IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

216 JAMAICA AVENUE, LLC,	)	Civil Action No. 06-1288
Plaintiff,	)	(Judge Boyko)
v.	)	
S & R PLAYHOUSE REALTY CO.,	)	
Defendant.	)	

MEMORANDUM IN SUPPORT OF MOTION OF PLAINTIFF 216 JAMAICA AVENUE LLC FOR SUMMARY JUDGMENT

James B. Niehaus (0020128)
jniehaus@frantzward.com
Christopher G. Keim (0067117)
ckeim@frantzward.com
FRANTZ WARD LLP
2500 Key Center
127 Public Square
Cleveland, Ohio 44114-1230
216-515-1660
216-515-1650 (fax)

Charles J. Cooper
ccooper@cooperkirk.com
David H. Thompson
dthompson@cooperkirk.com
David Lehn
dlehn@cooperkirk.com
COOPER & KIRK, PLLC
555 Eleventh Street NW
Suite 750
Washington, DC 20004
(202) 220-9600
(202) 220-9601 (fax)

Attorneys for Plaintiff

October 12, 2006

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Cases **Page**

Other

INTRODUCTION

In 1912, the Realty Investment Company leased a prime parcel of land situated at 1228 Euclid Avenue in downtown Cleveland, Ohio, to the Halle brothers so that they could expand their burgeoning department store (the "Lease").[1] Because the Lease ran for 99 years and included an option to renew for up to another 99 years, the Realty Investment Company understandably insisted upon inclusion of a standard "gold clause" to protect its rental income against inflation. The gold clause, in effect, indexes the rent amount to the price of gold by specifying that the annual rent at $35,000 "shall be paid in gold coin of the United States of the present standard of weight and fineness." Lease at 2.

This clause might seem esoteric today, but "[p]rior to the Depression," before there were sophisticated gauges of inflation such as the Consumer Price Index, "long-term leases often included gold clauses such as this to protect the lessor against inflation." *Trostel v. American Life & Cas. Ins. Co.*, 168 F.3d 1105, 1106-07 (8th Cir. 1999); STANLEY L. MCMICHAEL, LONG AND SHORT TERM LEASEHOLDS 54 (Cleveland, Ohio, 3d ed. 1925) ("Most leases specify that rental shall be paid in 'gold or its equivalent value' . . . ."). As the Supreme Court recognized when such provisions were common, a "contract to pay a certain sum in gold and silver coin is, in substance and legal effect, a contract to deliver a certain weight of gold and silver of a certain fineness, to be ascertained by count." *Butler v. Horwitz*, 74 U.S. 258, 260 (1869). By including this clause, the parties to the Lease were agreeing that the annual rent was 35,000 gold coin dollars as defined in 1912. Thus, as the real value of a dollar of paper currency declined and the value of an ounce of gold increased accordingly over the next 99 to 198 years, the gold clause would protect the lessor against inflation.

[1] Attached as Exhibit A is a copy of Exhibit A of the Complaint, which is a true, correct, and authentic copy of the Lease. Parties' First Submission of Joint Stipulated Facts ¶ 4.

In an attempt to stabilize the economy during the Great Depression, Congress suspended the operation of all gold clauses by Joint Resolution in 1933. The Joint Resolution permitted an obligor to discharge its gold-coin obligation by paying the "dollar for dollar" amount of the obligation. Under the Lease, that meant paying $35,000 in paper currency rather than 35,000 gold coin dollars as defined in 1912. Obviously, landlords with long-term leases containing gold clauses were exposed to the ravages of inflation, but tenants, such as the Halle brothers' successors-in-interest, enjoyed an enormous windfall.

In 1977, Congress amended the Joint Resolution to permit the use of gold clauses in any "obligation" that "issued" after October 27, 1977. Since then, federal and state courts have uniformly held that a post-October 27, 1977, novation of a lease containing a gold clause that had been rendered dormant by the Joint Resolution in 1933 revives the gold clause so that it is valid and enforceable against the lessee. Courts have also recognized that a dormant gold clause could be revived in other ways, such as by a modification and reaffirmation of the original lease.

In May 1982, the Halle brothers' successor-in-interest assigned the Lease to defendant, S & R Playhouse Realty Company. As required by the Lease as a condition of assignment, S & R "assume[d] and agree[d] to perform *each and all* of the covenants, obligations, and engagements of the Assignor and lessee under said Lease." 1982 Assignment and Assumption at 2 (emphasis added).[2] Obviously, the rental payment, including the gold clause, was one of the "obligations" of the Lease. Through this transaction, the parties effected a novation of the original Lease. Consequently, the Lease's gold clause has been valid and enforceable against S & R since May 1982. And quite apart from this novation of the Lease, the gold clause issued

[2] Attached as Exhibit B is a copy of Exhibit C of the Complaint, which is a true, correct, and authentic copy of the 1982 Assignment and Assumption. Parties' First Submission of Joint Stipulated Facts ¶ 4.

upon the May 1982 Assignment and Assumption for two other reasons: by assuming all obligations under the Lease, S & R came into privity of contract with the lessor; and by taking possession of the leasehold, S & R came into privity of estate with the lessor.

Nonetheless, S & R has paid only the "dollar for dollar" rent—$35,000 in currency—since becoming lessee, in breach of the Lease. S & R has continued to so breach the Lease since plaintiff, 216 Jamaica Avenue, LLC, purchased the underlying property and became lessor in February 2006. Because S & R subleases the building on the premises for office purposes at current market rates, it has reaped an enormous windfall over the past 24 years. The Court should grant summary judgment to plaintiff, finding that S & R is obligated to pay plaintiff 35,000 gold coin dollars as defined in 1912 (or its current equivalent in paper currency) per year and that, by paying the "dollar for dollar" amount, S & R has breached the lease.

