lessor the right to withhold consent to an assignment arbitrarily;\footnote{59}{Kendall, 40 Cal. 3d at 499 n.14, 709 P.2d at 844 n.14, 220 Cal. Rptr. at 825 n.14. Perhaps if the lessor says it often enough, loud enough, or both, the court will allow the lessor to refuse consent to the assignment arbitrarily. The following clause might be acceptable: "Lessor reserves the right to refuse consent to any transfer of all or part of the premises and lessor may withhold his consent to any transfer for any reason, or for no reason whatsoever, be it arbitrary, unreasonable or in bad faith and wholly devoid of merit, AND I MEAN IT."} it acknowledged that section 15.2(2) of the Restatement would allow and enforce such an "unambiguous" clause.\footnote{60}{See Kendall, 40 Cal. 3d at 499, 709 P.2d at 844, 220 Cal. Rptr. at 825; see generally Levin, Withholding Consent to Assignment: The Changing Rights of the Commercial Landlord, 30 De Paul L. Rev. 109, 111 (1980) (noting that the "commonly used approval clause language" does not satisfy the Restatement test for a clause that gives an absolute right to withhold consent).} One could characterize the Kendall decision, then, as merely interpreting an ambiguous clause in a lease by construing the term in favor of the lessee and against the drafter, typically the lessor. In fact, the Restatement's adoption of the minority position may be understood as nothing more than an acknowledgment that the standard approval clause (traditionally viewed as allowing the lessor to withhold consent arbitrarily) does not satisfy its test for a clause granting the lessor "an absolute right to withhold consent."\footnote{61}{Restatement (Second) of Property § 15.2(2) (1976). The Restatement allows the lessor to restrict alienability arbitrarily as long as "a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent." Id. Thus, the Restatement, and Kendall and similar cases, may stand for the limited proposition that courts will require the lessor to act reasonably in granting or withhold consent to a transfer when the lease sets forth no express language qualifying the basis on which that consent will be measured. One might, then, argue that the courts that have departed from traditional property law in this limited situation are merely placing on the lessor—the drafter of the lease in most cases—the burden of expressly stating that the lessor may withhold consent for an arbitrary reason.} If the court was simply requiring lessors who draft leases to state unambiguously in the approval clause the parties' understanding that the lessor may arbitrarily withhold refusal, then arguably such a rule would yield some benefit of greater clarity, and create no new costs.\footnote{62}{In the words of one of my colleagues, "It is not difficult to write a new consent clause that boldly and clearly states that landlord can—arbitrarily, capriciously, in good-natured..."}
This view, however, may be overly optimistic. New formulations of lease terms tend to increase the risk and cost of transactions because of the lack of interpretative guidelines and because the new phrasing may be subject to a typology of formulation errors that have yet to be addressed by the courts. As a result, "the production of well-validated, mature formulations is a costly, error-prone process." Under the guise of eliminating ambiguity, the court has instead eliminated certainty as an option, thereby forcing the parties to use often deliberately vague or "indeterminate" formulations.

Perhaps the court's mistake was its failure to announce that it was overruling prior bad law and prospectively adopting a new rule encouraging better draftsmanship. Unlike its ruling in Wellenkamp v. Bank of America, in which the court voided prospectively the use of analogous due-on clauses, the Kendall court rejected a prospective approach and applied its new rule to leases executed prior to the

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63 Without going into too much detail (especially detail that Professors Goetz and Scott already have explored), the long-term costs of developing newly required express terms that allow the lessor to arbitrarily withhold consent will inevitably outweigh any short-term gains to the parties. As Goetz and Scott have detailed:

First, parties who develop innovative forms bear significant, exogenous, legal risks. Since the legal system retains ultimate power over interpretation and enforcement, parties cannot be certain what effect will be given to any formulation until it is tested.

Second, the process of contractual formulation is subject to inherent endogenous hazards that emerge and undergo correction only over time.

Goetz & Scott, The Limits of Expanded Choice, supra note 9, at 278 (footnote omitted).

64 Id. at 279.

65 Indeterminate formulations are defined as those terms and conditions that, although anticipated, cannot be resolved at the time of contracting, forcing the parties to use generic and vague standards such as "good faith" or "reasonableness." See id. at 269 & n.15.

66 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978). For a discussion of the Wellenkamp opinion, see infra notes 72-78 and accompanying text.

67 In his dissenting opinion in Kendall, Judge Lucas urged such a prospective approach when he adopted language from the Court of Appeal decision:

Some jurisdictions have overruled the common law, at least as to residential leases, by legislative action. . . . This would appear to be the wisest procedure, if only to effect the repeal prospectively and thereby give force to those contracts entered into when the common law prevailed. . . . "To overturn a century and a quarter of existing real estate law without giving contracting parties 'fair notice' is my principal complaint with the majority's opinion. At the very least, I think the majority ought to make the rule they have adopted 'prospective.'"

Kendall, 40 Cal. 3d at 509, 709 P.2d at 851, 220 Cal. Rptr. at 832 (Lucas, J., dissenting) (citations omitted) (quoting Homa-Goff Interiors, Inc. v. Cowden, 350 So. 2d 1035, 1039 (Ala. 1977) (Bloodworth, J., dissenting)); see also Park, Kendall v. Pestana: Leasehold Transfers and
first California opinion adopting the minority position. Given its rejection of prospective application, the court simply changed a settled construction of a lease term resulting in a transfer of wealth from lessors to lessees who negotiated leases before *Kendall* was announced. If *Kendall* stands solely for the narrow position that a lessor can arbitrarily restrict alienability as long as the right to do so is stated clearly, such a wealth transfer serves no important policy, as those same parties can negotiate an absolute restriction on alienability in their next lease and thus reestablish the pre-*Kendall* relative wealth distribution. If the case merely addressed a question of construction, then the court would appear to have departed from its precedent for no reason.

Accordingly, the minority position, as articulated in *Kendall*, is better viewed as an ill-conceived attempt to apply an extraordinarily narrow view of contract law to an area previously governed by conventional property law. The court did not adequately explain why it departed from well-settled case law construing the standard approval clause as unambiguously permitting the lessor to withhold consent arbitrarily. If *Kendall* stands only for the limited proposition that a lessor must state his rights clearly, at best the case is a conundrum; at worst it is a farce. In fact, the widespread adoption of the minority position presages an absolute prohibition on a lessor’s right to restrict alienation arbitrarily. The case makes sense only as the first step in a line of cases that will bar the lessor from arbitrarily restricting alienability. Such a development would supposedly promote two policies: increasing the alienability of property, and affirming the applicability of the contract principles of good faith, fair dealing, and commercial reasonableness, implicit in all contracts, to leases.

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B. The Applicability of the Restraints on Alienation Doctrine

1. Wellenkamp v. Bank of America: The Due-on Sale Clause Analogy

Those who cannot remember the past are condemned to repeat it.\(^6^8\)

When it overruled the property rule that the lessor is free to restrain contractually the alienability of property to protect his reversionary interest,\(^6^9\) the court in Kendall used a balancing test. According to the court, "[T]he greater the quantum of restraint that results from enforcement of a given clause, the greater must be the justification for that enforcement."\(^7^0\) The application of the test led the court to reject the contention that a lessor has the right "arbitrarily" to restrict alienation merely to gain some economic benefit:

Nor is it reasonable to deny consent "in order that the landlord may charge a higher rent than originally contracted for." This is because the lessor's desire for a better bargain than contracted for has nothing to do with the permissible purposes of the restraint on alienation—to protect the lessor's interest in the preservation of the property and the performance of the lease covenants. "[T]he clause is for the protection of the landlord in its ownership and operation of the particular property—not for its general economic protection."\(^7^1\)


\(^6^9\) Kendall, 40 Cal. 3d at 498-99, 709 P.2d at 843, 220 Cal. Rptr. at 824.

\(^7^0\) Id. (quoting Wellenkamp v. Bank of America, 21 Cal. 3d 943, 949, 582 P.2d 970, 973, 148 Cal. Rptr. 379, 382 (1978)).

\(^7^1\) Id. at 501, 709 P.2d at 845, 220 Cal. Rptr. at 826 (citations omitted) (quoting Schweiso v. Williams, 150 Cal. App. 3d 883, 886, 198 Cal. Rptr. 238, 240, and Ringwood Assocs. v. Jack's of Route 23, Inc., 153 N.J. Super. 294, 303, 379 A.2d 508, 512 (Ct. Law Div. 1977), aff'd 166 N.J. Super. 36, 398 A.2d 1375 (Ct. App. Div. 1979)). It is one thing to state that the lessor may refuse, based on some personal whim, to consent to a voluntary transfer, and another to state, as the California court did, that the lessor may not refuse consent for "economic reasons of self protection," for instance, to obtain higher rental payments that reflect the appreciation that has occurred in the value of the leasehold. This Article expresses no opinion on whether the lessor should have the right to object to the transfer based on mere whim or personal caprice. Of course, federal law limits the exercise of the lessor's right to withhold consent. See, e.g., the Fair Housing Act of 1968, 42 U.S.C. §§ 3601-3631 (1982 & Supp. III 1985) (prohibiting discrimination in leasing and sale based on race, sex, religion, creed, or nationality).

A better way to interpret the issue raised by Kendall is to hold reasonable, as some courts have in the analogous mortgage situation, a lessor's (mortgagee's) refusal to consent to a transfer unless the rent (interest rate) is renegotiated. See Sonny Arnold v. Sentry Sav. Ass'n, 633 S.W.2d 811 (Tex. 1982).
Interestingly, in its formulation of the balancing test, the *Kendall* court tracked the language of a similar test used in *Wellenkamp v. Bank of America*, a 1978 case in which the California Supreme Court adopted the minority position on the enforceability of due-on-sale clauses in mortgages or deeds. Following the lead of several

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73 A due-on-sale clause, or more appropriately a due-on clause (because it includes a due-on-encumbrance as well as a due-on-sale clause), "is a device commonly used in real property security transactions to provide, at the option of the lender, for acceleration of the maturity of the loan upon the sale, alienation, or further encumbering of the real property security." *Wellenkamp*, 21 Cal. 3d at 946 n.1, 582 P.2d at 971-72 n.1, 148 Cal. Rptr. at 380-81 n.1. For a more complete definition of due-on clauses, see G. Nelson, & D. Whitman, Real Estate Finance Law § 5.21 (2d ed. 1985).

Oddly enough, there is substantial disagreement over whether the exercise of the due-on clause in a mortgage is a direct or indirect restraint on alienation. The Restatement lists and defines three types of direct restraints on alienation: forfeiture, disabling, and promissory. Restatement (Second) of Property § 15.2 comments b, c, d (1976). A leading commentator in the area concluded early in the debate that a due-on clause is a direct restraint:

[T]he due-on sale clause does not fit exactly within any of the established categories of direct restraints, disabling, forfeiture, or promissory. Yet it would appear that the due-on-sale clause is so closely akin to the promissory restraint as to justify designating it a direct restraint... Although written as an acceleration clause, the due-on-sale clause... burdens a mortgagor's ability to alienate as surely and directly as the classical promissory restraint. As such, the due-on-sale clause is truly a direct restraint insofar as the category of direct restraints can be articulated.

Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 Iowa L. Rev. 747, 773-774 (1973); see Maxwell, supra note 72, at 199-200. The court in *Wellenkamp*, however, viewed the restraint as an indirect restraint, i.e., it does not prohibit or forbid the transfer of the property but impedes the transfer, because it affects the price at which the subject property may be sold. *Wellenkamp*, 21 Cal. 3d at 948-52, 582 P.2d at 974-76, 148 Cal. Rptr. at 382-85; see generally Note, *The Due-On-Sale Controversy: Beneficial Effects of the Garn-St Germain Depository Institutions Act of 1982, 1984 Duke L.J. 121, 129-37 (due-on-sale clause is neither a direct restraint nor an indirect restraint and should not be held unenforceable). Some California authority indicates, however, that only direct restraints are impermissible. See Maxwell, supra note 72, at 200; accord Los Angeles Inv. v. Gary, 181 Cal. 680, 186 P. 596 (1919); Mountain Brow Lodge No. 82, Independent Order of
other states, the court in *Wellenkamp* held that an institutional lender may not automatically, upon the transfer of the mortgaged property, enforce a due-on-sale clause contained in a mortgage or deed of trust.

In its application of the balancing test, the court measured the “quantum of restraint” imposed by from the enforcement of the due-on clause against the “justification” for the enforcement of the clause. It found that the automatic exercise of a due-on clause created an impermissible restraint on alienation that exceeded the bank’s alleged justification for enforcement. More importantly, the court rejected the bank’s argument that it should be allowed to exercise the due-on clause to maintain its loan portfolio at current interest rates.

To justify its holding, the court stated that the risk of inaccurately

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Oddfellows v. Toscano, 257 Cal. App. 2d 22, 64 Cal. Rptr. 816 (1967) (modified on denial of rehearing). Because I conclude that this clause is not a restraint at all, I take no position on the inconsequential issue of what type of restraint it might be.

74 See Baltimore Life Ins. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (Ariz. Ct. App. 1971) (holding that a due-on clause could not be enforced upon transfer by the mortgagor unless the lender could show impairment of the security interest); see also Malouff v. Midland Fed. Sav. & Loan Ass’n, 181 Colo. 294, 509 P.2d 1240 (1973); Clark v. Lachenmeier, 237 So. 2d 583 (Fla. Dist. Ct. App. 1970); Gunter v. White, 489 S.W.2d 529 (Tenn. 1973); Mutual Fed. Sav. & Loan Ass’n v. Wisconsin Wire Works, 58 Wis. 2d 99, 205 N.W.2d 762 (1973) (all intimating that due-on-sale clauses may not be enforced solely at the whim of the mortgagee upon the transfer of the mortgaged premises, but failing to establish exactly when the mortgagee may exercise his rights pursuant to the due-on-sale clause). For a discussion of these cases and the pre-*Wellenkamp* law on this issue, see Note, Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability, 27 Stan. L. Rev. 1109 (1975).

75 This balancing test was developed in earlier opinions. See Tucker v. Lassen Sav. & Loan Ass’n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974) (holding that the automatic enforcement of a due-on clause upon the sale of the property by an installment sales contract constituted an impermissible restraint on alienation); La Sala v. American Sav. & Loan Ass’n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971) (whether a due-on-encumbrance clause is an unlawful restraint on alienation turns on whether the lender’s security interest is endangered); Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964) (holding that Cal. Civ. Code § 711 prohibiting restraints on alienation is not absolute, allowing for reasonable restraints on alienation); see generally Maxwell, supra note 72, at 197 (California Supreme Court decisions influenced by concerns for both free alienation and consumer protection); Note, Invalidation of Due-on Clauses, supra note 72, at 886 (*Wellenkamp* test is valuable only when concerns about unequal bargaining power are present).

76 *Wellenkamp*, 21 Cal. 3d at 947-53, 582 P.2d at 973-76, 148 Cal. Rptr. at 385-86. In this respect, Cal. Civ. Code § 711 (West 1982) states, “[c]onditions restraining alienation, when repugnant to the interest created, are void.”

77 *Wellenkamp*, 21 Cal. 3d at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385.
projecting interest rates over a twenty- or thirty-year period could not fairly be placed on mortgagors. One noted commentator summarized this holding: "The fact that the lender perceived the difficulty of predicting interest rates over twenty or thirty years and consequently tried to confine his agreement to the original borrower is [apparently] irrelevant under the doctrine of restraints."\footnote{Maxwell, supra note 72, at 208.}

The Kendall and Wellenkamp decisions are similar, not merely because they used the same balancing test: the economic positions of the parties—either mortgagor and mortgagee, or lessor and lessee—are also strikingly parallel.\footnote{See infra notes 118-129 and accompanying text.} Moreover, the traditional property rules that allow inalienability in both situations, and that were rejected by the courts, serve valid societal goals.\footnote{See infra notes 96-107 and accompanying text.} Thus, I contend that the California court, far from having learned from its mistakes in Wellenkamp, repeats them in Kendall.

2. **Leases and Mortgages: Functional Economic Equivalents**

Treating mortgages and leases as functional economic equivalents when comparing Wellenkamp and Kendall is not as novel as it might first appear. Before the thirteenth century, leases for a term of years were given by owner-lessees to usurious moneylenders to avoid the church's prohibition of usury. Thus, "A, in consideration of a lump sum amount of money, would grant a term of years to B of sufficient duration to allow B to recoup both his consideration and a profit."\footnote{Hicks, The Contractual Nature of Real Property Leases, 24 Baylor L. Rev. 443, 448 (1972).} Eventually, the mortgage developed as a more satisfactory method of rendering land as security for the money lent to a landowner. "As a result of the introduction of the mortgage into capitalism to provide security for money lending and the effect of the Black Death on the agricultural labor force, the leasehold interest developed into a term of years that created contractual rights in the lessee."\footnote{Id. at 541.}

Both mortgages and leases are consensual agreements creating bifurcated economic interests in one parcel of property. Although in most states a mortgage vests title in the mortgagor, the mortgagee

\footnote{78 Maxwell, supra note 72, at 208.}

\footnote{79 See infra notes 118-129 and accompanying text.}

\footnote{80 See infra notes 96-107 and accompanying text.}

\footnote{81 Hicks, The Contractual Nature of Real Property Leases, 24 Baylor L. Rev. 443, 448 (1972).}

\footnote{82 Id. at 541.}
Correctly Interpreting Long-Term Leases

gets a significant reversionary interest in the premises. What is usually referred to as the mortgagee's right of foreclosure, I characterize as a right of reversion. Thus, the right granted the mortgagee resembles the reversionary interest in demised premises that a lessor retains following the execution of the lease.

Conceptually, the mortgagee's position is analogous to a lessor's if one assumes that the mortgagor is purchasing the certainty of the mortgagee's reversionary interest in the property by entering into the mortgage transaction and making a down payment. The mortgagee, in exchange for the loss of that certainty, receives the down payment and part of the stream of income that flows from the property. If, however, the mortgagee is interested in the property solely for investment, i.e., for its possible appreciation in value, then the mortgagee can purchase the property (and consequently assume the risk that the property will decline in value—a risk borne by the mortgagor in the

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83 Although in some states title vests in the mortgagee following the execution of the mortgage, most states follow the lien or intermediate theory of title and view title as continuing to be vested in the mortgagor, at least until default. Even in those states following the title theory, however, the mortgagor is viewed as the equitable owner. See G. Nelson & D. Whitman, supra note 73, § 1.5.

84 Functionally, the mortgagee's right of foreclosure is akin to the lessor's reversionary interest, although technically a reversion may not be created in a third person and is always a retained interest. In the typical mortgage situation, O, the owner, is selling to Bob Byar, the purchaser/mortgagor. To finance the sale, Byar normally obtains a mortgage from Mortgagee Bank in which he promises to pay a monthly amortized amount for a lengthy period of time (typically 30 years). Until that debt is paid off, Mortgagee Bank retains an interest in the property called a right of foreclosure. If Byar fails to pay, Mortgagee Bank exercises its foreclosure rights and takes possession of the premises, normally for the purpose of auctioning it off at a foreclosure sale.

This example illustrates the standard form of the transaction; I contend the substance is quite different. In effect, the mortgagee, the party who puts up the bulk of the purchase price (anywhere from 80 to 95% in the typical mortgage transaction), should be viewed as the true purchaser of the property—very much like an owner/lessor of property. At the instant title is transferred, who has the larger interest in the property, Bob Byar or Mortgagee Bank? Functionally, Mortgagee Bank becomes the grantor and Byar the grantee. Mortgagee Bank purchases the property and then instantaneously transfers it to Byar with the security interest, the mortgage, attached (which is exactly what occurs in escrow) in exchange for the stream of income represented by the monthly payments. That security interest and the right to foreclose are very similar to a reversionary interest. Although the reversionary interest retained by the mortgagee is slightly different than that retained by a lessor, I argue that the mortgagee's interest is reversionary in some respects and should be analyzed accordingly. For a discussion of the mortgagee's right of foreclosure, see G. Nelson & D. Whitman, supra note 73, § 7.19.

85 In the typical lease transaction, O, the owner/lessor of Blackacre, conveys the present right to possess Blackacre for a term set forth in the lease. O's retained future interest in Blackacre is a reversion. See J. Dukeminier & J. Krier, supra note 4, at 410-11.
The only important difference between the two arrangements is the mortgagor's agreement in advance to buy the mortgagee's reversionary interest, an agreement that takes effect upon the expiration of the term—usually in twenty or thirty years. By comparison, the lessor has made no agreement with the lessee to transfer the reversionary interest upon expiration of the term. One can imagine many situations in which the parties may structure the transaction as either a lease or a mortgage, the only relevant difference being who receives title to the property after all payments called for in the transfer have been made.

The following generalizations accurately capture some important comparisons between a long-term lease and a mortgage: (1) the parties have entered into a long-term relationship; (2) the transferor retains an interest in the property; (3) the most valuable interest retained by the transferor is the stream of income (which may be reduced to a present value and, in most cases, is easily transferable by its holder) due the transferor from the transferee; and (4) the most valuable interest held by the transferee is the right to possession during the term of the agreement.

The reversionary interests are also similar. The mortgagee's interest is relatively small, because reversion is contingent upon the mortgagor's default, an event that may never occur. The longer the term

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86 In those states that prohibit deficiency judgments, however, the mortgagee can bear some of the risk of a decline in the value of the property to the extent that the mortgage note does not provide for recovery beyond the foreclosure value of the property. See, e.g., Cal. Civ. Pro. Code §§ 580-580d (West 1976 & Supp. 1988) (California's anti-deficiency statutes).

87 As a matter of fact, the distinction between a lease and a conveyance may be blurred further by complicated financial arrangements, often used to take advantage of the seller-transferor's previously existing, advantageous financing arrangements. For example, the seller may engage in short-term wrap-around mortgage financing and allow the buyer to delay payment of the downpayment (a lump sum, perhaps representing the seller's equity) until interest rates decline and permanent financing can be arranged or until the maturity date of the note, whichever occurs first. If the buyer-transferee cannot obtain suitable financing or is unwilling to make the required payments, the transferee can default and walk away from the property with no liability, assuming anti-deficiency legislation applies, as it does in California. See supra note 86. The mortgagor-lessee has, in effect, paid a "rent" for his use of the property during his term of possession.

88 Although the interest retained by the mortgagee, evidenced by his right to foreclose, may be viewed as negligible or de minimis, it has some value—and, in given situations, may be very valuable. Valuation problems, not lack of value, make it difficult to conceptualize the interest retained by the mortgagee as a reversionary interest. Placing a value on something that may
of the lease and the lower the value of the reversion, the more it resembles the mortgage situation—and the greater the reason to treat the lease as a mortgage and allow the lessor to transfer the stream of income—the property right—to higher value users. Thus, the economic interests in Wellenkamp and Kendall are analogous and should be treated similarly.

