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PROTECTING LANDLORD CONTROL OF TRANSFERS: THE STATUS OF "SOLE DISCRETION" CLAUSES IN CALIFORNIA COMMERCIAL LEASES

Susan E. Myster*

I. INTRODUCTION

In 1989, the California State Legislature resolved to codify a point of landlord-tenant law decided in Kendall v. Ernest Pestana, Inc.1 The California Legislature enacted Senate Bill 536 providing that commercial leases may include absolute prohibitions against transfer or express conditions on landlord consent to transfer.2 The Legislature also codified the results of Kendall and implied a reasonable standard of consent in commercial leases which do not specify the conditions of landlord consent.3

Unfortunately, while the legislation resolved many ambiguities in case law doctrine, it created many more uncertainties. The California Legislature specifically rejected California Civil Code section 1995.240(c), which would have authorized lease provisions bestowing the landlord with sole and absolute discretion in consenting to a tenant’s transfer of the leasehold interest.4 The rejection of this provision, and the ambiguity of sections 1995.240 and 1995.250, make it unclear whether a landlord may enforce a commercial lease's

1. 709 P.2d 837 (Cal. 1985).
3. Id.
4. Kenneth J. Stipanov, Assignment & Subletting of Commercial Leases Under the New Statutory Scheme, 8 CAL. REAL PROP. J., No. 4, at 18, 22 (1990). This type of clause would permit the landlord to refuse transfer of the lease for any reason, even on arbitrary or unreasonable grounds. Actually, the provision was titled CCC § 1995.240(c) on the first draft and re-numbered on the second draft of Senate Bill 536. See generally CAL. STATE SENATE, S.B. 536, 1989-90 Sess. (draft version Feb. 17, 1989). See also CAL. STATE SENATE, S.B. 536 1989-90 Sess. (Mar. 27, 1989) (reflecting Senate amendments).

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“sole discretion” clause. Additionally, the legislation denied the remedy available in California Civil Code section 1951.4 to leases containing clauses either absolutely prohibiting transfers or allowing the landlord sole discretion in consenting to transfers—suggesting possible disapproval of these provisions. These actions of the Legislature have left the status of commercial lease “sole discretion” clauses in a precarious and uncertain position.

This article will explore the validity of “sole discretion” clauses under the new California legislation, given the background of Kendall’s reasonableness standard governing commercial lease transferability. This article proposes that “sole discretion” clauses are enforceable under the legislation, although their uncertain status invites litigation.

In order to avoid litigation, this article will propose a practical solution for landlords who wish to retain absolute discretion and control over lease transfers without waiting for the Legislature to amend the code. This article will also furnish a workable explanation of the remedy in California Civil Code section 1951.4 and explain its relationship to sole

5. CAL. CIV. CODE § 1995.240 (West Supp. 1995) provides:
A restriction on transfer of a tenant’s interest in a lease may provide that the transfer is subject to any express standard or condition, including, but not limited to, a provision that the landlord is entitled to some or all of any consideration the tenant receives from a transferee in excess of the rent under the lease.

CAL. CIV. CODE § 1995.250 (West Supp. 1995) provides:
A restriction on transfer of a tenant’s interest in a lease may require the landlord’s consent for transfer subject to any express standard or condition for giving or withholding consent, including, but not limited to, either of the following: (a) The landlord’s consent may not be unreasonably withheld; (b) The landlord’s consent may be withheld subject to express standards or conditions.

6. See generally CAL. CIV. CODE § 1951.4 (West Supp. 1995). This provision enables the landlord, at his/her option, to continue operation of the lease after a tenant breach and collect future rent as it becomes due without any duty to mitigate rent expenses. Id.

7. See infra part IV.

8. See infra text accompanying notes 141-142.

9. See infra part V. CAL. CIV. CODE § 1995.230 (West Supp. 1995) may provide a workable solution which will allow landlords to effectively retain sole discretion over transfer of the lease. This section provides: “A restriction on transfer of a tenant’s interest in a lease may absolutely prohibit transfer.” CAL. CIV. CODE § 1995.230 (West Supp. 1995). Landlords could place this clause in commercial leases, and then unilaterally waive the prohibition if a suitable sublessee or assignee was found. Placing an absolute prohibition in the lease prevents the landlord from receiving the benefits of the remedy provided in CAL. CIV. CODE § 1951.4 (West Supp. 1995).
discretion clauses. Finally, this article will propose an amendment to modify and clarify the law to allow “sole discretion” clauses, and justify the remedy provided in Cal. Civil Code section 1951.4 for leases containing these clauses.

II. BACKGROUND

An examination of the topic’s background, and the evolution which provoked the new legislation governing transfer restrictions, will aid in understanding the current legislation and its ultimate impact.

A. Property Lease Overview

Before focusing on the specific clauses of a lease, it is important to comprehend the basic nature of a lease, and the various types of leases which exist.

1. Dual Nature of Lease

A lease is both a conveyance and a bilateral contract. A leasehold is an estate in land which grants the lessee the right of possession.

Two hundred years ago, a lease was viewed solely as a temporary conveyance of property interests—essentially a sale of a term of years. The lessee bore all risks associated with possession of the property, including responsibility for accidental destruction of the premises occurring by fire or otherwise. The lessor did not guarantee the premises were

10. See infra text accompanying notes 145-156. Cal. Civ. Code § 1951.4 was enacted in order to permit landlords to elect to continue the lease after a tenant breach rather than terminating the tenancy, and to collect rent without any duty to seek another tenant so long as the tenant’s right to possession is not interrupted. Cal. Senate Judiciary Comm., 1991-92 Regular Sess., Report on S.B. 256, at 3 (Mar. 19, 1991).

11. See infra text accompanying notes 162-165.


13. Olin L. Browder et al., Basic Property Law 329 (5th ed. 1989). The term “leasehold” will be used throughout this comment to signify the interest a tenant holds in leased property/premises, without regard to either the contractual or conveyance nature of a lease.

14. 3A George W. Thompson, Commentaries on the Modern Law of Real Property 124-25 (1981). Prior to this time, during the Norman Conquest of England in the eleventh century until about the fifteenth century when feudalism began to erode, property leases were viewed as contractual in nature. See James L. Winokur, American Property Law 293-94 (1982).

15. Winokur, supra note 14, at 293-94.
habitable or fit for their intended purpose—the motto of real estate transactions was “caveat emptor.” The tenant ordinarily bore responsibility for repairs, and if the parties negotiated any lease provisions such as a landlord’s promise to repair, the courts interpreted the covenant as a promise independent of the tenant’s duty to pay rent.

Gradually, the law has recognized certain contractual aspects of property leases. Today, the parties to a lease maintain a continuous relationship throughout the term of the lease, with mutual obligations regarding rent, maintenance, use of the premises, etc. For example, when a leased building is accidentally destroyed, the courts now find the lease terminated since the landlord’s performance has been rendered impossible. Moreover, not only have the courts looked to contract doctrines such as impossibility and frustration to terminate the lease, in extreme cases they have implied dependent covenants such as the “Implied Warranty of Habitability” (IWH) to address on-going landlord obligations to tenants. Nonetheless, not all leasehold covenants are mutually dependent.

Like a contract, a lease is bilateral; one party’s breach of a covenant may suspend the other party’s duty to perform his or her leasehold covenants. Here, the key innovative principles are the treatment of a lease as a whole, and the recognition that future rent may be due in the present. For instance, when a tenant abandons the premises and defaults on rent payments, the courts consider it an anticipatory breach.


17. SCHOSHINSKI, supra note 12, at 2-3.

18. BROWDER, supra note 13, at 329.

19. WINOKUR, supra note 14, at 293.

20. Id. at 296. This statement concerning the court’s analysis assumes no relevant statute applies; however, most American jurisdictions have enacted statutes which automatically terminate the lease upon accidental destruction of the premises. WINOKUR, supra note 14, at 296. The parties may negotiate a provision in the lease which specifically allocates the risk of loss. Ralph Borelli, an Industrial and Commercial Real Estate Developer, indicates that generally a standard lease permits the landlord a certain amount of days to rebuild, i.e., 90 or 180 days. Interview with Ralph Borelli, Industrial and Commercial Real Estate Developer (Feb. 25, 1993).

