



SUBLEASES & ASSIGNMENTS

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SUBLEASES AND ASSIGNMENTS

J. Cary Barton¹

I. OVERVIEW

Assignment and subletting are two different concepts with distinct legal consequences. Without a thorough understanding of the differing rights among landlords, tenants, subtenants and assignees resulting from assignments and subleases, parties may find themselves unpleasantly surprised. Tenants often seek to assign their leases or to sublet property that they are renting under their leases to avoid default or get out of obligations under the lease. The quantity of interest transferred is what distinguishes an assignment from a sublease. The purpose of this article is to explain and discuss some of the similarities and distinctions between assignments and subleases, both from a legal perspective and from business and practical perspectives, as well as to highlight issues that are of importance to all parties in a sublease or assignment transaction.

II. TENANT'S ALTERNATIVES

Difficult economic times surround us today and are adding an immeasurable amount of stress to businesses and commercial real estate investments. A tenant in economic duress often finds itself with liability under one or more leases for space which is no longer appropriate. This result can be due to downsizing, such that the tenant has terminated business at various locations, or the tenant may have 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 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 that 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". The attorney for the tenant will want to investigate the following issues:

- Analysis of lease provisions and applicable law – insure 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 professional is counseling the tenant on the ramifications of its actions. Probably little or no legal action is required, other than perhaps a few letters to the landlord. Based on this counseling, a tenant will often elect not to default in the performance of its obligations under the lease.

B. Lease Workout/Buyout

As the economy continues to struggle, many operating entities will experience significant deterioration in their financial positions, making the need to re-negotiate the terms and conditions of their leases inevitable. Some landlords will work with the tenant to restructure a lease in a way which is economically acceptable to both landlord and tenant. The purpose of a lease workout is to prevent default and maximize recovery in times of economic adversity. There are few "market" standards in terms of a workout and each situation is heavily negotiated. Workouts are agreed upon because there are incentives for both the tenant and the landlord. The tenant wants to save as much as possible of its investment in the premises and business opportunity while the landlord wants to avoid termination of the lease and a vacancy at the premises and receive payment of as much as possible of the future rent that was originally contemplated in the lease. Rather than compelling yet another default in an already brutal economy, a

¹ The author is very grateful to Reid C. Wilson, Esq., of Houston, Texas, for the permission he granted to base this presentation substantially on several fine prior presentations that Mr. Wilson had made on this subject. Mr. Wilson is not responsible for the contents of this presentation, however, and any mistakes contained herein are solely the responsibility of the author.

successful workout can produce some damage control for all parties involved. The professional 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.
 - What is the anticipated flexibility of the landlord?
 - Know the practicality of the landlord's legal remedies.
 - Know the lease - review all documents.
 - Know the financial condition of the tenant.
 - Future business prospects of the tenant – will the tenant's business plan convince the landlord that a lease workout is appropriate.
 - Know the timeline: How quickly do you need results? Are there 3rd parties who control your ability to have the necessary time to negotiate a reasonable deal?
 - Be Forthright.
- 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.

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 Federal Bankruptcy Law, a tenant has the absolute right to reject any and all leases. Bankruptcy Code §364(d)(4), 11 USCA §365(d)(4). Unless a tenant accepts or rejects a lease within sixty (60) days after filing for bankruptcy, the lease will be deemed rejected. *Id.* The rejection of the lease does not terminate the lease, but instead creates a breach of

the lease. In the matter of *Austin Development Company*, 19 F3d 1077, 1081 (Ct. of App. –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. *Id.* 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 a leverage to reach a non-bankruptcy lease workout.

In some situations, the lease in question may be very favorable to the tenant. Third parties may approach the tenant with a proposal under which the tenant would accept the lease and then sell the lease to the third party for funds that would become part of the bankruptcy estate. There is little that the landlord can do in the bankruptcy proceedings to preclude such a result.

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

D. Assignment and Subletting

While assignments and subleases are both means to achieve substantially similar ends, they do yield different legal and business results. Generally, a tenant's best solution for excess leased space is to either (i) market aggressively all of its premises for an assignment to a third party which will assume the remaining financial obligation (or at least a portion thereof), or (ii) if not all of the premises is to be made available, to sublet a portion of the premises. Since a tenant undertaking the assignment or subletting task does not place any risk on the landlord, this alternative is often the landlord's suggestion when a tenant seeks a lease workout or buyout.

III. ASSIGNMENT AND SUBLETTING LAW

A. Assignment

An assignment is the transfer of the entire interest of the tenant without the tenant retaining any reversionary interest. *Amco Trust, Inc. v. T.C. Naylor*, 317 S.W.2d 47, 50 (Tex. 1958). After the tenant assigns the lease, there is a direct relationship between the landlord and the new tenant. The result creates privities of estate and contract between the assignee and the landlord. *Id.* Therefore, an assignee is legally responsible to the landlord for compliance with all terms of the assigned lease and may be sued by the landlord directly in the event of any non-compliance. Another important incident of assignment that is commonly overlooked is that the original tenant is not automatically released from liability, unless the landlord releases the original tenant or limits the original tenant's liability to its interest in the leasehold.

Just because a lease is assigned doesn't mean the original tenant is no longer liable. Rather, after the assignment, the assignee becomes primarily liable for the obligations under the lease, while the assignor remains secondary liable. *Id.* The assignor continues in privity of contract with the landlord and, therefore, continues to be liable on the lease. *Interstate Fire Insurance Company v. First Take, Inc.*, 817 S.W.2d 142, 144 (Tex. App. – Houston, 1st Dist. 1991, writ denied). However, the assignor does not retain any rights under the lease, such as the right to terminate the lease under a “death or disability” clause in a doctor’s lease. *Twelve Oaks Tower I, Ltd. v. Premier Allergy*, 938 S.W.2d 102, 113 (Tex. App. – Hou. [14th Dist.], 1996, rehearing overruled). It is the substance, not the form, of a document which determines whether it is an assignment. *718 Associates, Ltd. v. Sunwest N.O.P., Inc.*, 1 S.W.3d 355, 361 (Tex. App. - Waco, 1999, pet. denied). So long as the entire lease term and the entire estate or interests held by the tenant are assigned, such that there is no reversionary interest of any type, an assignment has occurred. *Id.* The title of the document (e.g. “Sublease”) is irrelevant. *Id.*

Where an “assigning” tenant retains the right to re-enter the premises if the assignee fails to pay rent or otherwise perform under the assignment, as a remedy to protect the tenant, then the tenant has a reversionary interest, thus creating a sublease rather than assignment, notwithstanding that the entire lease term and all of the tenant’s rights were transferred to the assignee. *Novasad v. Clary*, 431 S.W.2d 422, 426 (Tex. App. – Houston, 1st Dist. 1968, writ dismissed). A mortgagee in possession is not an assignee, although the mortgagee of a leasehold estate which forecloses on the leasehold interest and takes possession would be an assignee. *Amco Trust, Inc.* at 51. An assignee has the right to exercise a purchase option or renewal option in a lease. *718 Associates, Ltd.* at 365.

B. Sublease

Any transfer of rights by a tenant which does not meet the strict requirements for an assignment is a sublease. The structure of a sublease is much different from that of an assignment. A sublease is an agreement between an original tenant and a subtenant to sublet a portion of the premises or sublet the entire premises for a defined term that is less than the term of the original lease. As far as liability is concerned, the original tenant retains all rights and obligations under the original lease. There is no direct relationship between the landlord and the subtenant, which may result in the loss of various rights for the subtenant. The subtenant pays rent to the original tenant and the original tenant is the subtenant’s landlord. A landlord has no rights to directly enforce a sublease unless the

lease specifically states otherwise. However, when the landlord consents to a sublease and the sublease states that the subtenant assumes the entire tenant’s liability under the lease, then the landlord has the right to directly enforce the lease against both tenant and subtenant. The tenant pays the landlord lease rent and the subtenant will pay the sublease rent to the tenant. Insuring that a tenant pays the rent can be a concern for the subtenant. *Amco Trust, Inc.* at 150, *718 Associates, Ltd.* at 360. The title and form of the transfer document (e.g. "Assignment") is not relevant. *718 Associates, Ltd.* at 361. If the original tenant retains any reversionary interest, the transfer is a sublease. *Amco Trust, Inc.* at 150. With a sublease, there is no privity of estate between the subtenant and the landlord. *Id.* The subtenant is not liable to the landlord to comply with the lease or sublease unless it specifically assumes the obligation to perform the lease. *Id.* A landlord has no rights to enforce a sublease directly against a subtenant, even if the landlord consented to the sublease. *Parr v. Farmers State Bank of Orange Grove*, 659 S.W.2d 883, 884 (Tex. App. - San Antonio, 1983, no writ). However, where the landlord consented to the sublease and the sublease provided that the subtenant assumed all of the tenant's liability under the lease, then the landlord was a third party beneficiary and could directly enforce the lease against both the tenant and subtenant. *Manges v. Willoughby*, 505 S.W.2d 379, 384 (Tex. Civ. App. - San Antonio, 1974, writ refused n.r.e.).

A subtenant may not exercise a purchase option or renewal option. *Novasad* at 427, *718 Associates, Ltd.* at 365.

An excellent discussion of the distinction between assignments and subleases, and the relative rights for the parties, is contained in *718 Associates, Ltd.*, 1 S.W.3d 355.

C. Privity

Privity of contract refers to the relationship formed between two parties entering into a lease or other agreement. The signing of a lease between a landlord and tenant creates privity of contract. Privity of estate refers to the parties between whom an estate in property is transferred. When the tenant takes an interest in real estate from a landlord, or a landlord grants a leasehold estate to a tenant, privity of estate is created. The original tenant has both privity of contract and privity of estate with the landlord. If the original tenant assigns its lease, it loses privity of estate with the landlord and the privity is then picked up by the assignee. The original tenant does continue to keep the privity of the contract, and therefore retains its contractual liability to the landlord. In a sublease, the

original tenant retains both privity of contract and privity of estate with the landlord.

D. Statutory Prohibition of Assignment and Subletting

TEX. PROP. CODE §91.005 states:

“During the term of a lease, the tenant may not rent the leasehold to any other person without the prior consent of the landlord.”

This prohibition applies both to assignments and subleases. *718 Associates, Ltd.* at 360. As a matter of public policy, this prohibition is incorporated into all leases by operation of law. *Id.* This statutory prohibition can be avoided if the lease clearly expresses such intent. *Id.* A statement in a lease that the tenant has the right to “assign or transfer this lease or to underlease or sublease the whole or any part of said lease premises” is sufficient to evidence a landlord’s authority for a tenant to assign or sublease a lease. *Id.* at 363. Tenants from other states may make the mistake of assuming that assignment/subletting is allowed in Texas if not specifically prohibited, as is the rule in the many other states.