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occur is very difficult when that occurrence is triggered by events beyond the control of the party holding the right. (For example, how do you place a value on a reversion that will become a possessory interest only if the holder of the preceding determinable fee, e.g., “the school board for so long as the premises are used for school purposes,” violates the terms of the grant?) Perhaps the only way to value the mortgagee's reversionary interest is to analyze a situation where a right to foreclose is exercised. Working backwards, one can calculate the exact value of the contingent reversionary interest at the time the mortgage was executed.

Compare, however, the rights of the lessor. Anyone who knows a little math, the terms of the lease, and something about the value of the property can sufficiently value the lessor's reversionary interest. The only difference between the two situations is certainty of possession. I suggest that the mortgagee has sold the certainty in the reversion to the mortgagor.

Even if the contingent right to foreclose is in fact structured or perceived as a certainty, it may be less valuable than the concomitant reversionary interest held by a lessor. When foreclosure occurs, any appreciation on the property realized by the sale goes to the mortgagee; whereas, on the termination of a long-term leasehold, any appreciation benefits the lessor. Thus, in a sense, the potential value of the reversion for the lessor is in some ways limitless, while for the mortgagee its upper limit may be the purchase price as represented by the stream of payments created in the mortgage. Nonetheless, the mortgagee's value includes, among other variables, the interest received on that purchase price and, depending on when foreclosure occurs, the amount of the downpayment. The return to the lender upon the sale of the property may be significant, therefore, even in the event of default.

For discussions, in the context of other legal systems, of applying similar rules to similar interests, see a trilogy of articles by Professor Levmore: Levmore, Rethinking Comparative Law: Variety and Uniformity in Ancient Tort and Modern Tort Law, 61 Tul. L. Rev. 235 (1986); Levmore, Variety, Uniformity in the Treatment of the Good Faith Purchaser, 16 J. Legal Stud. 43 (1987); Levmore, Waiting for Rescue: An Essay On The Evolution And Incentive Structure of the Law of Affirmative Obligations, 72 Va. L. Rev. 879, 881 n.8 (1986). In fact, a potential lessor can avoid the application of Kendall rule by camouflaging the long-term lease transaction as a mortgage transaction with a due-on clause triggered by the transfer of the lessee-mortgagor's interest. Following the repudiation of the Wellenkamp doctrine by the Garn-St Germain Depository Institutions Act of 1982, 12 U.S.C. § 1701j-3 (1982 & Supp. IV 1986), see infra notes 162-64, the lessor-mortgagor, by paying a nominal amount upon expiration of the term (call it a repurchase option) or upon the transfer of the premises (using a well-drafted due-on clause) can retake ownership of the estate and subsequently either transfer it to the higher value user without the consent of the lessee-mortgagor or raise the mortgage (rent) to market rates—exalting form over substance. Similarly, as a result of cases like Wellenkamp and Kendall, mortgage financing has undergone a revolutionary development, and mortgages are used now to establish a joint venture relationship between the mortgagor and the mortgagee.
3. The Counterproductive Effects of the Minority Rule

Interestingly, the economic consequences of *Kendall* are likely to be detrimental to the very class of participants the court was seeking to protect. Such a counterproductive effect is predictable given the aftermath of *Wellenkamp*, the analogous California case concerning due-on clauses in mortgages. In *Wellenkamp*, the court believed it was assisting homeowners or mortgagors by refusing to enforce a clause over which the parties had not negotiated and about which most mortgagors had very little understanding. The opinion has been read as pro-consumer in orientation, with the court’s primary goal that of protecting the mortgagor from accepting a contract of adhesion.91

Most commentators agree, however, that the long-term effect of *Wellenkamp* may be the reverse. By prohibiting due-on clauses, the court allowed current holders of advantageous mortgages (those with loans at below-market interest rates) to transfer the increased value of the loan, as opposed to the value of the land, to a transferee. This benefit to the mortgagor is more than offset by the loss to the mortgagor, who must now carry to maturity a below-market loan. The only way to offset that loss is to charge present and future borrowers higher rates—a response that may be impossible in the highly competitive world of commercial banking. Thus, those with advantageous mortgages will reap short-term gains that in the long run will be subsidized by future participants in the marketplace.93

The application of this lesson to the commercial leasing market suggests that similar consequences may follow from the *Kendall* decision. In the short run, the minority position will transfer wealth from lessors with long-term leases to lessees with long-term leases. In the long run, however, future lessees will pay the price for the fiscal “benefits” realized now by their predecessors. A commercial lessor forced to retain a below-market income stream faces two unacceptable alternatives if he wishes to maintain parity with other alienable investments. First, the lessor can raise the rent on other property to achieve acceptable yields. Second, the lessor can raise the rent on the subject

91 See infra note 144 and accompanying text.
92 The lessee would argue that the lessor agreed to this result when he agreed to the lease with a fixed rent schedule and with no adjustment clauses. This argument loses sight of the fact that both parties may benefit if they agree to a fixed rent with no adjustments if, and only if, the original lessee remains in possession.
93 See Crane, supra note 72, at 295-297.
property when the lease expires in an attempt to achieve an average market yield over time. In a free market, however, neither of these alternatives is possible: if the market allows a lessor to charge a higher rent to reflect increased costs, the lessor would have maximized profits by raising the rent to those levels at the time of contracting. In other words, the price of available space will be dictated by exogenous market factors, not endogenous adjustment mechanisms.

In a competitive rental market, the lessor will have no monopoly power over price and cost, and will not be able to pass on the costs caused by the Kendall rule to either current or future tenants—as long as other lessors are not similarly situated. Lessors with short-term leases will have a competitive advantage over lessors locked into long-term leases at below-market rents. Therefore, lessors with long-term leases may be forced out of the business of leasing commercial premises.\textsuperscript{94}

A further economic change can be expected: as commercial space is removed from the market, assuming demand remains constant, prices of the now scarce commercial premises will increase to reflect that scarcity. In the long run, future lessees will inevitably pay for losses suffered by current lessors. Lessees with long-term leases locked in at below-market rates will be able to reap a short-term benefit by selling the value in the leasehold. Wellenkamp teaches that ultimately this benefit will be paid for by the very class of litigants the courts are seeking to protect: lessees.

Perhaps I paint too bleak a future under the regime imposed by the adoption of the minority position. A lessor, like his mortgagee counterpart, may be willing to enter into a long-term lease transaction based on the assumption that the rent that he receives will remain the same if, and only if, the original lessee remains in possession of the premises. This risk may be a gamble the lessor is willing to take based on his experience dealing with lessees.\textsuperscript{95} Nonetheless, lessors will be less willing to enter into these transactions to the extent that, upon

\textsuperscript{94} To replace long-term fixed rate leases, the market may develop the following leases concurrently: 1) short-term leases with roll-over provisions calling for the renegotiation of rent, similar to short-term roll-over mortgages; and 2) long-term leases with variable payment rates pegged to some acceptable cost of living standard, similar to variable interest rate mortgages.

\textsuperscript{95} For a discussion of the analogous situation with mortgages, see Maxwell, supra note 72, at 208.
transfer by the lessee, they cannot adjust the value of their stream of income to reflect market rates. As a result, the lessee who, like the mortgagor, desires to lock into a fixed rate for a period of time coextensive with his possession may be unable to do so or may have to pay a premium.  

4. An Economic Approach to the Minority Position

The courts adopting the minority position tend both to dismiss the economic benefits of a standard clause allowing the lessor to restrict alienation arbitrarily, and to overstate any negative economic consequences this clause may have. Their approach places insufficient credence in the notion that property will inevitably be transferred to the user who values it most highly.  

Granting a lessor the right to limit a lessee's ability to alienate facilitates the movement of resources to their best use by creating a valuable entitlement in the lessor that can and frequently will be "purchased" by the lessee. Thus, the imposition of inalienability rules frequently will have distributive as well as efficiency consequences. In a private consensual transaction between commercial parties, as long as the bargaining process is not unfair, the law should respect and enforce an agreed allocation of an entitlement.

Consider the following hypothetical, which will be used throughout as a basis for comparison and analysis. Assume that Lessor Corporation ("LC") enters into a twenty year lease with Defense Contractor,

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96 Apart from the difficulty of determining the amount of the premium, the lessor will face difficulty in passing the charge on to the lessee because he probably does not enter into as many transactions as the analogous mortgagee. Moreover, he does not operate in a heavily regulated industry like banking where regulation and market forces may combine to stifle competition.

97 Assuming that both parties must consent to the transfer before it may take place (the traditional view), the lessor obviously must consent because the lessee has the right to possession during the term. The lessee must consent because the lessor has the right to object to the transfer for any reason. In this two-party bargaining situation, the Coase Theorem suggests that "in an environment where there are no obstacles to transacting, legal rights will tend ultimately to be allocated through trade if necessary, to the party that values them most highly, regardless of their initial assignment." C. Goetz, Law and Economics: Cases and Materials 52 (1984); see Coase, The Problem of Social Cost, 3 J.L. & Econ. 1 (1960); see also Hoffman & Spitzer, Experimental Law and Economics: An Introduction, 85 Colum. L. Rev. 991, 1009-13 (1985) (experiment results that support the contention that parties who can negotiate will bargain to an efficient outcome in an interactive harm problem, regardless of the legal rule).

98 Rose-Ackerman, Inalienability and the Theory of Property Rights, 85 Colum. L. Rev. 931, 940.
Inc. ("DCI") in 1975. DCI's primary business is bidding for government defense contracts and building the military hardware necessary when its bids are accepted. DCI leases space to manufacture its products because it can amortize fully and structure its bids for defense contracts so as to pass along the cost of leased space. Due to the structure of the bidding (a fee simple has a useful life beyond the applicable contract term, and the contract term is usually ten years or less), DCI cannot pass on the full cost of a purchase of an equivalent fee simple. Moreover, because the bidding is competitive, DCI is interested in obtaining the best possible rental rate over the term of the lease; any excess rental costs will either negatively impact its bids or be borne by DCI.

Hence, all things being equal, DCI would prefer to enter into a long-term lease at a fixed rate over the entire term of the lease, and at a cost that can be incorporated into the contracts for which it bids. DCI disfavors the uncertainty caused by inflation riders and automatic renegotiation clauses because, at the time of renegotiation, DCI already will have entered into a contract with the purchaser and will be unable to pass along to the purchaser any increased cost of leasing the premises. As a result, even though at the time the lease is executed, vacant warehouse space goes for $2.00 per square foot per month, DCI agrees to pay a monthly rate of $3.00 per square foot for the premises. Taxes, insurance, and maintenance are the lessee's responsibility under the lease (a "triple net lease").

LC, in exchange for the initial premium of $1.00 per square foot, drops its demand for a clause in the lease that would require renegotiation if inflation increases by more than 4% per annum as measured by mutually acceptable indices. LC retains the right to consent to any transfer of the premises by DCI, however, and both parties understand this term to mean that LC can refuse consent to any transfer by DCI for any reason, be it arbitrary or capricious, or for no reason whatsoever. DCI assents to such a clause because, at the time it enters the lease, it foresees no circumstances that would cause it to transfer the premises to another party.