21. SCHOSHINSKI, supra note 12, at 3.

22. See id. at 3.
entitling the landlord to the contractual remedy of money damages.\(^\text{23}\)

Despite these contract elements, it is important to remember that a lease is still theoretically both a conveyance and a contract.\(^\text{24}\) In fact, the Legislature has strengthened the conveyance concept of a lease in its protection of residential tenants. Laws prohibiting retaliatory evictions, ordinances concerning rent control, and regulations governing public housing all emphasize the conveyance concept of a leasehold.\(^\text{25}\)

A key issue in determining how completely the contract model of an on-going relationship with mutual obligations has taken hold is the recognition of an obligation of good faith and fair dealing.

2. Basic Leasehold Estates

There are four basic types of leaseholds: a term of years, a periodic tenancy, a tenancy at will, or a tenancy at sufferance.\(^\text{26}\) The first type of leasehold is a tenancy for a term of years. This tenancy has a fixed duration, usually one year or multiples or divisions thereof, which is determined and agreed upon by both parties.\(^\text{27}\) The second type of leasehold is a periodic tenancy. This is a tenancy of indefinite duration, with successively repeating periods of an agreed length.\(^\text{28}\) The third leasehold is a tenancy at will. This leasehold en-

\(^\text{23}\) Id. at 3-4. The money award the landlord receives is the remaining rent due under the lease, minus any rent the tenant has paid under the lease. The award is also decreased by the amount the landlord could reasonably avoid through mitigation: i.e., by seeking another tenant. Id. See, e.g., Sommer v. Kridel, 378 A.2d 767 (N.J. 1977).

\(^\text{24}\) Although some of the differences between the conveyance and contract nature of leaseholds are more noticeable in residential lease situations, most are equally applicable to the commercial setting. The examples enumerated here are intended only to highlight the distinctions between the two theories.

\(^\text{25}\) SCHOHINSKI, supra note 12, at 5-6.

\(^\text{26}\) BRODWER, supra note 13, at 329.

\(^\text{27}\) DUKEMINIER & KEIR, PROPERTY 425 (3d ed. 1993). Creation of a tenancy of any type is subject to the statute of frauds where applicable. A tenancy for a term of years terminates automatically on expiration of the agreed term; notice is not required unless either party desires termination prior to expiration of the lease. BRODWER, supra note 13, at 342-43.

\(^\text{28}\) DUKEMINIER & KEIR, supra note 27, at 426. A periodic tenancy may be from year-to-year, but the most prevalent type is month-to-month. If the tenancy has yearly periods, 6 months notice is required to terminate the lease unless controlling statutes dictate otherwise. Most jurisdictions have statutes requiring from 30 days to 6 months notice. If the tenancy has periods of less than
dures only so long as both parties desire. Finally, a tenancy at sufferance occurs when a tenant has legitimately gained possession of the property, but wrongfully remains in possession. For example, if a periodic tenancy for a term of one month existed, and the tenant was given thirty-days notice to vacate the premises, on the thirty-first day the tenant would be a holdover tenant with the leasehold interest termed a tenancy at sufferance.

3. Commercial Versus Residential Leases

There are two primary types of leases: commercial and residential. While these types are similar in some aspects, they do not share the same policy considerations. Residential leases typically reflect a higher turnover rate than commercial leases. The lessees in a residential setting are generally assumed to accept lease provisions without attempting negotiation; the landlord must have more discretionary powers in a residential setting, both in choosing tenants, as well as approving any sublease/assignment arrangements. In contrast, commercial lessees are assumed to have greater bargaining power and negotiate each clause of the lease.

In addition, commercial leases are based primarily on financial considerations, whereas a residential landlord may be concerned with non-financial attributes such as whether the tenant is quiet, neat, or has pets. These differences justify a distinct judicial treatment for each situation.

one year, required notice of termination is one full period in advance. BROWDER, supra note 13, at 343.

29. DUKEMINIER & KREIR, supra note 27, at 427. A tenancy at will could be terminated without notice by either party at common law. Most jurisdictions now require some notice—usually 30 days is sufficient. Sale of the property by the landlord, assignment of the lease by the tenant, or the death of either party will automatically terminate the lease. BROWDER, supra note 13, at 343-44.

30. DUKEMINIER & KREIR, supra note 27, at 431. A landlord typically has a choice in dealing with a holdover tenant: s/he may begin a new tenancy under the same terms as the prior tenancy, or treat the holdover tenant as a trespasser and take measures to evict the person. See BROWDER, supra note 13, at 344.

31. See Recommendation Relating to Commercial Real Property Leases: Assignment and Sublease, 20 CAL. L. REV. COMM'N REPORTS 251, 259 (1990). Due to the distinct policy considerations of each type of lease, this article will be limited to an analysis of commercial lease situations.


33. A commercial tenant may also be concerned with compatibility with other tenants in order to assure quiet enjoyment; however, commercial leases are more frequently motivated by finances alone than are residential leases.
B. Transfer of Leases: Assignment and Sublease

A leasehold may be transferred to another party by either an assignment or a sublease. Both devices purport to transfer the lessee's right to possession of the premises.

1. Assignment

An assignment is characterized by transfer of the lessee's entire interest in the leasehold. This transfer creates privity of estate between the landlord and the assignee. Figure 1 depicts the landlord-tenant-assignee interrelationship. The assignee receives and may enforce all covenants of the leasehold that run with the land; the landlord can enforce all covenants implied by law and running with the land against the assignee. However, the assignment does not create privity of contract between the landlord and assignee. Therefore, the assignee's duties and liabilities to the landlord terminate upon abandonment or reassignment.

Assignment can be made contractually binding under a third-party-beneficiary (TPB) theory if the assignee expressly assumes all of the tenant's leasehold obligations. The landlord is the legal "beneficiary" of the assumption and covenants under the lease, such as rental payments for the term of the lease, may be enforced against the assignee.

2. Sublease

A sublease is a transfer of an interest that is smaller than the lessee's remaining interest in the leasehold. The crucial element of a sublease is that the sublessor retains a

34. Schoshinski, supra note 12, at 553. Technically, a tenancy at will may not be transferred without destroying the tenancy. While it is important to understand the two types of transfer available, the distinction between an assignment and a sublease is not germane to the issue posed by this article. For the purposes of commercial lease transfer restriction clauses, the two types of transfer behave in the same manner and are treated in the same way.

35. See Schoshinski, supra note 12, at 553.

36. Myron Moskovitz et al., California Residential Landlord-Tenant Practice 181 (1986). Privity of estate is always shared between the landlord and the person in possession of the entire lease interest, as the quantum of the leasehold interest the lessee or assignee holds is equal to the leasehold interest the landlord relinquished.

37. Id.
38. Id.
39. Id.
40. Dukeminier & Krier, supra note 27, at 404.
reversionary interest in the leasehold estate. The landlord does not have privity of estate or contract with the sublessee; rather, the sublessor and sublessee share both privities, as do the landlord and sublessor.\textsuperscript{41} In practical terms, the landlord must seek enforcement against the tenant/sublessor, and the sublessor can attempt to indemnify the sublessee. In the same manner, the sublessee must enforce any covenants against the sublessor, who in turn looks to the landlord.\textsuperscript{42} Figure 2 portrays the lessor-sublessor-sublessee interrelationship.

