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Assignment or Subletting Primer: Use the Right Tool for the Right Job

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INTRODUCTION

Choosing between assigning and subletting can seem like a "no brainer": assignments are good if you want to turn over everything, and subletting is good if for less than everything. But that disregards some of the important consequences of may make one more advantageous than the other depending on the business goals. Sometimes the consequences can be the same for both transferor (meaning assignor or sublandlord) and transferee (meaning assignee or subtenant): for example, if a long-term lease or sublease is taxable for real estate transfer taxes, but an assignment of a long-term lease is not, both parties are drawn to the non-taxable transfer. Sometimes consequences are different for a transferor and transferee: for example, when the transferor is trying to be released from further liability under the lease, the transferor may prefer the assignment structure, but to be entitled to resume possession in order to mitigate its losses in the event of further default under the lease, a transferor may prefer a sublease structure. Some transferors will go to great lengths when the tenant is a subsidiary of the company selling assets, usually as part of the sale of one of the transferor's business lines, by having the tenant first reassign the lease back to the parent so it can become the transferor to allow the subsidiary to sublease and thereby retain remedies for protecting itself if the subtenant defaults or would otherwise be subject to eviction by the landlord. Arranged below are some of the more troublesome issues and variations on that rule in assessing strategies for using these tools.

Though there are many important considerations that should go into an analysis of how any transfer, whether assignment or subletting, could work. This presentation will attempt to avoid them. Consequently, these materials do not delve into individual state laws. Nor will these materials focus on issues that are basically considered the same for both kinds of transfers, even though those issues may be difficult and sometimes disastrous, such as the conditions to Landlord consent rights (rife with issues of creditworthiness, competition, tenant mix, percentage rent production, reputation, experience, permitted and exclusive uses ROFOs and ROFRS), landlord recapture rights, allocation of costs to analyze the transfer and the costs resulting from the transfer, timing and content of notices between the landlord and the transferor, direct or indirect transfers by transferors such as sale of equity or mergers as transfers by operation of law, temporary suspension of business during transfer, ineffective or defective obligations of transferor when applied to transferee.

1. FORMAL DIFFERENCES.

1.1. The Lease.

The landlord and tenant are bound to each other by the doctrines of privity of estate and privity of contract.

1.1.1. *Privity of Estate*. The privity of estate is due to the creation of a common interest in the leasehold where their interests in real property are founded. For example, landlord has the obligation to provide quiet enjoyment and tenant has the obligation to tender rent. The parties are bound to each other by those matters that "touch and concern the land". Vague, mystical, medieval, a place where real estate lawyers can thrive.

1.1.2. *Privity of Contract*. The landlord and tenant also enjoy bonds of privity of contract because they are parties of the mutual covenants, and successors to the parties may also preserve the privity. One common illustration is that a restriction that binds the land may bind the owner of the land regardless of the assignment of the original contract, because of the privity of estate relating to the possession of the land, where as an assignee of a contract may have privity of contract if there is a transfer of those rights. These differences have created critical differences between the two transfer events under discussion

1.2. Sublease.

1.2.1. *Privity with Sublandlord's Estate.* The structure of the sublease resonates with a number of issues found in the ancient rules of tenure. A sublease is created by a grant from the sublandlord to the subtenant of a lesser estate than the estate held by the sublandlord: therefore, there is privity of estate and privity of contract between them.

1.2.2. *No Privity of Landlord's Estate*. There is no privity between the prime landlord and subtenant, which results in various losses of rights for the subtenant; for example, prime landlord covenants running with the leasehold are not enjoyed by the subtenant, like the prime landlord's covenant of quiet enjoyment. The subtenant has no direct share with the prime landlord in the prime landlord's estate. it is something less than an assignment, as to the landlord, but something more than an assignment as to the transferor. These limitations can in the wrong circumstances be disastrous, but used purposefully, they can provide benefits that are not available to a transferor who would provide a transfer by using an assignment.