DCI knows that if the market for rental space has declined, DCI would be in an advantageous position to pocket or internalize gains. DCI is strongly risk-averse, however, and it is willing to forego the chance of future gain in exchange for the security of certitude. Assume that DCI's competitors, subject to the same market pressures, would pay the same premium for similar space for similar reasons.
Finally, assume that in 1987 like space leases for $5.00 per square foot as a result of inflation and the development of the adjoining area by other contractors and lessors. Assume further that DCI has outgrown its current space and wishes to terminate its lease to obtain more space. Using this hypothetical, I will analyze the economic consequences of a rejection of the common law rule with respect to commercially leased premises.\textsuperscript{101}

If the parties act rationally, the only question will be who will receive the windfall value of the premises.\textsuperscript{102} For the reasons developed below, the holder of the reversionary interest, the lessor, should be able to receive or share in that value by placing an appropriate restrictive clause or agreement in the lease. In fact, this may work to the lessee's advantage.\textsuperscript{103}

\textsuperscript{101} This hypothetical illustrates how the standard approval clause can promote efficiency goals. See infra notes 123-29 and accompanying text. Allowing the parties to negotiate for a clause that \textit{apparently} gives all the gains from the transaction to the lessor affects both parties favorably. Under the terms of such a clause, the parties entering into a long-term transaction will have well-defined rights. The lessee has the right to possession at a favorable rate, and the lessor cannot impede or affect that right. Here, the lessee trades his right to alienate for the right to a fixed rent (without escalators) that is coextensive with his right of possession. By granting to the lessor the right to restrict alienation, the lessee in effect warrants to the lessor that he will remain in possession during the term of the lease.

Thus, the lessor's right to restrict alienation may be likened to an additional security interest granted to the principal by the agent to extract a favorable interest rate (rent). In this situation the favorable interest rate is the certainty of fixed rent over a period of time instead of the uncertainty inherent either in a short-term lease requiring frequent renegotiation or in a lease containing clauses that adjust the rent during the lease term. The lessor's gain from the arrangement is the above-market price paid by the lessee for this certainty, as well as the additional "security interest."

\textsuperscript{102} My argument implicitly assumes that the two commercial parties, LC and DCI, have equal bargaining power. This market assumption may be incorrect in a residential setting where the lessee does not have the necessary bargaining position to extract concessions from the lessor. Thus, in residential settings the windfall may be awarded to the lessor solely as a result of the exogenous factors that create the lessor's superior bargaining position. I have no qualms with the court's "protection" of the lessee in situations involving allegations of bargaining process unfairness. See infra notes 146-51 and accompanying text. One should recognize, however, that by mandating alienability in this situation, the courts merely accomplish the flip-side of what is accomplished by using inalienability rules for distributive or redistributive purposes. See Rose-Ackerman, supra note 98, at 940.

\textsuperscript{103} If the parties agree that all the gain from the transaction should flow to the lessee, i.e. the lessee may transfer the premises without the lessor's consent or the lessor must act reasonably in granting or withholding consent, that clause should also be given effect. Presumably, the lessor received something of value in exchange for the transfer of his right to restrict alienability.
Any additional costs created by the inclusion of the clause merely represent the costs of a transaction—negotiation over potential windfall profits—that otherwise might not occur or that would occur only at a much higher cost. Formulations that grant the lessor the right to withhold consent arbitrarily provide the lessor an opportunity to renegotiate a broad range of terms, including rent. In either a rising or a falling market, the transfer of the premises allows the parties to account for changes that have occurred since the lease was executed.104 Hence, the rational lessor may be willing to pay for a clause that gives him a veto power over any proposed transaction, because this allows him some bargaining power. Similarly, the rational lessee may agree to such a clause because it is cheaper than the alternative: ascertaining every possible contingency that might later cause the lessee to transfer the premises to a third party.

Obviously, the parties could deal with changes in rental values in other ways. They could include a clause permitting adjustment of the rent to take account of exogenous factors;105 a lease containing an escalation clause based on consumer indices is a common example. Similarly, the parties can agree to shorter or sequential leases in which the rent is renegotiated or renewed every few years. Finally, if uncertainty looms as a large concern, the lessee can integrate the property into his business and obtain complete control of the premises by purchasing the fee.

Unfortunately, these alternatives may be undesirable given the particular fact situation. The parties cannot specify all fact situations that might cause the lessor to object to a transfer. Similarly, sequential leasing increases transactions costs by allowing opportunistic behavior.106 In addition, tax and accounting advantages may be avail-

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104 A rejoinder to my argument is that the lessor can respond to these unforeseeable developments by acting “reasonably.” This assertion fails to take into account the fact that the courts have interpreted “reasonably” narrowly so as to eliminate legitimate economic interests that the lessor may seek to protect. See supra note 71 and accompanying text.

105 In fact, the court in Kendall suggested that such clauses were preferable to the one before the court and represent a way for businesses to deal with the problem of inflation. 40 Cal. 3d at 504-05, 709 P.2d at 848, 220 Cal. Rptr. at 828-29.

106 Not only do frequent renegotiations increase transaction costs, but the parties may also wish to avoid forced periodic renegotiation because of the possibility of strategic bargaining after the parties have executed the initial lease. The lessor may be in a position to extract increased rental not because of any exogenous factors, but solely due to the fact that the lessee is entrenched in possession and will incur relocation and other costs if forced to move. Theoretically, the lessee will be willing to pay to the lessor an amount up to the fair market
able to an entity that leases, rather than purchases, property.\footnote{107}

The standard approval clause presents none of these problems. Moreover, it does not absolutely prohibit voluntary alienation of a leasehold estate; as long as the value in the leasehold has increased, the property will be transferred to the party who places the highest value on its use.\footnote{108} If the lessor withholds consent to an economically desirable transfer, the lessee can terminate the lease by surrendering the premises to the lessor. Under the modern view of the lease as a contract, the doctrine of mitigation of damages applies.\footnote{109} The lessor should not be able to recover damages from the lessee in a rising market, because he will be forced to transfer the remainder of the term to the new tenant to mitigate his damages. As a practical matter, damages and the question of mitigation will never arise because the lessor will "accept" the surrender of the lease\footnote{110} and lease the premises to the proposed assignee-lessee, as has actually occurred in a number of cases.\footnote{111}

- rental value plus relocation costs minus one dollar to remain in possession. This provides the lessor with the opportunity to engage in cheating and other opportunistic behavior. Opportunistic behavior is behavior of a performing party to an agreement that is "contrary to the other party's understanding of their contract, but not necessarily contrary to the agreement's explicit terms, leading to a transfer of wealth from the other party to the performer." Muris, Opportunistic Behavior and the Law of Contracts, 65 Minn. L. Rev. 521, 521 (1981). For a discussion of opportunistic behavior, see infra notes 135-37 and accompanying text.

\footnote{107}{See Note, supra note 42, at 86-88.}

\footnote{108}{See supra note 97.}

\footnote{109}{Compare, however, the view taken by the Restatement (Second) of Property § 12.1(3) (1976). The Restatement rejects the modern view and adopts the common law view that the lessor has no duty to mitigate, because to do so would encourage the abandonment of property. "Abandonment of property is an invitation to vandalism, and the law should not encourage such conduct by putting a duty of mitigation of damages on the landlord." Id. § 12.1 comment i. Although the issue is outside the scope of this Article, it would seem that, if the lessor has no duty to mitigate and the lessee abandons the premises, vandalism would be just as likely to occur, as the premises remain vacant.}

\footnote{110}{In an inflationary market where the leasehold increases in value, the lessor should never technically accept surrender of the leasehold in an attempt to hold the original tenant to the terms of the lease. Doing so may result in the lessee's receiving the rental value received by the lessor in excess of the rent reserved in the lease, thereby defeating the lessor's intent in refusing consent to the voluntary transfer in the first place. See J. Dukeminier & J. Krier, supra note 4, 238-239.}

\footnote{111}{For an egregious example of this, see, e.g., Dress Shirt Sales v. Hotel Martinique Assocs., 12 N.Y.2d 339, 190 N.E.2d 10 (1963) (lessor leased premises for a term of 10 years at an annual rental of $10,000 for the first five years and $12,000 for the next five. After one year lessee sought consent to transfer to an assignee and lessor refused; lessee paid $30,000 to
In light of the increased value of the leasehold, (now $5.00 per square foot per month), both parties may propose to transfer the interest to the higher value user. If DCI presents a proposed assignee who is willing to pay a higher rental, it can negotiate with lessor, LC, for a portion of that increased value. If LC refuses to transfer a portion of the increased value to DCI by consenting to alienation, LC runs the risk of being locked into a long-term lease in at a below-market rate ($3.00 per square foot per month) by DCI's decision to stay.

Arguably, circumstances might arise where both parties do not share in the gain when the leasehold appreciates in value even if the transaction results in a transfer to a higher value user. Consider the following: suppose that DCI's decision to vacate the leasehold is based on factors exogenous to the value of the leasehold—due to a downturn in DCI's business, DCI cannot meet its obligations under the lease. Because of this situation, presenting a proposed assignee to LC is in DCI's interest. LC has no incentive to accept the proposed assignee, however, as long as LC is required to share the higher rental value with the lessee. Given its ability to refuse any alienation, LC should withhold consent and then lease the interest to the proposed assignee after DCI's business difficulties force it to breach. In this context, LC can behave opportunistically and realize all the gains from any appreciated value.

The foregoing situation, in which the one party captures all the gain from the increased value of the leasehold interest is extremely rare, for two reasons. First, only a foolish lessee would inform the lessor of its precarious financial plight. Second, DCI still benefits because it has minimized its financial plight by being allowed to cancel a legal obligation at no cost. Furthermore, although a discussion of DCI's rights in bankruptcy is beyond the scope of this Article, the trustee for the bankrupt lessee might be able to "sell" the excess value of the leasehold to satisfy DCI's debts. The latter option is a credible threat to LC, and one that may make LC reconsider its position vis-a-vis DCI.

cancel lease, and lessor subsequently leased premises for the remainder of the term to the proposed assignee for an annual rental in excess of that paid by former lessee).

112 Certainly, in some situations keeping such information secret would be difficult, if not impossible.
Thus, the possibility that DCI may not share in the gains due to higher rental values seems slight. Usually, where LC discovers the higher value user, LC must offer to share with DCI some of the economic gains from the transaction. This is so because DCI can simply refuse to vacate the premises.\(^{113}\)

Compare this situation to one in which DCI does not have to negotiate to obtain LC’s consent to the transfer; the minority position dictates that if DCI presents a “reasonable” lessee, LC must consent to the transfer. DCI’s only interest is maximizing its stream of income from the sale of the leasehold,\(^{114}\) regardless of its immediate effect on the leasehold and the reversionary interest, thereby imposing externalities on LC.

For example, assume that DCI has outgrown the premises and is looking for an assignee-lessee to take its place. DCI’s only incentive is to maximize the gain that will occur when it transfers its interest to the new assignee. Thus, DCI will not be concerned about the assignee’s impact on either the reversionary interest held by LC or the detrimental effect the assignee may have on any other tenant of LC. If the assignee-lessee (TNT), a maker of explosives, is willing to pay a monthly rate of $6.00 per square foot to DCI for the remainder of the term, DCI should accept to maximize its self-interest.

The fact that LC may lose other tenants who will choose not to renew their leases (or in extreme cases, will breach their leases) because of TNT’s presence is external to DCI’s decision to assign to TNT. Similarly, the fact that LC will lose forever the opportunity to obtain Widget, Inc. as a lessee when Widget is willing to enter into a long-term lease extending into the reversionary period is likewise external and irrelevant to DCI.\(^{115}\) DCI’s interest is to maximize its

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\(^{113}\) For a discussion of the problems and the solutions for this bilateral monopoly situation, see infra notes 125-29 and accompanying text.

\(^{114}\) As a result of privity of contract, DCI remains contractually bound to LC to perform the covenants in the lease. How meaningful is this responsibility, though, when the premises are increasing substantially in value? Any breach by the sublessee will be met with grateful acceptance on the part of LC, which now can retake possession of the premises and let the premises at a higher rental. LC’s actions will negate any future damage claim against DCI, the original tenant.