C. Restrictions on Lease Transfer

There are many types of lease clauses that govern or restrict the ability of the tenant to assign or sublease his or her leasehold interest. There are variations on the various types of lease clauses, and they are often intermingled and combined.\textsuperscript{43} The basic types of lease clauses governing transferability of the leasehold are:

1. \textit{Free Alienability}. In a free alienability clause, the lease expressly states the tenant may sublease or assign his or her leasehold interest at will. Since ambiguous clauses are

\begin{itemize}
\item \textsuperscript{41} \textit{Schoshinski}, supra note 12, at 556.
\item \textsuperscript{42} \textit{Id.} at 556.
\item \textsuperscript{43} This article is limited to the problems and issues created by a "sole discretion" clause, and will not attempt to resolve any ambiguities which inhere in other types of restrictive lease clauses.
\end{itemize}
construed in favor of free alienability, this type of clause is clearly permissible under California law.\(^4^4\)

2. *Silent Consent Standard.* Under this provision, the lease requires the tenant to receive the landlord's permission to transfer his or her leasehold interest, but does not specify the standard governing the lessor's decision. The landlord is not expressly given absolute discretion, nor is s/he explicitly required to be reasonable. Where no standard of discretion is specified, the landlord is controlled by contract notions of good faith and fair dealing, and must specify a commercially reasonable justification for his or her refusal to permit transfer.\(^4^5\)

3. *Express Reasonable Consent Standard.* This standard dictates that the lessor is bound under the lease terms to standards of reasonableness: s/he may not unreasonably refuse to permit transfer of the tenant's leasehold interest. Typically, the phrase "consent shall not be unreasonably withheld" is applied. This type of clause is clearly permissible under California law.\(^4^6\)

\(^4^4\) Cal. Civ. Code § 1995.210(b) (West Supp. 1995) ("Unless a lease includes a restriction on transfer, a tenant's rights under the lease include unrestricted transfer of the tenant's interest in the lease.").


\(^4^6\) Cal. Civ. Code § 1995.250 (West Supp. 1995) ("A restriction on transfer of a tenant's interest in a lease may require the landlord's consent for transfer subject to any express standard . . . including . . . [t]he landlord's consent may not be unreasonably withheld.").
4. **Express Standard for Consent.** Any express standard which is placed in the lease, and initially agreed upon by both parties, will presumably govern all transfers.\(^{47}\) For example, the lease may specify that the proposed company's gross annual profits must be three times larger than the annual rent total in order to be approved as a transferee.

5. **Exceptions to the Consent Requirement.** The landlord's consent is required to effect a transfer, except in certain enumerated circumstances.\(^{48}\) For example, an exception for tenants transferring within a single commercial complex may be appropriate since the tenant has been previously approved by the landlord.

6. **Use Restriction.** Under a use restriction, the tenant is limited to certain specified uses of the property, or is prohibited from certain uses which are either enumerated or generally described.\(^{49}\) For example, a tenant may be prohibited from using the premises for a restaurant.

7. **Profit Shift.** If the leasehold interest is transferred, the landlord receives any proceeds from an increased rent, as well as premiums or fees generated by the transaction. Of course, the parties may bargain for the tenant to receive surplus proceeds.\(^{50}\) In practice, a lease may contain a provision

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\(^{47}\) The new legislation explicitly permits this type of restriction. **Cal. Civ. Code** § 1995.240 (West Supp. 1995) ("A restriction on transfer of a tenant's interest in a lease may provide that the transfer is subject to any express standard or condition.").

\(^{48}\) William G. Coskran, *Assignment and Sublease Restrictions: The Tribulations of Leasehold Transfers*, 22 Loy. L.A. L. Rev. 405, 418 (1989). Although the new California legislation does not specifically deal with this type of clause, it almost certainly would be permissible as long as the exceptions are explicitly stated in the lease, since this clause would permit greater alienability than would an "Express Standard for Consent" clause.

\(^{49}\) Although ambiguities are construed in favor of unrestricted use, the new California legislation permits the lease to explicitly forbid a change in use or condition a change in use on an express standard. See generally **Cal. Civ. Code** §§ 1997.210-1997.240 (West Supp. 1995).

\(^{50}\) **Cal. Civ. Code** § 1995.240 (West Supp. 1995). This type of clause is permissible under the new legislation. Civil Code section 1995.240 states: A restriction on transfer of a tenant's interest in a lease may provide that the transfer is subject to any express standard or condition, including, but not limited to, a provision that the landlord is entitled to some or all of any of the consideration the tenant receives from a transferee in excess of the rent under the lease." **Cal. Civ. Code** § 1995.240 (West Supp. 1995) (emphasis added).
stating that excess profit disputes will be referred to arbitrage.\textsuperscript{51}

8. \textit{Recapture}. Transfer is not prohibited, but the lessor may, upon the lessee's request to transfer the lease, terminate the lease at will and recapture the premises. The tenant may transfer only if the landlord decides not to exercise his or her option to terminate the lease. The California Supreme Court recently upheld this type of clause as legitimate in \textit{Carma Developers (California), Inc. v. Marathon Development California, Inc.}\textsuperscript{52}

9. \textit{Sole Discretion Consent Standard}. Pursuant to this standard, the tenant must seek landlord approval in order to transfer his or her interest, but the landlord may refuse at his or her sole discretion. This standard enables the landlord to unreasonably withhold consent. The clause typically states that "consent may be withheld in the sole and absolute discretion of the lessor." It is not clear, however, whether this type of restrictive clause is permissible under current California law.\textsuperscript{53}

10. \textit{Absolute Prohibition}. The tenant is not permitted to assign or sublease his or her interest in the leasehold estate under any circumstances. Of course, the landlord may unilaterally waive this provision.\textsuperscript{54} This type of clause is clearly permissible under the new California legislation: California Civil Code section 1995.230 states: "A restriction on transfer of a tenant's interest in a lease may absolutely prohibit transfer."\textsuperscript{55}

D. \textit{Motives to Restrict Transfer}

A tenant negotiating for lease provisions will attempt to maximize free transferability of the leasehold. In contrast, a landlord will attempt to restrict the transferability of the leasehold. The rationales behind each viewpoint deserve a closer examination.

\textsuperscript{51} Ralph Borelli, \textit{supra} note 20.
\textsuperscript{52} 826 P.2d 710 (Cal. 1992).
\textsuperscript{53} This article will attempt to answer whether "sole discretion" clauses are valid under California case law and legislation. \textit{See infra} text accompanying notes 110-144.
1. **Tenant Motivations**

Tenants that lease commercial property need free alienability of their leasehold interests in order to maintain business flexibility. This interest in flexibility is critical in both long-term leases and falling real-estate markets. Innumerable events could trigger a desire to transfer the lease: sale of the business where location is a key variable, a need to expand or decrease the size of the premises for storage or other reasons, or corporate or personal reasons for relocating the business.

In obtaining a loan, a tenant may wish to use his or her leasehold interest as security. To be valuable as security, the leasehold interest must be transferable by the tenant so that if foreclosure occurs, someone else can gain the tenant’s interest. Furthermore, if a tenant obtains a loan, perhaps to make business improvements or expand, the lease must permit transfer.

2. **Landlord Motivations**

A landlord will attempt to make the lease provisions regarding transfer as restrictive as possible to allow careful screening of tenants and ensure a steady influx of rental income. A landlord is given considerable discretion in his or her initial selection of a tenant, but unless the landlord carefully drafts the lease, any transferee who gains the remaining leasehold interest may be unknown to him or her and chosen by the tenant, subject to landlord consent.

Landlords in commercial shopping centers have particularly strong interests in screening potential transferees. If the periodic rent is based on a percentage of gross sales formula, the type and success of the new business will have a considerable effect on a landlord’s rental income. A tenant may have a “drawing” influence, and attract customers to the shopping center. A substitute tenant for this type of business must be chosen carefully, since a “drawing” business may help maintain the profitability of the center and increase the percentage rents of nearby stores. If the shopping center has a particular image, the transferee business must be closely examined to determine if it properly meshes with the

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center's atmosphere. For example, a landlord of the prestigious Stanford Shopping Center in Palo Alto would not wish to have J.C. Penney or Walmart move into the shopping center as a transferee. In addition, a landlord may also object to a transferee who is a direct competitor of another tenant's business.