E. Landlord Consent

Landlord consent is always required, unless the lease specifically authorizes a tenant to assign or sublet the leasehold premises without the landlord’s consent. *Id.* In practice, most leases will specifically prohibit assignment or subletting without landlord consent, unless the tenant has significant negotiating power. Since the statutory prohibition of assignments or subletting is solely for the landlord’s benefit, only the landlord may bring an action for any wrong done as a result of a sublease or assignment made without the landlord’s consent. If the original tenant does assign or sublet the lease without the landlord’s consent, the landlord may refuse to accept rent and treat the lease as forfeited. The statutory prohibition against assigning a lease without the landlord’s consent may be avoided only by a clear expression of such intent in the lease agreement. For example, a lease provision granting the lessee the right to assign the lease without the landlord’s consent when the tenant is mortgaging its interest will not operate as a relinquishment by the landlord of the right to consent to subsequent assignments. A lease may include a provision that the landlord will not unreasonably withhold consent to a sublease or assignment. In that case, the reasonableness of the landlord’s refusal to consent is determined by reference to the terms and conditions of the original lease. It is unreasonable for

the landlord to condition consent on a change in the terms and conditions of the original lease based on what the landlord finds economically advantageous at the time of the attempted assignment or sublease.

Unfortunately for tenants, unless the lease agreement provides otherwise, a landlord need not act reasonably in withholding consent, as there is no implied duty of good faith and fair dealing in Texas in connection with the landlord/tenant relationship. *Trinity Professional Plaza Associates v. Metrocrest Hospital Authority*, 987 S.W.2d 621, 625 (Tex. App. – Eastland, 1999, pet. denied). This is true even if the lease is a long term ground lease. *Id.* The court will not consider the fact that the landlord’s refusal to consent to an assignment or sublease creates the practical equivalent of a restraint on alienation. *Id.* If a tenant desires to require a reasonableness standard for a landlord’s consent, it must be clearly included in the lease. *Id.*

“It is well settled law that a landlord has no duty to accept an assignment of a lease unless the parties clearly evidence such intent. [citations deleted] As previously noted, the lease in the instant case did not impose a duty upon lessors to accept the assignment of the lease. Since the lease did not impose a duty on lessors to accept such an assignment, they did not breach the lease when they refused to accept such an assignment.” *Vasquez v. Carmel Shopping Center*, 777 S.W.2d 532, 536 (Tex. App. – Corpus Christi, 1989, writ denied).

In *Vasquez*, the landlord refused to approve the assignment of a lease for an ill tenant unless the rent was increased. The proposed assignee refused, so the landlord locked out the delinquent tenant and sued for back rent (which it recovered).

Where a landlord’s consent to an assignment or subletting is “not to be unreasonably withheld,” there is no clear standard from Texas cases. One case struggling with an appropriate standard for a landlord’s consent used the following words and phrases to describe the elements of unreasonableness in the act of withholding consent:

- arbitrary
- without fair, solid and substantial cause or reason
- capricious, despotic, tyrannical, bound by no law
- without regard to principles
- irrational
- beyond the bounds of reason or moderation
- immoderate
- exorbitant
- irrational, foolish, unwise, absurd, silly, preposterous, senseless and stupid
- no room for difference of opinion among reasonable minds.

Mitchell's, Inc. v. Nelms, 454 S.W.2d 809, 813 (Tex. Civ. App. – Dallas, 1970, writ ref'd. n.r.e.). Ultimately, the court looked to the language of the lease in determining whether the landlord's refusal to consent to a sublease was reasonable.

The Fifth Circuit, applying Texas law, held that the reasonableness of a refusal to consent to an assignment or sublease was determined by reference to the terms and conditions of the prime lease, noting this is consistent with the Second Restatement of Property. *BMB Corporation v. McMahan's Valley Stores*, 869 F.2d 865, 869 (CA - 5th Cir., 1989). The court held that it would be unreasonable for a landlord to condition consent to a transfer on a change in the terms and conditions of the prime lease. *Id.* Reasonableness is to be determined by reference to the prime lease, not by what the landlord later finds out is most economically advantageous, therefore a demand for higher rent would not be reasonable. *Id.* Specifically, a landlord could not withhold consent based on concerns that the assignee tenant would not pay the same amount of percentage rent, unless the prime lease contained a covenant that the tenant will endeavor to maximize the percentage rent. *Id.*

If the landlord claims that the basis for denial of consent is advice of counsel, the attorney-client privilege will not prevent the tenant from discovering documents upon which the landlord relied in denying the requested consent. *In re: S. R. Tjia and M. G. Soliman*, 50 S.W.3d 614, 618 (Tex. App. – Amarillo, 2001, rehearing overruled). Therefore, a landlord may not hide behind advice of counsel, and then assert the attorney-client privilege to prevent the tenant from contesting the reasonableness of the denial.

The requirement for consent to an assignment or subletting can be waived by the landlord accepting rent from the assignee or subtenant. *Nardis Sports Wear v. Simmons*, 218 S.W.2d 451, 614 (Tex. 1949).

Since the tenant will remain liable on the lease and the landlord cannot (if a reasonableness standard applies to the lease) either demand an increase in rent or withhold consent based on concerns about the amount of future percentage rent, the landlord is left to focusing on specific contractual provisions contained in the lease as a basis for denying or withholding its consent.

Most landlord forms specifically deal with the payment of excess rent in the event of a sublease, providing either (1) that all of the excess rent should be paid to the landlord (either with or without deduction of any type), (2) that a portion of the excess rent will be paid to the landlord (without any deduction), or (3) in leases aggressively negotiated by tenants, the landlord will be paid a portion of the excess rent net of the tenant's reasonable expenses of reletting.

Many lender documents for loans on income producing property require the lender's consent to lease changes and the language may be expansive enough to cover assignment or subletting. Obtaining consent from institutional lenders can be problematic, particularly where the servicing is being performed by a third party agent.

F. Construction

Subleases and assignments will be construed against the sublessor/assignor. *Ford v. B&B Vending Co.*, 512 S.W.2d 702 (Tex. Civ. App. – Amarillo, 1974, no writ).

G. Bankruptcy

The rejection of a lease by a bankrupt sublessor is also a rejection of the sublease. The lease is not automatically terminated; rather the rejection is considered a breach. The subtenant's rights are then determined by applicable non-bankruptcy law. *In Re: Austin Development Co., Id.* at 1084.

Rejection of a sublease by a bankrupt sublessor cancels the sublessor's covenants of future performance under the sublease. *In Re: Elephant Bar Restaurant, Inc.*, 195 B.R. 353 (W.D. Tx, 1996). Subtenant's remedy is limited to offsetting rent due. Bankruptcy Code Sec. 365(h)(1)(B), 11 U.S.C.A. Sec. 365(h)(1)(B). Although probably not a major problem in an assignment situation, in a partial sublease context where the subtenant must then perform under the prime lease to protect the rights to only a portion of the term or leased premises, this remedy is of limited practical benefit.

H. Modification of Entity as Prohibited Assignment

It is unclear the extent to which an entity tenant can modify its ownership structure without being deemed to violate a prohibition against assignment. Adding a partner to a partnership has been held not to violate a prohibition against assignment. *Denning v. Republic National Bank Bldg. Co.*, 294 S.W.2d 888 (Tex. Civ. App. – Dallas, 1956, writ ref'd. n.r.e.). However, the liquidation of a partnership and the assignment of all the rights of one partner to the other partner were held to violate a lease requiring consent to assignment. *Heflin v. Stiles*, 663 S.W.2d 131, 134 (Tex. App. – Ft. Worth, 1983, no writ). It also appears that a substitution of partners would be considered a violation of an anti-assignment clause. A related party merger is probably not a transfer, and even a merger with a third party might not be a transfer. *TXO Production Co. v. Mark*, 999 S.W.2d 137, 141 (Tex. App. – Hou [14th Dist.], 1999, pet. den.) [non lease case which analogized to lease cases in non Texas

jurisdictions]. To be safe, a partnership tenant should not expect it can do anything other than add partners without landlord consent. See B. Dow, *Assignment, Subleasing, Expansion Option and Right of First Refusal Aspects of Commercial Leases*, Real Estate Law: Leases in Depth, SMU School of Law, 1991 for a detailed discussion of the ability of an entity tenant to be sold without violating an anti-assignment clause.

It should be noted that Section 10.08(a)(2)(C) of the Texas Business Organizations Code, as amended, provides that, in the event of a merger of two entities, the real estate interests of the merged entity become the property of the surviving entity "without any transfer or assignment having occurred." This provision was enacted primarily at the behest of publicly-held tenants in order to permit companies to merge without having to obtain consents for the assignment of every lease to which the merged entity was a party. It is not clear whether this result can be varied by the terms of a lease agreement, but the public policy context of this provision suggests that such a variation would not be effective.

I. Duties of a Landlord to a Subtenant/Assignee in Possession Without Consent

If a subtenant or assignee takes possession of premises without required landlord consent, that party is a trespasser. *Lampasas v Spring Center, Inc.*, 988 S.W.2d 428, 433 (Tex. App. – Hou. [14th Dist.], 1999, no pet.). The only duty owed a trespasser by the owner is not to injure them willfully, wantonly, or through gross negligence. *Id.* at 434.

The trespasser takes the premises as the trespasser finds it and, if injured by unexpected dangers, the loss is the trespasser's. *Id.* A prohibited assignment does not invalidate a lease or relieve the tenant or assignee from liability under the lease. *Reynolds v. McCullough*, 739 S.W.2d 424, 432 (Tex. App.—San Antonio, 1987, writ. den.). The lease is not void, but voidable, at the landlord's option, not the tenant's. *Elliott v. Dodson*, 297 S.W. 520, 522 (Tex. Civ. App. – Fort Worth, 1927, no writ).

J. Quasi-estoppel

Quasi-estoppel is the legal term for equitable defenses such as ratification, election, acquiescence, waiver or acceptance of benefits, all of which may apply to lease assignments and subleases. *Twelve Oaks Tower I, Ltd. v. Premier Allergy*, 938 S.W.2d 102, 111 (Tex. App. – Hou. [14th Dist.], 1997, rehearing overruled). An assignee who paid rent may not later deny liability under the assigned lease, based on the landlord not consenting formally to the assignment, as it had availed itself of the benefits of the lease. *Id.* A landlord who accepts rent from an assignee which did

not obtain a required landlord consent will waive its right to object and to exercise its remedies under the lease. *Nardis Sportswear v. Simmons*, 218 S.W.2d 451, 454 (Tex. 1949). An assignment may be assumed where the assets of a business are sold and the purchaser took possession of the business premises and commenced paying rent. *Johnson v. Golden Triangle Corp.*, 404 S.W.2d 44 (Tex. Civ. App. – Waco, 1966, no writ), *Twelve Oaks Tower I, Ltd.*, at 113.

