A PRACTICAL GUIDE TO ASSIGNMENTS AND SUBLEASING

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ATTACHMENTS:

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I. OVERVIEW

Assignment and subleasing present interesting legal risk issues in leasing. This article is intended to highlight the legal and business aspects of subleases and assignments. Many tenants fail to properly anticipate sublease or assignment transactions. The article discusses how a tenant faced with excess space decides to sublet or assign its excess space. Several forms for sublease and assignment transactions are attached and others referenced. A checklist adapted to an office transaction for representing the three parties to a transaction is included: landlord, tenant/sublandlord and subtenant. The terms "sublandlord" and "subtenant" referenced herein may be used interchangeably with "sublessor" and "sublessee."

II. TENANT'S ALTERNATIVES

A tenant in economic duress often finds itself liable for one or more leases for space which is no longer appropriate. This can be due to downsizing, such that the tenant has terminated business at various locations, or the tenant has reduced space needs in one or more leased locations. Further, the expensive Class A space once considered important for a tenant, may become an unnecessary economic drain when the cash-poor tenant determines it can just as easily operate its business in a lower profile, less expensive premises.

Tenants have a number of practical and legal options under the foregoing circumstances.

A. Default

In rare circumstances, a tenant may determine it is in its best interest to simply default under the lease and hope for the best. Perhaps the remaining lease time is relatively short and thus the damage to the landlord is such that the landlord is unlikely to pursue its legal remedies. Maybe the landlord is not a litigious type. Finally, the alternatives to default may not be practical, and the tenant simply must hope that if it is held to its legal obligations, the time for payment to the landlord will be sufficiently far in the future that the tenant has had an opportunity to regain its financial strength and that the protections of Texas law (such as the requirement for mitigation of damages) will result in a legal award of damages which is "reasonable."

Due Diligence Issues:

- Analysis of lease provisions and applicable law – ensure that complete copies of the lease, plus all exhibits, modifications and amendments have been provided, together with any estoppel letters.
- Review with the tenant the impact of default and landlord's remedies, with emphasis on the following – (i) notice and opportunity to cure (if any), (ii) lock out, (iii) termination of right of possession versus lease termination and the impact of mitigation, (iv) landlord's lien, (v) security deposits, (vi) any additional collateral such as letters of credit and (vii) guaranties, if any.
- Non-legal effects of default (i.e., impact on tenant's business).

In this situation, the attorney is counseling the tenant on the ramifications of its actions, and little or no legal action is likely required, other than perhaps a few letters to the landlord. Only in rare circumstances will a tenant elect to default and risk the consequences.

B. Lease Workout/Buyout

In today's uncertain economic times, some landlords will work with the tenant to restructure a lease in a way which is economically acceptable to both landlord and tenant. Alternatively, the tenant might be able to buyout its lease. Landlords desire to maintain cash flow, and if a lease workout/buyout is approached as a constructive "win-win" solution, they can be successful.

The attorney will want to consider the following issues:

- Assessing the practicality of a lease workout/buyout by considering the following issues:
  - Type of landlord – prior dealings with the landlord.
  - Anticipated flexibility of the landlord.
  - Practicality of the landlord's legal remedies.
  - Applicable mortgagee rights.
  - Financial condition of the tenant.
  - Future business prospects of the tenant – tenant's business plan (is it professional and will it convince landlord that a lease workout is appropriate).

- Analysis of tenant's space needs, including the following issues:
  - Short term versus long term needs.
  - Tenant's desire to remain in the current space/building.
  - Marketability of the space.

- The three primary workout options are as follows:
  - Keeping the space and modifying the rent.
  - Lease buyout.
  - Combination.

The attorney's involvement may be significant, as many workouts are directed by the attorneys for the parties. Then, the resolution will be documented by the attorneys and executed by the parties.

C. Bankruptcy

When a tenant files bankruptcy, it has the absolute right to reject a lease and terminate liability, subject to a limited right for the landlord to recover damages.

In an extreme situation where either (i) the lease liability is the primary financial downfall of the tenant or (ii) the tenant has widespread financial problems, filing bankruptcy under the Federal Bankruptcy Code can be a tenant's best solution for unnecessary lease space. Under the Federal Bankruptcy Code, a tenant has the absolute right to reject any and all leases. 11 U.S.C.A. § 365(d)(4) (West, Westlaw through P.L. 118-6). Unless a tenant accepts or rejects a lease within sixty (60) days after filing for bankruptcy, all leases to which it is a tenant will be deemed rejected. *Id.* The rejection of the lease does not terminate the lease, but instead creates a breach of the lease. *RPD Holdings, LLC v. Tech Pharm. Servs. (In re Provider Meds, LLC)*, 907 F.3d 845, n.45 (5th Cir. 2018) (citing *In re Austin Dev. Co.*, 19 F.3d 1077, 1082–1083 (5th Cir. 1994). After the lease rejection, the rights of a mortgagee, assignee or subtenant will be decided by non-bankruptcy law, as the bankruptcy court no longer has any interest in the transaction. *In re Austin Dev. Co.* at 1084.

In certain circumstances, the threat of a bankruptcy filed for the primary purpose of rejecting one or more leases could be used as leverage to reach a non-bankruptcy lease workout.

Clearly, this is a legally intensive area. The actual bankruptcy is beyond the scope of this article.

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