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Leasing: assignment, sublease clauses

EDITOR'S NOTE: This article is part of a continuing series designed to acquaint nonlawyers with basic legal issues and considerations involved in leasing commercial property. It should not be considered a substitute for specific legal advice.

A leasehold interest in real property is freely assignable at common law. But since most landlords are very interested in having control over who occupies their properties, almost every commercial lease will have a section on assignment and subletting that prohibits assignment or subletting without the landlord's consent.

The Colorado Court of Appeals has held that, when a lease states that consent is required, a landlord's exercise of this right must be exercised reasonably unless the lease specifically says the landlord need *not* be reasonable. However note that, even if the lease assignment clause language gives the landlord the right to withhold consent without acting reasonably, in a situation where the tenant is seeking the assignment or sublease due to the fact that it is incapable of meeting its financial obligations under the lease, and therefore has defaulted or may default if it cannot assign or sublet the lease, the landlord's common law duty to mitigate damages may override the right to withhold consent arbitrarily to assignment.

Definition of the terms. What exactly are meant by "assignment" and "subletting"? An **assignment** is the transfer by the tenant of its *entire* interest in *all* of the leased premises for the *full* unexpired term of the lease. The tenant gives up the right to re-enter the premises upon the assignee's default, relinquishing all interest in the property, and the assignee pays rent directly to the landlord. A new landlord-tenant relationship is created between the landlord and the assignee, who has "stepped into the shoes" of the tenant and become the

new tenant. On the other hand, a **sublease** is a transfer of only a *portion* of the tenant's interest in the lease. It may be accomplished by a transfer of a portion of the premises, or by a transfer of all the premises for a portion of the remaining term, or, for that matter, a transfer of a portion of the premises for a portion of the remaining term. In a sublease, the tenant retains the right to re-enter the sublet premises upon the subtenant's default. Unless the parties agree otherwise, the subtenant pays rent to the tenant, which may be different in amount than that which the tenant must pay to the landlord. In other words, there is a landlord-tenant relationship between the tenant and subtenant, but no direct legal relationship between the landlord and the subtenant.

Subleasing vs. assignment. Usually the tenant is safer to sublease rather than to assign its lease. If the tenant assigns the lease, the tenant remains liable to the landlord for the tenant's lease obligations (unless the landlord releases the tenant), but gives up to the assignee all rights to the premises and becomes, essentially, a guarantor of the assignee's performance. If the assignee defaults, the assignor has no right of re-entry to the premises or other rights in the leased premises at all. If the assignor has to resume making rent payments, its only recourse will be against the assignee personally. Under normal circumstances, the landlord will not release any tenant/assignor unless it receives some financial incentive for doing so. Sometimes a tenant will be successful in negotiating a provision that requires the landlord to release it after the assignee performs satisfactorily for some specified period of time. A tenant that subleases its premises (or a portion of it) retains a right of re-entry and can therefore retake the premises and sublet them again should the subtenant default.

From the point of view of the

prospective new occupant of the premises, however, a sublease is riskier than an assignment because if the tenant/assignor defaults in its obligations to the landlord, the lease could be terminated, rendering the sublease ineffective. It is safer with an assignment, because the assignee becomes the tenant and need not worry that the tenant/sublandlord will take its money and run, leaving it only with a personal action against the tenant/sublessor.

Standards for the exercise of the right to consent. When the lease (or the law) provides that the landlord may not unreasonably withhold his consent, the landlord must act accordingly. Some well-drafted leases give specific examples of bases for reasonable withholding of consent, such as financial weakness of the proposed assignee compared with the tenant at lease execution, whether a change in use is proposed and its effect on tenant mix, increased need for services or additional strain on available parking, etc. Many leases require the tenant that proposes an assignment of the lease to provide financial or other data concerning the proposed assignee, and to pay expenses, such as accountants' and attorneys' fees, incurred by the landlord in connection with evaluating whether to give consent and, if consent is given, preparing or reviewing the assignment documents. Tenants can sometimes negotiate a cap on such expenses.

Other restrictions or conditions on the right to assign or sublet that a landlord may impose include:

1. Giving the tenant the right to assign the lease only as collateral for a loan.
2. Permitting the landlord the option to terminate the lease if consent is requested (enabling the landlord to lease directly to the proposed assignee — this is often called a "right to recapture").

3. Giving the landlord the right to receive all or a portion of any consideration received by the tenant for the assignment, including any difference between the subtenant's rent and the rent payable by the tenant. The tenant should make sure that it is allowed to first deduct its expenses in connection with the assignment or sublease.

4. Automatically terminating any options or similar rights contained in the lease upon any assignment or sublease, even if it is one to which the landlord consents.

Landlord's reservation of a right to make certain types of lease modifications as a condition of its consent to the assignment.

Requirements for Documentation

"Deemed assignments." If the tenant is an entity such as a corporation or limited liability company, often a lease often will define certain changes in the ownership makeup of the tenant entity, for example, a change in the ownership of 50 percent or more of the outstanding shares of a corporation-tenant, as constituting an assignment that requires landlord's consent. Depending on the makeup of the tenant entity and its plans for the future, this could be a significant point that the tenant will want to negotiate. A tenant should seek at least the right to assign the lease to related parties, such as a corporation or partnership of which it or its owner is a majority owner, or a co-tenant. If the landlord grants this right, it should still require compliance with the lease provisions concerning documentation of the assignment, or at the least require notice of the assignment and a copy of the assignment document.

Note: Fox has treated the topic of assignment and subletting in greater depth in articles published in the CREJ's June 6-19, 2001; March 6-19, 2002; and March 20-April 2, 2002, editions. ▲