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What's Missing From This Real Estate Contract?

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I write about commercial real estate negotiations, deals and legal issues.

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When participants in real estate and other business transactions negotiate their contracts, they think about what might happen later and what legal consequences should arise from those events or circumstances. For example, a contract might prohibit a party from doing something. It might also say that if a party wants to do something, then the other party has certain rights, such as a consent right.

Those provisions often focus on whatever the parties have on their mind, but they sometimes don't go as far as they should. The net result of this failure is a gap that allows one party or the other to do something that, if the parties had thought to address it in their contract, would likely not have been allowed. This deficiency seems to arise most often in contract language relating to transfers.

As one very common example, many leases and other contracts restrict the right of a party to assign the contract, or in other words bring in someone else who would take over that party's rights and obligations

under the contract. Sometimes a contract or lease assignment requires the other party's consent. Other times no consent is needed if the assignment meets certain tests.

In one recent Delaware case, a contract said that a party could not transfer its rights or obligations under the contract "by assignment, ... merger, consolidation, ... [or] change in management or control" of that party. The party subject to that assignment restriction was owned by a holding company, which was in turn by owned by another holding company, which was in turn owned by a third holding company—essentially a great-grandparent company.

That last company, the great-grandparent, was the subject of a corporate merger that resulted in a change of control and a replacement of managers at all levels throughout the enterprise.

The other party to the contract argued that the corporate merger of the great-grandparent amounted to a prohibited transfer of the contract. The court disagreed, concluding that the merger happened at the great-grandparent company level. The contract itself wasn't transferred by merger or any other way. The contracting party remained as the exact same entity owned by the exact same holding company.

That's perhaps not what the parties (or at least one of them) had in mind when they wrote their anti-transfer language. When they referred to a "merger" or "change in management or control" they might have been thinking about possible corporate transactions anywhere in the ownership structure. But that's not what they said. They just referred to a "transfer" of the contract by various possible means. One of those possible means of "transferring" the contract was a merger, which would have captured the case where just the specific contracting party merged into another entity and transferred the contract as part of the merger. Technically, though, that's not what actually happened. What actually

happened was something else, beyond the scope of the restriction that the parties had negotiated.

The transfer prohibition in the contract sounded quite fierce and extensive in theory. In practice, though, it didn't accomplish whatever the parties may have wanted it to accomplish. This happens with astonishing frequency, creating openings for contracting parties to do things that the other party might perceive as being inconsistent with the "spirit" of the deal.

When attorneys and their clients negotiate contracts, they need to watch for these sorts of gaps and openings. Perhaps they're intentional, but perhaps not. In contract negotiations, it can help to go beyond the words in the document and think about the wide range of possible events that might happen, and then make sure that the words capture everything they should capture.

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I help buyers, sellers, borrowers, lenders, tenants, property owners, and other commercial real estate market participants identify and achieve their business goals. To do that, I need to understand risk, security, numbers, value, financeability, flexibility, and exit strategy. Some legal issues matter a lot and many don't. It's important to know the difference. I write extensively on commercial real estate law and practice – over 300 articles and five books on leasing, lending, and other areas, with some emphasis on ground leases. I occasionally serve as an arbitrator or

expert witness in complex real estate disputes. That lets me see how transactions go wrong. Often, the problems could have been avoided by keeping it simple and following the money, but everyone got sidetracked. As a Forbes contributor, I try to tell stories that teach worthwhile lessons for real estate deals. **Read Less**