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Landlord-Tenant Law in Maryland

Prepared by:
Lawrence S. Conn
Baxter, Baker, Sidle, Conn & Jones, P.A.

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Lawrence S. Conn
Baxter, Baker, Sidle, Conn & Jones, P.A.
120 E. Baltimore Street, Suite 2100
Baltimore, MD 21202
Direct: 410-385-8126
Fax: 410-230-3801
Email: lsc@bbsclaw.com
Website: http://www.bbsclaw.com/

I. Negotiating Leases and Basic Lease Terms.

A. Brokers and Term Sheets

B. Who, What, Where, When, Why and How Much.

1. Who – Parties and Guarantors – credit and liability, security for tenant and landlord obligations (cash, letters of credits, bonds and third party guarantees); assignments and subleases; limits on guarantees

2. What – Type of Premises: Ground lease, single tenant lease, space lease; "As Is" vs. Landlord work and warranties, repair obligations, compliance with law

3. Where – Carefully identify leased premises – legal descriptions and plats; use of common areas and adjacent properties; right to measure; access and visibility, signage rights; parking rights

4. When – Dates of lease, delivery, and rent commencement (landlord work, permits; other site improvements, third party approvals)

5. Why – Permitted use by tenant and trade names – effect on balance of project, effect on lease assignment and subletting; exclusives and radius restrictions for retail leases (see below)

6. How Much – Base Rent (fixed, CPI, market); Taxes, insurance and other common area costs (over base year or all) – fixed or actual, caps, exclusions; utilities – meter or submeter

II. Office Leases.

A. Financial Incentives

Many commercial tenants are savvy enough to request free rent from motivated landlords. Tenants want the free rent period at the beginning of the term. Landlords want the free rent to be due upon a default. Beware of operating expenses, taxes and other pass-throughs during the free rent period.

Do not hesitate to ask for other economic incentives. Landlords are offering moving expenses and substantial build-out costs. Highly motivated landlords may also take care of tenant's obligations under existing leases.

B. Base Rent

Tenants should be wary of consumer price index increases for base rent. If indexes are used, annual and aggregate caps should apply. Watch out for the timing of rent increases. Landlord leases may increase the rent after less than a full first lease year. Particularly in new construction, the commencement date for rent must be carefully defined.

To compare dissimilar offers, discount to present value all payments during the term. Make your best estimates as to future liability for operating expenses and other pass-throughs, and bargain for limits on such costs, as discussed below.

The tenant's proportionate share of expenses should always be based on its share of gross leasable area, not leased and occupied area, placing the risk of vacancy on the landlord. Make certain that the definition and measurement of the leased premises is fair and accurate.

Carefully examine which operating expenses are to be passed through. As an example, capital expenses should be excluded, unless operating expenses will be proportionately reduced. At minimum, capital expenses should be amortized in accordance with generally accepted accounting principles, and the tenant's annual contribution commensurately limited.

C. Real Estate Taxes

Tax pass-throughs are generally easier to define than operating expenses. First verify whether you must pay a pro rata share of all taxes or just increases over a base year. The base year is more difficult to define for new construction, and if a single tax bill covers more than just the tenant's building. Beware of increasing costs from property tax phase-ins on new buildings.

As in operating expenses, the tenant's share should be based on gross leasable area and care should be taken to identify and limit the definition of the premises. Obtain the right to receive copies of all tax bills. Make sure the tenant receives the benefit of any tax refunds, which may be reduced by the landlord's related expenses.

D. Utilities

Tenants are best off by contracting directly for utility services. Submetering the premises is generally preferable to surveying the tenant's usage.

If the landlord provides utilities, the tenant should clarify whether additional costs will apply to use of the premises beyond stated business hours. Seasonal limits on temperature variations should be specified. Verify the extent and cost of janitorial services to be provided by the landlord.

E. Rights and Renewals

Tenant rights to additional space, and to extend the initial term, are of no advantage to the landlord. But in this economy, more tenants may be given these options. Tenants generally desire a simple, clearly written provision without any conditions. Such a provision may include rent concessions and landlord build-outs from the original lease.

Renewal rent "to be determined by the parties" is dangerous for the tenant, because the option may be voided by a court for vagueness. Consumer price indexes are often used, but may not reflect the market rent. A common solution is to calculate rent based on appraisers engaged by landlord and tenant, if the parties cannot agree upon the renewal rent, a third appraiser would choose the better of the two appraisers. The rental clause must be carefully crafted to address the applicable rental market, the appropriate base year for taxes and expenses, the scope of landlord's build-out, and the precise procedures to be followed.

F. Compliance with Laws

Obligations to comply with all laws affecting the premises should be limited. Landlords generally will agree to take care of required capital expenditures, unless such compliance arises from a tenant's unique case or new improvements by the tenant.

G. Other Tenant Concerns

The above does not exhaust the list of tenant concerns. Tenants (and their attorneys) should also focus on limits on tenant's use of its premises, rights to assign and sublet, and tenant's rights to make alterations and improvements. Tenant's rights to exclusive parking spaces and to such parking and common facilities to be defined. Further retail lease protections include limits on merchant association dues, and restrictions against the landlord making changes to a shopping center which interfere with access or visibility of the tenant's store.

Each form of lease is distinct, and the particular needs of a tenant must be taken into account. In the current market, landlords are giving significant concessions in the base rent. This is the time for tenants, in both new leases and renewals, to bargain for concessions to the remaining terms of the landlord's standard form.