Another reason a commercial landlord may be concerned with a particular transferee is that a transferee may increase the burden or wear on the facilities. For example, use of heavy equipment may disrupt the business of other tenants, thus threatening the financial security of the complex. A particular transferee may also lead to an increase in the demand for parking spaces, elevator use, electricity, water, and trash services; each of which may decrease landlord profit or depreciate the premises. The landlord may need to increase insurance coverage for the complex, depending on the type of business involved. The building may require physical alterations of some sort to accommodate the transferee. Perhaps worst of all, the landlord's real property tax burden may increase if the transfer results in an increase of the assessed property value.

Ironically, a tenant who initially bargains for free transferability may find him or herself bargaining with a sublessee for restrictive terms for many of the reasons discussed above. The sublessor will also fear the sublessee's breach of the primary lease, especially a violation for which the sublessor may be held liable by the landlord. Careful lease drafting can prevent these types of problems from occurring.

E. Legal Status of Restrictive Transfer Clauses

California law is fairly well settled, although it represents the minority view: a landlord may not unreasonably reject transfer where a lease requires landlord consent to transfer but does not specify the governing standard. However, the law remains unclear as to whether "sole discretion" standards are valid and enforceable. An understanding of the legal history of landlord consent is helpful to an exploration of the current uncertain status of the law.

57. Coskran, supra note 48, at 421.
1. Majority Jurisdiction Viewpoint

The common law and majority view (outside California) on commercial lease transferability provides: (1) a tenant's interest is freely transferable unless the lease provides otherwise; (2) if fairly negotiated, express lease provisions prohibiting transfer or conditioning transfer on the lessor's sole discretion are enforceable; and (3) if no standard for lessor consent is specified, the lessor can withhold consent at his or her sole discretion.58

California law followed the majority view prior to Kendall.59 In Kendis v. Cohn,60 the lease provision required landlord consent prior to transfer. Additionally, the lease required the transferee to be "of good character and repute and satisfactory to the lessors."61 The trial court found the assignee to have met this condition, and deemed the lessor's refusal to consent arbitrary.62 In contrast, the appellate court found the term "satisfactory to the lessors" to contain a subjective element.63 The Court of Appeals held that in the absence of a covenant on the lessor's part not to be arbitrary, the reasonableness of the landlord's decision was irrelevant.64

In Richard v. Degen & Brody, Inc.,65 decided forty years later, the Court of Appeals reaffirmed the common law majority rule. In Richard, the lease required consent of the lessor to transfer, and provided that any transfer effected without consent would terminate the lease.66 The appellate court upheld the lessor's right to arbitrarily refuse consent to a transfer, and stated the applicable rule as follows: "[W]here a subletting or assignment of the leased premises without the consent of the lessor is prohibited, he may withhold his consent arbitrarily and without regard to the qualifications of the proposed assignee."67

60. 90 Cal. App. 41 (1928).
61. Id. at 49.
62. Id. at 41.
63. Id.
64. Id. at 67.
65. 5 Cal. Rptr. 263 (Ct. App. 1960).
66. Id. at 265.
67. Id. at 269.
The California appellate court re-examined the Richard precedent in Cohen v. Ratinoff. The lease in dispute in this case also required consent of the lessor to transfer, but the tenant pleaded a cause of action under the theory of breach of contract. The court recognized that contractual obligations of good faith and fair dealing applied to leases and militated against an arbitrary refusal to transfer. Even though no standard of consent was specified, the court demanded that the landlord have a "good faith reasonable objection" to the assignment or sublease.

The court reaffirmed the rule established in Cohen in Schweiso v. Williams. In Schweiso, the lease contained a provision requiring landlord consent to transfer. The landlord refused the proposed transferee without stating reasons, and demanded a sum of money for his consent to the transfer. The court stated the landlord must have a good faith reasonable objection to the transfer based on the contractually implied obligations of good faith and fair dealing. The court explained its rationale: "[D]enying consent solely on the basis of personal taste, convenience or sensibility or in order that the landlord may charge a higher rent than originally contracted for have been held arbitrary reasons failing the tests of good faith and reasonableness under commercial leases." The California Court of Appeals may have followed in the footsteps of Cohen, a decision from another appellate division, partially because of the egregious actions of the landlord (extracting "blood money" as a condition of consent). The decisions of Cohen and Schweiso set the stage for the California Supreme Court's decision in Kendall.

Even where restrictive clauses are enforceable, the scope of such a clause is strictly construed in favor of transferability. Thus, a particular transaction will usually escape the restriction unless the clause expressly addresses it. For exam-

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68. 195 Cal. Rptr. 84 (Ct. App. 1983).
69. Id. at 87-88.
70. Id. at 88.
71. Id. at 89.
72. 198 Cal. Rptr. 238 (Ct. App. 1984).
73. Id. at 239.
74. Id. at 240.
75. Id. (citations omitted).
76. Id.
ple, courts have held a sublease permissible where the lease prohibited any assignment, and vice-versa.\textsuperscript{77}

2. Kendall's Implication of Reasonableness Standard

Addressing the issue for the first time, the California Supreme Court reconsidered the common law rule established by Richard and rejected it, in part, in Kendall v. Ernest Pestana, Inc.\textsuperscript{78} Kendall involved a "silent consent standard" type clause that required the lessor's consent for transfer but did not expressly state any standard for consent.\textsuperscript{79} The court characterized the lessor's refusal to consent to transfer as arbitrary, and implied a contractual standard of good faith and fair dealing upon the lessor.\textsuperscript{80} The court also cited the policy behind California Civil Code section 711 against restraints on alienation.\textsuperscript{81}

The court commented that "[t]he traditional majority rule has come under steady attack in recent years."\textsuperscript{82} The opinion further stated: "A growing minority of jurisdictions now hold that where a lease provides for assignment only with the prior consent of the lessor, such consent may be withheld only where the lessor has a commercially reasonable objection to the assignment, even in the absence of a provision in the lease stating that consent to assignment will not be unreasonably withheld."\textsuperscript{83} The common law rule presumes the standard to be one of "sole discretion," whereas Kendall implies a standard of commercial reasonableness.

\textsuperscript{77} See, e.g., Cross v. Bouck, 165 P. 702 (Cal. 1917) (a covenant against assignment not breached by a sublease); Buck v. Cardwell, 327 P.2d 223 (Cal. 1958) (no breach of a covenant against subleases when one tenant assigns the lease to a co-tenant).

\textsuperscript{78} 709 P.2d 837 (Cal 1985).

\textsuperscript{79} \textit{Id.} at 839.

\textsuperscript{80} \textit{Id.} at 849.

\textsuperscript{81} \textit{Id.} at 843-49. The Kendall Court acknowledged that a lease is both a conveyance and a contract. Both the policy against restraints on alienation and the duty of good faith and fair dealing, in combination with stare decisis based on the Cohen and Schweiso decisions, prompted the Court's decision to imply a standard of commercial reasonableness where the lease requires landlord consent but does not specify an applicable standard.

\textsuperscript{82} \textit{Id.} at 841.

The majority in *Kendall* held that if a tenant bargained for a reasonableness standard, it would be expressed in the lease.\(^8\) There is no reason to imply such a standard into a lease if it is not bargained.\(^8\) The minority *Kendall* view implies a standard of reasonableness based on certain policy rationales: (1) the implied covenant of good faith and fair dealing applies to all contracts; and (2) alienability of leasehold interests is favored, so any restrictions are strictly construed to allow transferability.\(^8\)

Despite their modifications of the traditional common law doctrine, the *Kendall* decision and its progeny did not directly hold the parties could not bargain and expressly provide for a sole discretion standard.\(^8\) In fact, the *Kendall* court noted: "This case does not present the question of the validity of a clause absolutely prohibiting assignment, or granting absolute discretion over assignment to the lessor."\(^8\) Thus, while *Kendall* implies a standard of reasonableness where no consent standard is specified, it remains unclear whether "sole discretion" clauses are enforceable in California.