1.3. Assignment.

1.3.1. *Privity with Landlord's Estate*. An assignment of a leasehold, by comparison, is created by the transfer of the tenant's estate (or a prorated portion of it[1]). Therefore, the assignee has a direct relationship and privity of estate with the landlord because its right of possession is derived directly from the landlord. As a result, the technical result is that there is privity of estate and contract between the landlord and the assignee successor to the tenant, [2] whereas there is no privity between the landlord and the subtenant. Another important incident of assignment is that the assignor retains privity of contract and is not automatically released[3], unless the landlord expressly either releases assignor or limits assignor's liability to its interest in the leasehold. In that exposure to liability the assignor is like a sublandlord, but without the power to cure the risk. The secondary liability, as it is in

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[1] See more information on Assignments *pro tanto*, at 51 C.J.S. Landlord and Tenant §§ 37(2) and 44(3), and 49 Am. Jur. 2d Landlord and Tenant §393.

[2] "An assignment does not relieve the assignor from liability under the contract. Rather, after the assignment, the assignee becomes primarily liable for the obligations under the contract, while the assignor remains secondary liable. The debtor may then sue the assignor, the assignee, or both. See *Herigstad v. Hardrock Oil Co*., 101 Mont. 22, 52 P.2d 171 (1935); *Southern Surety Co. v. W.E. Callahan Construction Co*., 283 S.W. 1098 (Tex.Civ.App. 1926); see also *Sobol v. Avila*, 480 P.2d 116 (Colo. App. 1970) (not selected for official publication)." *Roget v. Grand Pontiac, Inc*., 5 P.3d 341, 345 (Colo. Ct. App. 1999).

[3] "When a lease is transferred by assignment, the assignee steps into the lessee's shoes and acquires all the lessee's rights in the lease. Privity of estate ends between the lessor and lessee and is created between the lessor and the assignee. The assignee therefore becomes bound by the covenants running with the land. Privity of contract between the lessor and lessee, however, does not end by the mere assignment of the lease and the lessee is therefore still bound by the lease provisions. Since Italian Fisherman [assignor] transferred to Armand's [assignee] all of its "right, title and interest" in the Rockville property, one may conclude that the assignment was unequivocal and the Italian Fisherman had divested itself of any interest in the property." *The Italian Fisherman, Inc. v. Middlemas*, 545 A.2d 1, 8-11(Ct. App. of Md. 1988). There is a common law theory of subrogation that generally applies to protect guarantors, but the court case did not address that as an alternative.

the nature of a guaranty would arguably be extinguished upon the occurrence of events that would otherwise extinguish a guarantor's liability, such as a material change to the underlying obligation.

1.3.2. *Indirect Divestiture of Subleasehold*. One aberrant outcome of the differences is that while the sublandlord may be able to avoid future liability by simply voluntarily surrendering its paramount leasehold to the landlord thus causing a merger of the estate and most likely the accessory contract liabilities, concerned commentators have been diffident in asserting whether the surrender divests the sublease, substitutes the sublease even though there is a lack of attornment, or merely severs it from liability.[4] A surrender by a subtenant to a prime landlord would be impossible. By comparison, a surrender by an assignor of its interest may divest its contractual liabilities, though the fact that the assignor lacks an estate in realty could prevent the surrender; whereas, a surrender by the assignee would certainly divest an assigned lease.

1.3.3. *Consequential Loss of Assignor Privity of Estate*. If the assignor of the lease is not expressly released by the prime landlord, the transferor (assignor) would remain secondarily liable on the lease after assignment. The surviving liability of the assignor may be further reinforced when drafters try to expressly retain for the assignor the right to re-enter rather than compel a re-assignment. Otherwise, if there is a default by the assignee under the lease and the assignor had no right of re-entry, then the assignor, at least under one case, would be liable to the prime landlord, and yet would be merely a creditor of the assignee, without the express benefit of being able to mitigate those damages through repossessing and reletting the leasehold originally assigned. Drafters consider an assignor's right of re-entry as equivalent to a landlord right of re-entry: neither of which is a recapture of the term of the remainder of the estate for years.

