LJN LAW JOURNAL NEWSLETTERS

Commercial Leasing LAW & STRATEGY®

An ALM Publication

Volume 25, Number 11 • May 2013

IN THE SPOTLIGHT

The Assignment Clause in an Agreement of Sale

By Melanie J. Scroble

No party may assign this agreement.

This sentence appears to the untrained eye to be a simple and clear prohibition of an assignment in an agreement of sale. But, as in any legal document, nothing that appears to be simple and clear is simple or clear. Parties with this very clause in their agreement of sale have been permitted to assign all or a portion of their rights or duties thereunder due to a variety of reasons determined by various courts. One thing is certain: If this is the clause in an agreement of sale, the negotiating attorneys have not sufficiently protected their clients' interests.

So what is missing from this clause? In an agreement of sale, a party has rights (such as a buyer's exclusive right to purchase the property) and it has duties or obligations (such as a buyer's obligation to pay the purchase price). This simple anti-assignment clause does not specify whether rights can be assigned, or if duties can be delegated, or both. This clause can be interpreted to prohibit a buyer from assigning its rights, but the buyer may still be free to delegate its duty to pay the purchase price in

continued on page 5

Parking: It's Not Just About the Ratios Anymore

By Marsha Anderson Bomar and David S. Lima

New approaches to parking are offering retailers and developers greater flexibility and the opportunity to reduce costs and environmental impacts.

For decades, parking requirements for retail-commercial developments have been driven primarily by two constituencies, both trying to estimate what the consumer actually wants and needs: government regulators, guided by public interests, and retailers seeking to maximize profit and convenience for customers. Unfortunately, both groups have tended to believe that those two goals are mutually exclusive when they are, in fact, totally congruent. Traditional parking ratios have generally been based on attempts to model the need for parking based on the assumption that it must always accommodate the highest or peak parking demand. Government agencies did not want traffic and on-street parking to become an issue on peak demand days and retailers did not want to turn away customers. Those ideas have evolved over time, and recently, in some cases, have been turned on their heads. Retailers particularly have begun to consider the marginal costs of providing each space versus the likelihood of turning away a customer due to lack of parking.

Those involved in the design of shopping centers have postulated for years that parking demands may be more "art" than "science," but modern methods of studying parking use have greatly improved our ability to get it right.

Mixing It Up

One major factor affecting the parking equation is the rise of mixed-use centers, especially when they serve as community hubs. Consider the case of the former Sunnyvale Town Center, which opened in 1979 in Sunnyvale, CA, and was demolished in 2007. A very typical urban mall of its time, this two-level center had three anchor stores and a parking ratio of approximately five parking spaces per thousand square feet of building area (a 5.0 ratio) provided by a network of parking garages. In total it encompassed approximately 400,000 square feet of

continued on page 2

In This Issue

In the Spotlight

continued from page 1

exchange for the deed. Thus, when drafting an assignment clause, it is important to be clear that "no party may assign its rights or delegate its duties" under the agreement of sale.

This is especially important because if the anti-assignment clause is vague, or even silent, courts are likely to enforce or permit assignability, as the law in this area favors the free assignability of parties' interests absent a clear restriction.

It is also important to keep in mind that even a properly drafted anti-assignment clause cannot prohibit an involuntary assignment required or mandated by law, such as an assignment in connection with a bankruptcy filing.

Violation of the Prohibition

Now that we know what to include in an anti-assignment clause, what happens when a party assigns anyway? A buyer cannot assign an agreement of sale when the anti-assignment clause is drafted properly, correct? Well, it depends. If the clause states that "no party may assign its rights or delegate its duties" and the buyer assigns the agreement of sale anyway, while the seller likely can put the buyer in default, the assignment still takes place. In this event, it becomes up to a seller to decide whether to enforce the agreement of sale by utilizing the default clause, possibly triggering the termination of the deal and perhaps collecting monetary damages (usually the amount of the earnest money down payment). However, presuming that most sellers' goals are to close title, obtain the sale price and walk away, termination of the agreement of sale will not make a seller whole. In the end, while the seller may be stuck with a buyer it did not want or with a flip it tried to prevent, allowing the assignment (even though it violates the agreement) might be favorable. The seller will need to decide whether to waive the default and close with this new buyer or lose its deal.