IV. ASSIGNMENTS IN PRACTICE

A. Circumstances When Assignment is a Tenant's Best Option

Assignment of the tenant's complete term and interest under a lease may be its best choice under the following circumstances:

1. the space is highly marketable, particularly if it is in a desirable building, has a desirable configuration and contains a high level of tenant finish;
2. the tenant no longer has a business need to be in the particular building, the building is too expensive, the space is too big or the space no longer works efficiently; or
3. the space is not easily divisible.

B. Landlord's Consent / Landlord's Mortgagee's Consent

1. Consent required. The landlord's consent will be required unless it is clearly stated otherwise in the lease. Although tenants commonly negotiate several specific exceptions to landlord consent to an assignment or subletting (related party transactions/limited reallocation of ownership interests/sale of all of tenant's assets/estate planning considerations), those exceptions are unlikely as a practical matter to apply to an economically distressed tenant attempting to off-load excess lease space.
2. Landlord consent not to be unreasonably withheld. Texas has no clear test for a landlord's reasonableness. The court will likely look to the language of the lease for help in setting a reasonableness standard. Without more, a requirement for an increase in rent in order to approve an assignment or sublease would be unreasonable. The tenant's best strategy is to approach the landlord in advance and discuss what issues are important to the landlord in considering a proposed assignee or subtenant. Unfortunately, an economically distressed

tenant is unlikely to have the ability to challenge by lawsuit unreasonable landlord requirements, particularly those which are borderline (i.e. some arguable relationship to issues in the lease).

3. Purchase of the tenant entity to avoid landlord consent. There may be circumstances where it might be possible, from a corporate or partnership law perspective, to structure a sale of the tenant entity in an attempt to evade the requirement for landlord consent. Based on the unsettled state of Texas law, this is not advisable, particularly where the tenant is a partnership. See discussion in Section III.H., *supra*.
4. Mortgagee consent. In almost every case, there will be a mortgage on the landlord's project. Most likely the loan documentation, and possibly a subordination, non-disturbance and attornment agreement signed by the tenant for the benefit of the mortgagee, may have the effect of requiring mortgagee consent for the assignment or sublease. Further, the subtenant or assignee may insist upon a non-disturbance agreement from the mortgagee. Obtaining consent from an institutional, out of state mortgagee may be problematic.
5. Timing. Particularly with institutional landlords and mortgagees, the timing of consent can be problematic. Since every month of delay is a huge issue with the cash-poor tenant, there should be advance planning in order to minimize the delay in obtaining any required consent. Also, as is common in direct lease transactions, requiring a non-disturbance agreement for the benefit of an assignee/subtenant might be a "good faith" or "best efforts" obligation that can be satisfied after the commencement date.

C. Tenant's Focus and Concern

When negotiating a lease, a landlord and future tenant are primarily focused on reaching agreement on the financially significant terms of their lease relative to the present market conditions and each other. The rights of the landlord's lender in the event of needing future financing or in the event of a foreclosure of the landlord's property are not dominant in the minds of either the landlord or tenant during lease negotiations. In lease negotiations, the immediacy of the principal parties' concerns relative to one another is much more important than the potential thoughts and stipulations of a future third party. This is where legal counsel is

strongly advised to ensure that potential third-party legalities are covered and future controversy is minimized.

D. Tenant Liability

Unless specifically released by the landlord, the tenant's liability on the lease will continue after the assignment. Sometimes, landlords will agree to limit or release a tenant's liability, but only after qualifying the credit of the assignee. If a release of the tenant's liability is critical for the transaction, this must be established and agreed to by the landlord at the inception of marketing of the premises. Other issues to be addressed include release/substitution of any security deposit, release/substitution of additional collateral, release and substitution of guarantors and any other credit issues specific to the transaction.

The tenant may need to rely upon the fact that the assignee has liability for all obligations under the lease. The assignee will almost always agree to indemnify the tenant, but in the event of a default by the assignee of its obligations on the lease, that indemnification is probably of no real benefit. Without a release of liability, the tenant will be jointly and severally liable with the assignee.

E. Subordination, Non-Disturbance, & Attornment Agreements

A subordination, non-disturbance, and attornment agreement (SNDA) addresses the priority of the rights of tenants and lenders. It deals with how and when the rights of tenants will be subordinate to the rights of lenders or, sometimes at a lender's option, senior to the rights of lenders. The non-disturbance portion assures tenants that their rights to their premises will be preserved ("nondisturbed") on specified conditions within their control, even if the landlord defaults on its loan and the lender forecloses. The attornment component of the SNDA agreement provides that the tenant will continue to perform its obligations under the lease in the event that a new landlord takes over the lease and may also specify that the lender or such purchaser will have certain specified rights thereafter. It assures a lender, generally, that the tenant will attorn to (that is, confirm privity of contract by agreeing to continue as tenant of the new landlord) the lender or a purchaser following a foreclosure. An SNDA agreement may also include other provisions for confirming or modifying further rights and obligations.

F. Marketing the Premises

1. Through landlord (or its brokers). There may be circumstances where it is in the best interests of all of the parties that the leasing

agent for landlord's project be engaged to find a new tenant for the tenant's premises. This would be a minority circumstance, as the landlord's leasing agent is most likely to favor its ongoing client, the landlord, in showing space in the project. Where this issue can be addressed and the tenant's space will receive a fair opportunity to be leased, then using the landlord's agent (being the agent most knowledgeable with the project) may be appropriate. In this circumstance, the landlord is handling the re-leasing in essence, but without absorbing the economic risk. This circumstance could also be favorable where it is likely that, in order to market the space most effectively, an additional lease term will need to be provided by a lease directly with the landlord commencing after termination of the lease being assigned. This is particularly true where the lease being assigned has no extension option.

2. Through separately retained brokers. In most instances, the tenant retains an independent broker to handle the marketing of the premises. The broker will coordinate with the landlord and the landlord's leasing agent in order to be able to provide an extended term, if that is necessary to attract a tenant. A good working relationship with the landlord and its leasing agent is often important. The retained broker owes its loyalty only to the tenant.
3. Marketing expenses. The tenant should consider a realistic marketing budget to potentially include extensive advertising costs, space planning expenses and a tenant improvement allowance. An aggressive marketing program is necessary since the underlying lease is a depreciating asset (i.e., the term is reducing) and the tenant's burden to perform under the lease continues until an assignee is obtained.
4. Selection of Assignee. In these tough times, the tenant should be prepared to respond quickly and focus on the most likely candidate to actually close the deal, not necessarily the best economic deal. Today, there is no time to waste on "flakey" deals. Also, the tenant must be prepared for the reality of low/no credit assignees, particularly if they are not interested in getting additional terms from the landlord. These are part of a subculture of "wandering subtenants," who are gypsy-like, constantly moving to the next

low rate deal. They do not renew at termination.

G. Financial Issues

1. Upfront payment. In the best of all possible worlds, the assignee would pay a lump sum amount to the assigning tenant in order to receive the benefits of the assigned lease. However, it is more likely that the assigning tenant may make a lump sum payment to the assignee in order to entice it to assume the lease obligations.
2. Security deposit. Preferably, the tenant will want its security deposit refunded after the assignee has provided the landlord with a replacement security deposit. In the alternative, the tenant may agree to have the assignee reimburse the tenants for the security deposit. Possibly, the security deposit would remain in place with an agreement that when it is released at the end of the lease term, it would be paid to the tenant (which would require a tri-party agreement with the landlord). This last alternative would expose the tenant's security deposit to the risk of the assignee's default and is not recommended.
3. Additional collateral. Preferably, additional collateral will be released or substituted with new additional collateral deposited by the assignee. If not, the additional collateral could remain in place with an indemnity agreement by the assignee for the benefit of the tenant.
4. Rent payment. Since the assignee is stepping into the shoes of the tenant, rent is paid directly by the assignee to the landlord. Any tenant who is not released from liability will want evidence of the assignee's payment of rent.

H. Modification of the Lease

The assignee will be encouraged to accept the lease without any changes. However, the assignee may insist upon modifications. Although perhaps rare, there are circumstances when the landlord is happy to be rid of the financially challenged tenant and looks forward to the move-in of the assignee. In those circumstances, the lease can be modified, either in a tri-party assignment/ modification agreement signed by landlord, tenant and assignee (see example attached), or by a two party modification agreement signed by the landlord and either the tenant (immediately prior to the assignment) or the assignee (immediately after the

assignment). All documentation can be coordinated through a “closing”.

I. Practical Assignment Issues

1. **Tenant Release.** Every tenant will want to be released from liability on the lease upon an assignment. Some landlords will never release a tenant. Others will release the tenant if the assignee meets the landlord’s underwriting requirements for new tenants.
2. **Landlord cooperation.** In today’s uncertain economic conditions, some landlords are happy to cooperate with cash-poor tenants, because the landlords are concerned with the long term viability of the tenant. In some circumstances, the landlord is willing to make minor concessions in lease documentation, but generally the landlord limits its cooperation to attempting to facilitate the assignment transaction. Issues regarding the reasonableness of the landlord’s consent are rarely a problem when the tenant, or the tenant’s attorney, has convinced the landlord, or the landlord’s attorney, that the tenant’s economic problems are legitimate and that a cooperative approach is in the landlord’s best interest.
3. **AS-IS condition.** The tenant has a strong preference to assign the lease with the lease premises in their current, AS-IS, WHERE-IS condition. Tenants may be willing to provide a cash payment to the assignee rather than remodeling the premises.
4. **Renewals.** The tenant will want to address its continued liability in the event the assignee elects an extension option under the assigned lease. Since the tenant has continued liability on the lease, if the lease is extended under provisions in the original lease agreement, that liability will be extended. A knowledgeable tenant will want the lease assignment document to provide either that the assignee agrees not to exercise a renewal right (or an expansion right) thereby increasing tenant’s liability, or will cause the landlord to release the tenant at that time. The tenant will be released automatically if the landlord and the assignee negotiate a new lease extension after the assignment is effected.
5. **Assignee default.** Since tenant has continued liability, it will look for practical remedies in the event of a lease default. A provision in an assignment document that the tenant has

the right to retake possession of the leased premises upon a default by the assignee provides a very practical and effective remedy, but constitutes a reversionary right, and converts the assignment to a sublease. This may be an acceptable legal conclusion for the parties, however, the tenant will want to have the assignee/subtenant specifically assume obligations under the lease so that the assignee/subtenant will have direct legal liability to the landlord. The assignee/subtenant will want the landlord to acknowledge its right to exercise all options. As a result, the “sublease” transaction could have the hallmarks, including legal results, of a true assignment, but the assigning tenant would have a recapture right to provide protection against an assignee default. The author has never seen it used, but another alternative to enable an assignor to regain possession would be to have the assignee execute a deed of trust to secure performance encumbering the assigned leasehold estate, although this strategy would probably require landlord and landlord’s mortgagee’s consents.