1.4. Recharacterization.

This distinction between the sublease and the assignment of course provides an excuse for mischaracterization and recharacterization. The characteristic of a sublease is that the sublandlord has a right of repossession and reversion. The use of a reassignment can create an equivalent outcome. The more the assignment appears to resemble a sublease, or the reverse, they each can be subject to recharacterization for purposes of tax law, lease law, contract law, bankruptcy law, and financial reporting requirements. When the assignor retains a continuing interest in the leasehold estate, even though it does not retain an estate in time, the assignment may be recharacterized as a sublease because the re-entry right is like the reversionary interest upon a default.[5] If the re-entry were deemed a re-assignment, there is a higher likelihood the arrangement could be recharacterized as a sublease. To the extent an assignment would require landlord consent, the assignor may also seek the landlord's advance consent to that re-entry without terminating the original assignment. The gravity of this issue is not only the balance between the assignor and assignee as to how remedies must be exercised, but it is also an issue for the landlord as to whether its consent was required. For example, if a sublease term is one day less than the prime lease, but the subtenant has exercised an option to extend beyond that date, there has been litigation as to whether the exercise results in a sublease being recharacterized as an assignment because the exercise of the option caused the entire estate to be held by the subtenant.[6]

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[4] The consequences are more than anomalous, and reach a level of absurdity. The subtenant has no obligation to pay rent to the sublandlord, because the sublandlord surrendered its rights. The prime landlord has no rights because the doctrine of merger concludes that the prime landlord obliterated any privity of contract or estate when the leasehold was merged into and extinguished by the fee estate. The common law enables the subtenant to retain possession without paying any rent. "A subtenant is not liable to the head landlord under the head lease. He is not liable for rent or for breach of other covenants. There are three general exceptions to this. First, if the prime tenant is insolvent the head landlord may resort to the subrents – and has a preference therein ahead of other creditors of the prime tenant – to the extent necessary to satisfy the prime tenant's liability under the head lease." . See 1 Milton R. Friedman and Patrick A. Randolph, Jr. FRIEDMAN ON LEASES at 236-237 Section 7:7.1 (5th ed. 2007, including Release #6). Id at §7:7.3, fn. 590 (5th Ed.). "This preference may be analogized to a vendor's lien." Id. at fn.523. However, language in the prime lease can overcome the presupposition. "California law has long held that a tenant's surrender of his estate to the landlord does not destroy the estate of the underlessee if the tenant has made an underlease. (*Buttner v. Kasser,* (1912) 19 Cal. App. 755, 760 [127 P. 811].)" *Chumash Hill Properties, Inc. v. Peram*, 46 Cal. Rptr. 2d 366, 370 (1995).

[5] "A sublease is involved if the tenant has reserved a right to take back the possession of the leased property upon the occurrence of some event, the event usually being the failure of the transferee to meet some rental payment." RESTATEMENT OF PROPERTY § 15.1 Reporter's Note 8.

[6] *Joseph Brothers Company v. F.W. Woolworth Company*, 641 F.Supp 822 (N.D. Ohio, 1985).

2. TRANSFEROR'S ANALYSIS: TO BE A SUBLANDLORD OR AN ASSIGNOR.

2.1. Sublandlord Duties.

2.1.1. *Back to Back Liabilities of the Sublease*. Disregarding the effect of a recognition agreement (discussed below), the analysis of different benefits and the detriments to a sublandlord, when compared to those of an assignor, can be distinguished in different ways. Detriments, as a general matter, revolve around duties and the liability for breach of duties. A sublandlord retains an estate and grants a lesser estate. Consequently, it has independent and equivalent liabilities as those of traditional landlord duties which the sublandlord cannot avoid merely by referencing the prime lease terms and disclaiming liability for prime landlord duties. For example, one landlord duty is the implied warranty of quiet enjoyment; this is a core incident of privity of estate and is applicable to the sublandlord duties to the subtenant, but as discussed above, it is not a duty of the prime landlord to the subtenant. A second example is that sublandlord is liable for wrongful eviction it may cause. A third duty is that sublandlord generally has to avoid impairment of the subtenant's leasehold rights. To the extent a subtenant's rights can be preserved only by entitling it to setoff, to abatement, or to escrow rent due, the sublandlord is in a more perilous position than an assignor because the sublease may entitle subtenant to stop rent while the sublandlord remains liable to the prime landlord under the prime lease to pay that rent.