To further complicate matters, even if the seller decides to put the buyer in default, terminate the agreement of sale and collect damages, the buyer would still have a strong argument that the seller is not entitled to damages because the seller's damages are difficult to prove. If the assuming buyer can pay the identical purchase price and perform in the same fashion as the assigning buyer, how is the seller harmed? The seller could argue that it may be losing out on a higher "flipped" assignment purchase price, but the seller was willing to sell for the contract price in the first place.

Fortunately, a seller's attorney can avoid this drafting pitfall by inserting the following language at the end of its non-assignment clause: "No party may assign any of its rights or delegate any of its duties under this Agreement. Any assignment or delegation in violation of this section shall be automatically void." With this language, the assignment in violation of the agreement of sale never takes place and the original buyer remains the liable and active party to the agreement of sale.

But what if the original buyer cannot perform? What if the buyer was going to default and could avoid such default only by assigning to a third party? Since it may be in a seller's best interest to prevent a default by a buyer in order to effectuate a closing of title, a seller may condone the assignment, notwithstanding the violation of the agreement of sale. Thus, a knowledgeable drafter would make sure that the clause gave the seller the power to decide whether the assignment would be void or valid by adding: "No party may assign any of its rights or delegate any of its duties under this Agreement. The Seller may, in its sole discretion, deem any assignment or delegation by a buyer in violation of this section to be automatically void."

Carve-outs to an Anti-assignment Clause

Most agreements of sale include buyer carve-outs where a buyer can assign the agreement in certain events or under certain circumstances. Typical carve-outs include: assignments to related parties such as parents, subsidiaries, affiliates or merged entities; assignments to entities within which a certain individual (sometimes the original buyer or the individual most affiliated with the original buyer) will control, manage or hold an interest in the new entity; and assignments that are subject to the seller's consent. As a buyer's attorney, it is important to try to obtain numerous carve-outs to give the client as many options as possible to purchase the property. In the event a buyer decides to assign the agreement of sale to an unrelated third party, a buyer can look to these carve-outs for any possible loopholes.

If the agreement of sale permits assignments to any entity that Johnny Assignment controls, manages or holds an interest, and Johnny Assignment wants to assign to an unrelated third party, he now has some options. Perhaps Johnny can become a co-manager of the assuming buying entity in its operating agreement for a limited time, or perhaps Johnny can invest a small portion in the deal and purchase a .05% interest in the assuming buying entity. While neither of these options is ideal for a buyer, they do provide beneficial loopholes.

So how can a seller's attorney best close the loop holes? The attorney needs to limit these carve-outs as much as possible. Language such as "assignments to entities within which Johnny Assignment will be the sole manager or will hold at least a fifty percent interest in" should be negotiated.

continued on page 6

Melanie J. Scroble is a partner at Ansell, Grimm & Aaron P.C., Clifton, NJ. Ms. Scroble's practice mainly consists of commercial real estate matters, with an emphasis on shopping centers and retail pads with "big box" tenants. She has extensive experience in drafting and negotiating purchase and sale agreements and leases. E-mail: mjs@ansellgrimm.com.

In the Spotlight

continued from page 5

Thus, very restrictive carve-outs will close all loopholes so the original buyer cannot assign the agreement of sale? Well, not quite. Another way for a buyer to circumvent the anti-assignment clause is for the original buying entity to remain as the buyer under the agreement of sale, but to sell all of its membership interest or the like to the assuming third party. In that event, the buyer would not be technically violating the anti-assignment clause, but would effectively be achieving the same end. This loophole will work only in certain situations, and is easier to accomplish when the original buying entity is a newly formed single-purpose entity or owned solely by one individual or entity. Therefore, when representing the buyer, it might make sense to form a new entity to be the original purchaser, just in case the buyer wishes or needs to assign later and this is the only assignment loophole available.