J. Assignment Forms

Attached are 3 lease assignment forms as follows:

- Most basic assignment form
- Simple assignment form
- Tri-party assignment form including landlord estoppel, lease modification, lease assignment, and release of tenant, payment to assignee and conveyance of furniture to assignee

V. SUBLEASING IN PRACTICE

A. When is Subleasing Appropriate?

Subleasing is appropriate whenever assignment is not practical. Any time the tenant reserves a reversionary interest, the transaction is a sublease. Obviously, where the tenant desires to retain a portion of the space, the remaining premises will be sublet.

B. Consent by Landlord and its Mortgagee

The issues regarding consent for a subleasing transaction are the same as in an assignment transaction.

C. Tenant Liability

Like an assignment transaction, in a subleasing transaction the tenant’s liability remains. The primary difference is that the subtenant generally has no liability directly to the landlord. If it is desired that the

subtenant is to be liable to the landlord for obligations under the lease, then that should be specifically stated. The subtenant should be aware that where it assumes obligations under the prime lease, and the landlord consents to the sublease, then the landlord is considered a third party beneficiary of the subtenant's assumption such that the landlord may sue the subtenant for lease violations.

A tenant should ensure that the subtenant agrees to perform all the lease obligations of the original lease but within a shorter period of time than that required for the tenant. A tenant will not want to assume any of the landlord's responsibilities under the original lease and will want to limit its obligations under the sublease. A tenant ideally only wants the obligations pertaining to the non-subleased premises and payment of rent for the entire lease premises.

D. Marketing the Premises

The issues encountered in subleasing a portion of the leased premises are the same as assigning the entire lease, except more extreme as the size of the space and length of term reduces. However, tenant may need to "spruce up" the area to sublet for it to show well to prospects. It may also be preferable to actually vacate that space so the prospect can better imagine its operations in the space.

E. Financial Issues

1. Rent payment. The tenant remains liable to pay all rent. Typically, the tenant will pay all prime lease rent to the landlord and the subtenant will pay the sublease rent to the tenant. It is possible, but rare, to structure a transaction for the subtenant to pay its rent directly to the landlord with the tenant paying the difference. Most landlords will not want to be involved in the collection of sublease rent.
2. Insuring tenant pays the rent. The subtenant may have concerns about the tenant's payment of rent on the prime lease. Where the tenant is financially distressed, these legitimate concerns may lead to a subtenant's desiring to pay sublease rent directly to the landlord. Where the sublease premises are simply excess space of a solvent tenant, these concerns are less significant. More practically, the assignee can request a personal guaranty or additional collateral for the tenant's obligation. Some subtenants just hope for the best, figuring that the sublease rent will be sufficient to keep the tenant economically viable.

3. Calculation of rent. Sometimes, the calculation mechanism for sublease rent is different (and often simpler) than for the prime lease rent. For example, the sublease rent may be quoted on a gross basis, while the prime lease rent is payable on a net basis. Care should be given to insure there is clarity regarding the relative party's obligations.
4. Subtenant's improvements. If the subtenant requires modifications to the premises, the parties must address the requirement for approvals from the landlord, the landlord's mortgagee (if applicable) and the tenant.
5. Security deposit. The parties must determine whether the security deposit will be replaced on a prorata basis by the subtenant, a separate deposit made by subtenant with tenant, or the subtenant will simply indemnify the tenant for a prorata portion.
6. Credit enhancement. The tenant may require a lease guaranty or additional collateral to secure the subtenant's obligations under the sublease, just as a landlord might do in a direct lease.

F. Practical Sublease Issues

1. Tenant. In a sublease, the tenant will have many of the same concerns which a landlord has in a direct lease transaction, with a few unusual twists:
 - (a) Subtenant's rent should be due to tenant sooner than the outside deadlines for rent payments due under the prime lease, in order to provide tenant the ability to use the subtenant's rent payments in making the prime lease payment. Subtenant should covenant to perform all lease obligations as to the subleased premises, but within a shorter time period than that required for tenant, in order to give tenant an opportunity to cure any non-performance by the subtenant.
 - (b) Tenant will not want to assume any of landlord's responsibilities under the prime lease. Tenant will want to disclaim any obligation to provide any services to the subtenant, or at least to limit any services required to be provided to those which the landlord is obligated to provide under the main lease. Tenant will want to limit its obligations under the sublease to (i)

- payment of rent for the entire lease premises, and (ii) performing obligations as to the non-subleased premises. Thus, tenant will want to pass-through to the subtenant casualty, condemnation and interruption of service issues as to the subleased premises.
- (c) Subtenant modifications to the subleased premises must be addressed, particularly the approval process. Tenant will wish to limit those modifications, for practical and legal reasons.
 - (d) The subtenant will be required to have insurance consistent with that required to be held by the tenant and will be expected to show both tenant and landlord as additional insureds.
 - (e) Since the relationship between tenant and subtenant is a landlord/tenant relationship, tenant will usually require subtenant to waive all express and implied warranties.
 - (f) Where tenant desires the transaction to be a sublease rather than an assignment, despite the fact that the entire leased premises is being sublet, the tenant will require a clear reversionary right be retained by the tenant.
 - (e) The parties must deal with timing for obtaining consents from the landlord, as well as the possibility that the consent will not be freely given, or will be given with conditions.
2. Subtenant. The subtenant will have similar issues to a tenant in a direct lease transaction, with the added concern of whether tenant will perform all of its obligations on the prime lease. A key concern is the loss of the sub-leasehold estate for reasons outside the subtenant's control, including defaults by the tenant in performing the tenant's obligations under the original lease. The prime landlord is entitled to terminate and divest the prime leasehold and all its rights, including the sub-leasehold estate, in the event of a default on the prime lease. More issues include the following:
- (a) Subtenant will want landlord's consent (and possibly landlord's mortgagee's consent) to the sublease transaction. The timing and form of these consents could be critical. Even if the mortgagee's consent is not required under the landlord's loan documents, subtenant may want a non-disturbance agreement in the event of a foreclosure of the landlord's project.
 - (b) Subtenant will want landlord to provide an estoppel letter confirming that there are no uncured defaults under the prime lease.
 - (c) A careful subtenant will review the prime lease and in the event of concerns about the subtenant's ability to comply strictly with the lease provisions, subtenant will require a modification or waiver of those provisions by the landlord.
 - (d) Insurance requirements should be carefully addressed.
 - (e) Subtenant will want to insure there is an adequate legal description of the sublease premises.
 - (f) Subtenant will want to insure it has received all necessary consents from tenant and landlord for any necessary build-out at inception and will want the right to make additional modifications without obtaining tenant's consent, so long as it has obtained landlord's consent.
 - (g) Where there are renewal or expansion rights, subtenant may want the right to participate if tenant intends to elect those rights.
 - (h) The allocation of parking between tenant and subtenant should be carefully addressed.
 - (i) Although many landlords are very reluctant to provide these assurances, knowledgeable subtenant may want a landlord to agree to various protections as follows:
 - (i) notice of tenant default,
 - (ii) right to cure tenant default,
 - (iii) right to assume the lease after a tenant default,
 - (iv) landlord agreement not to disturb subtenant if landlord terminates the prime lease,
 - (v) subtenant's right to exercise renewal/expansion rights relating to the subleased premises.

3. Landlord. The landlord's concerns with a sublease will primarily relate to the complication of an additional party utilizing a portion of the lease premises. The landlord's issues include the following:

- (a) Determining what restrictions there are to its unfettered ability to deny consent and/or establish requirements for that consent.
- (b) Desire for no conflict with the terms of the prime lease or with the rights of other tenants in the project on issues such as:
 - uses
 - parking
 - intensity of use
 - business hours
 - energy consumption

Landlord may wish to condition its consent to issues of this type being appropriately addressed.

- (c) Landlord will want to insure there will be no unintended amendments of the prime lease. The landlord will want to require that the sublease contain a provision stating that, in the event of any conflict between the lease and the sublease, the terms of the lease will control.
- (d) Landlord will not want to have any privity of contract with a subtenant, rather, it will likely insist that its only landlord/tenant relationship will be with the tenant. This eliminates any duties to the subtenant, but also simplifies legal relationships by eliminating one party. If the approved sublease requires the subtenant to assume the obligations of the lease, then the consenting landlord is deemed a third party beneficiary so it can sue the assignee directly. Landlord will want to specify clearly that it is not assuming any liability as to the subtenant or the sublease.
- (e) Landlord may insist that the subtenant waive all claims against landlord, as well as provide appropriate insurance, with landlord as an additional insured.
- (f) In some circumstances, the landlord may allow or request direct payment of sublease rent from the subtenant.

Landlord may want to specify that such acceptance is not a ratification of the sublease as a direct lease so that in the event of a default by the tenant the landlord retains all remedies.

- (g) Landlord will want to address the question of whether the subtenant may deal directly with the landlord and *vice versa*. Some landlords may not want to have any direct communications for legal reasons, while others may wish to have direct communication for practical reasons.
 - (h) Landlord may insist that its attorney's fees and costs regarding the sublease transaction be paid prior to any consents being granted.
4. Mortgagee. Many mortgage documents require approval of all leases over a specified square footage, or the modification thereof, or the change of any tenant. A sublease may trigger the requirement for mortgagee's approval, collateral assignment of prime landlord's rights, pre-approval of any modification that would impair or prejudice its rights, prohibition against assignment or subletting of the leasehold without its consent and, as with the SNDA model, extinguishment of the subtenant's rights to recognition if the subtenant is in default under either (a) its sublease beyond cure periods, (b) the recognition agreement beyond cure periods, or (c) under either the sublease or the recognition agreement where the default is incurable. The mortgagee's concerns should be no different than for a direct lease transaction. The concerns of the other parties will be with the timing and potential non-responsiveness of a mortgagee to a transaction that all of the other parties have approved.

G. Subleasing Forms

Most sublease forms are "pass-through" forms whereby the prime lease is incorporated by reference and the subtenant agrees to comply with all of the prime lease provisions as they apply to the subleased premises. Some subleases provide that the tenant bears all the obligations of the landlord under the prime lease. When a pass-through form is proposed by the tenant subleasing the premises, the attorney for the proposed subtenant must review carefully the prime lease, as there will likely be many provisions under the prime lease which are not appropriate to be

incorporated by reference in the sublease without modification or clarification. As an alternative to a pass-through sublease, there is no reason (other than a desire not to have a conflict with the prime lease) not to utilize a standard lease form for the relationship between the tenant and subtenant, if that instrument is carefully drafted to conform to the prime lease and the sublease transaction.