STATEMENT OF FACTS

On March 15, 1912, the Realty Investment Company agreed to lease to the Halle brothers a parcel situated at 1228 Euclid Avenue. The Lease term runs for 99 years, from April 1, 1912, to March 31, 2011, with an option to renew for 25, 50, or 99 years. Lease at 5. The Lease provides that the annual rent would begin at $10,000 and escalate to $35,000 in the eleventh year and thereafter, including any renewal period. Rent is due on the first day of April, July, October, and January. The Lease also provides that "[a]ll of said rents shall be paid in gold coin of the United States of the present standard of weight and fineness" (the "gold clause"). Lease at 2.

The standard of weight and fineness of gold coin that prevailed in 1912 was defined by the Gold Standard Act of 1900, which provided that "the dollar consisting of twenty-five and eight-tenths grains of gold nine-tenths fine . . . shall be the standard unit of value" for all gold coins of the United States. Gold Standard Act, ch. 41, § 1, 31 Stat. 45, 45 (1900). Given this

standard, the Lease in effect obligates the lessee to pay 1,693 ounces of pure gold every year, whether in 1922, 2006, or 2110.[3] As the real value of a dollar of currency declines and the value of an ounce of gold increases accordingly over time, the real value of the rent owed under the Lease remains roughly constant, thereby protecting the lessor against inflation. Thus, whereas 1,693 ounces of gold had a value in 1912 of $35,000, its current value is roughly $1 million.[4]

As described above, gold clauses were unenforceable from 1933 to 1977. But in 1977, Congress amended the Joint Resolution to authorize the use of gold clauses. Pub. L. No. 95-147, § 4(c), 91 Stat. 1227, 1229 (1977). The amended Joint Resolution provides: "An obligation issued containing a gold clause or governed by a gold clause is discharged on payment (dollar for dollar) in United States coin or currency that is legal tender at the time of payment. *This paragraph does not apply to an obligation issued after October 27, 1977*." 31 U.S.C. § 5118(d)(2) (emphasis added). Thus, gold clauses that issue after October 27, 1977, are valid and enforceable. On May 21, 1982, the Halle brothers' successor-in-interest under the Lease conveyed its interest to S & R (the "1982 Assignment and Assumption"). Yet, S & R has been paying only the face amount of $35,000 since becoming the lessee in 1982. First Submission of Joint Stipulated Facts ¶ 3 ("Stipulations"). For its April 1, July 1, and October 1, 2006, quarterly payments, S & R tendered $8,750, which plaintiff rejected. *See* Stipulations ¶ 3. By paying only the face amount of rent, in breach of the gold clause, S & R has reaped an enormous windfall by

[3] One gold coin dollar in 1912 contained 23.22 grains of pure gold, or 9/10ths of the coin's total weight of 25.80 grains. Consequently, paying $35,000 in gold coin was tantamount to paying 812,700 grains of pure gold, that is, 35,000 multiplied by 23.22. Because there are 480 grains of gold in an ounce, the gold clause "in substance and legal effect," *Butler*, 74 U.S. at 260, requires the lessee to pay 1,693.125 ounces of gold per year, or 812,700 divided by 480. The same result can be obtained through the shortcut of dividing the annual rent in gold coin dollars, or 35,000, by the price of gold in 1912, or $20.671835 per ounce, which yields 1,693.1249 ounces per year. *See Trostel*, 168 F.3d 1108-09.

[4] The closing market price of gold on October 11, 2006, was $574.50 per ounce. *See* http://www.kitco.com/charts/historicalgold.html.

charging its subtenants rents that reflect the property's market value in 2006, but paying plaintiff rent that reflects only the property's value in 1912.

SUMMARY OF ARGUMENT

As demonstrated below, the obligation to pay in gold became binding on S&R in 1982 for three separate reasons, each of which is sufficient to have revived the gold clause against S & R. First, the transaction as a whole created a novation of the lease. Second, S & R's assumption of "each and all" of the obligations under the Lease brought it into privity of contract with the lessor. Third, S & R's possession of the leasehold brought it into privity of estate with the lessor. Thus, the gold clause is now a valid and enforceable obligation against S & R.

ARGUMENT

I. The Lease Sets the Rent Amount at 1,693 Ounces of Pure Gold per Year.

There is simply no room for doubt about the gold clause's purpose. The Supreme Court and other courts have repeatedly made clear that such clauses were designed to hedge inflation. For example, in *Perry v. United States*, a $10,000 government bond stated, just like the Lease here, that "[t]he principal and interest hereof are payable in United States gold coin of the present standard of value." 294 U.S. 330, 347 (1935) (quotation marks omitted). The Supreme Court held that "[t]he '*present* standard of value' stood in contradistinction to a *lower* standard of value. . . . We think that the reasonable import of the promise is that it was intended to assure one who lent his money to the Government and took its bond that he would not suffer loss through depreciation in the medium of payment." *Id*. at 348-49.[5]

[5] *See also Guaranty Trust Co. v. Henwood*, 307 U.S. 247, 257 (1939) (Gold clauses "afford creditors . . . protection against possible depreciation of United States money."); *Norman v. Baltimore & O.R. Co.*, 294 U.S. 240, 302 (1935) ("We also think that, fairly construed, these clauses were intended to afford a definite standard or measure of value, and thus to protect against a depreciation of the currency and against the discharge of the obligation by a payment of

