No. 199

CPS Operating Company LLC,
Appellant,
v.
Pathmark Stores, Inc.,
Respondent.

Y. David Scharf, for appellant.
E. Leo Milonas, for respondent.

SMITH, J.:

We interpret a contract to assign a lease of real property, and hold that the risk that the City of New York might not permit the assignment was one that the buyer agreed to take. That risk did not give the buyer an excuse for terminating the contract.

I

The property in question is on the Lower East Side of Manhattan, and was sold by the City for $475,000 in 1981 to the sponsor of an urban renewal project. The agreement between the City and the sponsor, called a Land Distribution Agreement (LDA), contained provisions designed to assure that, for at least 25 years, the land would be used for a Pathmark supermarket. The provision relevant to this case says:

> "The Sponsor represents and agrees that the Disposition Area shall be developed as a supermarket shopping center which Sponsor shall lease for a twenty-five year term to Supermarket General Corporation for operation of a Pathmark Supermarket. The City consents and approves such lease disposition of the Disposition Area, (the 'Pathmark Lease'), provided that until a period of twenty-five (25) years has elapsed following the completion of the improvements comprising the Project, the Sponsor may lease to a Lessee other than Supermarket General Corporation or may permit the sublease of the Pathmark Lease only upon obtaining the prior written approval of [the City] which shall not be unreasonably withheld or delayed."

The parties do not dispute that the "completion of the improvements" occurred in January 1984, so that the restriction would expire in January 2009.

As the LDA contemplated, the project sponsor leased the property to Supermarket General Corporation, now known as Pathmark Stores, Inc., defendant in the present case. The sponsor later transferred the property to Pathmark's present landlord.

By the early twenty-first century, the value of Lower East Side real estate had increased enormously, and Extell Development, Inc., plaintiff's parent, became interested in developing the property for residential use. After negotiations with both the landlord and Pathmark, plaintiff agreed in 2007 to acquire Pathmark's leasehold interest for $87 million. Plaintiff and Pathmark entered into a Leasehold Assignment Contract on August 14, 2007, and plaintiff made a deposit of $5 million, later increased to $6 million in exchange for an extension of the closing date. But after the agreement was signed, the real estate market fell, and plaintiff, finding the deal no longer attractive, terminated the agreement on the eve of closing.

Plaintiff does not dispute that it terminated for economic reasons, but it claims that it was entitled to do so because Pathmark had breached the agreement. Pathmark, denying that it was in breach, kept plaintiff's $6 million deposit, and plaintiff brought this lawsuit to recover it. Pathmark counterclaimed for a declaratory judgment and damages.

Supreme Court denied both parties' motions for summary judgment. Pathmark appealed, and the Appellate Division, with one Justice dissenting, reversed and granted summary judgment dismissing the complaint (CPS Operating Co. LLC v Pathmark Stores, Inc., 76 AD3d 1 [1st Dept 2010]). The Appellate Division granted leave to appeal to this Court on a certified question, and we now affirm.

II

The case turns on whether Pathmark breached the Lease Assignment Contract, thus giving plaintiff a right to terminate it. Plaintiff relies primarily on the following provision of the Contract:

> "Seller [Pathmark] hereby represents and warrants to Buyer [plaintiff], as of the date hereof that: (a) Seller is not prohibited from consummating the transactions contemplated in this Contract, by any . . . agreement, instrument or restriction to which Seller is a party or is bound (other than . . . any . . . Permitted Exceptions) . . . ."

Plaintiff says that Pathmark was "prohibited from consummating" the lease assignment transaction because, under the 1981 LDA, the lease could not be assigned before January 2009 without the City's consent. There may be a number of flaws in this argument -- among them the fact that Pathmark was not a party to the LDA -- but one fatal flaw is enough to dispose of the case: The LDA was one of the "Permitted Exceptions" that were excluded from Pathmark's representation and warranty. Included in the contract's list of "Permitted Exceptions" was: "Terms, Covenants, Conditions, Provisions and Reverter set forth in the Land Disposition Agreement dated as of 6/3/81 . . . ."

Thus, the risk that Pathmark might be "prohibited from consummating" the assignment agreement by the LDA was a risk that plaintiff expressly agreed to take. Perhaps the use of the words "Permitted Exceptions" to describe this risk-shifting is unusual; it may well be correct, as the dissenting Justice in the

Appellate Division said, that "'[p]ermitted exceptions' are generally understood as encumbrances listed in a real property contract that need not be removed by the seller" (76 AD3d at 13). But the words were obviously used in a broader sense here -- the "Permitted Exceptions" are expressly excluded from Pathmark's representation and warranty that it was free to close the deal. The risk that an objection from the City would prevent the closing, or require rescission, may have been thought a small one: we see no obvious reason why the City would not have consented to an assignment for residential development, particularly when the restriction, assuming it to be binding, had only a year and a half to run anyway. But however great or small the risk, plaintiff took it.

Contrary to the suggestion made by plaintiff and the Appellate Division dissent, this allocation of risk did not violate public policy. We may assume for present purposes that, at least until January 2009, there could be no transfer and no residential development without City approval. No public policy prohibited plaintiff from agreeing, as it did, but this was plaintiff's problem and not Pathmark's -- that, if the City thwarted the transaction, Pathmark could still retain plaintiff's deposit, and plaintiff would be in breach for failure to close.

Plaintiff's remaining argument is without merit.

Accordingly, the order of the Appellate Division should be affirmed, with costs. The certified question should be

answered in the affirmative.

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Order affirmed, with costs, and certified question answered in the affirmative. Opinion by Judge Smith. Chief Judge Lippman and Judges Ciparick, Graffeo, Read, Pigott and Jones concur.

Decided November 15, 2011