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# STRATEGIES FOR A CHANGING ECONOMY: ASSIGNMENTS AND SUBLEASES OF COMMERCIAL AND OFFICE SPACE

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In a changing economy, a company's space needs can change dramatically-and quickly. A company in contraction may need to cut its overhead by reducing its space, but a long-term lease can make this the tenant's, and not the landlord's, problem. And a growing company may want to expand its space cautiously, incrementally, or temporarily, and the prospect of entering into a typical commercial lease of five or even ten years does not provide the flexibility the company requires. Many companies, therefore, have turned to assignments or subleases of leases as a way of adjusting the size of their space and their rent overhead.

Although these terms often are used interchangeably, an assignment technically involves the assignee taking over the lease for some or all of the space, for the entire remaining term of the lease. The assigning tenant, unless released by the landlord, remains liable for the lease, but has no rights to the space: even on a default by the assignee, the assigning tenant has no right to take the space back (thus, the assigning tenant is sometimes said to have no "right of reversion"). In contrast, a sublease involves a transfer of fewer rights than are set forth in the prime lease-less space, fewer years, perhaps even lower rent. The prime tenant remains contractually liable for the performance of the prime lease and is the party with whom the owner continues to do business. Should the subtenant breach the sublease, the prime tenant has the remedies of eviction and damages, and, provided the prime lease is not breached, will re-possess the subleased space.

The fundamental tension affecting the assignment or subleasing transaction is that the transaction itself can be surprisingly complicated,

as it deals with an existing agreement for the subject space between two parties, and one of those parties, the landlord, may be inflexible and even uncooperative, while there is an expectation by, and even pressure from, all parties to keep the transaction simple or inexpensive.

This tension usually causes a mistake on the very first legal step, which is to examine the documents that comprise the lease. The lease is not only the core "lease" document, but also any other documents that may have expressly or "de facto" amended the lease or have added or confirmed its provisions. For example, the prospective subtenant must examine any estoppel certificates given by the tenant in connection with any landlord financings (these often confirm certain essential lease terms, sometimes in a manner contrary to the apparent provisions of the written lease), landlord consents, a commencement date agreement, an option exercise or waiver, work letters, consents to alterations, rules and regulations (including signage rules-few issues are as taken for granted as signage, especially by sub-tenants), construction rules, and service rate schedules.

Other documents, while not necessarily comprising the lease, provide important leasing information and also demonstrate what conduct or additional charges to expect from the owner. These documents include rent escalation statements, tax statements (especially any assessment district information that could lead to a sudden increase in applicable property taxes), operating expense statements, CPI and CAM charge calculations, and utility charges.

Finally, the tenant may have documents that shed light on the space's construction and systems. The prospective sub-tenant should insist on seeing "as-built" construction drawings, schematic drawings showing cabling for computers, fiber optics, and telephone, and use and occupancy permits. Any services that require service or maintenance from outside parties will be evidenced by contracts: these contracts may contain important liability limitations, and the new tenant will want to be named as an additional insured on any applicable insurance policies.

These documents should provide the information necessary for the prospective tenant to decide whether, strictly from a legal standpoint, the prime lease provides the terms and conditions needed to do business. The prospective tenant will be able to address such issues as, whether the tenant's intended use is consistent with the prime lease's use clause; whether the term of the lease is sufficient for the intended use; whether the space can be altered, or the finishes or fixtures improved, for the needs (which might include privacy or security) of the intended use; whether a list of approved contractors contains contractors with whom the prospective tenant is willing to do business (a specialized use may require a specialized contractor, who might not be on the owner's approved list); whether hours of operation or services (such as service elevators or HVAC) will accommodate the prospective tenant; whether adequate parking and sufficient signage will be available; and, whether customer, vendor, and employee traffic will be restricted under the lease or, more likely, under the rules and regulations of the property.

The lease documents will also reveal whether the prime tenant

negotiated a bundle of legal rights with which the prospective tenant can, or cannot, live. For example, the prospective tenant will want to know whether the prime lease contains a detailed description of allowed pass-through expenses, with auditing rights; covenants binding the landlord to maintenance and repairs, including of the building's systems and its structural elements; a relocation clause, permitting the landlord to move the prime tenant to other comparable space within the building or even to other comparable space nearby and owned by the same landlord; and, lawsuit rights in favor of the prime landlord's potential claims, with only arbitration rights, and extremely limited discovery, pertaining to probable tenant claims.