\(^{115}\) One might object that the hypothetical is unrealistic because TNT is a ultrahazardous user whose use of the premises should be restricted by a well-drafted use clause. (Pursuant to traditional property law, the lessor may limit the uses of the leasehold allowed to the lessee; in addition, the lessor may limit the purposes for which the lessee is given possession. Any violation of the restriction on use results in termination of the lease and a cause of action for
short-term gain, its present interest in the land, irrespective of the harm it may cause to LC, who holds the reversionary interest and other related interests. In the long run, however, an assignment to Widget at $5.50 per square foot might either consolidate or increase the value of LC's property. Yet LC cannot try to negotiate for a portion of the rent paid by TNT to DCI to offset any economic detriment caused by the transfer because a "reasonable" response as defined by the minority rule does not include economic renegotiation.\textsuperscript{116}

The effect of adopting the minority rule, which requires the lessor to act reasonably, is to give the lessee all the gain from any future transfers to the lessee and deny the lessor the ability to protect his reversionary interest or his interest in related property. The Kendall court argued that the holder of the reversionary interest, LC, can recoup any loss it suffers as a result of being locked in at the lower rate because it benefits from the increased property value due to inflation.\textsuperscript{117} This assertion ignores the fact that LC has been excluded from sharing in the proceeds of the increased value until the reversion takes effect; moreover, it assumes that the increased value is steady and constant and will remain upon the expiration of the term. In reality, then, the minority position restrains the lessor by limiting him to the stream of income at the originally negotiated lower rate.

In summary, lease clauses giving lessors the arbitrary right to restrain alienability serve valid contractual functions. First, they provide an opportunity to renegotiate a broad range of lease terms with the proposed assignee. A new tenant always signals changed circumstances by the lessor against the lessee. See 42 Cal. Jur. 3d, Landlord & Tenant §§ 92-93 (1978). A narrowly drawn use clause that essentially prohibits TNT's occupation of the premises, however, is merely another kind of inalienability clause, and should be treated as such by the courts that have adopted the minority rule. Thus, the battle merely shifts to the drafting and interpretation of use clauses. Proponents of the minority position, then, must likewise call for the enforcement of "reasonable" use restrictions only, giving "reasonable" the same sort of narrow interpretation in this context that it has with respect to alienation. See supra notes 22-27 and accompanying text.

\textsuperscript{116} Assuming that the law must allocate the increased value of the leasehold to one party to avoid the problem of bilateral monopoly, see infra notes 125-29 and accompanying text, that value should be transferred to the lessor, not the lessee. The lessor can best internalize the costs associated with the transfer of the premises because of his reversionary interest in the premises. Moreover, any fortuitous gain in the value of the property is best put to use in the hands of the lessor. The lessor has some incentive, even if it is marginal, to use some of the gain from the increased appreciation to improve the leasehold.

\textsuperscript{117} Kendall, 40 Cal. 3d at 504, 709 P.2d 847-48, 220 Cal. Rptr. at 828-29.
stance—that much is foreseeable by both parties at the time the initial lease is negotiated. But the precise nature of the changes and the ways in which the lessor will want to respond to them are not foreseeable ex ante; therefore, the parties cannot reduce important elements of the arrangement to well-defined terms. The rational lessor may be willing to pay for a clause that says if the lessee wishes to transfer his interest to another, the lessor obtains some bargaining chips, among them a veto power through his right to restrain alienability arbitrarily. The rational lessee may agree to that clause ex ante because the agreement is cheaper than specifying every possible contingency if the lessee should decide to assign at a later date.

A second purpose of these clauses is a more precise version of the first. The clauses provide the lessor with an opportunity to share in the gains from breach that might accrue to the lessee by virtue of an unforeseen rise in rental values.

Third, and most important, the standard approval clause maximizes the gains from alienation and minimizes the losses. Alternatives such as short-term leases, leases with escalation riders, and leases with mandatory renegotiation clauses are less effective substitutes for clauses allowing the lessee to restrain alienability. These alternatives do not give the parties as much incentive to exploit market conditions efficiently and to maximize gains and minimize losses to both parties. The clause encourages parties to negotiate over the division of the windfall and to strike a balance between present and future interests, thereby facilitating joint maximization of gain. More importantly, this maximization will result in the most efficient use of the property.

5. The Economic Benefits of the Traditional Rule

The foregoing hypothetical has illustrated why parties might want to include a standard approval clause in a long-term lease. The minority position restricts parties’ freedom in structuring a lease agreement. In an attempt to interject contract principles into commercial leasing arrangements and to protect a class of litigants the court perceived as aggrieved, the Kendall court ignored the economic realities of the situation, much as it did in Wellenkamp.\(^\text{118}\) Specifically, the court failed

\(^{118}\) *Wellenkamp* is an analogous situation in which an inalienability rule (the due-on clause) served valid and legitimate societal goals that were ignored by the courts. As one commentator noted:
Correctly Interpreting Long-Term Leases

1988] 

789

to realize that the standard approval clause has identifiable economic benefits to parties seeking to reduce various transaction costs of leasing.

Professor Susan Rose-Ackerman contends that inalienability rules, which are pervasive in modern societies, have valid public policy justifications and serve legitimate societal goals.\textsuperscript{119} Summarizing a rather complex work, Professor Rose-Ackerman states, "[t]he efficiency rationales for inalienability rules are second-best responses to market failures that arise because of externalities, imperfections in information, or difficulties of coordination."\textsuperscript{120}

The long-term commercial lease provides support for this position. The lessee cannot provide the lessor with precise information about a possible future assignee ex ante. Similarly, the lessee cannot adequately guarantee ex ante that he will remain in possession of the premises. Even if the lessee tries to convey this information to the lessor, the lessee who will stay for the entire term cannot command a lower rent in exchange for this promise, because the lessor has no mechanism by which he can adequately monitor the lessee's promise.

Enter the arbitrary restraint on alienability. By granting the lessor the right to restrict alienation arbitrarily, the lessee provides a mechanism that solves the asymmetrical information problem in both the present and the future. The lessee presently conveys to the lessor a right that allows the lessor to monitor effectively whether the lessee keeps his promise in the future. The lessee bonds that any future assignee will be satisfactory to the lessor, even though the lessee can-

\textsuperscript{119} Rose-Ackerman, supra note 98, at 933 (1985).

\textsuperscript{120} Id. at 938.
not provide ex ante any specific information about the assignee-lessee.\textsuperscript{121}

One could counter the foregoing analysis by observing that a lessor’s right to restrict alienation arbitrarily is not designed to solve the information asymmetry problem. According to this line of argument, the lessee has not warranted that any future assignee will be satisfactory; rather, he has agreed only that the lessor will be able to internalize all of the windfall (the increased rent the premises command) if any assignee is proposed in a rising market. But this argument mischaracterizes the situation, because the right granted to the lessor is the right to negotiate for a division of the windfall. The lessee can always remain in possession and negate the lessor’s opportunity to receive a higher rental. This valuable right of the lessee checks any attempt by the lessor to engage in strategic bluffing to gain all or a disproportionate percentage of the windfall.

The lessee asserts two things when he presents an assignee and the applicable lease restrains alienability: this is an acceptable tenant from the lessor’s perspective, and some agreement must be reached on the division of the windfall. If either assertion is unsupportable, the lessor will reject the proposed assignment. Obviously, the division of the windfall may have something to do with the “acceptability” of the proposed assignee, but that is left to the negotiating skills of the parties.\textsuperscript{122}

Limited inalienability rules may also resolve the problem of the inefficient distribution of resources caused by difficulties in coordina-

\textsuperscript{121} In fact, the long-term commercial lease that grants the lessor the right to restrict alienability may be viewed as a long-term contract analogous to contracts in the debtor-creditor situation. In other words, the debtor-lessee is borrowing the use of the creditor-lessee’s land (instead of cash), and the rent represents interest and partial return of principal. One can view the lessor’s right to restrict alienation arbitrarily as a promise by the lessee that he will remain in possession and pay off the loan. Correspondingly, one can view the lessee’s promise to remain in possession as a bonding and monitoring device granted to the lessor to reduce the lessee’s costs. “Inasmuch as creditors fear broken promises that in effect lower the interest rate ex post, it is in the debtor’s interest to lessen these fears by offering a package of promises that creditors can easily monitor and therefore trust.” Levmore, Monitors and Freeriders in Commercial and Corporate Settings, 92 Yale L.J. 49, 51 (1982) (footnotes omitted).

\textsuperscript{122} For further discussion of the windfall’s division and how the leverage given to the lessee prevents the lessor’s total internalization of the windfall, see supra notes 108-17 and accompanying text.
tion.\textsuperscript{123} Granting the lessor the right to withhold consent arbitrarily is one way of controlling the "opportunistic behavior" of an assigning lessee who may be interested more in the short-term profits which flow from the transfer, rather than in the impact on the lessor's rights in the property.\textsuperscript{124} At first glance, however, allowing restraints on alienation appears to foster higher costs and more inefficiencies than would the adoption of the minority rule.

Whenever two different parties have interests in property and the approval of both is required to effect a transfer, the transaction costs associated with the transfer increase, as does the risk that one party may hold out. By requiring both parties to consent to a transfer, both may engage in strategic bargaining, and no transfer will take place. In other words, the rules have created a bilateral monopoly, defeating the purpose of any efficient rule to allow transfers to a higher value user. "To envision a system where \textit{A} [lessee] may possess and use property while only \textit{B} [lessor] has the right to alienate it is to embed a complex network of bilateral monopolies in the original distribution of property rights."\textsuperscript{125} Although our subject is consensual voluntary transactions rather than the initial distribution of property rights, the creation of a bilateral monopoly compounds the risk of inefficiencies.\textsuperscript{126}

\begin{itemize}
\item \textsuperscript{123} Professor Rose-Ackerman explains this coordination problem:
\begin{quote}
More narrowly focused coordination problems arise in controlling the opportunistic behavior of a person who purports to act on behalf of another. An inalienability rule may mitigate these problems when the law that directly controls the parties' relationship is inadequate. The law protects creditors, for instance, by preventing a person close to bankruptcy from giving away assets. Similarly, mineral leases that require payment of royalties equal to a percentage of the mining profits may include diligence requirements to induce leaseholders to search for resources.
\end{quote}

Rose-Ackerman, supra note 98, at 940.
\item \textsuperscript{124} One can argue that the lessor's promise to act reasonably with respect to his decision to consent to a transfer is merely another species of inalienability rules. The lessee cannot freely transfer his premises without the consent of the lessor, thus limiting the lessee's right of alienability. In this situation, however, the lessor's decision to withhold consent must be tempered by reason.
\item \textsuperscript{125} Epstein, Why Restrain Alienation?, 85 Colum. L. Rev. 970, 971 (1985).
\item \textsuperscript{126} Professor Epstein addresses the bilateral monopoly problem in this context of the voluntary transaction:
\begin{quote}
Voluntary exchanges work for the mutual benefit of both sides . . . To insure that exchanges can go forward, rights of alienation must be vested somewhere, or resources will remain fixed in the hands of those who do not want them. There seems no better place in which to locate exclusive rights of alienation than with the parties already entitled to possession and use.
\end{quote}
\end{itemize}
In certain types of leases—those I call relational leases—formulations that allow a lessor to withhold consent arbitrarily constitute one method of solving mutual dependency and vulnerability problems that might arise later from a bilateral monopoly. The alternatives to such a clause are less attractive than the creation of a bilateral monopoly for a certain class of lessors and lessees. A limited bilateral monopoly is not necessarily detrimental, just as certain restraints on alienation may serve legitimate purposes as the next best alternative, given market imperfections.