The *Restatement Second of Property* adopts the minority rule on the validity of approval clauses in leases:

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.\(^8\)

The Comment to the Restatement explains that a landlord may be understandably concerned about certain qualities of a tenant, e.g., his or her reputation for meeting financial obligations.\(^8\)

Under the Restatement rule, the lessor's interest in the character of his or her tenant is protected by the lessor's right

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84. *Kendall*, 709 P.2d at 849.
88. *Id.* at 844 n.14.
89. *REST. 2D PROPERTY § 15.2(2) (1977).*
90. *Id.* at comment a.
to object to a proposed assignee or sublessee on reasonable commercial grounds.\textsuperscript{91} The lessor's interests are also protected by the fact that the original lessee remains liable to the lessor as a surety even if the lessor consents to the assignment and the assignee expressly assumes the obligations of the lease.\textsuperscript{92}

It is quite possible that the Restatement view influenced the Court's decision in \textit{Kendall}. However, the Restatement rule goes farther and explicitly permits a "sole discretion" clause if it is a fairly negotiated portion of the lease. It seems clear that the California rule following \textit{Kendall} was to imply a standard of commercial reasonableness where no express standard governing lessor consent to transfer was explicitly stated. The rule with respect to "sole discretion" clauses was slightly more uncertain and exposed a legal problem in the commercial landlord-tenant context.

\section*{III. Identification of the Problem and Its Legal Relevance}

It is important to explain the uncertainty and ambiguity which the new Civil Code sections create in regard to "sole discretion" clauses. Additionally, this article explores the importance of this problem, and its resolution, to the legal community and commercial landlords and tenants.\textsuperscript{93}

\subsection*{A. Ambiguity of New Statutes}

In 1989, the California Legislature resolved to remedy questions left unanswered by prior California case law. The California Senate Judiciary Committee recognized that \textit{Kendall} "left unresolved . . . whether a lease may absolutely prohibit assignment or grant absolute discretion to a landlord to prohibit an assignment."\textsuperscript{94} Senate Bill 536 proposed a series of provisions to resolve the issue by allowing the lessor to absolutely restrict any transfer, or to restrict transfers upon express conditions or standards which are reasonable at

\textsuperscript{91} \textit{Id.} at 112-13 n.7.
\textsuperscript{92} Peiser \textit{v. Mettler}, 528 P.2d 953, 957 (Colo. 1958); Samuels \textit{v. Ottinger}, 146 P. 638, 639 (Cal. 1915).
\textsuperscript{93} See infra part III.B.
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the time of the lease agreement and the proposed
assignment.95

Unfortunately, the question of whether “sole discretion”
clauses are permissible was not explicitly addressed, except
in a bill that the legislature ultimately rejected.96

The policy justifications which provoked the initial legis-
lative proposal were: (1) parties should be able to contract
freely for any term, so long as the result does not amount to
an adhesion or unconscionable contract; and (2) once an
agreement is made, parties should be able to rely on and en-
force the agreement, unless a term has proven to be
unreasonable.97

In support of its recommended statutes, the California
Law Revision Commission stated: “The statute should make
clear that the right to agree to limitations on transferability
includes the right to agree that the tenant’s interest may not
be transferred without the landlord’s consent, which may be
given or withheld in the landlord’s sole and absolute discre-
tion.”98 The intent of the Bill’s sponsors seems to have in-
tended to favor the validity of “sole discretion” clauses.

However, the Law Revision Commission recognized that
absolute prohibitions on transfer, and particularly “sole dis-
cretion” clauses, might provide a pitfall for commercial ten-
ants without equal bargaining
power.99 The tenant’s only re-
course would be to challenge the provision as an
unenforceable adhesion contract or an unconscionable
clause.100 The Commission noted: “This of course presents a
paradox: If the ‘mom-and-pop’ tenant could not afford a law-
ner to negotiate a lease, how could they afford a lawyer to

95. Id.
96. MURRAY & HAMRICK, supra note 54, at 65, 67. The authors note the
initial Senate version contained section 1995.250(c), which authorized a restric-
tion providing that “[t]he landlord has absolute discretion to give or withhold
consent, including the right to unreasonably withhold consent.” Id. However,
the code section indicated here arose only on the second amendment. The origi-
inal bill listed this provision as CAL. CIV. CODE § 1995.240(c); the second
(amended) version changed the numbering to section 1995.250(c). On its third
reading, the provision was stricken. See supra note 4.
97. MURRAY & HAMRICK, supra note 54, at 65, 67.
99. Recommendation Relating to Commercial Real Property Leases: Assign-
ment and Sublease, 20 CAL. L. REV. COMM’N REPORTS 251, 258 (1990) [here-
inafter Recommendation].
100. CAL. CIV. CODE § 1995.250 (West Supp. 1995). See also Recommenda-
tion, supra note 99, at 258.
contest a lease clause?” Nonetheless, the Commission proposed authorization of “sole discretion” clauses.

After the initial proposal of Senate Bill 536, the Legislature rejected California Civil Code section 1995.250(c), which expressly allowed “sole discretion” clauses in commercial leases. Thus, the question of whether a lease may contain a “sole discretion” clause remains unanswered.

Another factor which leaves in question the status of “sole discretion” clauses under the new legislation is that the remedy provided for by California Civil Code section 1951.4 is not available to leases containing either absolute prohibitions on transfer or “sole discretion” clauses. Under California Civil Code section 1951.4, the landlord may keep the lease in force and require continued payment of rent notwithstanding abandonment by the tenant. This “lock-in” option is available only if the lease expressly incorporates the remedy and allows a tenant, either expressly or impliedly, to reasonably assign or sublet. While this seems to indicate legislative disapproval of “sole discretion” clauses, the absence of any statutes that explicitly deal with these clauses is puzzling.

B. Relevance to the Legal Community

Resolution of the legal status of “sole discretion” clauses in commercial leases will affect many sectors of the community: lawyers, landlords, and tenants.

Lawyers have a significant stake in this issue, as they must advise their clients, often commercial landlords or tenants, of what actions are appropriate in particular situations. Resolution of this problem will impact the way in which lawyers advise landlords and tenants of their rights and duties. Lawyers must also draft the lease clauses, or negotiate to al-

102. See Recommendation, supra note 99, at 267.
103. See generally Murray & Hamrick, supra note 54.
104. See generally id.
106. The legislative history in this section of the article is provided only as background, to gain an understanding of the treatment of “sole discretion” clauses. See infra text accompanying notes 123-156 (analyzing Senate Bill 536’s legislative history and the significance of the Legislature’s denial of CAL. CIVIL CODE § 1951.4 (West Supp. 1992) remedy for leases containing “sole discretion” clauses).
ter the lease provisions, in order to either maximize restrictions on transfer or maximize the freedom to transfer the leasehold.

Landlords will be particularly interested in a resolution of this problem. Currently, a lease provision granting the landlord “sole discretion” is in an uncertain position and may invite litigation. In order to assure a steady rental income, landlords should be able to maximize restrictions on transfer.107

Tenants will be equally interested in a resolution, so that they may bargain for a provision rather than attempting to litigate their way out of a tenuous restriction. As long as tenants are aware of the valid restrictions on transfer, they may knowledgeably negotiate lease provisions and avoid those which may be disadvantageous. Moreover, current uncertainty in the law may persuade landlords to adopt more restrictive prohibitions on transfer, which anomalously are permissible under current law.

IV. ANALYSIS

It is important to explore the language of the new statutes, and the legislative intent which prompted them, to determine whether “sole discretion” clauses are permissible in commercial leases. This article will also analyze the interplay of the remedy provided in California Civil Code section 1951.4, and the significance to practitioners of its denial of application to “sole discretion” clauses.108


Although the “plain meaning” rule is in disfavor as the sole means of statutory interpretation,109 it is useful to examine the language of the statute and the meaning it suggests before resorting to legislative analysis to discover the intent of the framers.

107. See supra part II.C (describing landlord motives to (safely) restrict transfer of commercial leaseholds).
108. See infra part IV.C.
Clearly, leases may absolutely prohibit transfer. California Civil Code section 1995.230 states: "A restriction on transfer of a tenant's interest in a lease may absolutely prohibit transfer." However, the status of "sole discretion" clauses is not so explicit as there are no statutes which specifically mention this standard.