Seller's Consent

Assignments that are subject to a seller's consent have been interpreted in various different ways depending on the language of the clause. The first question to ask is, is the seller's consent a condition precedent to the validity of the assignment? In this event, if the seller's consent is not obtained, the assignment does not take place. Or is the seller's consent a personal covenant that a buyer promises to obtain? In this event, if the seller's consent is not obtained, the assignment takes place in violation of the terms of the agreement, which could trigger a buyer default. To make sure that courts interpret the consent requirement to be a condition precedent, the drafter should use terms such as "any assignment without the Seller's consent shall be void" or "The Seller's consent is a condition precedent to any assignment."

If an assignment is subject to a seller's consent, when can a seller withhold consent? The seller's attorney should try to insert language in this clause to make the seller's decision as to whether to consent to an assignment to be in its sole discretion. The buyer's attorney, on the other hand, should try to insert language in this clause to make the seller's decision subject to a reasonableness and a time standard, such as "not to be unreasonably withheld or delayed." In some states, a reasonableness standard automatically applies, even when the language "in its sole discretion" is utilized, and in most cases, courts will require sellers to act in good faith notwithstanding the wording of the contract.

Also, does a seller's consent have to be in writing? If it is not specifically set forth in the clause that the seller's consent has to be in writing, some buyers have argued that the seller gave its consent in the course of fair dealings by interacting with the new buyer or having discussions or communications about the possibility of assigning the agreement of sale at some point during negotiations. To avoid this situation, a seller's attorney should be sure to include language that "consent can be granted only in a writing signed by the seller."

When the standard for a seller's consent is based upon reasonableness, what is "reasonable"? Some determinations regarding whether a seller is making a reasonable decision include the financial strength of the assuming buyer and its business reputation. If an assuming buyer has the equity to perform, it would be difficult for a seller to argue that withholding its consent to the assignment is reasonable. In most cases, the only performance required by the buyer is to pay the purchase price and assume any leases. If there are particular concerns about any sale for a seller, a seller's attorney should set forth specific standards of reasonableness so that it is clear that a seller can reject an assignment based upon such things as prior bad dealings or another circumstance that is not necessarily tied to the financial strength of the new buyer. Otherwise, if the new buyer can pay, it is difficult for a seller to justify withholding consent.

For a buyer's attorney, obtaining the reasonable-standard language puts the buyer in a good position. Another effective way to limit a seller's decision power is to enforce a time standard. A buyer can be general and require that consent not be "unreasonably delayed" or more specific and require that if the seller does not grant or withhold consent within a specific time frame, the consent shall be deemed granted. Since time is of the essence in many real estate deals, the time frame should be as brief as possible.

Other Considerations

Courts look not only at the assignment clause, but at the entire agreement of sale to determine the parties' intentions. Does the title page, after the buyer's name, include "and its assigns"? Does the conveyance document clause or the forms of conveyance documents attached to the agreement of sale as exhibits, name the original buyer or is there any mention of "assigns"? In all these instances, the attorneys need to make clear the buyer's or seller's intentions and tie them back to the negotiated assignment clause. If the assignment clause properly prohibits assignments, but includes language throughout the agreement referring to a buyer's assigns, confusion arises, providing the potential for assignability loopholes.

Conclusion

While there are many drafting tips that attorneys for sellers and buyers can utilize, the one common thread in the legal history of the assignment clause is that there is no standard language that will resolve every single consideration regarding the assignment clause. The themes that are universal seem to be that it is difficult for sellers to prohibit assignments; that less is never more when it comes to this clause; and that the drafting attorneys have their work cut out for them.

—❖—