In some situations, limited restraints on alienation, instead of creating harmful bilateral monopolies, can resolve "common pool" problems\(^{1}\) that arise between contracting parties. Common pool problems may be created by consensual arrangements in which two or more parties pool their resources to create a joint venture. The lessor-lessee relationship is an example of a joint venture in which both parties have an interest in one asset, the demised premises. Each party wants to exploit his joint interest in the property to maximize gain; yet each must also protect his respective interest in the premises from harm from his co-venturer. The lessee might desire to exploit his present possessory interest in the premises at the expense of the lessor's future reversionary interest.\(^{2}\) Conversely, the lessor might wish to protect his reversionary interest at the expense of the present interest. In sum, each party's interest in the premises is slightly different from, and antagonistic to, the other's. In a consensual transaction, inalienability rules represent attempts to limit and reduce exposure to common pool problems by preventing substitutions in

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\(^{1}\) Epstein explains the "common pool" problem as follows:
Whenever assets are held in common pools, there are dangers of overexploitation by each of its members. The root of the problem lies in the uneven match between benefits and burdens when something of value—say animals or oil—is removed from the common pool. The party who removes it receives all the gain from the removal, but only bears a small fraction of the cost. The social costs from any given removal may therefore be greater than the private gains of the removal, which are in turn greater than the private costs to the individual who removes it. . . . [Hence] every part owner has the strong incentive to remove something of value from the pool, so that if removal is done by all, the common pool may be destroyed, leaving every member worse off than he would have been if some restrictions upon individual removals had been imposed collectively.

\(^{2}\) Id. at 978.

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parties that could increase the risk of higher-than-expected costs.\textsuperscript{129}

C. The Lease as a Contract: The Covenant of Good Faith and Fair Dealing

The courts that follow the minority rule cite a second reason, in addition to the policy disfavoring restraints on alienation, for their decisions—the contractual nature of the lease. The \textit{Kendall} court, for example, followed the lead of many commentators and prior opinions and construed the lease as a contract with an implied covenant of good faith and fair dealing.\textsuperscript{130} In general, applying modern contract principles to landlord-tenant law is a salutary development; a lease usually should not be treated differently from any other contract.\textsuperscript{131}

Problems occur, however, when courts apply contract principles incompatible with the purposes of the instrument, assuming that all

\textsuperscript{129} Professor Epstein has pointed out that any change in parties, notwithstanding other provisions of the agreement designed to control opportunistic behavior, exacerbates the risk of increased cost, or surcharge:

Contracting affords the means for two or more parties to pool their separate resources into a common venture. One question that frequently arises is, who will be the parties to the venture after it is created? Here both sides often agree that the rights that they have created under contract shall not be assignable without the consent of the other. The reason for the agreement is the fear of a surcharge—of additional burdens—upon a promisor should the promisee assign the right to a third party. The promisee is a known quantity chosen and selected by the promisor. Even if the legal system gives the promisor the same rights against the promisee's assignee, the value of those rights still may be reduced by the assignment. . . . Preventing the assignment reduces the cost to the promisor by fixing the content of the obligation that would otherwise run to an unidentified party. Where the gains to the promisor exceed the costs to the promisee, this arrangement will be in the mutual interest of both parties. The other obligations of the promisor (e.g., the interest rate [or rent]) can be adjusted to compensate the promisee for the loss of the right of alienation. Id. at 982.


\textsuperscript{131} The application of warranties of habitability to the residential landlord-tenant situation exemplifies the salutary application of modern contract principles to landlord-tenant law. See Cunningham, supra note 7; Rabin, The Revolution in Residential Landlord-Tenant Law: Causes and Consequences, 69 Cornell L. Rev. 517 (1984).
contracts should be treated similarly. This misapplication results in
the same "form over substance" problems created when the courts
blindly assume that all leases should be treated alike and, thus, that
the commercial lessor-lessee relationship is comparable to the residen-
tial lessor-lessee relationship.

Consequently, supporters of the minority position erroneously con-
clude: (1) that the lessor's duty to mitigate requires his reasonable
consent to an assignment; 132 (2) that giving any increased value attrib-
utable to inflation to the lessor is not fair, because the lessee acquired
the contractual right to use the premises during the entire term—a
right that includes the right to transfer; and (3) that the expectations
of the parties are such that granting the increased value to the lessee is
appropriate.133 I will begin my analysis with this last erroneous
conclusion.

1. Expectations: How Far Should They Take a Court?

Courts adopting the minority position state that to allow the lessor
to restrain alienability arbitrarily breaches the covenant of good faith
and fair dealing and contravenes the expectations of the parties.134 In
a sense, the courts have interpreted the implied covenant of good faith
and fair dealing as both applicable to commercial leases and appro-
priate in that context to prevent opportunistic behavior that the lessee
does not anticipate ex ante.135

In the context of the lease agreement and the standard approval
clause, opportunistic behavior is not to be confused with conduct con-

132 See, e.g., Kendall, 40 Cal. 3d at 502, 709 P.2d at 846, 220 Cal. Rptr. at 827.
133 See id. at 501-03, 709 P.2d at 846-47, 220 Cal. Rptr. at 827-29.
134 The same wrong-headed argument was made in the analogous situation in Wellenkamp.
The mortgagor characterized the due-on clause as a "sleeper" clause of which the borrower is
unaware when he agrees to the contract. Thus, the borrower allegedly is surprised to learn
that the lender will condition his consent to a transfer on an increased interest rate. In this
scenario, the court found the lender's motives to be irrelevant.

But what should his [borrower's] expectations be? The language of the typical clause
describes the borrower's rights and duties unambiguously; he may repay the loan on a
periodic basis only as long as he owns the securing property. Understanding the lender's
motives does not alter the borrower's obligations under the contract.

Note, supra note 73, at 128-29.
135 Professor Muris has demonstrated that certain legal principles, particularly such implied
terms, are in reality low-cost methods of deterring costly opportunistic behavior. Muris
focuses on the methods used to control such behavior, which is ambiguous in character and
thus costly to deter and to detect. Muris, supra note 106, at 521-22.
Correctly Interpreting Long-Term Leases

In one sense, opportunism represents a response to a situation that was not contemplated by the parties ex ante, and that therefore was not addressed in the agreement. In the typical commercial lease situation, the lessee cannot credibly argue that there was surprise or overreaching on the part of the lessor. Furthermore, generally neither party has made a formulation error that could cause the terms to be misunderstood by the parties. Proponents of the minority rule, however, not only fail to recognize that the parties may agree in good faith to a clause that expressly allows the lessor to restrict alienation arbitrarily, but they also ignore the clause’s valid commercial purposes.

Instead, these situations involve interpretation errors created by the courts that have changed the rules in the middle of the game for unpersuasive and unproductive reasons. In Kendall, for example, the California Supreme Court refused to enforce the agreement pursuant to its terms and in accordance with the expectations of the parties to the agreement. This would not necessarily have been a negative development, had some viable policy goal or objective been served by the change. Unfortunately, as the foregoing analysis of the minority

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136 Professor Muris distinguishes the two behaviors as follows:
Although opportunism provides a basis for condemning as a breach certain conduct that does not violate explicit contractual language, not all breaches involve opportunism. For example, one party may gain sufficiently from the breach to compensate the nonbreacher for any losses and still benefit. Without a wealth-transfer, no opportunism exists although a breach still occurs. In addition, when exogenous circumstances render performance within the terms of the contract impossible, a breach exists, but opportunism does not.

137 As a result, opportunistic behavior is frequently present in relational contracts.

138 See supra notes 118-129 and accompanying text.

139 This type of formulation error is aptly described as follows:
In addition to such errors, precipitated by the parties themselves, the state may in effect superimpose new and thus "erroneous" instructions on an original formulation [agreement] that was well understood between the parties but disputed for strategic motives. Such errors will occur when the court either enforces terms that were almost certainly not contemplated by either party or refuses to enforce terms that were.

140 See 40 Cal. 3d 988, 709 P.2d 837, 220 Cal. Rptr. 818. The lessee could not allege that he expected to be able to transfer the premises contingent upon the lessor's reasonable actions, because he could have negotiated for precise formulations that would have clearly required the lessor to act reasonably. The only realistic assertion the lessee could have made was that he was the subject of an adhesion contract, due either to lack of information or lack of bargaining strength.

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HeinOnline -- 74 Va. L. Rev. 795 1988
position has argued, the court's changing the rules in the middle of the game served no viable policy objective. Moreover, by refusing to apply the minority prospectively, the decision negated the ex ante expectations of the parties.141

2. The Inapplicability of Unconscionability to Commercial Leases

Implicit in the reasons given for the minority's adoption of section 15.2(2) of the Restatement is the notion that the lease and, more particularly, the standard approval clause allowing the lessor to restrict alienability are adhesive or unconscionable.142 Perhaps the Kendall court's real concern was the adhesive and unconscionable nature of the contract,143 not its alleged unfairness, just as this was the concern in the analogous mortgage situation in Wellenkamp. In addition, some commentators have suggested that an implicit goal in Wellenkamp was the protection of the borrower from the lender's use of

141 See supra notes 66-67 and accompanying text.
142 An adhesion contract is defined as a standard form contract offered to the weaker party on a "take-it-or-leave-it" basis. The weaker party is forced to agree, or "adhere" to, the terms presented by the party with superior bargaining power. As a result, the contract terms supposedly reflect this inequality of bargaining power. See generally Note, The End of Due-On-Sale Clause, at 574 (discussing contracts of adhesion); Comment, Contracts of Adhesion Under California Law, 1 U.S.F. L. Rev. 306, 306 (1967) (defining the phrase "contract of adhesion"). An adhesion contract may produce an unconscionable agreement. Goetz and Scott define unconscionability as follows: "The unconscionability doctrine represents an ambitious effort to bring the traditional categories of unfairness—fraud, duress, incapacity—under a single analytical umbrella.... [U]nconscionability represents the subjective reactions of the particular decision-maker to the unfairness of a particular transaction." Goetz & Scott, Relational Contracts, supra note 9, at 1136 n.111 (footnotes omitted) (quoting Goetz & Scott, supra note 16, at 589 n.91).

For purposes of precision and uniformity, I prefer to recast this argument, using the Uniform Commercial Code's definition of "unconscionability" found in U.C.C. § 2-302 (1976). (Comment 1 to this section proscribes "unfair surprise" and "oppression.") Inherent in the Wellenkamp court's disapproval of due-on clauses and, as we shall see, restrictive transferability clauses is the notion that by enforcing such clauses the courts create an "unfair surprise" to the mortgagor-tenant that is also "oppressive." Adhesion, which refers to the more limited situation where a party lacks bargaining power and an unfair agreement results, is too narrow to encompass the element of oppression.
143 In Kendall, the court stated the issue as follows:
"He [the lessee] took the downside risk that he would be paying too much rent if there should be a depression in the rental market.... Why should he be deprived of the contractual benefits of the lease because of the fortuitous inflation in the marketplace?]"
. Respondent [lessor] here is trying to get more than it bargained for in the lease.
Kendall, 40 Cal. 3d at 504, 709 P.2d at 847-48, 220 Cal. Rptr. at 828-29 (quoting Miller & Starr, Current Law of California Real Estate § 27.92, at 321 (1977 & Supp. 1984)).
market leverage and superior bargaining power to extract a contract that unfairly favored the mortgagee.\textsuperscript{144} In fact, one can argue, using the reasoning in \textit{Wellenkamp}, that lender-prepared documents, like mortgages with due-on clauses, are signed by borrowers out of economic compulsion, ignorance, or both.\textsuperscript{145}

Notwithstanding the merits of the unconscionability or adhesion argument in \textit{Wellenkamp},\textsuperscript{146} any allegation of unconscionability regarding a clause that allows the lessor to withhold consent arbitrarily is doomed to fail for several reasons. First and foremost, the parties can rarely, if ever, allege unequal bargaining power in these cases. The courts have applied this new rule to \textit{commercial},\textsuperscript{147} not residential, leases, as the latter are governed largely by statute.\textsuperscript{148} Although the unconscionability doctrine may apply to some short-term or form leases,\textsuperscript{149} it should not apply in the interpretation of clauses in the long-term commercial lease.\textsuperscript{150} As Professors Goetz and Scott note, \textit{"[a]lthough an unconscionability analysis does invite intervention in specific cases, it is rarely invoked in agreements between commercial parties because its doctrinal foundations rest on assumptions of imperfect information and related claims of bargaining process unfairness."}\textsuperscript{151}
On a more basic level, it is difficult to argue that the common law property rule is unfair, given the express formulations through which the lessor can secure the right to restrict alienability arbitrarily where unconscionability is absent. Alienability is merely one criterion of value; a lessee benefits from the increased value of premises, because he is permitted to use the premises without paying increased rent. Presumably, this potential advantage motivated the lessee at the outset of the contractual relationship to eschew the use of a lease with an escalation clause and other alternatives.