California Civil Code sections 1995.240 and 1995.250 are the only statutes which conceivably cover the topic of "sole discretion" clauses. Both of these sections deal with lease restrictions which may be placed on transfer. California Civil Code section 1995.240 states:

A restriction on transfer of a tenant's interest in a lease may provide that the lease is subject to any express standard or condition, including, but not limited to, a provision that the landlord is entitled to some or all of any of the consideration the tenant receives from a transferee in excess of the rent under the lease.

The question of interpretation is whether the phrase "any express standard or condition" can encompass the subjective standard of a landlord's sole discretion.

California Civil Code section 1995.250 contains nearly the same language as the preceding subsection:

"A restriction on transfer of a tenant's interest in a lease may require the landlord's consent for transfer subject to any express standard or condition for giving or withholding consent, including, but not limited to, either of the following:

(a) The landlord's consent may not be unreasonably withheld.

(b) The landlord's consent may be withheld subject to express standards or conditions."

The query for both sections then, is whether the phrase "express standard(s) or condition(s)" includes or excludes "sole discretion" clauses.

The terms in the phrase "express standard(s) or condition(s)" seem to imply explicit limitations or delineations, but the terms are not self-evident. Therefore, an examination of external sources is illuminating.

According to Black’s Law Dictionary, a standard is “[a] measure or rule applicable in legal cases such as the ‘standard of care’ in tort actions.”\textsuperscript{113} Unfortunately, the terms “measure” and “rule” are fairly ambiguous, but they offer some guidelines for understanding a “standard.” Under this definition, the “standard” may be an applicable rule which is fairly complex. For example, the “reasonable person” standard in tort cases is essentially the standard of care the ordinarily prudent person would follow in similar circumstances.\textsuperscript{114} This “standard” is ambiguous and subject to various interpretations, yet it qualifies as a “standard.”

The word “condition” is defined by Black’s Law Dictionary as: “an event, fact, or the like that is necessary to the occurrence of some other, though not its cause; a prerequisite; a stipulation.”\textsuperscript{115} Here, a “condition” is almost anything which must happen before another thing (here, presumably a transfer) may occur.

The statutes incorporate the phrase “standard(s) or conditions,” suggesting that only one of these words need accurately describe the lease clause. Piecing the two definitions together, the phrase “any express standard or condition” may be restated as “any rule, measure or prerequisite event or fact.” Both “standard” and “condition” are words modified by the term “express,” which typically means explicitly stated. Black’s Law Dictionary explains the difference between express and implied conditions:

Conditions are either express or implied, the former when incorporated in express terms in the deed, contract, lease, or grant; the latter, when inferred or presumed by law, from the nature of the transaction or the conduct of the parties, to have been tacitly understood between them as a part of the agreement, though not expressly mentioned.\textsuperscript{116}

Therefore, the “rule, measure or prerequisite event or fact” must be explicitly stated in the lease, rather than simply inferred or understood.

\textsuperscript{114} Richard A. Epstein, Cases and Materials on Torts 134-35 (5th ed. 1990). Note the formulation of the “reasonable person” standard of care here is for the purpose of example only.
\textsuperscript{116} Id.
Arguably, a “sole discretion” provision fits within the definitions expounded here. A sole discretion clause gives the landlord absolute discretion and allows him to refuse transfer for unreasonable or arbitrary reasons. This clause is similar to the “reasonable person” standard explained earlier in that it prescribes a general mode of conduct. The prerequisite event or fact dictated in a “sole discretion” clause is that the landlord must subjectively approve the transferee prior to the transfer.

However, opponents of the “sole discretion” clause will argue that a provision which gives the landlord total power to approve or deny transfer is not a rule, measure, or prescription of a mode of conduct, but rather the lack of any such prescription. Instead, the landlord is given complete freedom without any limitations whatsoever. Such freedom cannot be classified into such a limit-focused definition.

Another factor that militates against inclusion of “sole discretion” clauses within the phrase “any express standard(s) or condition(s)” is that such a subjective power essentially allows the landlord to utilize a multitude of implicit standards. For example, a lessor could place a “sole discretion” clause in the lease and then set an agenda of several standards which he or she does not disclose, such as: (1) the transferee must generate fifteen times the amount of rent in gross income; (2) the transferee corporation must have an established track record of at least fifteen years; and (3) the transferee must not close its business on Sundays. While these standards may be legitimate if expressly stated in the lease, their implicit use is questionable. If the landlord’s “standard” is essentially a hidden agenda, courts are likely to hold that such provisions do not fall within the language of California Civil Code sections 1995.240 and 1995.250.

117. See Cal. Civ Code § 1995.250(c) (West Supp. 1995). While theoretically the landlord has no restrictions on his right to approve or deny a transfer under a “sole discretion” clause, s/he is of course subject to anti-discrimination laws. See Cal. Civ. Code § 51 (West Supp. 1988).

118. The language of Cal. Civ. Code §§ 1995.240-250 (West Supp. 1995) regarding “any express standard(s) or condition(s)” would likely encompass these specific and well-defined situations, especially where the motivations may be traced to financial or business reasons. The problem arises when the standards are not spelled out in the lease, although they are perhaps envisioned by the lessor. Cal. Civ. Code §§ 1995.240-250 (West Supp. 1995)
The "plain meaning" interpretation of these statutes, as evidenced from the above discussion, is ambiguous. While both sides can muster compelling arguments, such uncertainty regarding lease provisions invites unwanted litigation.

Although the legislation in its current state is ambiguous as to whether "sole discretion" clauses fall within the phrase "any express standard(s) or condition(s)," the first two drafts of Senate Bill 536 indicate the legislation's sponsor clearly intended to encompass "sole discretion" clauses. The preamble of the February 17, 1989 edition reads:

The bill would also specify that a restriction on transfer . . . in a nonresidential lease . . . may require the consent of the landlord for transfer subject to any express standard or condition for giving or withholding consent, including, among other provisions, . . . a provision that the landlord has absolute discretion to give or withhold consent, including the right to unreasonably withhold consent.119

Additionally, the original version of California Civil Code section 1995.240 (later changed to section 1995.250) specified:

A restriction on transfer of a tenant's interest in a lease may require the landlord's consent for transfer subject to any express standard or condition for giving or withholding consent, including, but not limited to, any of the following: (a) The landlord's consent may not be unreasonably withheld; (b) The landlord's consent may be withheld subject to express standards or conditions; (c) The landlord has absolute discretion to give or withhold consent, including the right to unreasonably withhold consent.120

The sponsors of the original bill clearly viewed "sole discretion" as a permissible standard as that term is used in sections 1995.240 and 1995.250. However, the omission of these statements from the final version of the Bill leaves us with no explicit pronouncement on the status of "sole discretion" clauses.

Some might consider the omission of "sole discretion" clauses to indicate they are clearly not permissible under the new legislation. After all, if the legislature wanted to include

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120. Id. at 5 (emphasis added).
“sole discretion” clauses, it could have explicitly stated so. This analysis parallels that of the “mischief rule,” which states that if a law is not enacted, we must presume the prior law governs. Of course, here the rule is inapposite since the preceding law regarding “sole discretion” clauses is unclear.

B. Legislative Interpretation of California Civil Code Sections 1995.240 and 1995.250

An examination of a bill’s legislative history is often helpful in determining the legislative intent behind the bill. When interpreting a statute, a court is guided primarily by the legislative intent which motivated passage of the statute. Courts will also construe the statute against its plain meaning in order to give effect to the intent of the legislature.

This section will analyze the legislative history of Senate Bill 536 (1989) in order to determine if the legislature intended to include “sole discretion” clauses within the language of California Civil Code sections 1995.240 and 1995.250. Many steps of the legislative process, from a bill’s proposal and recommendation, to its final vote on the Senate floor, indicate something about the legislative intent. This article will try to glean meaning from several of these legislative steps regarding the intended disposition of “sole discretion” clauses.