2.1.2. *Direct Liabilities of the Assignment.* By contrast, the assignment would automatically pass through the duties and liabilities between the landlord and the assignee. Though these issues are not dominant, this could sway a sublandlord transferor to prefer to assign rather than sublease to a transferee, notwithstanding the other powerful arguments to the contrary based on rights of damages and eviction.

2.2. Sublandlord Administration.

2.2.1. *Prime Lease Compliance*. Another characteristic of the sublandlord's duty to the subtenant and the prime landlord, but one which rarely attends the assignor, is as the intermediary for administrative housekeeping. The sublandlord forwards notices, collects sublease rent, and pays prime lease rent, maintains insurance and is otherwise liable for errors in the performance of its sublandlord duties and prime tenant duties. This administrative responsibility exposes the sublandlord to possible liability claims from subtenant for negligence and business interference in addition to simple breach of contractual duties. These are more reasons for the transferor to prefer the assignment over the sublease. The sublandlord can appoint the subtenant as its agent to perform those duties directly, but the sublandlord would still need to monitor the activity for its own well-being unless it could achieve the unlikely benefit of a release from those duties by prime landlord.

2.2.2. *Sublandlord Retention of Prime Lease Remedies*. Another issue is preservation of sublandlord rights. In the sublandlord efforts to remain aloof from the continuing dynamic of the landlord tenant relationship, a common request of subtenants, which is granted frequently but not uniformly, is that the subtenant be permitted to pursue remedies in the name of the sublandlord. This raises a variety of possible risks that the assignment would handily avoid, such as inappropriate or negligent exercise of the power resulting in unforeseen sublandlord liability is in the traditional issues that revolve around providing any tenant rights to contest ownership liabilities such as real estate taxes or violations of law.

2.3. Sublandlord Mitigation.

2.3.1. *Sublandlord Retention of Sublease Remedies*. The preeminent benefit to a sublandlord of a sublease, compared to an assignment, is the sublandlord's structural retention of the power to mitigate its own damages, a power inherent in the sublease and non-existent in the assignment. If a subtenant defaults, a sublandlord can exercise traditional landlord remedies and accelerate for rent due, or evict the subtenant, re-enter and relet the subleased premises, or terminate the sublease. The assignor cannot exercise those rights without a contractual right to them, which may trigger recharacterization problems referred to above.

2.3.2. *Sublandlord Retention of Possession*. A further complement of those protections is that the sublandlord remains involved in the notice procedures and, in the context of actual or constructive notice, is the primary possessor-in-interest for otherwise uninformed third parties. The assignor cannot evict the assignee, nor repossess the leasehold, unless separately agreed to by the prime landlord. However, the sublandlord can evict the subtenant. If the prospective assignor transferor cannot obtain a release or limitation of liability from the prime landlord, this would be an important reason for the transferor to prefer to sublease rather than to assign to a transferee.

