

Question 4

Lori owns a small shopping center. In April 1999, Lori leased a store to Tony. Under the lease Tony agreed to pay Lori a monthly fixed rent of \$500, plus a percentage of the gross revenue from the store. The lease term was five years. In part the lease provides:

Landlord and Tenant agree for themselves and their successors and assigns:

* * *

4. Tenant has the right to renew this lease for an additional term of five years, on the same terms, by giving Landlord written notice during the last year of the lease.
5. Tenant will operate a gift and greeting-card store only. Landlord will not allow any other gift or greeting-card store in the center.

* * *

In July 2000, Tony transferred his interest in the lease in writing to Ann. Ann continued to operate the store and pay rent.

In February 2003, a drugstore in the shopping center put in a small rack of greeting cards. Ann promptly complained, but Lori did nothing.

Beginning in March 2003, Ann stopped paying the percentage rent, but continued to pay the fixed rent alone. Lori took no action except to send a letter in April 2003 requesting payment of the percentage rent that was due.

In January 2004, Ann sent a letter to Lori requesting that Lori renew the lease according to its terms. Lori denied that she had any obligation to renew.

1. Is Ann entitled to a renewal of the lease? Discuss.
2. Is Lori entitled to the past-due percentage rent from:
 - a. Ann? Discuss.
 - b. Tony? Discuss.

Answer A to Question 4

Ann's Right to Renew the Lease

Statute of Frauds

The statute of frauds requires that a lease for possession of property for longer than one year must be evidenced by a writing, signed by the party to be charged. Here, the lease was for a period of 5 years. So to be enforceable it must comply with the statute of frauds. The facts imply that a written lease was drawn and the lease stated the amount of rent[,] the lease term, a right to renew, and a restriction on landlord[']s lease to a competitor and tenant[']s type of use. The Statute of Frauds has been met.

Sublease vs. Assignment

When a lessee purports to transfer less than its entire term, or entire rights and remedies under a lease, the resultant transferee shall be considered a sublessee and the transfer shall be considered a sublease. In this case, the sublessee would not be considered a successor or assignee of the original lessee and would not be in privity of contract with the landlord. Thus, a sublessee may not enforce lessee's rights under the original lease, against the landlord. Conversely, a landlord may not enforce its right to collect rent from a sublessee.

The facts indicate simply that "Tony transferred his interest in the lease in writing to Ann". Because this transfer was in writing, the Statute of Frauds is satisfied. Because it appears that Tony's entire interest in the lease was transferred to Ann, Ann's is an assignee and the transfer shall be considered as assignment.

Does the covenant for tenant's right to renew the lease for an additional five years, on the same terms, by giving landlord written notice during the last year of the lease run with the land?

In order for Ann to be able to enforce her right to renew the lease, she will need to establish that the covenant runs with the land. A covenant is said to run with the land when four criteria are met:

1. The original parties intended that future takers be bound.

Here, the express terms of the lease state "landlord and tenant agree for themselves and their successors and assigns". This language clearly indicates that landlord and tenant intended their successors to be bound.

2. The successor must have knowledge of the covenant.

Ann has actual knowledge of the covenant as it is expressly stated in the original lease and she is seeking to enforce the covenant.

3. There must be horizontal and vertical privity between the parties.

Ann is in horizontal and vertical privity of estate with landlord by virtue of the assignment from Tony, thus, this criterion is met.

4. The covenant must “touch and concern” the land.

A covenant will be held to touch and concern the land if it burdens the land. Here, a 5 year possessory interest in the demised premises, touches and concerns the land.

Because the covenant to renew the lease “runs with the land,” unless Ann is in material breach of the lease, she will be entitled to enforce the covenant upon her satisfaction of the “notice during the last year of the lease” requirement. Ann gave written notice to Landlord (Lori), in January of 2004, the last year of the lease. She has met this requirement & is entitled to renew the lease. (She may have waived the non-competition covenant and the renewed lease may not include this covenant - see below.)

[2a.] Did Ann’s failure to pay the percentage rent constitute a material breach of the lease, discharging Lori’s duties under the lease and permit Lori to collect the percentage rent from Ann?