The California Law Revision Commission’s recommendation which was submitted with the proposed statutes plainly states that California Civil Code section 1995.240 does not

121. The United States Supreme Court stated that “[n]o statute is to be construed as altering the common law, farther than its words import. It is not to be construed as making any innovation upon the common law which it does not fairly express.” Shaw v. Railroad Co., 101 U.S. 557, 565 (1879).
122. See infra part II.E (explaining the law governing “sole discretion” clauses prior to the new legislation).
123. See generally CAL. CIV. PROC. CODE § 1859 (West 1990); Milligan v. City of Laguna Beach, 670 P.2d 1121, 1122 (Cal. 1983); In re Lance W., 694 P.2d 744, 764 (Cal. 1983).
125. See infra text accompanying notes 127-144.
126. See infra text accompanying notes 127-144.
cover clauses requiring landlord consent to transfer: "This section does not apply, and section 1995.250 does apply, to a restriction on transfer of a tenant's interest in a lease that requires the landlord's consent for transfer." Thus, "sole discretion" clauses clearly are not covered by California Civil Code section 1995.240. Although, as implemented, the statute's language was unclear as to whether these clauses were encompassed, the clear intent of the Legislature as to which clause applies is controlling. Further, there are no statements in the Senate and Assembly analyses that disagree with the California Law Revision Commission's designation of California Civil Code section 1995.250 (and not section 1995.240) to deal with clauses requiring landlord consent for leasehold transfers.

In contrast to section 1995.240, California Civil Code section 1995.250 was initially proposed in order to expressly permit "sole discretion" clauses. As Kendall left unclear whether "sole discretion" clauses were permissible, the California Law Revision Commission resolved to clarify the ambiguous state of the law. The Commission stated: "The statute should make clear that the right to agree to limitations on transferability includes the right to agree... that the tenant's interest may not be transferred without the landlord's consent, which may be given or withheld in the landlord's sole and absolute discretion." The originally proposed statute reflected this desire: California Civil Code section 1995.250(c) specifically allowed "sole discretion"


128. The legislature might later have left both Cal. Civ. Code §§ 1995.240-250 (West Supp. 1995) purposefully vague in order to potentially include "sole discretion" clauses. However, nothing in the legislative record indicates that the legislature deviated from the expressed intent of the California Law Revision Commission to exclude these clauses from the coverage of § 1995.240.


131. See supra note 4 and accompanying text.


134. Id. at 258.
The Senate’s interpretation of California Civil Code section 1995.250 is in accord with that of the Law Revision Commission, at least until the provision allowing “sole discretion” clauses was eliminated.  

Many important policy considerations prompted the proposal to allow “sole discretion” clauses in commercial leases. First, both the landlord and the tenant have an interest in avoiding litigation spawned by either interpretation of the implied “reasonableness” standard or a challenge to a “sole discretion” clause in the lease which is not supported by law. A second, related point is that the parties should be able to rely on a negotiated provision. 

Other concerns played a role in shaping the new legislation, such as the principle of freedom of contract. Parties should be permitted to negotiate any appropriate provisions to govern lease transfer, and be assured of their enforceability. This is especially true when the two parties involved possess equal bargaining power; where bargaining power is unequal, general contract limitations such as unconscionability, adhesion, etc., will remedy unfairness. 

At some point between the second and third versions of Senate Bill 536, however, the provision discussing “sole discretion” clauses were valid and enforceable in commercial leases. Kendall v. Ernest Pestana, Inc., 709 P.2d 837, 844 n.14 (Cal. 1985).
cretion" clauses was omitted. A note mentions that the Bill was: "[a]mended in committee to specify that a landlord's consent for transfer may be withheld subject to express conditions (deleting a provision in the bill that would otherwise allow a landlord to prohibit transfer without any reason)." The analyses abruptly changed their summary and description of the Bill, but no reasons for the change were advanced.

It is possible that "sole discretion" clauses, which theoretically permit a landlord to unreasonably and arbitrarily withhold consent to transfer, were not politically popular. It is not recorded whether the Legislature faced pressure to omit these provisions, or whether it simply decided to exclude these provisions on the merits. However, it seems likely the Legislature would mention its disapproval of these clauses if they were meant to be substantively rejected. The lack of any discussion suggests the Legislature purposely wrote the code sections in an ambiguous manner to allow "sole discretion" clauses, while avoiding their explicit authorization.

C. Interplay of California Civil Code Section 1951.4 Remedy

This section will explore what denial of the section 1951.4 remedy suggests about the validity of "sole discretion" clauses, and will provide a practical guide to using the remedy.

The preclusion of California Civil Code section 1951.4's "lock-in" remedy for leases containing "sole discretion" clauses suggests the Legislature wished to provide an incentive for landlords to mitigate damages when tenants abandon

143. Nathaniel Sterling, Assistant Executive Secretary of the California Law Revision Commission, noted that the Assembly Judiciary Committee Chair and several members did not want the legislature to clearly endorse the authorization of unreasonable provisions. The Committee understood that its silence did not answer the question of the validity of "sole discretion" clauses, and recognized that litigation might be required to solve the issue. The Committee also recognized that "sole discretion" clauses might occur and would probably be valid, but could not place itself in a position of publicly endorsing these clauses. Interview with Nathaniel Sterling, Assistant Executive Secretary of the California Law Revision Commission (May 11, 1993).
144. An ambiguous drafting of the code sections would also permit the Legislature to appear to bow to political pressure by omitting the section which explicitly permitted "sole discretion" clauses.
the premises in violation of the lease without directly imposing a duty to mitigate on all landlords as other jurisdictions have done.⁴⁴⁵ In leases that harshly restrict the tenant’s right to transfer, it may be more fair to prohibit the landlord from collecting the full amount of rent due under the lease without a duty to mitigate. Allowing this remedy in situations where the landlord may refuse consent for any reason whatsoever may even encourage the landlord to refuse transfer simply to lessen his or her burdens and responsibilities: the landlord would be able to have the unit empty, but still collect rent each month until the lease expired.

Though the Legislature may have disapproved of this remedy for leases containing “sole discretion” clauses, this does not mean the Legislature wished to invalidate “sole discretion” clauses themselves. In fact, there is no evidence within the statutes of such an intention.⁴⁴⁶

1. How the Section 1951.4 “Lock-In” Remedy Works

Senate Bill 256 (1991) was enacted to clarify the California Civil Code section 1951.4 remedies for landlords and tenants for violation of each other’s transfer rights.⁴⁴⁷

Prior to the Bill’s enactment, the law prohibited a landlord from invalidating a wrongful transfer without also terminating the lease. The landlord could either: (1) terminate the lease, or (2) allow the transfer and sue the tenant for damages.⁴⁴⁸ The sparsity of these options sometimes deprived the landlord of the benefit of his or her bargain, as he or she

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⁴⁴⁸ Id.
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was forced to incur additional expense in order to sue for damages.¹⁴⁹

Senate Bill 256 allows the landlord to terminate a wrongful transfer without terminating the underlying lease. Therefore, the assignee or sublessee no longer has a right to possession, though the original tenant retains this right.¹⁵⁰ Additionally, the original tenant and assignee are jointly and severally liable for any damages caused by a wrongful assignment.¹⁵¹ The tenant is also given rights under Senate Bill 256. If a landlord withholds consent to a transfer in violation of provisions of the lease prohibiting the unreasonable withholding of consent, the tenant may terminate the lease or sue for contract damages.¹⁵²

The remedies provided by California Civil Code section 1951.4 work in the following manner:

1. Is the breach caused by a landlord or tenant? If landlord, go to step 2. If tenant, go to step 11.

2. Does the lease provide for the California Civil Code section 1951.4 remedy? The statute provides for the inclusion of the following clause in order to secure such a remedy:

   The lessor has the remedy described in California Civil Code section 1951.4 (lessor may continue lease in effect after lessee's breach and abandonment and recover rent as it becomes due, if lessee has right to sublet or assign, subject only to reasonable limitations).¹⁵³

If yes, go to step 3. If no, this remedy is not available to the landlord.