III. Retail Leases.

A. Percentage Rent

In retail leases, tenants usually must pay percentage rent, based on gross sales in excess of a specified minimum sales level. The percentage often varies based on the type of business, and may be subject to negotiation. One compromise is a declining percentage for increased sales levels.

Consider paying percentage rent only after annual sales have exceeded the breakpoint. Strong tenants may obtain increases in the breakpoint for a lease commencing during the Christmas shopping months.

Tenants should insist on a number of exclusions from gross sales. Compare lease provisions governing sales records against the tenant's practices. Tenants may reduce costs by eliminating requirements for audits by certified public accountants, or limiting such audits to annual reports.

B. Anchor Tenants; Rent Abatements; Self-help

In retail leases, be extremely careful of the role of anchor tenants. These tenants, such as major department stores, often take a free (or reduced) ride on common area expenses. Attempt to limit the landlord's discretion in defining who receives such favorable treatment. A minimum square footage for anchors will provide some protection. Improvements that exclusively benefit anchors should not be passed through to all tenants.

In retail leases, strong tenants (a larger class today) can bargain for rent abatements, or at least the right to close their stores, if a given percentage of the center goes dark. The percentage may be based upon square footage, or the number of tenants open and operating. Landlords prefer that any such co-tenancy rights be based on the number of tenants required to be open under existing leases. Such rights may also be based upon the hours which anchor tenants are required to be open.

C. Noncompetition and Exclusives

Radius clauses in retail leases prohibit the tenant from competing with its business at the leased premises. These clauses must be limited in scope to remain enforceable. Tenants may seek exclusives, which prohibit the landlord from leasing to competitors in the center and in the surrounding area. Many food court tenants are unpleasantly surprised at the opening of a business selling substantially similar fare. All of these clauses must be carefully scrutinized; because of antitrust and similar challenges; they will be strictly construed against enforcement.

An exclusive clause protects a tenant by prohibiting a landlord from leasing other property it owns to a competitor of the tenant. See Raymond W. Goldfaden, Exclusives and Other Use Restriction Clauses, in The Commercial Property Lease 81 (Patrick A. Randolph, Jr. ed., 1993). See also "Validity, construction, and effect of lessor's covenant against use of his other property in competition with the lessee-covenantee," 97 A.L.R.2d 4 (1964). An exclusive clause is a restrictive covenant that limits the use and alienability of land. As such, exclusive clauses are disfavored at law and are narrowly construed. See Grand Union Co. v. Laurel Plaza, Inc., 256 F. Supp. 78, 82 (D. Md.), aff'd, 369 F.2d 697 (4th Cir. 1966); Patuxent Dev. Co. v. Ades of Lexington, Inc., 257 Md. 398, 263 A.2d 584 (1970); see also Norris v. Williams, 189 Md.

73, 54 A.2d 331 (1947) ("[R]estrictions upon the use of land are in derogation of the natural right which an owner possesses to use and enjoy his property, and are repugnant to trade and commerce."). Some issues relating to exclusive clauses include: whether a tenant will be bound by only existing exclusives (i.e., as of the date of the lease) or also future exclusives and whether the "incidental" sale of goods or services will violate the exclusive.

Maryland law recognizes the enforceability of restrictive covenants including exclusive clauses; however, such covenants are construed against the person in whose favor they were made and are construed liberally in favor of the unrestricted use of the property. See Patuxent, 263 A.2d at 588; Maryland Trust Co. v. Tulip Realty Co., 153 A.2d 275, 282 (Md. 1959); see also Norris, 54 A.2d at 333 ("[R]estrictive covenants are construed strictly against their establishment and effect, and liberally in support of the unrestricted use of the land.").

A lessor "is under no implied obligation to give any one tenant the exclusive right to sell [its products]." 3 Milton R. Friedman, Friedman on Leases § 28.2, at 1568 (4th ed. 1997). See also "Implied covenant in lease for business purposes, that lessor will not compete in business activity for conducting of which lessee leased the premises," 22 A.L.R.2d 1466 (1952). Moreover, "a restrictive covenant will not be extended by implication beyond the original intent of the contracting parties so as to include an area not clearly expressed in the agreement or deed of the contracting parties." Maryland Trust, 153 A.2d at 282. In Maryland Trust, the court refused to extend by implication an express exclusive clause contained in a deed.

> The general rule is that restrictive covenants are strictly construed so as to favor the unrestricted use of property. Moreover, a restrictive covenant will not be extended by implication beyond the original intent of the contracting parties so as to include an area not clearly expressed in the agreement or deed of the contracting parties. And, if there is a doubt, it will be resolved in favor of an unrestricted use.

Maryland Trust, 220 Md. at 409 (citations omitted).

When such an exclusivity provision is not expressly included in the lease, such a restriction will **not** be implied. *See* Fontainebleau Hotel Corp v. Kaplan, 108 So.2d 503, 505 (Fla. Ct. App. 1959); Stockton Dry Goods Co. v. Girsh, 227 P.2d 1, 3 (Cal. 1951); *see also* Maryland Trust, 220 Md. at 409 ("a restrictive covenant will not be extended by implication beyond the original intent of the contract parties so as to include an area not clearly expressed in the agreement or deed of the contracting parties"). As the leading commentator on leases explains:

> The owner of a building containing a half-dozen stores may theoretically lease them all to different shoe merchants. He is under no obligation to give any one tenant the exclusive right to sell shoes or anything else. Nor is he barred from competing with his tenant, absent a covenant to this effect.