2.4. Interference with Assignor Rights to Reentry or Reassignment

2.4.1. *Assignor's Risks from Assignee's Creditors*. The prime landlord would typically have requirements that an assignee have a credit quality at assignment no less than that of the tenant at commencement of the lease and the assignee at the time of the initial assignment. Interference with assignor's right to reassignment or re-entry can arise if the assignee's creditors attach liens to the leasehold; then the assignor's rights may be subject to the reassignor's (assignee's) judgment or creditor liens. The assignee could also impair the leasehold in ways other than lien encumbrances, so that the assignor's rights would be problematic or of diminished value, such as by permitting third parties' rights of use or occupancy. If the assignee/reassignor is thinly capitalized, it is impractical to expect that the assignor could be able to force the assignee to cover the assignor's losses. The assignor may also face the risk that the reassignment is frustrated because the prospective assignee/reassignor is unable, rather than unwilling, to make the assignment. For example, the assignee's guarantors may object that the assignor's rights impair their expectations of the performance by their obligor, the initial assignee, and may interfere with the mitigation available by subrogation.[7]

2.4.2. *Primacy of Sublandlord to Subtenant Creditor's*. By contrast, a sublease would always be subordinate to the sublandlord's estate and therefore liens on the subtenant's interest in the subleasehold would be subordinate as well: the termination of the sublease terminates liens on the sublease. In addition, parties in interest with Subtenant, such as its guarantors, as a general rule would not be able to impede the Sublandlord's termination of the sublease.

2.5. Bankruptcy Rejection of Right to Re-Entry or Reassignment

A more extreme risk to the assignor is if the assignee files for bankruptcy and rejects the contractual obligation to allow re-entry. One countermeasure would be to have the assignee guaranty to assignor the payment of the prime rent, with the guaranty collateralized by a collateral right of re-entry or assignment of the lease. The collateral assignment would need to clear the same hurdles with the prime landlord and assignee's lender, if any, as a pre-approved consent to a conditional reassignment.

2.6. Assignor's Independence from Ownership Risk

A benefit of the assignor over that of a sublandlord is that the assignor lacks incidents of ownership during the period of assignee's tenure. The assignor can sidestep liability that arises during the period after the assignment. If those liabilities arose after the assignment, the assignee could choose to remain outside of the ownership of the leasehold and avoid those liabilities by avoiding re-entry or reassignment, such as environmental risk.

2.7. Possession as Notice of Rights

2.7.1. *Assignee Possession*. Lastly, the assignee has much better circumstances to claim that its possession provides notice for third parties that possession is in the assignee. Concomitantly, the assignor has better claim that it is not in possession.

2.7.2. *Sublandlord Possession*. By comparison, the subtenant's right to that standard by constructive or actual notice is much less clear. Of course, the more the assignment appears to resemble a sublease, or the reverse, it can be subject to recharacterization.

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[7] "Although Dow [landlord] may sue either the lessee or assignee of a lease, "as between the assignee and the lessee, the assignee bears the primary liability for rent accruing subsequent to the assignment." After an assignment, the lessee is treated in the fashion of a surety or guarantor of the assignee. In other words, as with a surety or guarantor, the liability of the assignor is secondary vis-à-vis the assignee. * * * Because the lessors of the Rejected leases were entitled to an administrative priority for the postpetition monies due them through the date of rejection, G & W [as guarantor of the lease] may step into their shoes. G & W paid Dow several months' rent which otherwise PS [lessee/assignee] would have had to pay at the time of assumption. Thus, provided G & W protects the estate either by directing Dow to accept the payments under G & W's guarantees or by obtaining an assignment from Dow, it can assert Dow's rights." *In re Wingspread Corp*., 116 B.R. 915 (SDNY 1990).

3. TRANSFEREE'S ANALYSIS: TO BE A SUBTENANT OR AN ASSIGNEE.

3.1. Divestiture of Subleasehold.

A subtenant has numerous concerns about the risks of a sublease, but a key concern is about the loss of the subleasehold estate for reasons outside of subtenant's control. The principal fear is that the prime landlord is entitled to terminate and divest the prime leasehold and all rights that derive from the leasehold, including the subleasehold estate. The major source of protection against that is the recognition agreement. The subtenant would also seek protections with a non-disturber. The recognition agreement can be vulnerable to various attacks. For a transferee, it has greater inherent frailties than those that inhere in an assignment.