If a pass-through sublease form is utilized, subtenant will want to consider excluding all or a portion of any of the following provisions in the prime lease:

1. Additional rent provisions (if the sublease is on a gross basis or if the sublease is on a pass-through basis with different provisions than the prime lease).
2. Insurance.
3. Assignments/subletting.
4. Alterations.
5. Limitation on landlord's liability to its interest in the building (which could result in an, effectively, non-recourse sublease as to the sublessor).
6. Indemnifications.

Attached as Attachment D is an example of a quasi pass-through forms of sublease.

VI. LEASE NEGOTIATION OF SUBLEASING AND ASSIGNMENT PROVISIONS - SOLVING FUTURE PROBLEMS BEFORE THEY HAPPEN

A clear understanding of the difference between assignment and subletting, and why the tenant desires to be able to assign/sublet, allows the attorney to properly negotiate the assignment/ subletting provisions of a lease at inception, whether representing the landlord's or the tenant's interest.

A. Landlord's Perspective

1. Only landlord is in the real estate business. Landlords have their own reasons for seeking to prohibit, or severely limit, a tenant's ability to assign or sublet. The landlord is in the real estate business and considers the tenant to be utilizing the landlord's real estate only for the purpose of facilitating the tenant's business enterprise. The landlord does not want the tenant to compete with the landlord in the real estate business by offering to assign/sublet its lease to a third party, thereby becoming a competitive landlord. By signing the lease, a landlord

sees tenant as committing to provide a portion of landlord's income stream, upon which income stream the landlord relies in committing to its lender and its investors to make various payments. Landlord is not a "partner" with tenant in tenant's business enterprise and does not believe it should share in any risk from that enterprise. From the landlord's point of view, the obligation to pay rent should be at the top of tenant's financial obligations. Many landlords believe that once the landlord has provided the premises to a tenant, in compliance with the build-out obligations of the lease, and thereafter continues to maintain the building and deliver the building services to the premises in accordance with the lease, the less the landlord hears from the tenant, the better.

2. Landlord should control tenancy. This dominant view of the world by landlords manifests itself in form assignment/subletting provisions which require landlord consent under all circumstances. Landlords want to have an opportunity to consider any proposal for a change in tenancy of their buildings since they consider any change to be, functionally, a re-leasing by the landlord. Since the landlord owns the building, the landlord believes it should have a say in its tenants. Most landlords will want an opportunity to recapture any premises offered for assignment/subletting. The landlord's view is that if the tenant does not want the space, the landlord should have the right to take it back, since the landlord owns the building. Further, only the landlord is in the real estate business and so long as landlord releases tenant from the lease as to the premises being offered for assignment/subletting, the tenant is being treated fairly and receiving the benefit of its bargain in executing the lease (being the opportunity to use the premises for its business purpose, not to compete with landlord in the real estate business).
3. Tenant is always liable. If the landlord approves an assignment/subletting, the landlord will expect the tenant to remain liable for performance of the lease. Landlord initially dealt with the tenant, and is approving the assignment/subletting purely as an accommodation to the tenant. In the rare instance where a landlord is willing to release a tenant from liability, most landlords

would prefer to terminate the tenant's lease and enter into a new lease directly with the assignee/subtenant rather than approve an assignment/sublease and release the tenant.

4. Only the landlord should profit from rent. Landlords will expect to receive any "surplus" rent received by a tenant in an assignment or subletting. This expectation is consistent with the landlord's view that only it is engaged in the real estate business and the tenant's only reasonable expectation in signing a lease is to obtain a location where it can operate its primary business enterprise.
5. Options are for the original tenant only. Landlords typically will not allow exercise of various options (primarily renewal and expansion options) if any portion of the premises has been sublet by the tenant or the lease has been assigned. Landlord views these options as a special bonus to a tenant who has directly performed all of its obligations under the lease and has, itself, the need for all of the leased premises. Since these bonus provisions operate to bind the landlord, but not the tenant, the landlord refuses to be bound if the tenant who negotiated these special provisions for the benefit of its business no longer needs them. Further, the landlord relied upon the size of the tenant, as indicated by the amount of square footage it required initially, in determining which of these "bonuses" to provide to tenant, so a subtenant taking only a portion of the premises might not have "qualified" for the options. Typically, tenants taking smaller spaces receive fewer of these bonus rights.

B. Tenant's Plead for Flexibility

1. The future is hard to forecast. A tenant's primary basis for signing a lease is to provide a location for the operation of its business enterprise. However, tenants have difficulty forecasting with certainty their actual space needs over the duration of a long term lease and require flexibility to deal with business and economic circumstances which result in excess space. A careful tenant will want to have flexibility in converting excess space into cash flow through subletting or assignment or in ridding itself of obligations with respect to such excess space.
2. Businesses can be sold. Also, a careful tenant will want to deal with the potential that its business enterprise may be sold and the acquirer may desire to step into the tenant's position (without the uncertainty of discretionary landlord consent).
3. Landlord only cares about the income stream. The tenant will want its landlord to give the tenant as much flexibility as possible in assigning or subletting its premises and will take the position that so long as the landlord is receiving its stream of rent income, the landlord should not be concerned with who is using the premises, but only that the premises are being used consistently with the lease terms...and the rent is being paid. Therefore, if tenant is paying the rent and insuring that the occupancy of the premises is consistent with the lease provisions, the landlord should allow the tenant to assign the lease or sublet a portion of the premises, without the landlord's consent. Notice to the landlord would be the only requirement.
4. Recapture denies tenant its benefit of the bargain...and needed flexibility. Obviously, no tenant likes a recapture provision, since it reduces the tenant's control of the premises. A tenant's position is that it may wish to engage in a short term sublease, but keep the premises under its control for potential future use. Further, a tenant sees the lease as providing it the use of the premises for the lease term (and any extensions) and binding the tenant to pay rent for that term. Since tenant has the financial obligation to pay, it should receive the right to have the "use" continue, even if a third party has the physical use under a sublease/assignment. If the sublease/assignment produces a profit, the recapture eliminates that profit, with the landlord then having the right to the profit - an unfair circumstance in the tenant's eyes.
5. Liability is okay unless a credit worthy assignee steps in. A reasonable tenant will have no objection to remaining primarily liable on the lease when they sublease a portion of the premises. However, when they assign the lease, if the assignee is creditworthy, particularly as creditworthy as the tenant on the date of the assignment, the tenant will want the landlord to release the tenant from liability. Further, in the event of an assignment, the tenant is "out of the loop" and it is "unfair" for the landlord to subject the tenant to continuing economic risk when

a new creditworthy tenant assumes the lease. Under a true assignment, the tenant has no reversionary interest, and thus no right to recapture. Unless the tenant is released, it is totally at risk of a sub-tenant default with no practical ability to protect itself.

6. Profit goes to the party with right to use the premises...tenant. A tenant will want to retain any excess rent it obtains from an assignee or subtenant. The tenant's view is that it has "ownership" of the premises for the lease term and should have all rights relating to the use thereof, including any "upside" due to a rise in rental market. Since landlord received the benefit of its bargain (payment of the stated rent in the lease), it is "unfair" to deny the tenant market rent.
7. Options follow the lease. Tenants will fight any requirement that the tenant be in full possession of the premises (or at least not have assigned or sublet any portion of the premises) in order to exercise option rights. The tenant's view is that if it has complied with the financial and performance obligations of the lease, it should receive all benefits thereunder.

C. The Standard Middle Ground

There may be fairly typical compromise provisions accepted by landlords and tenants in specific markets when negotiating assignment/subletting provisions in leases. However, each transaction is dependent upon the parties' relative negotiating position. These positions are impacted by current market economics, the economic strength of the parties, the tenant's credit standing, the size of the transaction and the importance of the transaction to the building. The following provisions provide sample results that could be reached through such negotiations.

1. Landlord Consent. Landlord's consent would not be required for transfers to "affiliates" of the tenant, if tenant is merged (or substantially all assets sold), or if the business unit using the premises is sold in a bona fide sale. These three exclusions provide tenant with foreseeability that it will not lose the right to the use of the premises in the event of a legitimate change in its business structure, unrelated to the premises. Landlord will want protection that the circumstances are not being fabricated to allow an assignment or subletting that would otherwise require landlord consent. For example, "single asset" entities may be

prohibited from acquiring the lease, even if an "affiliate" of the tenant. The landlord wants to prevent the stock of that assignee from being sold to evade the third party assignment prohibition.

Any other assignment or subletting would require landlord consent, but landlord will agree not to unreasonably delay, condition or withhold consent. Landlord may want to list factors which may be considered in granting consent. The landlord will want to be sure the tenant won't "steal" potential direct tenants from landlord. These concerns are legitimate and most tenants will approve them. Tenant will want to carefully review these provisions to insure that they do not result in, effectively, landlord retaining absolute discretion.

Tenants will want to be particularly concerned with any "creditworthiness" provisions, as the tenant's position will be that since the tenant is remaining liable, the creditworthiness of the assignee or subtenant should not be relevant to landlord, but only to tenant. If the standard is the tenant's credit, then the comparison should be to the tenant's credit at the time of the assignment/subletting, not at the time of the original lease execution. In many situations, the reason for the assignment/subletting is a deterioration of tenant's business or a dip in the general business cycle, therefore, a comparison to the original lease date will be harder for the tenant to satisfy. Further, tenant will argue that history is in the past and the landlord is already stuck with the tenant in its present financial condition. Therefore, so long as the landlord is not losing ground, it should be satisfied. Further, if landlord is not releasing the tenant, the assignee or subtenant is extra credit anyway.

Some landlords will agree to a defined period within which it will evidence its approval or disapproval of an assignment/subletting, provided adequate information and documentation regarding the proposed assignment/sublease is provided. Provisions of this nature should be combined with deemed approval or disapproval provisions in order to reduce the possibility of arguments as to whether the landlord has waived its rights to approve an assignment/subletting.

Some landlords are requiring that tenant's waive any claim for damages relating to an unreasonable withholding of consent based on cases in other jurisdictions holding landlords liable for unreasonably withholding their consent to assignments or subleases. When this is included as a "boiler plate" provision, it should be removed so that landlord's obligation to act reasonably can be effectively enforced.