Friedman, *supra*, at 1568.

Both Fontainebleu and Stockton considered the Maryland case of Belvedere Hotel Co v. Williams, 137 Md. 665 (1921), and determined that that case **does not** hold that a restrictive covenant can be implied in a lease. In Belvedere, the landlord had leased to the tenant the "barber shop and manicuring **concession** in its hotel for a term of two years." Belvedere, 137 Md. at 673 (emphasis added). The Court of Appeals held that the use of the specific word "concession" demonstrated a clear intent to lease more than a mere part of the premises, but rather the word demonstrated an intent to lease to the tenant the privilege of being the barber for the entire hotel and, thus, the landlord could not also permit another barber to lease space in the hotel. Id. As Judge Briscoe explained:

> The plain language of the lease is that the party of the first part agrees to lease to the party of the second part the barber shop and manicuring concession in its hotel for a term of two years.
>
> The use of the word "concession" in the lease, we think, shows an intent to convey more than a part of the premises. As stated by the appellee in his brief, the concession granted by the lease was the concession "in its hotel," and was clearly intended to be the concession of the privilege for the entire hotel.

Id. at 673. Thus, both the Fountainbleu and Stockton courts recognized that the operative language in the Belvedere lease was the word "concession" and that in the absence of the "concession" language, there is no restrictive covenant.

In Eastern Shore Markets, Inc. v. J.D. Associates Ltd. Partnership, 213 F.3d 175 (4th Cir.(Md.) May 22, 2000), the Fourth Circuit considered a case wherein a tenant, Eastern Shore Markets, Inc., sued its shopping center landlord under Maryland law for (1) breach of an express covenant not to interfere with Eastern Shore's reasonable access to its grocery store premises, (2) breach of an implied covenant to refrain from destructive competition, which allegedly was committed when the landlord introduced a competing grocery store into the shopping center, and (3) related torts. Judge Smalkin, of the U.S. District Court, dismissed Eastern Shore's complaint under Federal Rule of Civil Procedure 12(b)(6). The Fourth Circuit affirmed the district court's dismissal of the claim for breach of an express covenant, but vacated its dismissal of the remaining claims of the complaint, and remanded for further proceedings. Significantly, the Fourth Circuit held:

> Eastern Shore claims that three attributes of its lease give rise to either an implied covenant of exclusivity or an implied duty not to engage in competition deliberately destructive of the mutual benefit contemplated by the contract. First, Eastern Shore points to the lease's provision for the calculation of rent based in part on the gross sales made by Eastern Shore. Second, Eastern Shore notes that, under the lease, it agreed to operate only a grocery store on the leased premises. Third, Eastern Shore highlights the shopping-center site plan, which was made part of the lease, and its inclusion of Eastern Shore's store as the only grocery store in the tenant mix. Eastern Shore asserts that these attributes of the lease illustrate the parties' understanding that Eastern Shore's grocery store would be the only grocery store in the shopping center, or, alternatively, that J.D. Associates would not deliberately thwart Eastern Shore's ability to attract customers and be profitable.
>
> To the extent that Eastern Shore alleges a breach of an implied covenant of exclusivity, we agree with the district court that such an allegation fails to state a claim upon which relief can be granted. A covenant of exclusivity is a valuable benefit for which parties to agreements traditionally bargain and on which they generally either reach or deliberately decide not to reach agreement. Therefore, when parties do not include such a clause in their agreement, we are not free to insert one by implication. Even when the parties include an express restrictive covenant in a deed or lease, under Maryland law the covenant is generally "strictly construed so as to favor the unrestricted use of property." Maryland Trust Co. v. Tulip Realty Co., 220 Md. 399, 153 A.2d 275, 282 (Md.1959). We have found no published opinion in which a court has held that, in Maryland, a restrictive covenant of exclusivity arises out of the implied covenant of good faith and fair dealing.
>
> But this conclusion does not end the analysis in this case. Eastern Shore has not limited its complaint to breach of an implied covenant of exclusivity, although it has confusingly styled its arguments to include such a claim. In its

arguments, Eastern Shore has treated as interchangeable its claim for breach of a covenant of exclusivity and its claim for breach of an implied covenant against destructive competition, and it has used both labels to describe aspects of the implied covenant of good faith and fair dealing. Significantly, however, Eastern Shore's complaint, on which our decision must be based, explicitly couches its claim in terms of a breach of the implied covenant of good faith and fair dealing, which Maryland clearly recognizes. Giving the claim its asserted scope, we cannot say that it fails under any probable set of facts to state a claim upon which relief can be granted. Food Fair and Automatic Laundry together establish that, under Maryland law, the intentions of parties as expressed in the lease providing for rent calculated in part as a percentage of sales, combined with the circumstances surrounding the lease's formation, may give rise to an implied covenant to refrain from competition that is destructive to the mutual benefit of the contracting parties. See Food Fair, 200 A.2d at 173-74; Automatic Laundry, 141 A.2d at 500-01.