3.2. Independence of Subtenant from Prime Landlord.

3.2.1. *Subtenant Reframed Covenants*. As a general matter, one benefit of a sublease for a subtenant is that it can insulate the subtenant from direct liability for duties that are created under the prime lease except as otherwise expressly provided in the sublease. The liability of the subtenant under the sublease, specifically for rent, may be far less punishing than prime lease rent, though the consequence of default for non-payment of prime lease rent may be more extreme, meaning termination of the sublease without the right to provide substitute cures. In addition, subtenant can negotiate for a number of benefits from the sublandlord that the sublandlord may not have been able to negotiate with the prime landlord, such as set off, limited liability, early termination, and tenant improvement allowances. To the extent subleases are of some smaller portion of the sublandlord premises, subtenants can also negotiate expansion options up to the boundary of the sublandlord's demised premises. Consequently, the subtenant and its guarantors, without privity with the prime landlord, can keep the prime lease requirements at a distance and, if the subtenant is protected by a recognition agreement of its sublease contract terms, virtually irrelevant. The battle for the subtenant is whether it is expected to step up into the prime lease, albeit pro tanto like an assignee, or if the prime landlord is expected to step down into the sublease.

3.2.2. *Assignee Pre-existing Covenants*. The assignee takes what the assignor got, and therefore as to the landlord cannot refashion those covenants in the assignment unless by amendment to the lease itself.

3.3. Mitigation.

From the transferee's point of view, an assignment could be less appealing than a sublease, especially because the subtenant can contractually negotiate to require its sublandlord to mitigate damages if local statutes do not otherwise require it. An assignee, by comparison, having no negotiating relationship with the prime landlord, rarely revises the impositions built into the prime lease in an equivalent fashion. The assignee's surrender or abandonment is made directly to the prime landlord.

3.4. Independence of Assignee from Assignor.

Under an assignment, the transferee would have a direct relationship with the landlord rather than an intermediated relationship as in a sublease. The assignee's right to the leasehold is not at the mercy of the assignor or shaken by its mistakes, as would be the case for a subtenant deriving its continuing right of possession from a sublandlord. For example, after a valid transfer, the dissolution or termination of the assignor cannot affect the assignee's leasehold, whereas as the sublandlord's dissolution or termination could affect the subtenant's estate. The assignee ordinarily has a contractual grant under the lease entitling it to interact with the landlord's mortgagee. The sublease has no privity.

4. DRAFTING COMPARISONS AND CONTRASTS.

4.1. Similarities.

In comparing provisions of a sublease to the corresponding provisions of a lease assignment, the first distinction should be between an assignment of the whole lease compared to an assignment *pro tanto.* The assignment *pro tanto* and sublease are much more alike because the assignor retains an interest in the balance of the leasehold space, whereas a sublandlord may retain an interest in the balance of the space but certainly retains an interest in the balance of the term, the reversionary interest. Comparing a sublease and a complete assignment, traditional provisions can include some of the following.

4.1.1. *Recitals*. Both approaches would have recitals as to the lease in question: laying the foundation for its parties, the genesis of its formation, and its subsequent history builds a framework around the intended transfer and the real property interest being transferred.

4.1.2. *Disclaimers*. The assignor and the sublandlord will both disclaim any responsibility to perform the original landlord's duties, and will insist the subtenant or assignee expressly assume the obligations of tenant under the original lease.

4.1.3. *Reduced Transferee Cure Periods*. One commonly overlooked similarity is the need for the sublandlord and the assignor to control the risk of loss arising from a subtenant or assignee failing to perform tenant obligations: they both should seek to scale back the assignee or subtenant's cure periods. That would allow sublandlord or assignor, as the case may be, to reassert its power to cure a tenant default.

4.1.4. *Accelerated Remedies Against Transferee*. They would both look for remedies against the transferee, whether subtenant or assignee, including accelerated damages, right of re-entry, and rights of termination.

4.1.5. *Landlord Consent*. A more obvious similarity is that both the assignment and sublease generally need a landlord consent where the prime lease has an express provision, but not where it is silent.