2. Landlord's Recapture Right. A far more powerful means by which the landlord seeks to control the leasing process and the economic value of the premises is by treating each proposed assignment or sublease as granting an option to the landlord to terminate the lease. A landlord's rationale for this provision is that the landlord is in the real estate business, does not share profits that the tenant makes from its business operations in the premises, and should always be entitled to capture any profits that may be generated by a rising real estate market. Landlords may recapture the premises, but only after giving tenant the right to rescind its proposal to assign or sublet the premises to be recaptured. Typically, this rescission right will be for a relatively short period. Another option is to limit the recapture right to a specified period after the tenant first notifies the landlord it intends to market space for assignment/subletting. With this timing, the tenant does lose the space, but at least does not lose the time and effort to market the space and reach a letter of intent with a potential sub-tenant, only to then have the landlord take the space back.
3. Tenant's Continuing Liability. Tenant will continue to be liable for a sublease. For a major credit tenant, the landlord may agree to release the tenant upon an assignment, if a "comparable" credit tenant is proposed, with the standard being either net worth or a comparison to tenant's credit at lease inception or assignment.
4. Excess Rent. Landlord and tenant will split equally any "profit" from a sublease or assignment transaction. Tenant should be able to recover leasing costs, including commissions and tenant improvements, as well as recovering the unamortized cost of its original above "Building Standard" tenant improvements, before sharing any profit with landlord. A landlord may recognize that, if it

insists on recapturing all profit, there may never be any profit to recapture.

5. Option Provisions. Landlord will not be required to allow the exercise of renewal or expansion options if tenant is not in full occupancy. Landlord will not require any provision which would limit the ability of an assignee to exercise renewal or extension provisions in the event of a permitted assignment.

VII. CHECKLIST

Attached are a checklist and marketing outline prepared originally by Candace Baggett of The Calibre Group, a Houston, Texas office leasing firm, focusing on practical issues relating to subleasing, which have been adapted to industrial leasing.

VIII. CONCLUSION

In today's uncertain times, more and more tenants find themselves with extra space, but little understanding of the process to eliminate that space. Assigning the tenant's entire interest under a lease or subletting a portion of the leased premises can provide a substantial economic benefit to the tenant. The legal issues to the tenant as well as the assignee or subtenant require a clear understanding of the legal and practical distinctions between assignments and subleasing.

ATTACHMENT A

LEASE ASSIGNMENT

Date:

Assignor:

Assignee:

Lease:

Date:

Landlord:

Tenant:

Premises:

Effective Date:

Assignor assigns to Assignee all of Assignor’s interest in the Lease as of the Effective Date. Assignor remains liable on the Lease. The Lease is attached as Exhibit “A”.

Assignee assumes Assignor’s obligations under the Lease and accepts the premises “AS IS”.

Landlord consents to this Lease Assignment

Signed _____, 200__.

ASSIGNOR:

LANDLORD:

By: _____

By: _____

Name: _____

Name: _____

Title: _____

Title: _____

ASSIGNEE:

By: _____

Name: _____

Title: _____

ATTACHMENT B

ASSIGNMENT OF LEASE

_____ ("Assignor"), for and in consideration of the sum of Ten and No/100 Dollars (\$10.00) and other good and valuable consideration, the receipt and adequacy of which are hereby expressly acknowledged, ASSIGNS TO _____ ("Assignee"), all of Assignor's right in the Lease dated _____ ("Lease"), executed by _____ ("Landlord") and Assignor leasing the premises located in _____ as Suite _____ with the following mailing address: _____.

The Lease has an initial term of _____, commencing _____ and ending _____. Assignor is aware of no uncured default by any party to the Lease. A true and complete copy of the Lease (and any modifications) is attached as Exhibit A. Assignor represents to Assignee that the terms and conditions of the Lease have not been modified except as disclosed in Exhibit A. Assignee assumes the Lease and agrees to perform all of Assignee's obligations as tenant under the Lease. Assignee assumes the obligation to cure any defaults which may presently exist under the Lease. All prepaid rentals, security deposits, operating expense reimbursements and/or other credits under the Lease are assigned by Assignor to Assignee. Landlord may deal exclusively with Assignee in the future regarding all aspects of the Lease.

Assignor remains liable on the Lease. In the event of default by Assignee of any of the terms, conditions, or covenants contained in the Lease, Landlord may exercise any remedies against Assignor and/or Assignee. Assignee indemnifies and holds Assignor harmless from, and agrees to defend Assignor with respect to, any claims, causes of action or damages relating to the Lease from the date hereof. Assignor agrees to promptly provide Assignee copies of any correspondence received from Landlord which does not reflect that it has been also sent to Assignee.

Assignee acknowledges that any further assignment or subletting of the Lease requires Landlord's consent. Landlord consents to this Assignment, but waives no rights under the Lease. This Assignment is binding upon and inures to the benefit of the parties, their heirs, executors, administrators, legal representatives, successors and assigns. This Assignment constitutes the sole agreement of the parties relating to the assignment of the Lease and fully sets forth the rights, duties, and obligations of each to the other as of its date. Any prior agreement, promises, negotiations, or representations are of no force and effect.

EXECUTED effective the ___ day of _____, 200__.

ASSIGNOR:

By: _____

Name: _____

Title: _____

ASSIGNEE:

By: _____

Name: _____

Title: _____

ACKNOWLEDGED BY LANDLORD FOR THE LIMITED PURPOSED OF APPROVING THE ASSIGNMENT PURSUANT TO THE PROVISIONS OF THE LEASE:

LANDLORD:

By: _____

Name: _____

Title: _____

Landlord's Address: _____

ATTACHMENT C

ASSIGNMENT AND MODIFICATION OF LEASE

This Assignment and Modification of Lease ("Assignment") is entered into as _____, between _____ ("Landlord"), _____ ("Assignor") and _____ ("Assignee") relating to (i) the assignment by Assignor to Assignee of Assignor's rights under Lease dated _____, between Landlord and Assignor ("Lease") for Suite _____ ("Premises") in the _____ Office Building, Houston, Harris County, Texas ("Building"), (ii) the agreement of Landlord to modify the Lease for the benefit of Assignee, and release any rights against Assignor (contingent on Assignor's performance hereunder) and (iii) Landlord's consent to this transaction. A true and complete copy of the Lease (and any modifications) is attached hereto as Exhibit A. All defined terms utilized in this Assignment and not otherwise defined shall have the meanings set forth in the Lease.

BACKGROUND FACTS

1. The Lease was executed by Landlord and Assignor regarding the Premises for a _____ (____) year term commencing _____, and terminating 5:00 o'clock p.m. Central Time on _____.
2. The Lease has not been modified or amended in any way, except as set forth in Exhibit A.
3. Assignor desires to vacate the Premises and assign all of its rights under the Lease to Assignee.
4. Assignor's performance under the Lease is secured by a cash security deposit in the amount of \$ _____ ("Security Deposit") plus \$ _____ in the form of 2 Letters of Credit (cumulatively, the "LC's") and a contract credit of \$ _____ from unused Tenant Improvement Allowance ("Allowance"); all pledged for the benefit of Landlord (cumulatively referred to as the "Security").
5. Assignor agrees to make a cash payment of \$ _____ to Assignee.
6. Assignor agrees to convey to Assignee certain personal property, at no charge.
7. As consideration for Landlord's agreement to this Assignment, Assignor agrees to pay Base Rental and Tenant's Proportionate Share of Excess due under the Lease (cumulatively, the "Rent") to Landlord for the remainder of _____, as and when it comes due (_____ Rent having been paid), and to release to Landlord for Rent due for _____ and a portion of _____, _____, any claim Assignee, its successors or assigns may have in and to the Security Deposit in the amount of \$ _____ and the Allowance and to pay Rent to Landlord, monthly, beginning in _____ at the estimated (including estimated increases in operating expenses over the base year) rate of \$ _____ per month (such release of Security Deposit and Allowance and payment of Rent not to exceed in the aggregate the sum of \$ _____) for a portion of _____, in accordance with the terms hereof.
8. Landlord agrees to (i) approve the assignment of the Lease to Assignee, (ii) release Assignor from all obligations under the Lease through the Possession Date (defined in Section 2 below) other than to pay the Rent referenced above, and (iii) to modify various provisions of the Lease for the benefit of Assignee.
9. The parties desire to set forth their agreements in a single document to eliminate misunderstanding and confusion regarding the transaction.

Agreements

For consideration of \$10.00 and other good and valuable consideration received by each of the parties and the mutual agreements contained herein, the parties agree as follows:

1. Assignment. Effective on the Possession Date (defined below), Assignor assigns to Assignee all its right, title and interest under the Lease (including but not limited to all rights to estimated Excess of Operating Expenses over the Base Year). Landlord consents to that assignment, such that Landlord and Assignee shall henceforth have a direct landlord/tenant relationship, provided that Assignee is not liable for Rent for the first \$_____ of Rent and other payments due under the Lease for calendar year 200__, or any amounts due Landlord under the Lease for calendar year 200__ (including Rent). Assignor remains liable for an amount ("Assignor's Rent") equal to the sum of Rent and other obligations under the Lease, including escalations, for all calendar year 200__ and the first \$_____ of Rent and other financial obligations under the Lease for calendar year 200__, subject to a credit of \$_____ for the Security Deposit and \$_____ for the Allowance as described above. Landlord waives any right to terminate the Lease based on this Assignment.

2. Possession of the Premises. Assignor shall vacate the Premises as soon as possible after it executes a new lease or sublease for alternative space, and in no event later than _____, 200__ (the date Assignor vacates being the "Vacation Date"). Assignor represents to Landlord and Tenant that it has selected alternative space and has tentative proposals for that space (which alternative space is anticipated to be available for Assignor's occupancy not later than _____, 200__). The Premises shall be delivered to Assignee on the Vacation Date, broom-clean, in its current, AS-IS condition, and free from damage due to Assignor vacating the Premises, subject to normal wear and tear. Assignee may take possession of the Premises immediately upon Assignor's vacating it (the date Assignee takes possession being the "Possession Date," provided the Possession Date is deemed to be _____, 200__ if possession is not taken by Assignee prior to that date). If the Vacation Date occurs beyond _____, 200__ (subject to Force Majeure as defined below), Assignor shall pay to Assignee \$_____ for each day of delay, until the first to occur of the following: (i) the Vacation Date, or (ii) the Termination Date (defined below), which damage amount shall be payable not later than ten (10) days after the earlier of (y) the Possession Date, or (z) the Termination Date. If the Vacation Date occurs after _____, 200__, Assignee may terminate this Assignment by written notice to Assignor (the date Assignee terminates this Assignment being the "Termination Date"), but shall continue to be entitled to the \$_____ per day delay penalty as liquidated damages not exceeding the aggregate sum of \$_____. If this Assignment is so terminated, the original Lease between Assignor and Landlord shall be reinstated and not amended as hereinafter provided. The \$_____ per day penalty is stipulated as liquidated damages based on the fact that Assignee will not have access to the Premises and the damages incurred by Assignee are difficult and uncertain of calculation. Assignor indemnifies Assignee from any claim by Landlord for any damages to the Premises caused by Assignor, its employees, directors or agents as a result of vacating the Premises or the occupancy of the Premises by Assignor prior to the Vacation Date or Termination Date, as applicable, but subject to normal wear and tear. No later than the 2nd business day after the Vacation Date, Assignee shall inspect the Premises and if there are damages due to Assignor vacating the Premises, then Assignee shall notify Assignor, in writing, detailing the damages and the required repairs. Assignor shall make the repairs as soon as possible so not to impede Assignee's work to the Premises, but in no event to exceed 10 business days. If repairs are not timely made, Assignee may cause those repairs to be made at Assignor's expense and Assignor will reimburse Assignee for the reasonable cost of repairs. The _____, 200__ deadline for the Vacation Date shall be extended, day for day for each day an event of Force Majeure causes Assignor to be unable to timely vacate the Premises, despite Assignor's best efforts to the contrary. Force Majeure is (i) acts of God, (ii) unanticipated governmental action, delay or restraint, and (iii) other cause not reasonably anticipatable by Assignor which is not within Assignor's reasonable control through the exercise of foresight and diligence.