Eastern Shore alleges in its complaint that J.D. Associates willfully undermined its profitability and threatened its viability. It asserts that certain features of its lease agreement contemplate a particular tenant mix and an important role for its store as the only grocery store within the shopping center. Viewing the complaint in the light most favorable to Eastern Shore, as we are required to do on review of a 12(b)(6) motion, we cannot conclude that Maryland courts would categorically refuse to recognize an implied covenant to refrain from destructive competition in the lease between Eastern Shore and J.D. Associates. We recognize that further proceedings below may reveal facts and defenses counseling against the implication of such a covenant. But without the benefit at this stage of the right to evaluate facts, we conclude that this claim should not have been dismissed under the rigid standards that control the disposition of 12(b)(6) motions.

D. Express and Implied Covenants of Continuous Operation.

Landlords generally plan the development of a shopping center around a strong tenant mix, including "anchor tenants" upon which the landlord and other tenants rely to draw business to the shopping center. The operation of an anchor tenant affects the landlord's rental stream as well as the survival of the other tenants in the shopping center. An anchor tenant which ceases operations will likely have a significant impact on the number of customers attracted to the shopping center. As one court noted, each of the tenants in a shopping mall depends upon the landlord and the other tenants to provide a suitable mix of tenant types which not only draw customers to the mall, but circulate them through the mall and past each tenant's storefront. The subtle economic reality of the tenants' interdependence becomes clear for the tenants and the landlord when an anchor tenant prematurely ceases operations. See Massachusetts Mutual Life Ins. Co. v. Associated Dry Goods Corp., 786 F.Supp. 1403, 1413 (N.D. Ind. 1992). In Massachusetts Mutual Life, the court explained how an anchor store's closing adversely affects a shopping center mall:

> [the anchor store] attracts a more affluent customer than do the store's other anchors; fewer customers of that sort will come to the mall to shop at Wards or Target. The reduction in customers coming to Scottsdale Mall will reduce the flow of customer traffic through the mall, reducing the sales business of all mall tenants. Those hardest hit will be the specialty shops that are geared to the more affluent customer and the shops located closest to Ayres.
>
> Evidence produced at the hearing indicates that a shopping mall is based on the concept facilitating a unified and a compatible operation between the landlord, anchor tenants, and specialty shops. The specialty shops rely on the anchor tenants to draw a substantial portion of the customer base to the mall, and customers of any one place of business in a mall are potential customers of any of the other merchants in the mall.
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> * * *
>
> If the upscale specialty shops suffer reduced gross sales, MassMutual's rental income will suffer. All but four or five of the mall's non-anchor tenants have lease arrangements

> whereby the tenant pays a minimum base rent, but pays a percentage of gross sales if sales reach a specified point. [Various] non-anchor tenants paid mall rental on a percentage basis in 1991; an unspecified number of other non-anchor tenants fell just short of sales levels that would have required rent payment on a percentage basis. If the Ayres store's departure causes specialty shops' gross sales to fall, MassMutual will lose: (1) the additional percentage rent that previously successful non-anchor tenants, who have paid percentage rent in the past, would have paid in the years remaining on the Ayres lease; (2) the potential for increased percentage rent from increased future sales from those non-anchor tenants already paying percentage rent; and (3) additional percentage rent that other non-anchor tenants, who now pay the base rent, may have owed as a result of increased sales in coming years.

786 F.Supp. 1403, 1411-12 (N.D. Ind. 1992).

Accordingly, a landlord will often provide a clause in its leases which requires the tenant to maintain an active and operational concern, i.e., a continuous operations clause. See M. Leo Storch Ltd. Partnership v. Erol's, Inc., 95 Md. App. 253, 628 A.2d 408 (1993); Landover Mall Ltd. Partnership v. Kinney Shoe Corp., 944 F. Supp. 443 (D. Md. 1996). See also "Lease of store as requiring active operation of store," 40 A.L.R.3d 971 (1971).

In the event that the lease does not include an express continuous operation clause, some courts have held that the tenant is under no obligation to occupy the leased premises. However, other courts have recognized an implied continuous operation clause. For instance, in Lagrew v. Hooks-Superx, Inc., 905 F.Supp 401 (E.D. Ky. 1995), the court examined the factors a court may consider in determining if an implied covenant of continuous operation exists:

> To determine whether to imply a covenant of continuous operation, the courts look to the terms of the lease and the surrounding circumstances. Generally, the courts take several factors into account: (1) whether base rent is below market value, (2) whether percentage payments are substantial in relation to base rent, (3) whether the term of the lease is lengthy, (4) whether the tenant may sublet, (5) whether the tenant has rights to fixtures, and (6) whether the lease contains a noncompetitive provision.

Id. at 405.

E. A Tenant's Right of First Refusal To Purchase The Leased Premises.

Court have held that, ordinarily, a change in a corporation or partnership's owners does not legally change ownership of its assets and, therefore, is not a triggering event with respect to a tenant's right of first refusal to purchase the leased premises from the Landlord. *See Capital Parks v. Southeastern Advertising & Sales System, Inc.*, 30 F.3d 627 (5th Cir. 1994); *Engel v. Teleprompter Corp.*, 703 F.2d 127, 131 (5th Cir. 1983) ("a transfer of the stock of a corporation is not a transfer of the property and assets of the corporation itself"); *Celis v. CAI Wireless Systems, Inc.*, 1996 WL 102305 (E.D. Penn. Mar. 5, 1996) (applying California law); *In re Integrated Resources*, Inc., 1990 WL 325414 (Bankr. S.D.N.Y. Oct. 22, 1990); *Tenneco Inc. v. Enterprise Products Co.*, 925 S.W.2d 640 (Tex. 1996); *Loxterman v. Convenient Food Mart, Inc.*, 1996 WL 432458 (Ohio Ct. App. Aug. 1, 1996); *Power Test Petroleum Distribs., Inc. v. Baker-Tripi Realty Corp.*, 594 N.Y.S.2d 266 (N.Y. App. Div. 1993) (absent showing of bad faith by defendant landlord, transaction structured as sale of corporate stock rather than sale of corporate property itself did not trigger lease provision granting tenant right of first refusal); *Cruising World, Inc. v. Westermeyer*, 351 So.2d 371 (Fla. Dist. Ct. App. 1977), *cert. denied*, 361 So.2d 836 (1978); *Branmar Theatre Co. v. Branmar, Inc.*, 264 A.2d 526