Nor is there room for doubt about the gold clause's effect. Just like the Lease here, the 1917 lease interpreted by the Eighth Circuit in *Trostel* set the rent at $23,000 per year and then provided that "all payments under this lease shall be made in gold coin of the United States of America, of or equal to the present standard of weight and fineness," *Trostel v. American Life & Casualty Ins. Co.*, 92 F.3d 736, 738 (8th Cir. 1996). The Eighth Circuit declared that "[t]he only way for the gold clause to serve its function to protect the lessors against inflation is to use the 1917 value of gold." 168 F.3d at 1108-09. Thus, the Eighth Circuit held that the monthly rent, whether due in 1917 or 1998, was 92.72 ounces of pure gold, which was the amount of gold contained in 23,000 gold coin dollars in 1917.[6] *Id*. Other courts have consistently adopted this interpretation of similar gold clauses.[7]

---

lesser value than that prescribed."); *Butler*, 74 U.S. at 59 ("The obvious intent of the contract now before us was to secure payment of a certain rent in gold and silver, and thereby avoid the fluctuations to which the currency of the country . . . had been subject, and also all future fluctuations incident to arbitrary or uncertain measures of value . . . ."); *Trostel*, 168 F.3d at 1106-07 ("Prior to the Depression, long-term leases often included gold clauses such as this to protect the lessor against inflation."); *Fay Corp. v. BAT Holdings I, Inc.*, 646 F. Supp. 946, 948 (W.D. Wash. 1986) (same); *Wells Fargo Bank, N.A. v. Bank of Am.*, 38 Cal. Rptr. 2d 521, 523 (Cal. Ct. App. 1995) (same); *Equitable Life Assurance Soc'y v. Grosvenor*, 426 F. Supp. 67, 72 (W.D. Tenn. 1976) ("gold clause" "us[es] gold as an index of value to measure obligations"), *aff'd*, 582 F.2d 1279 (6th Cir. 1978).

[6] 23,000 gold dollar coins multiplied by 23.22 grains of pure gold per coin equals 534,060 grains of gold per year; 534,060 grains divided by 480 grains per ounce equals 1,112.625 ounces of gold; 1,112.625 ounces divided by 12 months equals 92.718 ounces of gold per month. The shortcut described in footnote 3 confirms the result: the annual rent in gold coin dollars, 23,000, divided by the price of gold in 1917, $20.671835 per ounce, equals 1,112.6249 ounces per year.

[7] *See Fay Corp. v. BAT Holdings I, Inc.*, 682 F. Supp. 1116, 1118 (W.D. Wash. 1988) (where 1929 lease set rent at $100,000 per year, clause providing that rent be paid " 'in lawful gold coin of the United States of America of the present standard of weight and fineness' " constituted a "gold clause" such that by paying only the face amount of rent, the lessee had received a "windfall" and had caused the lessor to "receive[] considerably less per month than it would have been entitled to under the gold clause in the lease"), *aff'd*, 896 F.2d 1227 (9th Cir. 1990); *Nebel, Inc. v. Mid-City Nat'l Bank*, 769 N.E.2d 45, 47, 54 (Ill. App. Ct. 2002) (following *Trostel*, holding that "the language and purpose of the gold clause supports using the 1906 value of gold to calculate the lease payments at issue").

In the face of this precedent, S & R has argued that the presence of an escalator in the first 10 years of the Lease negates the gold clause. Memorandum in Support of Defendant's Motion to Dismiss ("Def.'s Mot. to Dismiss") at 4. The Lease escalates the annual rent from $10,000 in the first year to $35,000 in the eleventh year and thereafter. But if the rent escalation were intended to guard against inflation, it would do a particularly bad job of it because the escalation would reflect the assumption that inflation, after the first 10 years, would be *0 percent over the next 188 years*. Not surprisingly, courts have concluded uniformly that a lease's gold clause functioned as an anti-inflationary measure even in the face of a separate rent escalator. Much like the Lease here, the lease considered by the Eighth Circuit in *Trostel* "set the amount of annual rent at $12,000 for the first five years of the lease, $15,000 for the next 49 years, and $18,000 for the remaining 45 years," yet, as noted above, the Eighth Circuit found that the gold clause protected the lessors against inflation by tying the rent to the value of gold at the time the lease was executed. *Trostel*, 92 F.3d at 738; *Trostel*, 168 F.3d at 1108-09. And under the lease considered in *Nebel, Inc. v. Mid-City Nat'l Bank of Chicago*, "[m]onthly rent for the subject premises during the first five years was $1,090 and, thereafter, $1,333.33 and 1/3 cents." 769 N.E.2d 45, 46-47 (Ill. App. Ct. 2002). Guided by *Trostel*, however, the Illinois Appellate Court found that the gold clause required that the rent be determined by the value of gold at the time that the lease was executed. *Id*. at 47, 54. In short, there is no inconsistency in a contract that contains both a gold clause and an escalation clause.

II. The Gold Clause Is Valid and Enforceable Against S & R.

As noted above, there are three independent bases for requiring S & R to honor the gold clause. We address each below.

A. The 1982 Assignment and Assumption Effected a Novation of the Lease.

As we show below, courts have unanimously held that an assignment of a lease that effects a novation of the lease resurrects a dormant gold clause. This case is materially indistinguishable from those cases. The 1982 Assignment and Assumption constituted a novation of the Lease, which thereby obligated S & R to honor the gold clause.