3. Assignor Payment to Assignee. Upon the execution of this Assignment by all parties and receipt of a telefax signed copy, Assignor will immediately wire transfer to the trust account of _____, Attn: _____, ("Escrow Agent"), \$_____ as a portion of the consideration for Assignee executing this Assignment. Upon receipt by Escrow Agent of a letter from Landlord acknowledging that Assignee is in possession of the Premises and all requirements of the Lease and this Assignment to be discharged as of that date by Assignee have been satisfied ("Landlord's Letter"), Escrow Agent shall deliver the funds to Assignee. At Assignee's request after the Possession Date, Landlord shall inspect the Premises and promptly issue such letter when Landlord has confirmed the appropriate facts. If the Termination Letter

is issued by Assignee, upon receipt, Escrow Agent will wire transfer the funds to Assignor without further authorization, less the applicable liquidated damages, which shall be delivered to Assignee.

4. Assignor conveyance to Assignee. Concurrently with the execution of this Assignment, Assignor has delivered to Escrow Agent the following: (i) a Bill of Sale conveying to Assignee the personal property of Assignor described therein ("Property"), executed by an authorized officer of Assignor (which shall be held in escrow by Escrow Agent pending receipt of the Landlord's Letter or the Termination Letter, and (ii) (a) a UCC search of the UCC records of the Secretary of State of Texas under Assignor's name (and the name of any assumed names utilized by Assignor) dated no earlier than _____, 200__ (the "UCC Report"), and (b) if the UCC Report reflects the existence of any liens against the Property, a release for all liens encumbering the Property shown in the UCC Report shall be delivered within ten days after the closing. Landlord consents to the conveyance of the Property. Escrow Agent shall deliver the Bill of Sale to Assignee concurrently with the delivery of the \$_____ check described in paragraph 3 above (or return it to Assignor, in the event of termination). The conveyance of the Property by the Bill of Sale is additional consideration for Assignee' executing this Assignment. Assignor warrants to Assignee that it is the sole owner of the Property and the property is conveyed free and clear of all liens and encumbrances.

5. Rent Payment by Assignor for Assignee' Benefit. Assignor retains the liability to pay the Assignor Rent. Once Assignor has performed under this Assignment and paid to Landlord all Assignor Rent, Assignor's obligation to pay Rent is satisfied. Assignor shall pay directly to Landlord and Landlord shall accept and credit to the Lease, monthly payment for Rent as provided in the Lease until Assignor has paid the entire Assignor Rent, subject to the credits provided for herein. If Assignor fails to pay the Rent monthly on or before the 5th calendar day of each month hereafter, Assignor authorizes and directs Landlord to draw against the LC's, as and when due, until the entire Assignor Rent has been paid. This Assignor Rent is additional consideration for Assignee executing this Assignment. Landlord agrees to draw on the LC's if Assignor fails to make timely payment of the Assignor Rent. Landlord waives any right to collect Rent from Assignee for the periods covered by the Assignor Rent (approximately through _____, 200__) such that this period is Rent free to Assignee. No default by Assignor will give any right to Landlord to collect Rent from Assignee for such period. Upon Assignor's payment of the entire Assignor Rent, Landlord shall deliver to Assignor the LC's.

6. Assignee Assumption of the Lease. Effective with the Possession Date, Assignee assumes all obligations of Assignor as tenant under the Lease with the exception of the obligations to pay the Assignor Rent

7. Release of Assignor and Landlord. Effective with the day prior to the Possession Date, Landlord releases Assignor from all of its obligations as tenant under the Lease (other than the obligation to pay the Assignor Rent) and Assignor releases Landlord from all of its obligations as landlord under the Lease. Upon the Possession Date and payment by Assignor of the Assignor Rent, Assignee releases any claims of any kind it may have against Assignor.

8. Assignor's Temporary Rights to Use the Premises. Assignee grants to Assignor a non-exclusive right to utilize the [_____]in the Premises (provided such use shall not reasonably interfere with Assignee' use) for a period not to exceed forty five (45) days after the Possession Date, at no charge. Landlord consents to this right.

9. Landlord Estoppel. Landlord acknowledges there are no uncured defaults under the Lease. Landlord waives any claims under the Lease which may be asserted against Assignee relating to defaults which occurred prior to the Possession Date. Effective upon Landlord's receipt from Assignor of the entirety of the Assignor Rent, Landlord releases Assignor from all obligations under the Lease.

10. Modifications of the Lease. Landlord and Assignee agree (with Assignor's consent) that the Lease is modified as follows (all references are to Sections in the Lease):

[Lease modification]

11. Miscellaneous Contract Provisions. Except as specifically modified by this Assignment, the Lease shall continue in full force and effect. All capitalized terms used in this Assignment and not specifically defined herein shall have the same meaning as defined in the Lease. Time is of the essence in the performance of this Assignment. THIS ASSIGNMENT IS SUBJECT TO TEXAS LAW AND ENFORCEABLE IN HARRIS COUNTY, TEXAS. This Assignment is the entire agreement of the parties relating to the assignment of the Lease by Assignor to Assignee. The parties agree to execute such other documents as reasonably necessary to carry out the purpose of this Assignment. This Assignment may be executed in multiple counterparts that shall be construed together as a single document. Facsimile signatures to this Assignment shall be binding on the parties when executed copies are distributed via telefax transmission, provided the parties agree to provide executed originals for each party as soon as practical.

12. Lender’s Consent. Landlord represents that it has the authority to execute this Assignment and Modification Agreement without the consent of Landlord’s Mortgagee, or will obtain that consent prior to execution. Landlord shall provide the parties reasonable evidence of its authority.

13. Special Termination Right. Assignor may terminate this Assignment by written notice delivered to _____, and received in his office no later than 5:00 o’clock p.m. Central Time on _____, _____, 200__, by personal delivery or machine confirmed telefax transmission, in the event that, despite Assignor’s commercially reasonable efforts, Assignor is not able to sign a lease for its alternative space by such date.

LANDLORD:

By: _____
Name: _____
Title: _____

ASSIGNOR:

By: _____
Name: _____
Title: _____

ASSIGNEE:

By: _____
Name: _____
Title: _____

ATTACHMENT D

SUBLEASE

Date:

Sublessor:

Sublessor's Address:

Sublessee:

Sublessee's Address:

Subleased Premises:

Sublease Commencement Date:

Sublease Termination Date:

Sublease Term:

Sublease Rent:

Permitted Sublease Use:

Base Lease:

Date:

Landlord:

Tenant:

Premises:

Sublessee agrees to--

1. Sublease the subleased premises for the sublease term beginning on the sublease commencement date and ending on sublease termination date.

2. Pay the sublease rent to Sublessor in advance of the first day of each month.

3. Obey all laws, rules and regulations, and terms of the base lease as they apply to the subleased premises.

4. Promptly move out of the subleased premises on the sublease termination date or on the earlier termination of this sublease.

5. Indemnify, defend, and hold Sublessor harmless from any loss, attorney's fees, expenses, or claims arising out of use of the subleased premises or resulting from Sublessee's failure to comply with the base lease.

6. Maintain public liability insurance for the subleased premises and the conduct of Sublessee's business, with Sublessor named as an additional insured, in the amounts stated in the base lease.

7. Maintain insurance on Sublessee's personal property.

8. Deliver satisfactory certificates of insurance to Sublessor before the sublease commencement date and thereafter when requested.

Sublessee agrees not to--

1. Use the subleased premises for any purpose other than the permitted sublease use.

2. (a) Create a nuisance, (b) interfere with any other tenant's normal business operations or Landlord's management of the building, (c) permit any waste, or (d) use the subleased premises in any way that is extra hazardous, would increase insurance premiums, or would void insurance on the building.

3. Change Landlord's lock system.

4. Alter the subleased premises.

5. Allow a lien to be placed on the subleased premises.

6. Assign this sublease or sublease any portion of the subleased premises without Sublessor's prior written consent.

Sublessor agrees to--

1. Sublease the subleased premises to Sublessee for the sublease term.

2. Comply with the Tenant's obligations under the base lease.

3. Use commercially reasonable efforts to enforce Landlord's obligations under the base lease.

4. Make available to the subleased premises all applicable services and rights provided under the base lease.

General Provisions

1. Defaults by Sublessee are (a) failing to timely pay sublease rent, (b) abandoning or vacating a substantial portion of the subleased premises, or (c) failing to comply within ten days after written notice with any provision of the lease or sublease other than the defaults set forth in (a) or (b) above.

2. Sublessor's remedies for Sublessee's default are to (a) enter on and take possession of the subleased premises, after which Sublessor may relet the subleased premises on behalf of Sublessee and receive the sublease rent directly by reason of the reletting, and Sublessee agrees to reimburse Sublessor for any expenditures made in order to relet; (b) enter the subleased premises and perform Sublessee's obligations; or (c) terminate this sublease by written notice and sue for damages.

3. Default by Sublessor is failing to comply with any provision of this sublease within thirty days after written notice.

4. Sublessee's sole and exclusive remedy for Sublessor's default is to sue for damages.

5. This sublease is subordinate to the base lease, a copy of which Sublessee acknowledges as received.

6. Sublessor may retain, destroy, or dispose of any property left in the subleased premises at the end of the sublease term.

7. Sublessor has all the rights of Landlord under the base lease as to Sublessee.

8. If either party retains an attorney to enforce this sublease, the prevailing party is entitled to recover reasonable attorney's fees.

[Add additional clauses here, if necessary.]

SUBLESSOR:

By: _____

Name: _____

Title: _____

SUBLESSEE:

By: _____

Name: _____

Title: _____

Consent of Landlord

Landlord consents to this sublease by Sublessor to Sublessee.

