

Client newsletter



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Negotiating Assignment and Sublease Provisions in Commercial Leases

In the ever changing landscape of corporate America, it is important for companies to remain flexible in order to adapt to changes in the market place. If business is good, a company may need more space than its existing premises provides and/or desire to relocate elsewhere. During an economic downturn, a company may need to downsize or discontinue business in order to remain viable. One way for a company leasing commercial space to ensure adaptability to market fluctuations is to negotiate flexible “assignment” and “sublease” provisions.

An “assignment” is a transfer by a tenant of its entire interest in the premises. The tenant retains no control over or interest in the leasehold estate or premises. A “sublease,” on the other hand, is a transfer of less than the entire interest of the tenant in the premises to a sublessee. The tenant, as sublessor, retains the balance of the interest in the estate and remains ultimately liable to the landlord.

In Mississippi, the assignment of lease agreements is governed by Miss. Code Ann. § 89-7-15 and § 89-7-21. These statutes provide that an assignee of a lease agreement enjoys the same rights and privileges against

the tenant as the landlord. Further, the tenant enjoys the same rights against the assignee as the original landlord. This right does not, however, include the right to recover on any warranty provided by the landlord.

Consent

Generally, in the absence of an express restriction, a tenant may freely assign or sublease its interest in a lease without any obligation to first obtain the landlord’s consent. *See Merchants & Farmers Bank v. McClendon*, 220 So. 2d 815, 821 (Miss. 1969). Commercial leases, however, usually always require the consent of the landlord to an assignment of the lease or to a sublease.

From a tenant’s standpoint, when a commercial lease requires the consent of the landlord it is important to ensure that language is added to the lease requiring that the landlord not “unreasonably withhold consent” to the tenant’s request to assign the lease or sublease a portion of the premises. In the absence of such language, a landlord can arbitrarily refuse to grant consent.

When determining what constitutes ‘reasonable’ in the context of approving a proposed lease assignment, the Mississippi Supreme Court has found that “the term ‘reasonable’ must refer to considerations of fairness and commercial reasonableness.” *Wright v. Rub a Dub Car Wash, Inc.*, 740 So. 2d 891, 899 (Miss. 1999). In *Wright*, a landlord refused to consent to a lease assignment unless the tenant or prospective assignee agreed to assume responsibility for a leaking underground storage tank used by the tenant but installed by a previous tenant. As a result, the tenant lost the sale of its business to the prospective purchasers. The tenant sued alleging the landlord unreasonably withheld their consent to the assignment. The trial court agreed.

On appeal, however, the Mississippi Supreme Court found that it was “commercially reasonable” for the owners to withhold consent to an assignment of the lease until the present or proposed tenant formally agreed to assume responsibility for the leaking storage tanks, no matter who owned them. The court recognized that although the obligation probably existed independently of a formal affirmation by the new tenant, the owner could

reasonably require the obligation be explicitly acknowledged in order to avoid future misunderstandings. Consequently, the court held that the fact the proposed assignee found the condition unacceptable did not make the landlord's failure to consent unreasonable.

Transfer of Tenant's Interest

Commercial leases usually contain language that broadly define an assignment to include a transfer by operation of law, by transfer of stock or other ownership interest in an entity, or by a merger or consolidation. As such, tenants may want to consider negotiating a clause to allow the tenant to assign or sublease without the landlord's consent notwithstanding one or more of these events.

In addition, tenants should consider having language added to the lease which allows the tenant to assign or sublease to a related company, particularly where the possibility exists for changes in corporate structure.

A tenant may want to seek a clause stating that it may assign the lease to any third party who acquires all or substantially all of the tenant's business and assets, provided that the assignee assumes the tenant's obligations under the lease from the date of the assignment forward. In order to protect its interest, the landlord may require that the assignee have assets equal to or greater than those of the tenant.

Use Clause

When negotiating commercial leases, tenants should also ensure that the

"use clause" is flexible enough to allow for changes in their business and not unduly limit their right to assign or sublease to a third party. One way to accomplish this is by negotiating into the lease a clause that establishes that an assignment or sublease may be for a use other than the tenant's use. This is particularly important where the use clause is narrowly tailored to the tenant's use. If the use clause is too narrow, a potential assignee or subtenant will be limited to the same use as the tenant. A restrictive use clause may limit a tenant's ability to assign or sublease even where the landlord has a duty to act reasonably.

Recapture

Tenants should also be aware that many commercial leases contain clauses which allow the landlord to "recapture" the premises and/or cancel the lease if the tenant seeks to assign the lease or sublease a portion of the premises. The right to recapture provides the landlord with, among other things, the ability to negotiate a new lease with the prospective assignee or subtenant at a higher rent (depending upon the market).

While the right of recapture may not be important to some tenants, it may be vital to those whose business relies on the location of the premises or that plan to expend large sums improving the premises. A recapture provision may unduly interfere with a tenant's ability to sell its business if the tenant's business relies on the immediately surrounding community. This is especially true where customers would not continue their patronage if the tenant were to move to another location. Likewise, tenants that plan to invest substantial capital

at their own expense to improve the premises may want to ensure that they can assign or sublet the premises at higher rents in order to recoup their capital investment.

Profits

A lease may also provide that in addition to or in lieu of the right to recapture space, a landlord may receive all of the profits from a proposed assignment or sublease. As such, it is important for the tenant to ensure that the term "profits" is adequately defined and address how any profit made in the event of assignment or sublease is to be allocated. While the landlord will argue that it is entitled to any profits from an assignment or sublease, a tenant might negotiate for a split of the profits or even all of the profits.

Limitation of Remedies

Commercial leases generally provide that the only remedy a tenant is entitled to is that of obtaining a declaratory judgment and/or injunctive relief. Such a limited remedy, however, is often not sufficient. By the time a tenant is able to obtain an injunction or declaratory judgment, the potential assignee or sublessee has moved on to another deal. Therefore, tenants should try to exclude such a limited remedy by negotiating for a clause to permit recovery of damages or the right to terminate the lease if the landlord wrongfully refuses to consent to an assignment or sublease. Such a clause would allow the tenant to seek damages for the value of the lost bargain with the proposed assignee or sublessee or termination of the lease for wrongful refusal to consent.

Other Considerations

When negotiating assignment and sublease clauses, tenants should remember that landlords will likely want to condition their consent to any assignment or sublease upon satisfaction of certain conditions by the proposed assignee, such as providing financial statements. Landlords will also likely want to

insert a clause in the lease providing that it may charge the tenant for legal fees incurred in reviewing a proposed assignment or sublease.

particular needs of tenant and landlord in mind. The result will be a lease that is fair to both tenant and landlord.

Conclusion

As with any other lease clause, the assignment and sublease clauses should be negotiated with the

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