The facts indicate that begin[n]ing in March 2003, Ann stopped paying the percentage rent. Lori took no action except to send a letter requesting payment of the percentage rent. The covenant to pay percentage rent is enforceable against Ann by Lori since this covenant “runs with the land” (supra). Ann will argue that Lori’s breach of the restriction on leasing space to a competitor discharged her duty to pay percentage rent. At common law, the duty to pay rent was held to be an “independent covenant” and was not discharged by a breach of the landlord in regard to improvements on real property. The modern trend is to find that the covenants under a lease for real property are mutually dependant. If Ann can prove that the landlord’s (Lori[’s]) breach of the covenant “not to rent to a competitor” gave rise to a claim that the amounts of rent she withheld comprised a reasonable “set off” of damages from Lori’s breach, her failure to pay the percentage rent may be discharged.

_____ Waiver:

Ann will also argue that Lori’s failure to enforce the percentage rent constituted a “waiver” which Ann then reasonably relied upon to continue her tenancy without paying percentage rent. The facts indicate that Lori’s only response to Ann’s failure to pay

percentage rent was to write one letter requesting rent in April 2003. On these facts, Lori may have waived the covenant to collect percentage rent.

Conversely, Lori may argue that Ann waived the covenant to not to [sic] lease to a competitor greeting card store by merely complaining in February 2003 and then taking no further action under the lease. If Ann would have claimed that Lori's breach of the covenant caused her business to be economically impacted to the point where she had to close shop, she might be able to present an argument for "constructive eviction". Since this did not occur, Ann may have waived her right to enforce the covenant.

Therefore, while the right in Lori to collect percentage rent from Ann may have arisen under the lease, as this covenant "ran with the land", a court might not enforce this covenant against Ann based upon the "mutually dependent" nature of this covenant with Lori's duty not to lease to a competitor, which Lori breached. In the alternative, a court may find that both parties waived their rights to enforce the respective covenants. It should be noted that as Tony's assignee, under the lease, Ann could raise any of Tony's rights and defenses against Lori - provided the covenants run with the land, as they do here.

[2b.] Lori vs. Tony:

Lori's right to collect past due percentage rent.

The assignment of Tony's interest in the lease to Ann did not discharge Tony's duties under the lease. In the facts presented Tony will remain in "privity of contract" with Lori and will therefore be bound by the contractual duties imposed by the lease. The proper method for Tony to have discharged his liability under this contract would have been for Tony & Lori to effect a novation of the contract. A novation occurs when the two parties agree to substitute in a stranger, in this case Ann, and discharge the original party to the contract. No novation occurred in the facts presented. Tony remains liable for the past due percentage rent owed to Lori, subject to the defenses which Ann could have raised, waiver, breach of mutually dependent covenant. For the reasons stated above, Tony will be subject to a claim for unpaid percentage rent based on his contractual liability to Lori, but he will likely be able to successfully defend this claim as set forth above.

Answer B to Question 4

4)

1. Lori's obligation to renew the lease

Validity of the Assignment

The first issue in this case is whether a valid contract exists between Lori and Ann. A lessee may assign his interest in a rental property to a third party unless the lease expressly forbids it. In this case, the lease between Lori and Tony did not forbid an assignment. Therefore, Tony had the right under the contract to assign his interest in the lease to Ann, and a valid contract existed between Lori and Ann. Furthermore, Lori accepted rent from Ann, which further indicates that the assignment was valid.

Terms of the Lease

The second issue is whether Ann has a right under the contract to enforce the provision in the lease that Tenant has the right to renew the lease for an additional term of five years on the same terms by giving the landlord notice. Under the terms of the contract, Ann will argue that Tony agreed for himself and his assigns (Ann) to the term of the lease allowing Ann to renew. Therefore, Ann would have the right to renew the lease, as long as she was not in breach of contract.

Lori would argue that there is no privity of contract between herself and Ann. The contract that Tony made with Ann was not expressly assumed by Lori. Therefore, any covenants that do not run with the land are not binding between Ann and Lori, because there is no privity of contract between them. Lori will further argue that the term of the lease requiring Lori to allow the tenant to renew does not run with the land: there is nothing about the agreement to allow the renewal that touches and concerns the property. Therefore, Lori will argue that her promise to Tony is not binding. However, because the terms of the contract are specifically binding on Tony's successors and assigns, Lori will lose this argument. Under the terms of the original contract, Ann is entitled to renew the lease.

Lori will further argue that Ann breached her covenant to pay rent. The duty to pay rent is an obligation that runs with the land: Ann is in privity of estate with Lori, and her failure to pay rent constitutes a material breach of the contract. Though Lori chose not to evict Ann for her failure to pay rent, she could evict her any time and may refuse to renew the lease at the end of the term.