1. Courts Have Unanimously Held That a Novation of a Lease Resurrects a Dormant Gold Clause.

In *Trostel*, the Eighth Circuit held that an assignment and assumption of a lease effected a novation under Iowa law and thus resurrected a gold clause. "To prove a novation under Iowa law, a proponent must show four elements: 1) a previous valid obligation; 2) agreement of all parties to a new contract; 3) extinguishment of the existing contract; and 4) validity of the new agreement." *Trostel*, 92 F.3d at 740. The assignment and assumption agreement stated that the assignee "accepts, assumes and agrees to be bound by all of the terms and conditions to be kept, observed and performed by the lessee in said lease . . . from and after August 1, 1990." *Id.* at 739 (quotation marks omitted). The "lease . . . provided that . . . a proper assignment would relieve [the lessees] of any further personal liability under the lease." *Id*. at 738. The Eighth Circuit "conclude[d] that under Iowa law the 1990 transfer of interest was a novation and that the parties were legally free to incorporate a gold clause into the lease agreement at that time." *Id*. at 741. Further, the Eighth Circuit found that the new lease included the gold clause because "[t]he intent of [the assignee] to be bound by ['all of the terms' of the lease], which included an explicit gold clause, is expressed in clear and unambiguous language, and the contract thus should be enforced as written." *Id*. at 743.

The Ninth Circuit reached the same conclusion in *Fay Corp. v. BAT Holdings I, Inc.*, 646 F. Supp. 946, 950 (W.D. Wash. 1986). Under Washington law, a "novation is commonly

defined as . . . the substitution of a new party concurrent with the release of an original party from liability. . . . The four essential elements of a novation are . . . : (1) A mutual agreement (2) among all parties concerned (3) for the discharge of a valid existing obligation (4) by the substitution of a new valid obligation or substitution of one party for another." *Id*. at 950. The lease permitted assignment as long as the assignee "shall expressly accept and assume all the terms and covenants in this lease contained, to be kept, observed and performed by the Lessee, and shall agree to become bound by all the provisions thereof and to become bound . . . to personally comply therewith." *Id.* at 949 n.4 (quotation marks omitted). The lease also provided that upon assignment, the assignor would be discharged from all obligations under the lease. *Id*. The court "view[ed] the release contained in . . . the original lease as valid assent by [lessor] to the assumption by [assignee] and release of [assignor]. With this assent, [lessor] has joined in a mutual agreement with [assignor] and" assignee. *Id*. at 951. The court "conclude[d] that the 1982 [assignment and assumption] was a valid novation, creating a new contractual obligation as of August 28, 1982. . . . [The novation was] a new [obligation] entered into after [October 27, 1977]. Therefore, the gold clause contained in the August 28, 1982 contract is enforceable." *Id*. at 952-53. The Ninth Circuit affirmed the trial court's "thorough and thoughtful opinions." *Fay Corp. v. Frederick & Nelson Seattle, Inc.,* 896 F.2d 1227 (9th Cir. 1990).

Under California law, which applied in *Wells Fargo Bank v. Bank of America*, "Novation is the substitution of a new obligation for an existing one. The substitution is by agreement and with the intent to extinguish the prior obligation. . . . Where novation is in the form of a substitution of a new debtor for an old one, the release of the old debtor is sufficient to constitute the requisite consideration for the new debtor's promise." 38 Cal. Rptr. 2d 521, 525 (Cal. Ct. App. 1995) (quotation marks and internal citations omitted). The assignee there "agreed to be

bound by and perform all of the agreements, covenants and obligations under the lease." *Id.* at 526 (quotation marks omitted). In addition, "the 1929 lease itself expressly provided that the lessee shall be relieved of all liability accruing under this lease from and after the date of any assignment." *Id*. (quotation marks omitted). The California Court of Appeal held that "[t]he 1981 transfer of the lease . . . constituted a new obligation . . . . This new obligation constituted a novation. . . ." *Id*. The court also found, consistent with *Trostel* and *Fay*, that the new lease therefore contained a valid and enforceable gold clause. *Id*. at 528-29.

2. The 1982 Assignment and Assumption Effected a Novation of the Entire Lease, Including the Gold Clause.

This case fits squarely within *Trostel*, *Fay*, and *Wells Fargo*: the 1982 Assignment and Assumption effected a novation of the Lease, which in turn contained a valid and enforceable gold clause.

Under Ohio law, just as under Iowa, Washington, and California law, "[t]he requisites of a contract of novation are: (1) A previous valid obligation; (2) an agreement of the old parties to the new contract, that is, of the two parties to the old contract and the party to the new contract; (3) that the new contract shall be so complete as to extinguish the old contract; (4) the making of a valid new contract." *Grant-Holub Co. v. Goodman*, 156 N.E. 151, 153, 23 Ohio App. 540, 545 (Ct. App. 1926) (quotation marks omitted). "[A]ll parties to the original contract must clearly and definitely intend the second agreement to be a novation. . . ." *Moneywatch Cos. v. Wilbers*, 665 N.E.2d 689, 691, 106 Ohio App. 3d 122, 125 (Ct. App. 1995). "Knowledge and consent to the terms of the novation need not be express, but can be implied from the circumstances or a party's conduct." *McGlothin v. Huffman*, 640 N.E.2d 598, 601, 94 Ohio App. 3d 240, 244 (Ct. App. 1994). "Where the parties to a contract and a third party are all in agreement that one party will be released from the contract obligations and the third party substituted in its place, a

novation has occurred. . . ." *Moneywatch*, 665 N.E.2d at 691-92, 106 Ohio App. 3d at 126.

i. S & R Was Substituted for the Halle Brothers Co.

