Thursday, October 24, 2024
1:30 PM – 2:30 PM

Seminar 14

Permitted Transfers: Assign of the Times or (Sub)let it Go!

Presented to

2024 ICSC+U.S. LAW
JW Marriott Orlando Grande Lakes, Orlando, Florida
October 23-25, 2024

by:

Jennifer Blasco
Jamestown, L.P.
Ponce City Market
675 Ponce de Leon Avenue NE
7th Floor
Atlanta, Georgia 30308
(404) 835-8205
Jennifer.Blasco@JamestownLP.com

Jeremy D. Cohen
Hartman Simons & Wood LLP
400 Interstate North Parkway SE
Suite 600
Atlanta, Georgia 30339
(770) 951-6788
Jeremy.Cohen@hartmansimons.com

Adriana Peters
Chiesa Shahinian & Giantomasi PC
105 Eisenhower Parkway
Roseland, NJ 07068
(973) 530-2090
apeters@csglaw.com

Short Summary: The operation of a successful retail business often requires that a tenant have the flexibility to reorganize at the corporate level, sell its business or certain locations, or perhaps assign the lease or sublease its premises to an affiliated company without being required to request consent by its landlord as waiting for such consent could slow down or even derail a much larger transaction. Permitted transfer provisions in leases allow the tenant to assign its lease or sublet its premises without procuring the landlord's prior consent, but such provisions must be drafted in such a way that the landlord will be comfortable with the new assignee/sublessee who will be operating in its center. This seminar will explore assignments and subleases generally, but will focus on the positions that counsel for landlords and tenants will want to consider when drafting and negotiating permitted transfer provisions.

1. Types of Lease Transfers

a. Assignments

i. One mechanism that is used to transfer a lease is an assignment. An assignment is a transfer of leasehold rights and obligations by an existing tenant ("Assignor") to another party ("Assignee"), with the Assignee becoming the new "Tenant" under the lease.

ii. In the event of an assignment, the Assignor remains liable for the tenant's obligations under the lease unless expressly released by the landlord or the lease expressly allows for a release from liability.

iii. A transfer through an assignment is typically documented in an "Assignment and Assumption of Lease Agreement" between the Assignor and the Assignee, which is often, but not always, consented to by the landlord. If consented is required from the landlord, it is typically handled within the assignment agreement.

iv. In the Assignment and Assumption of Lease Agreement, the Assignee expressly assumes in writing the rights and obligations of the "Tenant" under the lease.

b. Subletting

i. Subletting is another mechanism used by tenants to transfer a lease. Subletting is defined as the leasing ("Sublease") by a tenant ("Sublandlord") to another party ("Subtenant") of all or a portion of the premises to allow the Subtenant to operate therein.

ii. In a Sublease, the tenant remains liable to its landlord under its existing lease agreement with its landlord ("Master Lease").

iii. The Subtenant is typically required to perform the Sublandlord's (original tenant's) duties and obligations under the Master Lease if the Sublease is for the entire premises.

iv. The Subtenant is almost always prohibited from further subletting the premises, assigning the Sublease or subdividing the premises.

v. Landlord is typically entitled to excess profits when the Sublandlord receives rent from the Subtenant which exceeds the rent payable under the Master Lease.

vi. The Sublandlord may require reduced cure periods or a recapture/re-entry right to protect the Sublandlord in the event the Subtenant does not perform its obligations under the Sublease which would cause the Sublandlord to be in default under the Master Lease.

vii. The Subtenant would need to expressly create the right to compel the Sublandlord to enforce the rights of the tenant against the landlord under the Master Lease.

viii. If the landlord's consent is required, it is usually documented in a separate consent agreement.

2. Permitted Transfers

a. A "Permitted Transfer" constitutes a transfer of a lease through either assignment or subletting that does not require the landlord's consent; provided that the Assignee or Subtenant complies with certain conditions.

b. While the landlord's consent may not be required, there may be certain parameters that the landlord requires must be met by the proposed transferee, which requirements are built into the lease. If the proposed transferee does not meet the requirements, then the transfer would not constitute a "Permitted Transfer" and the tenant would be required to obtain the landlord's consent.

c. Landlords typically require that a proposed transferee meet certain threshold requirements in order for the Assignee or the Subtenant to be considered a "Permitted Transferee" and not be subject to the landlord's consent requirements.

i. *Minimum Tangible Net Worth*. Landlords may require that the proposed transferee meet a minimum tangible net worth threshold. Typically, a landlord requires that a permitted transferee's tangible net worth be equal to or greater than the tangible net worth of the

transferor as of the time of both lease execution and the effective date of the transfer. If there is a lease guaranty in place, landlords typically would require any substitute guarantor also meet the tangible net worth requirement.