Ann will will [sic] argue that the duty to pay rent in the form of the percentage check has been excused by Lori's breach of contract. The contract contained a provision that Lori would not allow any other gift or greeting card store in the center. Ann can correctly argue that that [sic] a restriction of this type is a covenant that runs with the land: The restriction

touches and concerns the leased property, because it has the effect of making Ann's gift store more valuable. Furthermore, as mentioned above, the contract expressly states that the covenants in the lease would be binding upon each party's assignees, and Ann as Tony's assignee, can sue under the terms of the contract.

The next issue is whether Lori's decision to allow the drug store to put up a small rack of greeting cards constituted a breach sufficient to allow Ann to stop paying the rent. If Lori's decision constituted a material breach, Ann would be excused from her duty to pay rent. Because Lori would be in breach, Ann could suspend her performance of her rent obligations. Furthermore, as the non-breaching party, she would be entitled to renew the lease under the terms of the agreement between the parties. However, Lori did not breach the terms of the contract. The facts indicate that the contract required Lori not to allow "any other gift or greeting-card store in the center." The facts indicate that the store that sold the cards was a drug store, and that the cards it sold were contained on one small rack. Therefore, under the terms of the contract, Lori will be successfully be [sic] able to show that she was not in breach of the contract. Because Lori did not breach the contract with Ann, Ann was not relieved of her obligation to pay the percentage rent. Ann's material breach of contract, her failure to pay the percentage rent, excused Lori from her obligation under the contract to renew the terms of the lease according to Ann's request.

In the alternative, Lori will argue that even if her decision not to stop the drug store from selling greeting cards did constitute a breach of contract, the breach was minor. A material breach occurs when one party fails to pe[r]form in such a way that the value of the contract is substantially destroyed. Ann may argue that allowing even one card rack in one other store expressly breached the lease and should therefore be considered material. However, Ann will lose this argument: the facts indicate that the drug store primarily sold other things, and that it carried one small rack of card[s]. Allowing the drug store to sell card[s] did not substantially impair the value of the contract for Ann. Therefore, if a breach occurred at all, it was a minor breach. A minor breach does not excuse the other party from performing its obligations under the contract. In this case, Ann had no right to cease paying the percentage rent, because the breach was minor. On the other hand, the failure to pay the full amount of rent owed constituted a material breach, and Lori would have been entitled to evict Ann or sue for damages. Lori's rights concerning the rent itself are more fully discussed below: with regards to the obligation to renew the contract, Lori was excused because of Ann's material breach.

2. The Past Rent

Ann's Obligations

The next issue is whether Lori is entitled to recover for the percentage rent from Ann. As mentioned above, because the covenant to pay rent runs with the land, and because the contract expressly states that the obligations of the lease would be bi[n]ding on assignees such as Ann, Ann was obligated to pay rent. For the reasons discussed above, she will

lose her argument that Lori breached the contract.

Ann's duty to pay rent is a covenant that runs with the land. Since Ann is the tenant in possession of the property, she is in privity of estate with the [sic] Lori. Lori may sue Ann to recover for the value of the rent that she is owed.

Ann may try to argue that Lori is estopped from suing her for the rent. She will argue that, although Lori requested the rent, she allowed Ann to continue occupying the premises for 8 months after requesting the percentage rent. She will argue that Lori's acceptance of the rent constituted a waiver of her right to collect the percentage rent. However, Ann will lose this argument as well. Although Lori had the option of evicting Ann and suing for the rent, she also had the option of letting Ann stay and suing for damages. Ann's obligation to pay rent has therefore not been discharged. Lori clearly did not waive this right, because she sent Ann a letter requesting the percentage rent to be paid.

Tony's Obligation

The next issue is whether Lori may sue Tony to recover the percentage rent that Ann has not paid. The rule is that when two parties sign a contract, and one party assigns its interests in the contract to a third party, the assignor remains liable to the obligee on the original contract. The landlord may collect rent from any party with whom she is in privity of contract or privity of estate.

In this case, Tony and Lori signed the original contract. Tony assigned his interests to Ann. As an assignor, Tony is not relieved of his duty to ensure that the contract is fully performed. Lori may sue Tony for his obligation to pay rent and to pay the percentage of revenues that the store [sic] earned. Tony will have the same defenses available to him that Ann had: he can argue that Lori was in breach and that this breach relieved Ann of her duties to pay. However, for the reasons discussed above, these defenses will not be successful. Because Ann remains liable for the percentage rent, Tony is also liable.