The lease clause that will assume a pre-eminent role in the continuance of the transaction, however, is the assignment and subletting clause. In California, if a lease is silent concerning the right to assign or sublet, then these rights are implied. Conversely, a commercial lease may expressly deny the tenant the right to assign or sublet. The middle ground often is that the lease may be transferred, but only subject to the consent of the landlord. If this consent is not expressly qualified-by, for example, language to the effect that the consent may be withheld in the landlord's sole and absolute discretion-then the landlord's consent is required by law to not be unreasonably withheld.

The reality in California is that most standard commercial lease forms provide for transfer upon the landlord's consent, and for reasonableness in the granting or denying of that consent. Statutory law, at Civil Code section 1951.4, all but dictates this result, by allowing landlords who allow for transferability of the lease subject to reasonable consent, to continue the lease in effect, rather than bear the burden of mitigating their leasing damages, after the tenant's default and abandonment of the premises.

The outer bounds of what constitutes reasonable grounds for denial of a proposed lease transfer have not been fully defined by California courts. Probable acceptable grounds for denial would be those based on the transferee's creditworthiness, business (not only whether the transferee's use is consistent with the lease's use clause, but whether the use is consistent with the nature and quality of the building and with the other uses therein), whether the proposed transferee is a current or recent prospect of the landlord or is an existing tenant, and whether some aspect of leasing or subleasing to the prospective tenant might cause a breach in an agreement to which the landlord is a party.

The mechanics of drafting the sublease may not appear important to the businessperson, but some knowledge of the alternative approaches to drafting the sublease can help one appreciate the difficulty of documenting the transfer and also highlight a few issues that will arise at this stage. At one end of the spectrum, the sublease can be drafted so as to repeat, almost ver batim, those provisions of the prime lease that the sub-tenant will be expected to perform or honor, with the term "sub-tenant" inserted for "tenant" throughout the repeated language. This approach results in a lengthy document that requires each party involved, including the landlord, to carefully match up the language of the lease to the language of the proposed sublease, scouring the text for

any discrepancies. This approach has the appeal of appearing to guarantee accuracy, but challenges the patience of all parties.

At the other end of the spectrum, a sublease can be drafted simply to refer to certain numbered paragraphs of the prime lease, and recite that the responsibilities of those sections shall be borne by the sub-tenant and not the tenant. Other sections are often listed and referred to as provisions that will be contractual between the tenant and sub-tenant. This approach is economical, but under adversarial scrutiny, this approach may not survive the legal microscope.

Care needs to be taken, therefore, that important drafting issues are raised and negotiated, and that rights or duties are not inadvertently mis-allocated or undermined. For example, the tenant may want the sub-tenant to pay rent three to five business days prior to the time the rent is owed to the landlord. The sub-tenant may want the right to insist that the tenant challenge pass-throughs, adjustments, or calculations. The sub-tenant will not want to inadvertently assume the obligation to restore the property to its condition prior to the commencement of the prime lease, particularly if substantial tenant improvement work was undertaken. Time frames under the prime lease, for performance of tenant obligations or for landlord consent of certain items, will need to be revised to make sure the prime tenant takes the subtenant's demands to the landlord in time to comply with the limitations of the prime lease and to make sure that the landlord responds promptly to any requests.

Finally, the proposed transferee must determine whether it will require a non-disturbance agreement from the prime landlord and perhaps from the prime landlord's lender. A non-disturbance agreement provides that the transferee's tenancy will remain intact in the event of a termination of the prime lease or a foreclosure of the owner's title. As there probably will not be a clause in the prime lease requiring that these assurances be provided to the subtenant, the subtenant and the tenant will have to negotiate for these, thereby risking that the owner will use the negotiations as an opportunity to raise its own issues.

Assignments and subleases that are consummated in a hurried manner, under the misconception that the transaction is at least as simple as entering into a primary lease, overlook issues and information of potential importance to all of the parties involved. Time and money spent attending to the details of the transaction will decrease the probability that time and money will have to be spent on the relationship at some later time.