LANDLORD:

By: _____

Name: _____

Title: _____

(add acknowledgements, if necessary)

ATTACHMENT E

Subleasing² Checklists

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I. Prime Lease Drafting Considerations from the Tenant's Viewpoint**A. Broad use clause****B. Sublease clause**

1. Tenant has right to sublease.
2. Tenant has right to sublease to related entity, affiliate, and successor without landlord's consent or right of recapture.
3. Tenant has right to enter into office sharing arrangements with related entities.
4. Landlord's consent not to be unreasonably withheld, delayed, or conditioned.
5. Limit timing of notification to landlord of pending sublease.
6. Restrict information to be provided to landlord regarding sublessee.
7. Limit amount landlord may charge for legal review of sublease.
8. Limit time period within which landlord must respond.
9. Eliminate landlord's right to recapture. If landlord has the right to recapture, negotiate tenant's right to withdraw request for landlord's consent to sublease if landlord intends to recapture.
10. Restrict reasons landlord may withhold consent. For example, use and character of sublessee are acceptable reasons a landlord may withhold consent, but not financial instability of sublessee/assignee. Tenant does not want to exclude project tenant or occupant as acceptable sublessee. Tenant's "fallback" position would be to exclude project tenant or occupant if landlord has comparable space for lease.
11. If tenant procures a sublessee who has credit equal to or greater than that of tenant, tenant will be released from liability under the lease.
12. Definition of "profit" should not equal any amount paid in excess of rent stipulated in lease. Tenant has right to recoup its reasonable costs such as downtime, leasing commissions, remodeling costs, unamortized tenant improvements, attorneys' fees, advertising, *etc.*
13. State how "profit" is to be split between landlord and sublessor.
14. Consider providing that sublessee has right to sublease/assign.
15. Provide that landlord's mortgagee will provide a nondisturbance agreement in favor of future sublessees.

C. Assignment of lease provisions

1. Tenant has right to assign ("flow-through") its options (renewal, expansion, *etc.*) to sublessee.
2. Tenant has right to assign ("flow-through") its parking rights to sublessee.
3. Tenant has right to assign ("flow-through") its signage rights to sublessee.

² In most instances, checklist also applies to assignments. Attached with permission of Ms. Baggett.

II. Sublease Considerations from the Sublessor's Viewpoint

A. Initial issues

1. Review sublease provisions of prime lease to determine sublessor's right to sublease, timing of notice to landlord, landlord's consent requirements, landlord's right to recapture, charges landlord may impose for legal review, compliance with sublease procedures, removal of items that could arguably be classified as "fixtures," *etc.*
2. Determine marketability of premises.
3. Ascertain if space is divisible. Work with space planner to ensure compliance with life/safety codes.
4. Determine if furniture and equipment may be sold or leased as part of sublease.
5. Establish early dialog with landlord regarding sublessor's intent to sublease, landlord's plan to exercise any right to recapture, landlord's willingness to extend term and on what basis, *etc.* If prime lease provides that "profit" will be split, discuss with landlord anticipated "profit" and expenses that sublessor will incur and deduct prior to the splitting of any "profit."
6. Obtain copy of landlord's preferred form of sublease agreement and consent to sublease. Discuss proposed revisions with landlord.

B. Assignment of prime lease provisions

1. Verify if options can be assigned (renewal, expansion, *etc.*) Even if options are not assignable, try to ascertain willingness of landlord to extend lease and/or grant a renewal option if desired by sublessee. Try to get sublessor released from liability by landlord if options exercised.
2. Verify if parking rights can be assigned. Agree to convey no more than what sublessor has contractually obtained from landlord.
3. Verify if signage rights can be assigned.

C. Economics

1. Provide that sublease is same type of transaction as prime lease. For example, if the prime lease is a net lease, try to structure the sublease as a net lease.
2. Provide that expense pass-throughs are based upon landlord's billings, not actual expenses of the building or project.
3. Provide that sublessee pays rental prior to due date under prime lease.

D. Credit/liability

1. Review sublessee's financial statements to determine risk imposed by transaction.
2. Sublessee is to provide adequate security deposit. Address credit enhancement issues by obtaining an unusually large security deposit, prepayment of rent, guaranty by corporate parent, letter of credit, personal guaranty.
3. Try to get sublessor released from liability by landlord if sublessee has credit equal to or greater than that of sublessor. Try to get guarantors released from liability.

E. Leasehold improvements

1. Leasehold improvements are to be provided "as-is, where-is."

2. Limit sublessee's/assignee's rights to alter/remodel the premises without sublessor's approval.
3. Disclaim express and implied warranties with respect to leasehold improvements, including implied warranty of suitability of premises for sublessee's intended purposes.

F. Default by parties

1. Provide that sublessor has no liability for landlord's failure to provide services.
2. Provide that sublessee must perform obligations under prime lease in shorter time period than that required of sublessor/assignor.
3. Address default by sublessee/assignee. Sublessor will want sublessee to assume obligations under the prime lease, and sublessor will want to be able to enforce landlord's remedies.
4. Sublessor will want the clear right to regain possession in the event of sublessee's default.
5. Provide holdover rate and terms.
6. Ensure that landlord's written consent to sublease has been obtained prior to date of move-in by sublessee. Prime lease probably provides that sublessor is in default of lease otherwise.

III. Sublease Considerations from the Sublessee's Viewpoint

A. Initial issues

1. Get copy of sublease language from prime lease early on in process of evaluating the sublease opportunity.
2. Obtain copy of entire prime lease as soon as possible since sublessee is bound to terms of prime lease and covenants to comply with prime lease.
3. Establish early dialog with landlord to ascertain landlord's intentions vis-à-vis the proposed sublease transaction, as well as landlord's willingness to extend the term and basis of any extension.

B. Economics

1. Try to structure sublease on a gross versus net lease basis whenever possible, irrespective of type of prime lease.
2. Try to negotiate the highest expense stop/base year possible to limit sublessee's exposure to operating expense escalations.

C. Credit/liability

1. Review sublessor's financial statements to determine risk imposed by transaction.
2. Provide minimal security deposit.
3. Try to avoid any credit enhancement, such as additional security deposit, prepayment of rent, guaranty by corporate parent, letter of credit, personal guaranty.

D. Leasehold improvements

1. Obtain sublessor's/landlord's consent to alterations/remodeling in advance for initial work.
2. Provide that sublessor's consent is not required for future renovations.
3. Negotiate upfront tenant improvement allowance or alternately, a rental abatement period to offset the cost of refurbishing premises.

E. Assignment of prime lease provisions

1. Review options (renewal, expansion, etc.) to determine if they are assignable. If not, try to obtain from landlord. If landlord is amenable to providing a renewal option to sublessee, consider attaching the form of lease to be used in the event of a renewal if new lease terms are desirable. Note that there is usually a distinction between an assignment and a sublease regarding the assignability of options. Typically, in a sublease situation, the landlord must agree to the assignment of the options unless the lease provides otherwise.
2. Review parking rights to determine if they are assignable. If not, try to obtain from landlord.
3. Review signage rights to determine if they are assignable.
4. Obtain estoppel letter from landlord and preferably from sublessor.

F. Default by the parties

1. Sublessor to use reasonable efforts to cause landlord to perform landlord's obligations.
2. Address potential default of landlord. Sublessee wants to obtain agreement of sublessor to enforce prime lease if landlord defaults. Sublessee may want right to bring action against landlord in name of sublessor.
3. Address potential default by sublessor. Obtaining a nondisturbance agreement from landlord may be desirable so if lease is terminated, landlord will honor sublease.
4. Obtain nondisturbance agreement from landlord and landlord's mortgagee, if possible. Review existing nondisturbance agreement to ascertain if it is sufficiently broad to protect and cover sublessee's rights.
5. Sublessee wants right to cure defaults of sublessor and to offset monies against sublease rentals.
6. If sublease covers only part of premises, sublessee may wish to seek right to cure defaults of other sublessees that could result in termination of lease and sublease.

G. Other agreements

1. Verify that landlord's preferred form of sublease agreement and consent to sublease are being utilized in proposed transaction. Discuss proposed revisions with landlord.
2. Obtain landlord's consent to sublease in writing so assignee is not regarded as trespasser. Landlord may have right to terminate sublease if landlord's approval has not been obtained.

ATTACHMENT F

What Determines the Marketability of Your Sublease Space?

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Numerous factors influence prices and the marketing to closing time, such as:

- **Economy** – National and local economic events.
- **Submarket** – Overall health of the particular submarket taking into consideration:
 - vacancy rate, lease-up time (time to market the space), rates being charged and concessions being offered in your building.
 - vacancy rate, availability of sublease space, lease-up time (time to market the space), rates being charged and concessions being offered in your class of building for comparable sublease space.
 - vacancy rate, availability of direct space, lease-up time (time to market the space), rates being charged and concessions being offered in your class of building for comparable direct space.
- **Building** – Desirability of your building (management, efficiency, location, *etc.*)
- **Landlord** – Willingness of your owner to work with potential sublessees regarding additional requirements such as an extension of the term, additional parking, *etc.*
- **Parking** – Availability, number and cost of employee and visitor parking in your building.
- **Condition** – Attractiveness of your office space
- **Configuration** – Efficiency, suitability for a wide range of businesses as opposed to uniquely suited to a more limited market.
- **Term** – Generally, the longer the term, the more marketable the space unless the term is unusually long. Generally, a three – five year sublease term is attractive to most sublessees. In addition, sublessees want to know:
 - if the term may be extended
 - if the space is encumbered by another tenant
- **Concessions** – Tenant improvements, rental abatements, *etc.* Concessions are employed to entice a prospective sublessee to proceed with a space that might not be ideally configured for their needs. An aggressive “below market” price is usually an even stronger initial inducement.
- **Deliverability** – If your space is not vacant, have you committed or are you close to committing to relocate to another building or closing your facility? A date certain encourages consideration of your space.
- **Risk** – Sublessees evaluate the potential sublessor's financial stability/risk of default.

³ Attached with permission of Ms. Baggett.

- **Sublease/assignment language** – Review your lease to determine:
 - right to sublease
 - restrictions/conditions to subleasing
 - rights of your landlord in the event of proposed sublease (*e.g.* time to respond, what triggers the time period, landlord's right to approve or disapprove sublease or sublessee, landlord's right to recapture, *etc.*).

- **Quoted rental rate** – In general, when quoted rental rates decline, marketing time is typically reduced. Rate has been and continues to be of major importance as sublessees are looking for deals. As additional sublease and direct spaces continue to come onto the market, rate remains the most critical component. Since sublessees are bargain hunters, your ability to undercut your competition from direct landlords and other sublessors who may be marketing more desirable spaces in more attractive buildings is important to your success. A low price is often an exchange that a sublessee is willing to accept in order to lease space that may not fit its needs exactly. We almost always advise our clients to specify an asking price/rental rate in their listings as opposed to saying “negotiable.” We believe that this approach saves you and potential sublessees' time and does not scare away prospects who may assume incorrectly the price is too high for them.

The above outlines in very general terms issues to be considered as we research and evaluate the market and the competitiveness of your sublease space in order to effectuate a sublease, recapture of your space or cancellation of your lease.