Of course, if the market falls, the lessee will nevertheless have to pay the rent reserved in the lease. Confusion results, however, when the courts compare this situation to where the lessee seeks to transfer to a third party the increased value of the premises. The proper comparison is to a lessor's inability to raise the rent when the value of the premises has increased and the lessee remains in possession. The comparison of like situations reveals perfect symmetry: irrespective of market fluctuations, the lessee will be required to pay the rent reserved in the lease as long as the lessee is in possession. Bringing a third party into the equation—proposing a voluntary transfer—changes the rules.

Furthermore, this assertion—that giving the gain from the increased appreciation to the lessor is unfair, because in a declining market the lessee is stuck with a bad deal—is ill-conceived because it fails to recognize the way markets actually work. As a result of the costs imposed by litigation (i.e., uncompensated attorneys' fees and hardship from opportunistic behavior by remaining in possession or negotiating a buy-out with the lessor. The lessor cannot force the lessee to vacate the premises, so without renegotiation, the deal remains the same: the lessee remains in possession and pays the rent reserved in the lease. If, however, the lessor allows the lessee to transfer the premises, some of the increased value in the leasehold may be captured by the lessor. See supra notes 101-13 and accompanying text. Interestingly, recapture options are currently popular in commercial leases. These options automatically grant to the lessor any increased rent received by the assigning tenant from the assignee-tenant; thus, the lessee is free to alienate the premises, as long as all the gain from the alienation is remitted to the lessor. These recapture clauses, which apparently are designed to promote alienability, will have the opposite effect. As all gains will be awarded automatically to the lessor, the lessee has no incentive to seek out, or transfer the property to, the higher value user. Similarly, the lessee has no incentive to accept a higher value user presented to him by the lessor because, once again, all gains are awarded to the lessor.

152 I address below in the context of the mitigation doctrine the problem of dissatisfaction with the rules that apply when the lessee vacates the premises and the value of the premises is worth less than the rent reserved in the lease. All of the reasons that support the modern,
the risk, however slight, that the lessee may posit a valid reason to defend any action to collect past-due rent), the parties have incentives to negotiate a new, less costly lease in the event of a severe economic downturn that negatively affects the value of the leased property. The lessee's leverage or "trump" in this situation is the threat of litigation and the lessor's desire to avoid its costs.

Thus, realities dictate the existence of an implied agreement between the parties to renegotiate in the event of decreased value of the leasehold, as well as in the event of increased value. At the very least, nothing in the lease or law prevents this renegotiation. The courts adopting the minority position could achieve perfect symmetry only if they also adopted a rule to prevent renegotiation, not only when the premises increase in value, but also when the premises decline in value.

3. Mitigation and Alienability: Separate but Equal

As several commentators have noted, a number of courts have confused, in the leasing context, the issues of mitigation of damages and alienability. The courts are really accomplishing one of two goals by implying a reasonableness requirement into the lessor's decision to consent to alienation. First, some courts are harmonizing the rules that govern the alienability of premises with those that require the lessor to mitigate damages upon breach by the lessee.

In those states that do not require mitigation, the manipulation of the assignability doctrine is a way to require the lessor to mitigate damages without expressly adopting such a doctrine. Nevertheless, the legal distinction between alienability and mitigation should foreclose any attempt to apply one to the other or any assumption that because mitigation is desirable or applicable, a doctrine requiring the lessor to act reasonably should be desirable or applicable as well.

"better" rule that the lessor has a duty to mitigate also support a rule giving the lessor the gains from a transfer of the leasehold.

153 See, e.g., Levin, supra note 60, at 114-20.
154 Kendall is an excellent example of this. See 40 Cal. 3d at 502, 709 P.2d at 846, 220 Cal. Rptr. at 827 (California rule requiring mitigation is an example of a common law restraint on lessor's freedom to receive rent only from lessee).
Whether the lessor should be required to mitigate damages is resolved by one's view of the transaction: is it a lease or a contract? Although much has been written on the mitigation issue, the better view adopts a contract law approach and requires mitigation, at least in the residential context. The nature of the transaction is largely irrelevant to the issue of alienability, where the issue is one of the intent of the parties and the fairness of enforcing the clause. Consequently, even though the lessee who breaches the lease gets the benefit of something like rent when the lessor, to mitigate damages, transfers the lessee's interest in the leasehold, mitigation does not give the breaching lessee the extra market value that reflects any increased appreciation in the value of the premises. In other words, mitigation is not inconsistent with the traditional rule that allows the lessor to restrict alienation arbitrarily and receive most or all of the increased value of the premises.

Thus, in those states that require the lessor to mitigate damages in the event of a breach by the lessee, no practical reasons exist for the courts to be concerned with any inequities alleged to have arisen from the lessor's refusal to consent to an assignment. If the value of the premises has increased and the lessor refuses to consent to the transfer, the lessee may abandon and trigger the lessor's duty to mitigate. The lessor will be required to lease the premises to the proposed assignee-lessee; because the value of the premises exceeds the amount reserved in the lease, the lessor cannot recover any damages. As discussed above, the lessor should not be held to a reasonableness standard in the dissimilar situation where the value of the premises has declined and the lessee desires to transfer the premises to a pro-

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156 See, e.g., Sommer v. Kridel, 74 N.J. 446, 378 A.2d 767 (1977); see also Note, Landlord-Tenant—Landlord's Duty to Relet When a Tenant Abandons Leased Property, 43 Mo. L. Rev. 359 (1978) (enumerating social justifications for mitigation rule); Comment, The Landlord's Duty to Mitigate by Accepting a Proffered Acceptable Subtenant—Illinois and Missouri, 10 St. Louis U.L.J. 532 (1966) (preferring rule requiring mitigation); Annotation, Landlord's Duty, on Tenant's Failure to Occupy, or Abandonment of, Premises, to Mitigate Damages by Accepting or Procuring Another Tenant, 21 A.L.R.3d 534, 565-70 (1968) (collecting cases recognizing mitigation requirement); cf. Hicks, supra note 81, at 516-20 (discussing justifications for and arguments against mitigation rule). But see supra note 109 (discussing Restatement position).

157 For a listing of those states that have adopted the minority rule, see Levin, supra note 60, at 119 n.47.

158 Id. at 119.
posed transferee.¹⁵⁹

In those states that do not impose a mitigation duty on the lessor, courts should not adopt the minority rule on alienability in an attempt to impose mitigation rules piecemeal or indirectly. Critics of the status quo should target the laws and rules governing mitigation, not those regulating the alienability of long-term commercial leases. If a state adopts a mitigation rule that applies only when the lessor “unreasonably” rejects a proposed assignee, a self-interested lessee who wishes to trigger mitigation rules will present numerous prospective assignees in the hope that a court will later find the lessor’s refusal to consent to any one proposed assignee to be unreasonable. Each case will have to be litigated, with a substantial commitment of judicial resources, because “reasonableness” is such an elastic standard. If this outcome is the objective of the courts adopting the minority view, they should adopt expressly a mitigation requirement and stop tinkering with the lessor’s ability to restrict alienation.

By using “buzz words” like “restraints on alienation” and “the covenant of good faith and fair dealing,” proponents have made a misguided, albeit sincere, attempt to change the rules that govern alienability. Although I have criticized the approach and the reasoning of the minority view, I do not ignore the problems with the rules that govern the alienability of commercial leases. The real problem with the lessor’s right to restrict alienability lies in the fact that in certain limited situations his refusal to consent may be viewed as the product of a contract of adhesion. Classifications should be made that delimit which leases—commercial or residential—are contracts and which leases should be considered conveyances or, alternatively, fee substitutes.

IV. TREATING LEASES AS CONTRACTS: AN INTERACTIVE APPROACH

I have noted the similarities between the issues raised by the lessor’s attempt to enforce clauses granting lessors the right to restrict alienability arbitrarily and the enforceability of due-on clauses in the mortgages.¹⁶⁰ I have gone so far as to predict that the minority position

¹⁵⁹ See supra note 152 and accompanying text.
¹⁶⁰ See supra notes 69-90 and accompanying text.
may result in Wellenkamp-type consequences.161 Fortunately, section 341 of the Garn-St Germain Depository Institutions Act of 1982 (the “Garn Act”)162 preempted state restrictions on due-on clauses.163 Unfortunately, there appears to be no current groundswell of national opinion on a scale that indicates that legislatures will adopt a “Lease-hold Garn Act” to benefit commercial lessors and to correct the inequities that will occur as a result of the adoption of the minority position.164

Because of the detrimental consequences that would follow from decisions restricting the lessor’s right to restrain alienability, the trend represented by the minority position should be reversed.165 Leases should be viewed as contracts; however, long-term commercial leases are relational contracts,166 subject to rules different from those governing residential form leases or leases of limited duration. Accordingly, all leases should not be subject to the same rules, and long-term

161 See supra notes 91-96 and accompanying text.
163 See generally Note, supra note 73 (discussing the effects of Garn Act and its preemption of state law); Note, Mortgages—Due-On-Sale Clauses Enforceable in All Mortgages: Federal Preemption, 6 W. New Eng. L. Rev. 127 (1983) (reviewing state decisions that prompted Garn Act and the problems it solved and created).
164 One could argue that the lack of unified opposition to the minority position suggests that this issue is relatively unimportant compared to the analogous situation mortgagees found themselves in following Wellenkamp. In fact, it probably represents an inability on the part of the affected interest group to gain national attention. For a number of reasons, it is harder for lessors than it is for mortgagees to influence public opinion. First, lessors are not in a highly regulated industry like mortgagees (banks)—although residential lessors in certain jurisdictions might argue the contrary. Second, a differing treatment of “federal” versus “state” lessors creates no inherent supremacy problems or conflicts that would demand uniformity for the efficient allocation of resources and the smooth functioning of the market. This latter factor was a primary reason for the due-on controversy following the decision in Fidelity Fed. Sav. & Loan Ass’n v. de la Cuesta, 458 U.S. 141 (1982) (holding that federally chartered institutions are not subject to state laws on due-on clauses because of the preemptive effect of the regulations of the Federal Home Loan Bank Board). Third, legislatures and courts need not protect the efficient functioning of any secondary leasing market in which leases are packaged and sold to raise funds as they do in the mortgage situation involving the packaging and sale of mortgages with due-on clauses. Fourth—perhaps a major factor in Congress’ response to Wellenkamp—was the financial shakiness of federally insured savings and loans, which meant that the real obligor, if mortgage rates could not be adjusted to profitable limits, was the federal government. This factor is not present with respect to leases.
165 See supra notes 91-96 and accompanying text for a discussion of the problems.
166 For a definition and discussion of relational contracts and the applicability of the theory of relational contracts to long-term leases, see supra note 9 and infra notes 175-87 and accompanying text.
leases should not automatically be subject to the imposition of implied covenants, such as good faith and fair dealing, when the use of such covenants is designed to correct errors that occur as a result of bargaining imperfections. These imperfections simply do not exist in the commercial environment.  