4.1.6. *Transferor Representations and Warranties*. Both would cover the same areas relating to assignor/sublandlord representation and warranties. As part of that, both the assignment and sublease would typically include the panoply of terms relating to as-is condition; disclaimers by assignor/sublandlord, and releases of claims and waivers of defenses by assignee and subtenant.

4.1.7. *Transferor Recapture*. Another important but frequently overlooked similarity is the transferor's right to reclaim or repossess the occupancy. This drives to the heart of an assignor's risk if the new occupant fails to meet the original landlord's requirement, and consequently leaves the assignor as exposed as a sublandlord. It is actually worse for an assignor because the assignor may otherwise have foresworn its traditional source of recovery.

4.1.8. *Property Ownership*. The assignee and subtenant would both expect to distinguish what materials (whether personalty or alterations) would need to be removed notwithstanding they were not delivered or installed by the subtenant or assignee.

4.2. Dissimilarities.

4.2.1. *Changed Lease Provisions*. The sublease would ordinarily elaborate the variety of provisions in the prime lease that are either included or excluded, such as how references for prime landlord are incorporated as to be deemed to mean either sublandlord, both sublandlord and prime landlord (such as for consents), or only prime landlord (such as providing utilities). An assignment rarely addresses those issues because the assignor is cut out of the loop of participation in the landlord-assignee relationship. The assignee can implement changes only by amending the Lease. Issues relating to term, rent options, landlords building services, and premises configuration may be shortened or modified in a sublease, but would generally not be modified in an assignment because the entire lease, with privity of contract and estate, is being assigned. Covenants would be treated dissimilarly because the assignor would believe it is out of the privity of estate and therefore has no further obligation.

4.2.2. *Rescaling Materiality*. Many subleases involve smaller portions of larger spaces, so they would emphasize issues relating to sub-demising space, such as splitting life safety and electronic communication systems, subtenant allowances, removal of personalty and alterations upon surrender, and allocation of construction risk. They also dwell on issues relating to destruction and condemnation among other property right issues which an assignor believes it has left far behind. On those lines, the subtenant would need to be sure it could terminate if a large portion of its space becomes untenantable even though it may be a small portion of the larger demised premises. Sublandlords will also typically focus on security deposits and other collateral enhancement which is not part of an assignor's area of future concern.

4.2.3. *Transferee Enforcement of Lease*. In that vein, a subtenant will feel compelled to describe its subrogation rights to prime tenant's position in enforcing the prime lease. The assignee already has the power by the nature of the assignment. Similarly, the subtenant would expressly create the right to compel sublandlord to enforce tenant rights, whereas the assignee would not need an express statement because that right is already embedded in the assignment.

4.3. Unplanned Sublease.

4.3.1. *Operating Lease*. By comparison, aside from the ground lease, the sublease is permitted as a possibility, but rarely a planned economic component. It is not built into the economic stack. In these situations, the subsequent subtenant may reluctantly submit to the risk of divestiture if the prime lease is terminated either by the prime landlord upon prime tenant default or foreclosure of a prime leasehold mortgage. Because, the sublease is not necessarily a planned component, and it is not built into the economic structure, the prime landlord's subsequent consent may appear to be tendered more out of benevolence to the subtenant than out of obligation. Further, no recognition agreement may be mandatory. The subtenant may accept the risk of divestiture as a component of the occupancy, and factor that risk into its rent negotiations. Generally, the case where the prime tenant is an operating company, deriving revenue from sales or services rather than rent.

4.3.2. *Ground Lease*. The ground lease, by contrast, is designed by the prime landlord and the prime tenant to have subleases as an economically essential component. Many subtenants will grudgingly accept the structure as long as it leaves them no worse than a direct lease between subtenant and prime landlord. Therefore, if evil days fall upon the prime tenant, the subtenant would require a direct lease with the ground landlord, as if the prime lease were erased. The express contractual agreement between the prime landlord and subtenant as to recognition, non-disturbance and attornment are preferred safeguards to overcome the ponderous logic required to compel enforcement of the subtenant's occupancy rights based on theories of privity of contract and privity of estate.