(Del. Ch. 1970); *see also Frandsen v. Jensen-Sundquist Agency, Inc.*, 802 F.2d 941, 947 (7th Cir. 1986) (right of first refusal as to corporation's stock did not prevent sale of corporation's assets); *Sand v. London & Company, Inc.*, 121 A.2d 559 (N.J. Super. Ct. App. Div. 1956); *McClory v. Schneider,* 51 S.W.2d 738 (Tex. Civ. App. 1932) (supporting the principle that sale of stock of a corporation is not the same as a sale of the corporation's assets). *Cf. Baxter Healthcare Corp v. O.R. Concepts, Inc.*, 69 F.3d 785 (7th Cir. 1995) (sale of manufacturer's stock was not an assignment of its interest in the distribution agreement).

In *K.C.S., Ltd. v. East Main St. Land Dev. Corp.*, 40 Md. App. 196, 388 A.2d 181 (1978), a tenant brought suit against its landlord to enjoin the sale of stock in the landlord's corporation under a provision of the lease granting the tenant a right of first refusal on the sale or purchase of the leased premises. The Court of Special Appeals held that the sale of corporate stock of the landlord did not constitute a transfer of the landlord's corporate assets so as to trigger the tenant's right of first refusal:

> The general rule is that when a lease, as here, contains a "right of first refusal," a lessee may enjoin the lessor from selling the demised property to anyone other than the lessee. *Straley v. Osborne*, 262 Md. 514, 524, 278 A.2d 64, 70 (1971). *See also Westpark, Inc. v. Seaton Land Co.*, 225 Md. 433, 449-50, 171 A.2d 736, 743 (1961); *Annot*., 170 A.L.R. 1068 (1947); 49 Am.Jur.2d Landlord and Tenant § 374 (1970); 1A A. Corbin, Contracts § 261 (1963).
>
> The word sell ordinarily means to transfer title or possession of property to another in exchange for a valuable consideration. *Eastern Shore Trust Co. v. Lockerman*, 148 Md. 628, 636, 129 A. 915, 918 (1925).
>
> An analysis of the facts in the case *sub judice* demonstrates that there was no sale of the real property owned by Landlord. Title to the East Main Street properties as well as that located on Market Street remains in Landlord. What

has been sold is the stock of Landlord. While it is true that Landlord offered the realty it owned for sale through the real estate broker, the real property was not sold. Inasmuch as the lease between Landlord and Tenant did not extend to Tenant a "right of first refusal" to purchase all or part of the corporate stock of Landlord, no breach of the lease has occurred by virtue of the sale of stock by the stockholders of Landlord. Tenant is in no worse position than it was before the sale of the stock. Tenant still possesses all the rights and privileges conferred on it by the lease, including the "right of first refusal" to purchase the property demised to the Tenant.

There appears to be a dearth of cases dealing with the issue raised by Tenant, and which we stated at the outset. Perhaps this is true, because, as one authority suggests, the answer is usually obvious. Annot., 70 A.L.R.3rd 203, 206 (1976). We think it obvious in the matter now before us. Corporations are legal entities "conceived by the mind of man and legitimated by statute . . .." *Dixon v. Process Corp.*, 38 Md.App. 644, 645, 382 A.2d 893, 894 (1978). They may be owned by one person or by millions of persons. The sale of corporate stock is an every day occurrence, and indeed, an industry has been created for the purpose of buying, selling, and trading in stocks and other securities. **If, perchance, a large corporation with a multitude of stockholders entered into a lease with a tenant, and the lease contained a "right of first refusal" to buy the leased premises if it were offered for sale, no one would seriously contend that a transfer of some of the corporate stock from a seller thereof to a buyer would operate so as to trigger the "right of first refusal" on the theory that the sale of the stock is the equivalent to a sale of the demised premises. Yet, the only difference between that hypothetical and the case sub judice is the quantity of stock being sold. The fact that as a result of the stock sale the control of the corporate landlord will be altered did not change the ownership of the East Main Street property.** *Torrey Delivery, Inc. v. Chautauqua Truck Sales and Service, Inc.*, 47 App.Div.2d 279, 366 N.Y.S.2d 506 (1975). **That all the issued corporate stock of Landlord or part of the issued stock of Landlord was sold does not constitute a transfer of the property of the corporation so as to awaken the dormant clause of the lease pertaining to the "right of first refusal."**

40 Md.App. at 199-200 (emphasis added). *See also Compania de Astral v. Boston Metals Co.*, 205 Md. 237, 269, 107 A.2d 357 (1954) (stating that transfer of corporate stock may transfer control of corporation and its assets, but does not transfer ownership of the assets).