By acquiring all of the Halle Brothers Co.'s rights and assuming all of its duties under the Lease, S & R was substituted for the Halle Brothers Co. The 1982 Assignment and Assumption provides specifically that the Halle Brothers Co. agreed to "hereby sell, assign, transfer and convey to Assignee, its successors and assigns . . . all of Assign[or]'s right, title, and interest in and to the Lease and as lessee." 1982 Assignment and Assumption at 1-2. In return for these rights, S & R stated that it "hereby assumes and agrees to perform *each and all* of the covenants, obligations, and engagements of the Assignor and lessee under said Lease and all other terms and provisions thereof on the part of lessee to be observed and performed after the date hereof." 1982 Assignment and Assumption at 2 (emphasis added). In addition, S & R agreed that the assignment of the rights was "subject, nevertheless, to the payment of the rents and the observance of *all* and singular the covenants, conditions, terms, and agreements in said Lease contained." 1982 Assignment and Assumption at 2 (emphasis added).

In its motion to dismiss, S & R emphasized that it assumed only the obligations of the Lease "to be observed and performed after the date hereof." Def.'s Mot. to Dismiss at 7 (quotation marks omitted). S & R's argument, however, is untenable in light of the decisions in *Trostel* and *Fay* because, as shown above, the leases in those cases contained materially indistinguishable clauses. *See Trostel*, 92 F.3d at 739; *Fay*, 646 F. Supp. at 949. Even without the guidance provided by those decisions, it would be clear that this clause does not vitiate the novation. Rather, the phrase reflects "the rule . . . that when a lease is assigned by the lessee, the assignee becomes the principal obligor for the payment of the rent *thereafter accruing and the future performance of the covenants.*" *Gholson v. Savin*, 31 N.E.2d 858, 862, 137 Ohio St. 551,

557 (Ohio 1941) (emphasis added). Thus, S & R was not limiting the range of obligations it was agreeing to—indeed, it expressly agreed to perform "each and all" of the obligations under the Lease, which plainly includes the gold clause. Rather, it was making clear that it had no duty to perform past obligations—that is, ones that had already accrued but had not yet been performed.

In any event, that clause is irrelevant here because there were no outstanding past obligations for S & R to assume. The Lease requires as a condition of assignment that "the rents and all charges, assessments, liens and penalties then payable and covenants thereof at that time required to be performed have been paid, satisfied and performed." Lease at 4. In the 1982 Assignment and Assumption, the parties recited this requirement, and then the Halle Brothers Co. promised that it "has good right to sell, assign, and transfer the [Lease] in manner and form as above written; the said Lease and leasehold estate are free and clear from all liens." 1982 Assignment and Assumption 1-2.[8] Thus, S & R's agreement to perform "each and all" obligations that accrued after the date of the 1982 Assignment and Assumption was tantamount to an agreement to perform "each and all" obligations, period.

ii. The Halle Brothers Co. Was Released from All Obligations.

Upon the 1982 Assignment and Assumption, the Halle Brothers Co. was released from all obligations under the Lease. The Lease provides: "All personal liability of the lessees upon this lease and for the performance of the covenants herein contained shall cease and determine upon an assignment hereof . . . ." Lease at 4. S & R has suggested that the release of all "personal liability" is "is not equivalent to release of all liability," and that therefore the 1982 Assignment and Assumption did not effect a novation. Def.'s Mot. to Dismiss 7. Once again, however, S & R's argument is flatly inconsistent with the Eighth Circuit's decision in *Trostel*,

[8] The Lease provides that outstanding rent is a "lien." Lease at 4.

where, as indicated above, the lease discharged the assignor only of "any further personal liability." 92 F.3d at 738. Moreover, the release of "all personal liability" in fact eliminated all of the Halle Brothers Co.'s remaining obligations under the Lease, as we demonstrate below.

Ordinarily, "[a]n assignment of the term and the acceptance of the assignee as tenant discharges the lessee from all obligations arising from privity of estate, but not from those arising from privity of contract . . . ." *Wade v. March*, 176 N.E. 687, 689, 39 Ohio App. 111, 117 (Ct. App. 1931) (quotation marks omitted). Nonetheless, the nature of the assignor's contractual obligation toward the lessor changes upon assignment: "when a lease is assigned by the lessee, the assignee becomes the principal obligor for the payment of the rent thereafter accruing and the future performance of the covenants, and the lessee assumes the position of surety toward the lessor." *Gholson*, 31 N.E.2d at 862, 137 Ohio St. at 557.[9] In the context of an assignment of a lease, the term "personal liability" refers simply to the assignor's residual obligation as a surety against the failure of the assignee to perform its obligations under the lease. *See Sutliff v. Atwood*, 15 Ohio St. 186, 1864 Ohio LEXIS 119, at *16 (1864) (Upon assignment of a lease, the assignee "as between himself and the [assignor], in the absence of any agreement, is to be regarded as primarily liable for the rent, and the *personal liability of the [assignor] as collateral* thereto.") (emphasis added); *City Nat'l Bank & Trust Co. v. Swain*, 29 Ohio L. Abs. 16, 1939 Ohio Misc. LEXIS 1115, at *33 (Ohio Ct. App. Mar. 21, 1939) ("[I]t is the duty of the assignee to pay the rent while he enjoys the estate, and the *personal liability of the [assignor] is in the*