ii. *Minimum Number of Stores Operating*. If a tenant is a national or regional tenant, landlords often require that a proposed transferee have a certain number of stores operating within a certain geographic area.

iii. *Minimum Number of Years of Experience*. Landlords typically require that any proposed transferee have a certain number of years of experience operating for the same or similar use.

iv. *Operate for the Same Permitted Use*. The Landlord may want to require the permitted transferee operate for the same permitted use as the transferor as set forth in the lease.

v. *Relationship to the Tenant*. A Permitted Transfer clause in a lease often permits tenants to have the flexibility to engage in a corporate reorganization. Commonly, landlords characterize the following reorganizations as Permitted Transfers:

1. A transfer to any corporation or entity which is owned by or affiliated with the tenant;
2. A transfer to any subsidiary of the tenant or of the tenant's parent corporation;
3. A transfer to any corporation or entity which shall acquire the majority of the stock or majority of the assets of the tenant as a result of a consolidation, merger or sale; or
4. A transfer to any corporation or entity which acquires not less than a certain number of the tenant's other locations in the state in which the premises is located, or other geographic region.

vi. *Change in Control*. A change in the ownership of the tenant entity (including any percentage thereof) may constitute an assignment under a lease. However, landlords do not typically object to a change in ownership/control if the tenant is a publicly traded company or if the tenant wishes to transfer its leasehold interest intra-family, and under these limited circumstances, such a change of control may be a Permitted Transfer.

3. Additional Considerations for Permitted Transfers

a. **Assignment Fee**. Sometimes landlords require that tenants pay a fee to reimburse the landlord for the administrative costs and legal fees incurred with reviewing a proposed assignment.

i. Is there an assignment review fee? Landlords may impose assignment review fees, which can be fixed fees payable concurrent with an assignment request, or landlords may require the tenant reimburse its costs, which costs may or may not be subject to a maximum cap. In some instances, landlords may impose a combination of the foregoing, requiring both an initial request fee and a reimbursement of the landlord's costs in excess of the initial request fee.

ii. For Permitted Transfers, landlords may require an assignment fee only if the Permitted Transfer requires the landlord produce or review additional documents, as opposed to simply receiving notice of the Permitted Transfer and documentation supporting satisfaction of the minimum requirements.

b. **Landlord Termination and Recapture Right**. A lease may permit the landlord to terminate the lease and recapture all or a portion of the premises in the event of an assignment or sublet.

i. For Permitted Transfers, landlords often waive termination and recapture rights.

c. **No Circumventing Landlord Consent**. There is a concern that a tenant may structure a transaction so that on its face, it appears to qualify as a Permitted Transfer, although it would not be if the landlord was privy to the relevant documentation between the tenant and the proposed transferee.

i. When the tenant has the right to assign the lease without the landlord's consent, it is important for the landlord to emphasize that the tenant may not deliberately structure a transaction for the sole purposes of avoiding the requirement for the landlord's consent.

d. **Loss of Lease Rights**. In the event of an assignment, the landlord may qualify what rights under the lease may not be available to an assignee.

i. The landlord may reserve certain leasehold rights for the original tenant, and perhaps a Permitted Transferee, that may not transfer to an assignee. These leasehold rights may include:

1. Option(s) to extend the Lease Term
2. Exclusive Use
3. Co-Tenancy requirements
4. Right of first offer/refusal
5. Option to purchase
6. Pylon/Monument signage

e. **Collateral Assignment to Lender**. Tenants may request that the landlord waive any rights it may have under the lease (or in some jurisdictions, under law) in the tenant's personal property, trade fixtures and equipment ("FF&E"), and the tenant's receivables.
   i. If the tenant has taken out a loan on FF&E for the premises, the tenant's lender may require the right to cure a default by the tenant or even take a collateral assignment of the lease to protect its interest in such collateral.

f. **Franchisor/Franchisee**. There are separate considerations when a lease is with a franchise.
   i. Most franchisors have a required lease rider that grants the franchisor certain rights in connection with the lease which would not ordinarily be granted a third-party.
      1. The franchisor will want to reserve the right to take an assignment of the lease in a variety of circumstances, including:
         a. Termination of the franchise agreement between the tenant and the franchisor.
         b. The franchisor exercising its right of first refusal in connection with a franchisee's sale of its business.
         c. In the event of a tenant/franchisee default, the franchisor's right to cure such default on the franchisee's behalf.
      2. The assignment to a franchisor will typically be without the requirement of the landlord's consent.
         a. Subsequent assignments by the franchisor to another franchisee will typically require:
            i. Landlord's consent unless minimum requirements are met.
            ii. The franchisor remaining liable under the lease unless minimum requirements are met.
      3. The franchisee lease rider may require the franchisor's consent to any assignment under the lease and in the event of an assignment, if the franchisor was a guarantor under the Lease, release of the franchisor from any liability thereafter.