However, some courts in other jurisdictions examine the motives of the corporate owners in making a stock sale and hold that, for purposes of a right of first refusal, a "sale" occurs upon a transfer (a) for value (b) of a significant interest in the subject property (c) to a stranger to the corporation, (d) who thereby gains substantial control over the property.

In *LaRose Market, Inc. v. Sylvan Center, Inc.*, 530 N.W.2d 505 (Mich. App. 1995), the court, relying upon *KCS, Ltd.*, *supra*, held that the sale of stock of a corporate landlord did not trigger a right of first refusal. However, the Michigan court also discussed a Utah case, *Prince v. Elm Investment Co., Inc.*, 649 P.2d 820 (Utah 1982), in which the court examined the motives of the corporate owners in making a stock sale:

> Plaintiff asks this Court not to follow *K.C.S., Ltd., supra*, arguing that the court ignored the apparent subterfuge involved in the sale. However, we find that the court in that case was fully apprised of the buyers' original desire to purchase the real estate rather than the stock, as well as the fact that they bought the stock for the same price they had offered to buy the land. *Id.*, 40 Md.App. at 197-198, 388 A.2d 181. Similarly, the court in *Cruising World, Inc., supra*, was aware that the stock purchaser had originally inquired about purchasing the land, which was adjacent to the buyer's land. *Id*. at 372. Neither court entered into the equitable analysis proposed by plaintiff.
>
> Other cases have examined the motives of the corporate owners in making a stock sale. For example, in *Prince v. Elm Investment Co., Inc.*, 649 P.2d 820 (Utah, 1982), the Utah Supreme Court agreed that a sale of stock generally

should not be equated with a sale of corporate assets, but went on to note:

> Although a transfer of corporate stock to a stranger to the lease may not be a "sale," and a transfer [of land] from a corporation to its stockholders (or vice versa) may not be a "sale," there would probably be a sale if these two steps occurred in sequence according to a pre-arranged plan. Otherwise, a lessor could incorporate and sell the stock [sic, "land" is intended] to himself individually, and the parties would have accomplished in a step transaction what they could not have accomplished directly. [*Id.* at 823, n. 3.]

Absent a showing of bad faith or wrongdoing on the part of the corporate lessor, such multistep transactions do not trigger a lessee's right of first refusal. *See Power Test Petroleum Distributors, Inc. v. Baker-Tripi Realty Corp.,* 190 A.D.2d 845, 594 N.Y.S.2d 266 (1993); *Kings Antiques Corp. v. Varsity Properties, Inc.*, 121 A.D.2d 885, 503 N.Y.S.2d 575 (1986), *app. dis*. 70 N.Y.2d 641, 518 N.Y.S.2d 1031, 512 N.E.2d 557 (1987); *Midland Container Corp. v. Sophia Realty Corp.*, 65 A.D.2d 784, 410 N.Y.S.2d 638 (1978). *Cf. Frandsen, supra* at 946-947.

In harmonizing a number of cases presenting a variety of transactions, the *Prince* court formulated a rule:

> **[F]or purposes of a right of first refusal, a "sale" occurs upon the transfer (a) for value (b) of a significant interest in the subject property (c) to a stranger to the lease, (d) who thereby gains substantial control over the leased property. [*Id.* at 823.]**

See also Belliveau v. O'Coin, 557 A.2d 75 (R.I., 1989) (finding no sale where conveyance of a parcel of property to the corporation was not made at arms' length and was "solely for legitimate tax-avoidance reasons"); *Sand v. London & Co., Inc.*, 39 N.J.Super. 513, 121 A.2d 559 (1956) (same); *Kroehnke v. Zimmerman*, 171 Colo. 365, 467 P.2d 265 (1970) (same; conveyance was "solely for the convenience of the lessors in managing the property"). From these cases and the *Prince* court's analysis, we discern that **where a sale of property occurs between an individual and a corporation, rather than a mere**

> **corporate stock transfer, equitable considerations such as the parties' motives for the sale and the relationship between the parties become relevant. These considerations are not relevant to a stock sale because the identity of the corporate landlord does not change.**
>
> Here, plaintiff asserts that the transfer of defendant's corporate stock to Kato constituted the first step in a prearranged plan to deprive plaintiff of its right of first refusal. The second step, presumably, would involve a conveyance of the demised property from defendant corporation to Kato as an individual. Plaintiff concedes, however, that this second step has not occurred; therefore, without evidence of some injury, plaintiff has presented no grounds for equity to intercede. Moreover, because plaintiff contracted with defendant corporation, not with the shareholders as individuals, the mere change in identity of the corporate shareholders did not trigger plaintiff's right of first refusal.

209 Mich.App. at 207-209 (emphasis added).

Similarly, in *McGuire v. Lowery*, 2 P.3d 527 (Wyo. 2000), real property purchasers brought claims against vendors for breach of a right of first refusal for an additional parcel and breach of contract to convey an access easement. The Supreme Court of Wyoming held that the vendors' transfer of the additional parcel, which they owned as individuals, to a corporation owned entirely by the vendors was not a "sale" of the parcel, for purposes of the purchasers' right of first refusal:

> The fact that the ROR parcel was included in the acquisition by Pronghorn Construction would have been germane, and it would have constituted a triggering event, had that transaction been a "sale" of the land as the McGuires insist. It was not, however, a sale by Lowery and Rabel to Pronghorn Construction. The argument of Lowery, Rabel and Pronghorn Construction is that the McGuires had no different situation, following that transaction, whether the land was titled in the names of Lowery and Rabel or was titled to Pronghorn Construction. They cite to *Kroehnke v. Zimmerman*, 171 Colo. 365, 467 P.2d 265 (1970). In that case, the Supreme Court of

Colorado ruled that a conveyance of real property by its owners to a corporation owned entirely by the owners of the property did not constitute a sale for the purpose of activating a first right of refusal. *Id*. at 267. The Colorado court reasoned that a transfer made solely for the convenience of the owners in managing their property is not a sale. *Id*.