Similarly, very lengthy long-term leases should be recognized as fee substitutes and should be treated as such for the purpose of alienability rules.

A. Long-term Leases: From Contract to Status?

We may say that the movement of the progressive societies has hitherto been a movement from Status to Contract.  

Many of the contract-based arguments relied on by critics of the traditional property rules on alienability have merit if used to analyze leases of limited duration. These arguments regarding contracts of adhesion and doctrines of unconscionability make more sense in leases of limited duration or form leases where the following necessary elements may be present—imperfections in the bargaining process and related claims of bargaining process unfairness. As I have noted, unconscionability should not be used with respect to long-term contracts or leases because the doctrinal foundations upon which it rests cannot be invoked in long-term leases.  

More importantly, the economic reasoning used to argue for the repudiation of the minority position does not apply in the context of

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167 On the contrary, the use of implied covenants, such as good faith and fair dealing, may be appropriate to limit opportunistic behavior that may occur in a relational contract when one party unilaterally exercises its termination option, see Goetz and Scott, Relational Contracts, supra note 9, at 1138-40.  


169 See Berger, Hard Leases Make Bad Law, 74 Colum. L. Rev. 791, 821-35 (1974) (of the sixteen long, small-type, and pro-landlord standard form residential leases the author examined, "almost all treat the tenant as a latter-day serf." Id. at 835); cf. Mueller, Residential Tenants and Their Leases: An Empirical Study, 69 Mich. L. Rev. 247, 274-75 (1970) (concluding that about half of all tenants actually read their leases, and even fewer understand them).  

170 Cf. R. Posner, Economic Analysis of Law 102-04 (3d ed. 1986) (concluding that only two reasons justify a "take-it-or-leave-it" policy with respect to form leases: the avoidance of unnecessary transaction costs or the seller's (lessor's) refusal to negotiate with the buyer for unique terms. The latter rationale is implausible because "[i]t assumes the absence of competition." Id. at 102).  

171 See Goetz & Scott, Relational Contracts, supra note 9, at 1136-40 (discussing doctrinal foundations of unconscionability in the context of terminating relational contracts).
short-term form leases. The argument in favor of the lessor’s right to reap the increased value in the leasehold realized when the property is transferred to the higher value user is weakened considerably if the lessor’s reversionary interest will come to fruition in the immediate future. The lessor may redirect the property to the higher value user, with the resulting benefits, upon the expiration of the term. In essence, the lessor of premises subject to a short-term lease may adjust his portfolio or interest in his property by periodically renegotiating the lease.

Unfortunately, those courts and commentators adopting the minority position have focused on the “status” of the parties to the transaction, as either lessors or lessees, rather than on the type of the transaction. The minority position effectively treats the commercial lessee’s rights as akin to his residential counterpart because of their parallel status, and the courts view the commercial lessee as prey to all the negative consequences, such as the absence of bargaining and freedom of contract, connoted by the status of “lessee.” As they mistakenly apply to the commercial lessor and lessee incompatible contract principles that mandate the use of certain status rights, the courts have reduced the freedom to contract by implying terms that the sophisticated parties to the contract cannot waive, even if both believe a waiver to be in their best interests. 172 This rigidity forecloses negotiations between the parties that might result in a better deal for both parties.

In addition to the disadvantages inherent in a status perspective, any corresponding gains that flow from status determinations and the use of form contracts are not really relevant in the commercial context. Standard form contracts are efficient when adopted as a convenience by parties who engage in many such transactions and when the costs of customizing a transaction do not outweigh the gains. 173 In most commercial lease transactions, the parties do not use form leases and do not engage in enough transactions to formulate standardized terms. Indeed, the transaction costs associated with such complex agreements mandate the use of a customized or particularized agreement suited to the needs of the parties.

172 See Goetz & Scott, Relational Contracts, supra note 9, at 1138.
Essentially, then, the courts have focused on the status of the lessor and the lessee as opposed to the type of agreement negotiated by the parties. This development—focusing on status rights rather than individual contract rights—is not new in the lessor-lessee relationship. What is new and unfortunate is the application of these status attributes to commercial, as well as residential, lessors.

**B. Long-term Leases: Relational Contracts?**

Historically, the landlord-tenant relation has moved from status to contract to property to modern contract. The treatment of leases as contracts is, in general, laudatory. Treating a long-term commercial lease like a form lease of limited duration, however, ignores the difference between these contracts. All contracts should not be treated alike; neither should all leases. Substance should triumph over form, and leases should be treated the same as similarly situated contracts or mortgages. Long-term leases are, and should be treated as, relational contracts; this treatment is merited at least with respect to the right of termination that the lessor may or may not exercise when the lessee attempts to voluntarily alienate the premises.

Although the scholarship on relational contracts has so far focused on agency-type relationships such as distributorships, joint ventures, and employment contracts, relational contracts are defined more broadly. Parties enter into these highly interactive relational contracts because they cannot possibly foresee all of the contingencies that might later arise and thus cannot optimally allocate all the risks at the time of contracting.

Conventional theory supports the proposition that parties will enter into relational contracts only after considering and rejecting as impracticable alternative methods of achieving their objectives. In other words, as in the foregoing hypothetical, the parties may decide that the most advantageous relationship for both the lessor and the

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174 See generally Hicks, supra note 81, at 446-52 (tracing the development of the real estate lease); Lesar, supra note 135, at 369 (examining the proposition that tenant statutes are increasingly contract-based, a reversal of the previous status orientation).

175 Lesar, supra note 130, at 377.

176 For the definition of relational contracts, see supra note 9.

177 For a comparison of relational and complete contingent contracts, see supra note 9.
lessee is a long-term lease. "The obvious answer is that all things considered, [the long-term lessor-lessee relationship is] more attractive than the available alternatives."\(^{178}\)

One of the key contingencies unresolved at the time of contracting is what will occur if the lessee desires to alienate his interest in the venture prior to the expiration of the agreement. The parties can deal with this contingency contractually in a number of ways, including granting the lessor the right to restrict alienability arbitrarily through the use of a standard approval clause.\(^{179}\) Even though relational contracts and courts construing them often deal with the uncertainty of future performance by defining the standard of performance in general terms like "reasonable," "best efforts," or "good faith,"\(^{180}\) the effect of these terms is quite different in this context. In relational contracts, resort to such vague terms is often a method of allowing for adjustments to future contingencies.

At first glance, my opposition to the minority view, with its flexible "reasonableness" standard, seems counter to my support of treating these leases like other relational contracts. This apparent inconsistency is explained by examining "reasonableness" as adopted by the minority position and comparing it to "reasonableness" in the context of relational contracts. "Reasonableness" is narrowly defined by the minority position to exclude a reasonable economic return on investment and to include only the ability of the assignee-lessee to perform the terms and conditions of his lease.\(^ {181}\) "Reasonableness" in the relational contract context prohibits opportunistic behavior that may occur because of a change of conditions not anticipated by the parties. Under this definition, "reasonableness" allows the lessor to realize a reasonable economic return on the investment, as long as that return is not the product of opportunistic behavior.\(^ {182}\)

Because these clauses serve legitimate purposes ex ante and are not problematic ex post, they should be enforced as written. If the clauses are not enforced, parties who are denied the freedom to use them may

\(^{178}\) Goetz & Scott, Relational Contracts, supra note 9, at 1095.
\(^{179}\) See supra notes 15-20 and accompanying text.
\(^{180}\) See Goetz & Scott, Relational Contracts, supra note 9, at 1092-93.
\(^{181}\) See supra note 27 and accompanying text.
\(^{182}\) See supra notes 135-37 and accompanying text.
Correctly Interpreting Long-Term Leases

find alternative ways of formulating their objectives. At this point, the question becomes whether forcing the parties to accomplish their objective in some new, untested way is efficient.

I propose a system that would apply rules according to the substance, rather than the form, of the transaction. Form leases of limited duration should be treated as discrete transactions (complete contingent contracts) subject to the normal rules of contracting, including adhesion and unconscionability. These leases are contracts that may be susceptible to bargaining imperfections; for example, residential leases and leases of a limited duration (say three years or less) may fall within this category presumptively. The transaction costs associated with negotiating a short-term relationship dictate the use of form contracts even with resulting bargaining imperfections. These imperfections may result in formulations that, for policy reasons, such as decreasing instances of unconscionable behavior, the court may examine and strike.

On the other hand, courts should treat long-term commercial lease transactions as relational contracts. Distinguishing among leases based on length of term is not without precedent. Leases of more than fifty years are treated as the conveyance of a fee. More often than not, leases of commercial premises and leases of more than three years are the products of individual negotiations with both sides rep-

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183 For example, by drafting a "use" clause narrowly tailored to fit only the initial lessee, the lessor can control the transferability of the premises. Whether the courts will enforce such an obvious attempt to thwart its ruling in this regard is questionable. For a discussion of this issue, see supra note 115. More importantly, even assuming that courts concerned with opportunistic behavior on the part of commercial parties are correct in focusing on the parties' status as lessors or lessees, they nevertheless often lose sight of the fact that it is really the market that allows the lessor to extract what may appear to be an unreasonable or unconscionable clause. "[P]rohibiting one manifestation of seller economic power [e.g., leases with restrictive transferability clauses], while ignoring the market structure which produced that power, will yield another manifestation of the power. In no event, however, will the power disappear." Schwartz, Seller Unequal Bargaining Power and the Judicial Process, 49 Ind. L.J. 367, 379-86 (1974); see J. Dukeminier & J. Krier, supra note 4, at 146-47.

184 See supra notes 168-70 and accompanying text.


resented by counsel. Thus, they are not usually subject to the same sort of bargaining imperfections that plague form leases. Thus, lengthy leases of a commercial nature should be examined as relational contracts that fit the conveyance mode of common law leases, wherein courts presume that the parties can freely negotiate the terms and conditions of their agreement without judicial intervention. 187

CONCLUSION

Using the theories of disallowing restraints on alienation and of implying covenants of good faith and fair dealing into every contract, an increasing number of courts in the last ten years has required the lessor to act "reasonably" in decisions to restrict alienability. By defining reasonable behavior to exclude the lessor's long-term economic interests, the courts have rewritten the original deal between the parties without obtaining any corresponding gain. Before more courts follow this trend, they should examine the development in light of the disastrous consequences that resulted in an analogous situation—the Wellenkamp interpretation of due-on clauses that restricted the alienability of mortgages.

The courts should treat leases like other contracts. Thus, short-term leases of three years or less and all residential leases should be subject to implied terms designed to correct inequities due to bargaining imperfections. Other leases, commercial and long-term, should be regarded as relational contracts that are the result of individually negotiated contracts and thus are not subject ex post to certain status obligations. In the absence of opportunistic behavior, contract terms in relational leases should be enforced as the parties have agreed. Any other result will cause the death of long-term leases as we know them, as commercial parties shift to more flexible, shorter-term leases. This outcome would be an unfortunate development that is unnecessary and that has no corresponding benefit.