g. **Store within a Store Concept**. The "store within a store" business model has become increasingly popular in recent years (i.e., a Starbucks within a Target, or Sephora within a Kohl's).
   i. There are several considerations for landlords if it is going to permit a "store within a store" sublease pursuant to its lease with a tenant. Some factors to consider are:
      1. The square footage which may be devoted to a "store within a store" concept;
      2. Whether the "store within a store" use is a violation of a co-tenant's exclusive or a prohibited use;
      3. Signage rights and the right to a separate entrance for the "store within a store" subtenant.

4. **Sample Provisions**.

Below are some sample provisions which reflect some of the concepts set forth above.

a. Landlord and Tenant revisions to a typical Assignment/Subletting provision:

ASSIGNMENT AND SUBLETTING

1. Restrictions on Assignment

Tenant shall have no right to transfer, assign, sublet, enter into license or concession agreements, or mortgage or hypothecate this Lease or the Tenant's interest in the Demised Premises or any part thereof without Landlord's prior written consent. Any attempted transfer, assignment, subletting, license or concession agreement or hypothecation shall be void and confer no rights upon any third person. Any assignment of this Lease without the prior written approval of Landlord shall be a violation of this Section. Landlord may deny its consent to assignment without cause or justification and may impose such conditions upon the granting of its consent as it may deem appropriate, including, without limitation, requiring the assignee to agree to new or different terms.

2. Change of Ownership

If Tenant or any guarantor is a corporation, limited liability company, partnership, or other business entity, a transfer, assignment or hypothecation of any stock or interest in such corporation, limited liability company, partnership, or other business entity by any stockholder, member, partner, or owner so as to result in a change in the control thereof by the person, persons or entities owning a majority interest therein as of the date of this Lease shall be deemed to be an assignment of this Lease.

3. Requirement for Transfer

In the event that Tenant proposes any Transfer of the Demised Premises or the Lease, whether by assignment, subletting or otherwise (each a "Transfer") Tenant shall notify Landlord in writing by certified mail at least sixty (60) days before the date on which the Transfer is to be effective and include with such notice (a) the name of the entity receiving a Transfer (the "Transferee"); (b) a detailed description of the business of the Transferee; (c) audited financial statements of the Transferee; (d) all written agreements governing the Transfer; (e) any information reasonably requested by Landlord with respect to the Transfer or the Transferee; and (f) a review and administration fee of Three Thousand and No/100 Dollars ($3,000.00). No such consent by Landlord to the proposed Transfer, and no such transfer, assignment or sublease shall relieve Tenant of its obligations under this Lease.

4. Sharing of Consideration

Tenant shall pay Landlord fifty percent (50%) of all rent and other consideration which Tenant receives as a result of a Transfer that is in excess of the Rent payable to Landlord for the portion of the Demised Premises and Term covered by such Transfer. Tenant shall pay Landlord for Landlord's share of the excess within thirty (30) days after Tenant's receipt of such excess. Tenant may deduct from such excess, on a straight-line basis over the term of such Transfer, all reasonable and customary expenses directly incurred by Tenant attributable to such Transfer.

5. Permitted Transfer

Notwithstanding the foregoing or anything to the contrary set forth in this Lease, Tenant shall have the right, with ten (10) days' prior written notice to Landlord but without requiring Landlord's prior written consent and without charge therefor and without Landlord having any recapture right, to assign this Lease or sublet all of the premises: (i) to any entity owned fifty percent (50%) or more by Tenant or any of Tenant's owners or affiliates; (ii) in connection with the sale of all or substantially all of Tenant's assets or stock; (iii) to the surviving entity in any merger, reorganization or consolidation or government action; (iv) to Tenant's franchisor or an affiliate of Tenant's franchisor; or (v) to any other approved franchisee of Tenant's franchisor or an affiliate of Tenant's franchisor having a tangible net worth at least equal to that of the initial Tenant under this Lease as of both the Effective Date of this Lease and the effective date of the proposed transfer (each a "Permitted Transferee" or "Permitted Transfer"). Any other assignment or subletting of this Lease shall require Landlord's prior written consent as described above.

b. **Franchisor/Franchisee-specific language**:

1. Tenant represents and warrants to Landlord that Tenant and Franchisor have entered or will enter into a franchise agreement (the "Franchise Agreement") allowing Tenant to operate for business in the premises under the trade name set forth in this Lease. Landlord has not read and is not aware of any of the terms of the Franchise Agreement, and therefore, cannot and does not make any representations or acknowledgements regarding the Franchise Agreement. In the event of any conflict between this Lease and the Franchise Agreement, this Lease shall control as between Landlord and Tenant. Tenant's indemnification obligations set forth in this Lease shall apply to any indemnified claims on account of the Franchise Agreement or any dispute between Franchisor and Tenant relating to Tenant's business and/or the Demised Premises. In consideration of the foregoing and notwithstanding anything to the contrary contained elsewhere in this Lease, Tenant shall have the right, without Landlord's prior written consent but upon at least thirty (30) days' prior written notice to Landlord, to assign this Lease to Franchisor, provided that all of the following conditions are satisfied:

(i) Tenant shall not at the time of such assignment be in default under any of the terms, covenants or conditions of this Lease or, if Tenant is in default, Tenant shall cure or shall cause Franchisor to cure all Tenant's defaults on or prior to the effective date of such assignment;

(ii) Franchisor shall operate for business in the Demised Premises under the trade name set forth in this Lease and for the purposes set forth in this Lease in the same manner as the franchise is being operated by a majority of Franchisor's other franchisees, all pursuant to all the terms, covenants and conditions of this Lease;

(iii) No such assignment by Tenant to Franchisor shall relieve Tenant or any Guarantor of any liability under this Lease, it being understood and agreed that Tenant and any Guarantor shall continue to be obligated hereunder irrespective of any transfer;

(iv) Franchisor shall assume in writing, in a form reasonably acceptable to Landlord, this Lease and all of Tenant's obligations hereunder and an original counterpart or copy of the fully executed assignment and assumption agreement shall be provided to Landlord no later than ten (10) business days after the effective date of the assignment; and

(v) Tenant shall pay the Transfer Fee to compensate Landlord for legal fees, costs of administration, and other expenses to be incurred in connection with the review and processing of such documentation.

2. Further, notwithstanding anything to the contrary contained elsewhere in this Lease, Tenant (including Franchisor as the current "Tenant" if Franchisor has assumed this Lease as provided in the Section above) shall have the right, subject to Landlord's prior written consent (which consent shall not be unreasonably withheld), to assign this Lease to a "bona fide franchisee" of Franchisor ("Franchisee"), provided that all of the following conditions are satisfied:

(i) Tenant shall not at the time of such assignment be in default under any of the terms, covenants or conditions of this Lease or, if Tenant is in default, Tenant shall cure or shall cause Franchisee to cure all Tenant's defaults on or prior to the effective date of such assignment;

(ii) Franchisee shall operate for business in the premises under the trade name set forth in this Lease and for the purposes set forth in this Lease in the same manner as the franchise is being operated by a majority of Franchisor's other franchisees, all pursuant to all the terms, covenants and conditions of this Lease;

(iii) Franchisee shall assume in writing, in a form reasonably acceptable to Landlord, this Lease and all of Tenant's obligations hereunder and an original counterpart or copy of the fully executed assignment and assumption agreement shall be provided to Landlord no later than ten (10) business days after the effective date of the assignment;

(iv) Tenant shall pay the Transfer Fee to compensate Landlord for legal fees, costs of administration, and other expenses to be incurred in connection with the review and processing of such documentation;

(v) If Franchisee is a corporation, partnership or limited liability company, the principal(s) of such entity (and the spouse(s) of such principal(s), as applicable) shall execute an absolute, unconditional personal guaranty(ies) in a form reasonably acceptable to Landlord and an original counterpart or copy of the fully executed personal guaranty(ies) shall be provided to Landlord within the same time period set forth above for the assignment and assumption agreement;

(vi) The tangible net worth (exclusive of goodwill, primary residence and retirement accounts, as applicable) of Franchisee and any new guarantor(s), immediately prior to and following such assignment, shall not be less than $_____ in the aggregate; and

(vii) No such assignment by Tenant to Franchisee shall relieve Tenant or any Guarantor of any liability under this Lease, it being understood and agreed that Tenant and any Guarantor shall continue to be obligated hereunder irrespective of any transfer as provided in this Lease.

For purposes hereof, a "bona fide franchisee" means a franchisee of Franchisor who (i) has executed Franchisor's standard franchise agreement and received all required training

under Franchisor's franchise program, and (ii) is acquiring or operating at least four (4) of Franchisor's store locations in the trade area including the Demised Premises and has at least five (5) years of retail business experience.