As an answer to *Kroehnke*, the McGuires cite *Prince v. Elm Inv. Co., Inc.*, 649 P.2d 820 (Utah 1982). In *Prince*, the Supreme Court of Utah held that a transfer of property from a sole owner to a partnership in which the owner was one of the partners was a sale for purposes of asserting a right of first refusal. *Prince*, 649 P.2d at 823. In that opinion, however, the Supreme Court of Utah distinguished the facts before it from *Kroehnke*. *Prince*, 649 P.2d at 823. The Utah court pointed out that although the partnership in Prince included the former owner, management decisions of the partnership had to be made unanimously. *Prince*, 649 P.2d at 821. Therefore, a significant change in control of the property occurred when the transfer was made to the partnership. In *Kroehnke*, however, as in the case at hand, the property remained under the control of the same persons, albeit in a corporate ownership rather than individual ownership.

This case is one of first impression with respect to the issue in Wyoming, and we rely upon persuasive authority from other jurisdictions that confirm the *Kroehnke* result. *Straley v. Osborne*, 262 Md. 514, 278 A.2d 64, 71 (1971); *Sand v. London & Co.*, 39 N.J.Super. 513, 121 A.2d 559, 562 (1956); *Midland Container Corp. v. Sophia Realty Corp.*, 65 A.D.2d 784, 410 N.Y.S.2d 638, 640 (1978); *Belliveau v. O'Coin*, 557 A.2d 75, 78 (R.I.1989). We hold that for a transaction to constitute a "sale" and trigger a first right of refusal, it must involve an arms-length transaction resulting in an actual change in control of the burdened property rather than simply moving it from the individual owners to an entity controlled by them. That concept does not fit the transaction in which Pronghorn Construction acquired this land because there was no change in control over the right to dispose of the land. Consequently, no event occurred during 1995 that would permit the McGuires to invoke their first right of refusal. The grant of summary judgment by the district court on that issue is affirmed.

2 P.3d 532-33.

There is an interesting recent Pennsylvania case, *Seven Springs Farm, Inc. v. Lynda Dupre Croker*, 2000 Pa.Super. 72, 748 A.2d 740 (March 13, 2000), in which the court (in a split decision) looked at the "form" of the transaction rather than its "substance" in holding that a proposed merger did not trigger a right of first refusal.[1] In *Seven Springs*, a closely held corporation and certain of its directors sought a declaratory judgment that a restrictive stock transfer agreement was inapplicable to a proposed cash-for-stock merger. The court held that (1) the proposed merger was not an act that triggered application of the agreement; (2) the proposed merger was not a "sale," such that it would be within the scope of the agreement; and (3) that equity would not bar proposed merger:

> Appellant argues the proposed "cash-out" merger is for all intents and purposes a sale, bringing it within the catch-all language of the Agreement. Indeed, the record strongly suggests the proposal was structured as a merger to circumvent the Buy/Sell Agreement. These families are embroiled in bitter infighting, and one may easily conclude from the record that appellees **are cloaking a sale in the accouterments of merger to circumvent appellant and the block of shares she represents; however, one may as easily conclude appellant's block is objecting to the merger for obstructive personal reasons as well. Both**

[1]In the context of a merger, one court has held that a right of first refusal may be deemed triggered if the merger transfers assets under the law of the owner's state of incorporation. *See PPG Indus., Inc. v. Guardian Indus., Inc*., 597 F.2d 1090 (6th Cir. 1979). *See also Nicholas P. Salgo Assocs. v. Continental Illinois Props.*, 532 F. Supp. 279 (D.D.C. 1981); *compare Orlando Regional Healthcare System, Inc. v. Columbia/HCA Healthcare Corp.*, 923 F.Supp. 1534, 1542 (M.D. Fla. 1996) (distinguishing PPG and Salgo on ground that the owner was surviving corporation of merger, and thus technically transferred none of its assets).

Yet in another case, *Star Cellular Tel. Co., Inc. v. Baton Rouge CGSA, Inc.*, 1993 Del. Ch. LEXIS 158 (Del. Ch. July 30, 1993), the court held that a trigger of a right of first refusal depends upon whether it alters "the pre-merger realities that were crucial to [the holder's] economic interests." *Id*. at *23-30. The court found that the merger did not affect the holder's crucial interests because it was between affiliated corporations. *Id*. at *29-30.

conclusions may be true, but this is immaterial to our inquiry. We are interpreting a contract, not the reasons for the positions of the parties. The question is the propriety of the merger, not the motivations behind it.

¶16 The Supreme Court has recognized the distinction between a "merger" and a "sale" is not easy to determine.

> [I]t is no longer helpful to consider an individual transaction in the abstract and solely by reference to the various elements therein determine whether it is a 'merger' or a 'sale'. Instead, to determine properly the nature of a corporate transaction, we must refer not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable.