[9] *See also Sutliff v. Atwood*, 15 Ohio St. 186, 1864 Ohio LEXIS 119, at *16 (1864) (after assignment, the assignor "is liable in the nature of a surety for the assignee during the continuance of his interest"); *Schottenstein Trs. v. Carano*, No. 99AP-1222, 2000 Ohio App. LEXIS 4493, at *5-*6 (Ct. App. Sept. 29, 2000) ("When a lease is assigned, the assignee becomes the principal obligor for rent payments and the lessee becomes a surety toward the lessor for the assignee's performance."); *Morse & Hamilton Ltd. P'ship v. Gourmet Bagel Co.*, No. 99AP-1253, 2000 Ohio App. LEXIS 4492, at *6-*8 (Ct. App. Sept. 29, 2000) (same).

nature of a security as between him and the assignee. . . .") (emphasis added). Thus, a release of "all personal liability" is tantamount to a release of surety liability. Because surety liability is the only liability that might remain after an assignment of a lease, the Lease's release of "all personal liability" thus had the effect of fully discharging the Halle Brothers Co. of *all* of its obligations and liability under the Lease.

S & R has cited *Young v. Hargrave's Administrator*, 7 Ohio 63 (Ohio 1936), to support its contention that the release of personal liability is "not equivalent to release of all liability." Def.'s Mot. to Dismiss 7. But *Young* provides no such support. The question there was whether a landowner who had granted a life estate and then sold the land was liable to the life tenant under an implied covenant of quiet enjoyment when the buyer of the land ejected the life tenant. *Young*, 7 Ohio at 68-69. The court mentioned in passing that this implied warranty "personally bind[s]" the grantor "for life." *Id*. at 69. The court then distinguished the nature of implied obligations in the context of a lease for a term of years, such as the Lease at issue here, from those in the context of a freehold estate, such as the life estate at issue in *Young*: "A warranty . . . is implied, in a lease, in a different sense from the implied warranty of a freehold. The latter depends on tenure, the former on contract." *Id*. The court said nothing about personal liability in the context of a lease for a term of years. Thus, *Young* did not address the question at issue here: whether the discharge of all personal liability under a lease upon an assignment and assumption eliminates *all* liability under the lease. Moreover, the court's discussion of obligations in the context of a freehold estate did not contemplate any liability that would remain after a discharge of the "personally binding" warranty.

iii. The Parties Consented to the Novation.

All three parties to the novation clearly and definitely intended to extinguish the old

Lease and replace it with a new one. By the express terms of the 1982 Assignment and Assumption, the Halle Brothers Co. and S & R agreed that S & R would be substituted for the Halle Brothers Co., as discussed above. By the express terms of the Lease, the lessor agreed to that assignment of rights and to that assumption of obligations—indeed, the lessor *required* the assumption as a condition of the assignment. Lease at 4 (assignment prohibited "unless the assignee shall expressly assume the lessees['] engagements hereunder"). By the express terms of the Lease, the lessor agreed to discharge the assignor upon assignment and assumption, as discussed above.

iv. S & R and the Lessor Agreed to the Gold Clause.

The gold clause was expressly included in the Lease of novation. "The intent of the parties to a contract is presumed to reside in the language they chose to employ in the agreement." *Kelly v. Medical Life Ins. Co.*, 509 N.E.2d 411, 413, 31 Ohio St. 3d 130, 132 (Ohio 1987). Here, the unambiguous language of the Lease and the 1982 Assignment and Assumption establishes that the parties included the gold clause. First, the Lease expresses the lessor's intent that the gold clause would bind all assignees. As discussed above, the Lease permits assignment only if the assignee assumes the obligations in the Lease, which included the gold clause. The Lease also provides that "assigns . . . shall become such in accordance with the terms and conditions hereof, with like force and effect in all respects as the same accrue to and are binding upon said original . . . lessees." Lease at 6. Second, the 1982 Assignment and Assumption expresses S & R's agreement to be bound by the gold clause. As discussed above, S & R "assume[d] and agree[d] to perform *each and all* of the covenants, obligations, and engagements" under the Lease, and took the rights under the Lease "subject, nevertheless, to the payment of the rents and the observance of *all* and singular the covenants, conditions, terms, and

agreements in said Lease contained." 1982 Assignment and Assumption at 2 (emphases added). Therefore, a valid and enforceable gold clause issued on May 21, 1982, when S & R entered into the 1982 Assignment and Assumption and effected a novation of the Lease.

* * *

The only case in which a court has found that a post-October 27, 1977, assignment of a lease did not impose a valid, enforceable gold obligation on the assignee is *Grand Avenue Partners, L.P. v. Goodan*, 25 F. Supp. 2d 1064, 1068 (C.D. Cal. 1996), *aff'd*, 160 F.3d 580 (9th Cir. 1998). But the court in that case held correctly "that [the] assignment does not constitute a novation . . . because the lessor/assignee was not completely relieved of liability by language in the original lease providing that the lessee/assignor shall be released from 'all direct liability hereunder accruing' after an assignment." *Grand Ave. Partners, L.P. v. Goodan*, 160 F.3d 580, 581 (9th Cir. 1998). The release of "all direct liability" was insufficient because "direct liability is tantamount to liability as primary obligor, [and therefore] the Lease does not release the assignor/lessee of contractual liability as a surety." 25 F. Supp. 2d at 1068. Thus, the lease at issue in *Grand Avenue* differs in a critical way from the Lease here because the Lease here expressly discharged the Halle Brothers Co. of "all personal liability," which, as shown above, is tantamount to surety liability, thereby eliminating *all* of the Halle Brothers Co.'s remaining liability under the Lease.[10]

B. Apart from the 1982 Novation of the Lease, the Gold-Clause Obligation "Issued" in 1982 for Two Other, Independent Reasons.