3. Has the lessor required compliance with an unreasonable standard or condition, or unreasonably withheld his or her consent to transfer? If yes, this remedy is not available to the landlord. If no, continue to step 7. If unsure of the reasonableness of the condition, proceed to step 4.

4. Is the condition in the lease restricting transfer unreasonable in the present circumstances? If yes, go to step 5. If no, go to step 7.

¹⁴⁹. Id. at 4.
¹⁵⁰. Id.
¹⁵¹. Id. at 5.
¹⁵². CAL. STATE SENATE, S.B. 256, LEGISLATIVE COUNSEL'S DIGEST, at § (2)(a).
¹⁵³. This clause is sanctioned by CAL. CIV. CODE § 1951.4(a) (West Supp. 1995) as an appropriate means of providing for the remedy within the lease.
5. Was the condition in the lease reasonable when it was originally created or the landlord does not require compliance with it? If yes, go to step 7. If no, this remedy is not available to the landlord. If unsure, go to step 6.

6. Examples of reasonable factors which the landlord may consider include: (a) credit rating of transferee, (b) similarity of previous use to proposed use, (c) nature or character of transferee, (d) requirements of transferee for services from landlord, and (e) impact of transferee on common utilities.\textsuperscript{154} If reasonable restrictions, go to step 7. If unreasonable, the landlord may not use this remedy.

7. Has the tenant breached the lease by violating one of its terms, i.e., wrongfully transferred the leasehold interest, and abandoned the premises? If yes, go to step 8. If no, this remedy is not available to the landlord.

8. Was the tenant evicted or otherwise deprived of his or her right to possession? If yes, the landlord cannot use this remedy but may obtain contractual damages under California Civil Code section 1951.2. If no, go to step 10. If unsure, go to step 9.

9. Did any of the following events occur: (a) landlord acts of maintenance or preservation, (b) landlord efforts to relet the property, (c) appointment of a receiver to protect the landlord’s interest under the lease, or (d) landlord withholding consent to transfer or termination of a transfer, not in violation of the lease, and based on express and reasonable standards or conditions? If yes, these acts do not terminate the tenant’s right to possession—go to step 10.\textsuperscript{155} If no, and no other egregious acts interfered with the tenant’s right to possession, also go to step 10.

10. The landlord may choose between: (a) termination of the lease and collection of contract damages under California Civil Code section 1951.2; or (b) terminate the transfer but keep the lease in effect, do not disturb the tenant’s right to possession, and continue to collect rent from the tenant under the terms of the lease.

11. Has the landlord withheld consent to a transfer in violation of express or implied provisions of the lease prohib-

\textsuperscript{154}CAL. CIV. CODE § 1951.4 (West Supp. 1995), Law Revision Comm’n Comments.

\textsuperscript{155}These are listed in CAL. CIV. CODE § 1951.4 (c) (West Supp. 1995) as acts which “do not constitute a termination of the lessee’s right to possession.”
iting the unreasonable withholding of consent? If no, the tenant may sue only for contract damages. If yes, go to step 12.

12. The tenant may choose between: (a) the right to contract damages, or (b) the right to terminate the lease.

V. PROPOSAL

A. A Practical Solution

In order to avoid potential litigation from placing a "sole discretion" clause in a lease despite the uncertain state of the law, a landlord may wish to phrase the restrictive provision in a more legally acceptable manner.

If the landlord wishes to maximize his or her control of the tenant's right to transfer, he or she may wish to use California Civil Code section 1995.230. This provision states: "A restriction on transfer of a tenant's interest in a lease may absolutely prohibit transfer." Of course, the landlord would be free to unilaterally waive this provision at a later time if an acceptable transferee was presented. This solution provides an enforceable method to restrict transfer. Unfortunately, leases containing this provision may not receive the benefits of the California Civil Code section 1951.4 remedy.

The landlord may also articulate the criteria which he or she normally uses to select a tenant or approve a transferee, and explicitly list them in the lease agreement. Any express standard or condition, preferably objective in nature, is enforceable. Of course, the standard may not be discriminatory. This method, while sacrificing some landlord subjectivity, is legitimate and retains the benefits of the California Civil Code section 1951.4 remedy.

B. Amendment to Legislation

In order to solve the ambiguities in the current law with respect to "sole discretion" clauses, the California Civil Code should be amended to include section 1995.250(c). This provision would state:

The landlord has absolute discretion to give or withhold consent, including the right to unreasonably withhold consent.

In addition, the words "including, but not limited to, either of the following," presently in California Civil Code section 1995.250 would be amended to read: "including, but not limited to, any of the following." 162

To make the "sole discretion" clauses more politically palatable, the legislation should include a provision mandating that "sole discretion" clauses be placed separately within the lease, in bold type, with an explanation of the effect of the provision. The statement of effect might be phrased in the following manner:

This clause permits the landlord to refuse consent to transfer (assignment or sublease) for any reason whatsoever, even an arbitrary or unreasonable reason. The landlord is under no obligation to state his or her reasons for refusing a transfer.

These provisions would help to ensure that "sole discretion" clauses are fairly negotiated and represent the intent of both parties.

In order to obtain the remedy provided by California Civil Code section 1951.4, another amendment must be enacted. 163 This amendment should explicitly state that "sole discretion" clauses are eligible for the section 1951.4 remedy. The statute could be titled section 1951.4(d), and would perhaps entail an amendment to section 1951.4(b)(2). 164 The new statute might be phrased in the following manner:

162. The changes indicated here are the provisions which the legislature struck from Senate Bill 536 before it was enacted.

163. If such provisions are taken to ensure that a tenant receives notice of the "sole discretion" clause, the landlord should be entitled to receive the section 1951.4 remedy. The Legislature may wish to provide a disincentive to these types of clauses by denying the remedy, but this judgment is better left to landlord/tenant negotiations.

164. CAL. CIV. CODE § 1951.4 (b)(2) provides that any restrictive transfer clauses must be "reasonable at the time the lease is executed" in order to obtain the remedy. See CAL. CIV. CODE § 1951.4 (b)(2) (West Supp. 1995). Other por-
The remedy described in this section is available to leases containing “sole discretion” clauses, provided: the clause is separated from other provisions of the lease, is in bold print, and its effect is clearly explained within the lease. If the tenant can affirmatively prove adhesion, unconscionability, or any other limitations on freedom of contract, the remedy will not be available to the landlord.

This provision would permit leases containing “sole discretion” clauses to obtain the section 1951.4 remedy.

Although some might argue it is unfair to allow this “lock-in” remedy to lessors who severely restrict assignment or sublease and saddle lessees for the full term of the lease, this restrictiveness is something the tenant should bear in mind when negotiating lease provisions. Both parties are free to state in the lease that the section 1951.4 remedy will not be available; in fact, under the statute, the remedy is not available unless explicitly provided for in the lease.165

V. CONCLUSION

Senate Bill 536 was enacted to resolve the legal uncertainties remaining after Kendall,166 but the process of amendment left the final version unclear as to the status of “sole discretion” clauses. The rejection of California Civil Code section 1995.250(c), which would have authorized “sole discretion” provisions, and the ambiguity of sections 1995.240 and 1995.250, make it unclear whether the landlord may enforce commercial lease “sole discretion” clauses.167 An additional factor which further clouds the issue is that the California Civil Code section 1951.4 remedy is not available to leases containing “sole discretion” clauses, indicating possible legislative disapproval.168

Based on the legislative history of section 1995.250, it seems the Legislature originally intended to allow “sole discretion” clauses in commercial leases so long as they are ex-

plicitly stated. However, the validity of these provisions remains in question due to the lack of definitive legislative pronouncements on this issue.

A legislative amendment pronouncing the validity of "sole discretion" clauses is sorely needed. In addition, a provision authorizing use of the section 1951.4 remedy for leases containing "sole discretion" clauses should be enacted. These additions to the current law will ensure that freedom of contract, rather than paternalistic regulation, prevails.

169. See supra notes 106-139 and accompanying text.