Farris v. Glen Alden Corp., 393 Pa. 427, 143 A.2d 25, 28 (1958).

* * *

¶25 We believe the Seventh Circuit was correct when it observed how formalities are crucial in corporate law. *See Frandsen, supra*. "If the distinction [between a sale of shares and a merger] seems somewhat formalistic, this is an area of law where formalities are important, as they are the method by which sophisticated businessmen make their contractual rights definite and limit the authority of the courts to redo their deal." *Id.*, at 947. It has been said of corporate law that it is not so much what is done, but how it is done. Even though this business has family roots, and the infighting has separated the parties along family lines, the fundamental fact remains this is a corporation, every bit as much as IBM and AT&T, and the ability of this corporation to act as such is not diminished by an agreement limiting how shareholders may dispose of their holdings.

¶26 The parties chose the applicable formalities and expressed them in the terms of this Agreement, ratified as recently as 1997, when the parties were battling, which shows two things. First, whatever the intent of the matriarch and her children, parties to the 1959

> **agreement, the relevant parties and their intent were vastly different when the current version of the agreement was modified in 1997. Any 1959 intent to keep things "in the family" had long since transformed, as there was not "one family" by 1997; any intent of these parties was limited to the best interests of "my branch of the family" when the 1997 contract was signed.**
>
> ¶27 Secondly, these parties knew full well in 1997 that they were not in a position to run a family business together; something had to give. Affirming the modified Agreement did nothing to restore the Ozzie and Harriet world that existed four decades ago; to impute the intent of the parties in 1959 to the combatants of 1997 is misplaced. Fully aware of this, and fully aware the corporation was examining its divestiture options, appellant took no steps to draft further protection for her position into the new amended Agreement. We cannot do so for her now.

748 A.2d at 746-749 (emphasis added; footnote omitted). Justice Johnson, joined by Justices Cavanaugh and Musmanno, filed a dissenting opinion in which he argued that the majority opinion was flawed in three respects. First, that the majority erred in interpreting the plain language of the Agreement to exclude cash-out mergers. Second, the majority erred in finding that the proposed merger is solely a corporate act, and as such does not constitute shareholder action. Third, that it fails to consider properly the intent of the parties, which underlies accurate interpretation of the Agreement.

As a point of interest, one Pennsylvania case highlights the problems of an owner who gives a right of first refusal in a real estate transaction but does not cover the possibility that the property might be offered in a package deal. In *Boyd & Mahoney v. Chevron U.S.A.*, 614 A. 2d 1191 (Pa. Super. Ct. 1992), Chevron purchased a gasoline station, subject to a simple right of first refusal benefiting the grantor. Chevron then sold the station to Cumberland Farms in a sale that included real estate throughout the United States with terminals, warehouses, offices, gasoline stations, inventories, accounts receivable, and other assets. The total purchase price for the sale exceeded $310 million, and Chevron did not offer the optioned gas station to the beneficiary of the option. The court held that the right of first refusal was triggered and that the applicable price should be the estimated fair market value of $158,000:

> Common sense and the applicable case law of this jurisdiction require us to hold that a right of first refusal as to the conveyance of a property cannot be defeated by including that property in a multi-property or multi-asset transaction. *L.E. Wallach, Inc. v. Toll*, 381 Pa. 423, 113 A.2d 258 (1955); *Atlantic Refining Co. v. Wyoming National Bank of Wilkes-Barre*, 356 Pa. 226, 51 A.2d 719 (1947). The right of first refusal is a valuable property right. The importance of the right to its holder is that the holder may assert ownership of the property provided that the owner meets the conditions of the right. The appellants' argument that the right can be nullified simply by packaging the property for sale with another asset not so encumbered has no merit. Appellants' logic would deprive the holder of the right the benefit of his or her bargain.
>
> It is well-settled that contractual rights of first refusal to purchase realty may be enforced by a decree of specific performance. *Warden v. Taylor*, 460 Pa. 577, 333 A.2d 922 (1975); *Gateway Trading Co., Inc. v. Children's Hospital of Pittsburgh*, 438 Pa. 329, 336, 265 A.2d 115, 119 (1970); *Driebe v. Fort Penn Realty Co.*, 331 Pa. 314, 200 A. 62 (1938). To prevail on an action for specific performance the holder has the burden of showing that there is a valid agreement; that the agreement has been violated; and that the holder does not have adequate remedy at law. *Messina v. Silberstein*, 364 Pa.Super. 586, 528 A.2d 959 (1987).
>
> The agreement in the instant case is a valid agreement. It is complete, certain and clear. It is also apparent that appellant Chevron violated the agreement by not informing Boyd & Mahoney of the sale and not permitting them to exercise their right of first refusal. Also, Boyd & Mahoney did not have an adequate remedy at law. The trial court found that the property was a "key" parcel for Boyd & Mahoney, being situated at the entrance to Boyd &

> Mahoney's commercial development properties. Ownership of the property would permit Boyd & Mahoney to control the architectural design and future development of the area. Therefore, the trial court did not commit an error of law or abuse of discretion in ordering specific performance.

419 Pa.Super. at 29-31. In addition, the court awarded the option holder over $500,000 as lost rents and profits, plus interest. The result of this was that the beneficiary of the option was entitled to receive not only the property but also the cash award in excess of the purchase price.