Regardless of whether the 1982 Assignment and Assumption constituted a novation of the Lease, the gold clause "issued" and obligated S & R to abide by its terms in 1982 for two

[10] At the time the lease was formed, California law was "ambiguous" as to whether an assignor of a lease ordinarily retained principal liability. *Grand Ave.*, 25 F. Supp. 2d at 1068-70.

wholly separate and independent reasons: S & R came into privity of contract with the lessor, and S & R came into privity of estate with the lessor. As a threshold matter, we note that although a post-October 27, 1977, novation of a lease containing a gold clause is *sufficient* to create a valid and enforceable gold-coin obligation under the amended Joint Resolution, a novation is not *necessary* to create such an obligation. As amended, the Joint Resolution's prohibition against gold clauses does not apply to "obligation[s] issued after October 27, 1977." 31 U.S.C. § 5118(d)(2). Courts have consistently equated the term "issued" with "entered into." *See, e.g.*, *Trostel*, 92 F.3d at 742 ("Although [the Joint Resolution] rendered the [gold] clause unenforceable, there is no reason that it could not be incorporated by reference in a new lease obligation entered into in 1990.").[11] This interpretation is consistent with the legislative history to the 1977 amendment, which "reveals that the word 'issued' was intended to mean 'entered into.' " *Rudolph v. Steinhardt*, 721 F.2d 1324, 1330 (11th Cir. 1983).

Courts have accordingly recognized that a novation is not the exclusive method of resurrecting a dormant gold obligation in a lease.[12] In *Nebel*, the lessor and lessee agreed to material amendments of their rights and obligations under the lease. As part of the amendment, the lessee " 'reaffirm[ed]' all terms and provisions in the Lease." 769 N.E.2d at 53. The Illinois Appellate Court held that the lease amendment "was a new obligation effectuated after October

[11] *See also Fay*, 896 F.2d at 1227 ("Congress determined in 1977 that obligations entered into after 1977 would be enforceable."); *Rudolph v. Steinhardt*, 721 F.2d 1324, 1331 (11th Cir. 1983) ("[W]e hold that the 1977 amendment to section 463 does not apply to obligations entered into before October 27, 1977."); *Nebel*, 769 N.E.2d at 50 ("First to be determined is whether the Lease Amendment was a new obligation 'entered into' after October 27, 1977, thereby reviving the enforceability of the Lease's gold clause."); *Wells Fargo*, 38 Cal. Rptr. 2d at 529 ("interpreting 'issued' as meaning 'entered into' ").

[12] Because a novation entails the "making of a valid new contract," *Grant-Holub*, 156 N.E. at 153, 23 Ohio App. at 545 (quotation marks omitted), the obligations in a contract of novation "issue," or are "entered into," at the time of novation. Accordingly, as noted above, courts have uniformly found that, under the amended Joint Resolution, a post-October 27, 1977, novation resurrects a dormant gold clause.

27, 1977, thereby reviving the enforceability of the gold clause in the Lease." *Id*. at 54. And although the Eighth Circuit in *Trostel* found that a novation had occurred, it also noted that a novation was not necessary: "American Life states in its briefs that the 1990 transaction was not a novation, but it does not dispute that a valid new obligation was formed." 92 F.3d at 740.

1. The Gold Clause Obligation Issued When S & R Came into Privity of Contract with the Lessor in 1982.

The gold clause issued when S & R came into privity of contract with the lessor in 1982. A mere assignment of the lessee's rights under a lease does not create any contractual relationship between the assignee and the lessor, but if the assignee assumes the obligations under the lease, the assignee comes into privity of contract with the lessor—irrespective of whether the assignment constitutes a novation of the lease. *Leitch v. New York C. R. Co.*, 58 N.E.2d 16, 18 (Ill. 1944) ("if there is an assumption of the lease obligations, then privity of contract also results").[13] As discussed above, under the 1982 Assignment and Assumption, S & R "assume[d] and agree[d] to perform *each and all* of" the obligations under the Lease—which included the gold clause—and agreed to take the rights under the lease "subject . . . to . . . the observance of *all*" of the obligations in the Lease. 1982 Assignment and Assumption at 2. Thus, in May 1982, S & R came into privity of contract with the lessor. That is, S & R entered into a contractual relationship with the lessor after October 27, 1977, and that contractual relationship therefore included a valid and enforceable gold clause.

[13] *See also South Lakeview Plaza v. Citizens Nat'l Bank*, 703 S.W.2d 84, 86 (Mo. Ct. App. 1985) ("The assignee becomes contractually bound upon acceptance of the assignment 'subject to all covenants in the lease' when the assignment contains this express language."); *Rauch v. Circle Theatre*, 374 N.E.2d 546, 550 (Ind. Ct. App. 1978) ("in cases in which [the assignee] expressly assumes the lessee's obligations under the lease, he is bound to the lessor under privity of contract"); *Martin's Fork Coal Co. v. Harlan-Wallins Coal Corp.*, 14 F. Supp. 902, 904 (E.D. Ky. 1934) ("where the assignee expressly assumes the covenants of the lessee, a liability arises which is based upon privity of contract") (quotation marks omitted).

2. The Gold Clause Issued When S & R Came into Privity of Estate with the Lessor in 1982.

The gold clause issued when S & R came into privity of estate with the lessor in 1982. Even if an assignee is not in privity of contract with the lessor, it owes the lessor a duty to comply with all covenants that run with the land. A covenant runs with the land when: (1) the covenant affects or touches and concerns the land in question; (2) the intent of the original lessor and lessee is for the covenant to run with the land; and (3) there is privity of estate between the lessor and the assignee. *Lone Star Steakhouse Saloon v. Quaranta*, 2002 Ohio 1540, 2002 Ohio App. LEXIS 7282, at *8-*9 (Ct. App. Mar. 18, 2002).

The gold clause touches and concerns the land. Because the duty to pay rent touches and concerns the land, *Taylor v. De Bus*, 31 Ohio St. 468, 471 (1877), a covenant that adjusts the rent amount over time also necessarily touches and concerns the land. *See St. Regis Restaurant, Inc. v. Powers*, 219 A.D. 321, 325 (N.Y. App. Div. 1927) (provision that added increased insurance premiums to rent amount "would clearly run with the land"); *Kozodoy v. Hindy*, 60 N.Y.S.2d 695, 698 (N.Y. Mun. Ct. 1946) (same). More generally, a covenant between a lessor and a lessee touches and concerns the land if it benefits the lessor's fee and burdens the lessee's leasehold. *See Lone Star Steakhouse Saloon*, 2002 Ohio App. LEXIS 7282, at *11; *LuMac Dev. Corp. v. Buck Point Ltd. P'ship*, 573 N.E.2d 681, 684, 61 Ohio App. 3d 558, 562-63 (Ct. App. 1988). By increasing the rent amount in response to inflation, as shown above, the gold clause undoubtedly enhances the value of the fee and concomitantly decreases the value of the leasehold.

The parties to the original Lease clearly intended for the gold clause to run with the land. The Lease provides that "all the covenants, agreements, stipulations, conditions, engagements and obligations of this lease"—which includes the gold clause—"shall accrue to and be binding upon the successors and assigns of the said original lessor and upon the heirs, personal

representatives and assigns, of the said original lessees, provided, as to their assigns, that they shall become such in accordance with the terms and conditions hereof, with like force and effect in all respects as the same accrue to and are binding upon said original lessor and lessees respectively." Lease at 5-6. Ohio courts have found repeatedly that "the use of such terminology as 'personal representatives, assigns, heirs, or successors' . . . clearly reflects upon and is indicative of the intention of the parties at the time of conveyance" that the covenant shall run with the land. *Lone Star Steakhouse Saloon*, 2002 Ohio App. LEXIS 7282, at *10.[14]

Finally, S & R came into privity of estate with the lessor when it acquired the leasehold pursuant to the 1982 Assignment and Assumption. *See Taylor*, 31 Ohio St. at 471. Accordingly, the gold clause issued and obligated S & R to abide by its terms in 1982.

CONCLUSION

For the foregoing reasons, the Court should adjudge that S & R is obligated to pay to plaintiff annual rent of 35,000 gold coin dollars as defined in 1912, or the current paper currency value of 1,693 ounces of pure gold, and that S & R has repeatedly breached this obligation since April 1, 2006, by repeatedly tendering only the quarterly face amount of $8,750.

[14] *See also Peto v. Korach*, 244 N.E.2d 502, 505, 17 Ohio App. 2d 20, 30 (Ct. App. 1969) ("heirs and assigns" evinced intent that covenant run with the land); *LuMac*, 573 N.E.2d at 684 ("We find that the use of the terms 'assigns' and 'successors' in the subject conveyance . . . clearly reflects that the grantors intended that this provision run with the land."); *Siferd v. Stambor*, 214 N.E.2d 106, 111, 5 Ohio App. 2d 79, 87 (Ct. App. 1966) (use of "such words [as] 'heirs and assigns[ ]' does clearly reflect upon and is indicative of the intention of the grantor at the time of the conveyance" that the covenant should run with the land).

October 12, 2006

Respectfully Submitted,

/s/ Charles J. Cooper

_____

James B. Niehaus (0020128)
jniehaus@frantzward.com
Christopher G. Keim (0067117)
ckeim@frantzward.com
FRANTZ WARD LLP
2500 Key Center
127 Public Square
Cleveland, Ohio 44114-1230
216-515-1660
216-515-1650 (fax)

Charles J. Cooper
ccooper@cooperkirk.com
David H. Thompson
dthompson@cooperkirk.com
David Lehn
dlehn@cooperkirk.com
COOPER & KIRK, PLLC
555 Eleventh Street NW
Suite 750
Washington, DC 20004
(202) 220-9600
(202) 220-9601 (fax)

Attorneys for Plaintiff

CERTIFICATE OF SERVICE

I hereby certify on October 12, 2006, copies of the foregoing Memorandum in Support Motion of Plaintiff 216 Jamaica Avenue LLC for Summary Judgment and Exhibits were filed electronically. Notice of this filing will be sent by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt. All other parties will be served by regular U.S. mail. Parties may access this through the Court's system.

/s/ Charles J. Cooper

Charles J. Cooper
COOPER & KIRK, PLLC
555 Eleventh Street NW
Suite 750
Washington, DC 20004
(202) 220-9600
(202) 220-9601 (fax)
ccooper@cooperkirk.com