5. RECOGNITION AND NON-DISTURBER.

The subtenant wants to preserve its rights under the sublease regardless of the defaults or other problems under the prime lease, and it seeks to preserve its rights by use of a non-disturbance and recognition agreement, which are usually considered synonymous. The prime landlord would consider the subtenant's request for preservation only if the prime landlord were certain its rights would not be prejudiced or adversely affected or at least it provided a backstop against worse losses. For example, the subtenant would want the prime landlord to confirm in its consent that the sublease meets all prime lease requirements, such as it does not violate or strain other exclusive or prohibited use clauses, and the prime landlord would be reluctant to confirm more than it knew.

5.1. Lease Survival.

In comparing and contrasting the effects of assignment to those of subleasing, the recognition and non-disturbance agreements play decisive roles. The recognition agreement can follow the route of transporting either the subtenant into the shoes of the prime tenant, or the prime landlord into the shoes of the sublandlord. The assignment follows only one route: the assignee is transported into the shoes of the assignor-tenant. Most importantly, but least appreciated, the recognition agreement falls short of providing a subtenant with the same protections an assignee enjoys, because the commencement of the recognition ordinarily takes effect when the prime lease fails, not at the commencement of the sublease itself. The assignment, by comparison, assigns those rights at that earlier date, at the commencement of assignment.

5.2. Inchoate Estates

5.2.1. *Subtenant's Future Estate*. The subtenant's recognition agreement, to enter into a lease in the future, would provide subtenant rights in the nature of an *interesse termini*.[8] If that doctrine applies, the prime landlord could breach its covenant and merely be liable for damages. The subtenant would have no right to injunction for possession, and the subleasehold mortgagee, if any, would have no collateral. If the sublease could be disregarded, divested, or terminated by payment of damages, the transferee must assess the risk of the loss of the sublease in the event of non-standard unmanageable early termination for causes outside its control. If the recognition covenants are enforceable, then the sublease recognition follows the structure of an assignment. In some instances a future tenant may require a current grant of that interest, and then leaseback to the transferor for

[8] "In all likelihood this was because at common law a lessee who had not entered into possession was not thought to have an estate in land. Rather, such a lessee was said to have an '*interesse termini*', or an interest in a term. Coke. Lit. 46b; 2 Blackstone, Commentaries *144." *Soffer v. Beech*, 409 A.2d 337, 341 (Pa. 1977). 'Because no livery of seisin is necessary to a lease for years, such lessee is not said to be seised, or to have true legal seisin of the lands. Nor indeed does the bare lease vest any estate in lessee; but only gives him a right of entry on the tenement, which right is called his interest in the term, or *interesse termini*: but when he has actually so entered, and thereby accepted the grant, the estate is then, and not before, vested in him, and he is possessed, not properly of the land, but of the term of years; the possession or seisin of the land remaining still in him who hath the freehold." Blackstone, book II, chap. 9, § 144.

it in turn to transfer to the transferee when the subordinate possession will occur in the future. The same reasoning can apply to a "sandwich" or "concurrent" lease where the involuntary subtenancy is back stopped by a senior estate to the subtenant.

5.2.2. *Assignee's Future Estate.* The risk in both the sublease future recognition agreement and an assignee's future right of re-entry is that a bankruptcy of the landlord and a resulting 363 sale of its estate may divest the subtenant or the assignee transferee of rights to the leasehold.[9]. In one case, a court reinstated a motion to stay a 363 sale free and clear where debtor landlord sought to sell its property free and clear of a space lease. Tenant argued it could remain either under 365(h), because a lease that is rejected does not result in dispossession if the tenant otherwise performs its real property obligations[10], or in the alternative (if the lease were not rejected), it cannot be dispossessed unless the landlord met one of the 5 requirements under 363 (f) for a sale "free and clear", which the landlord did not do. In the Revel case the gating issue was whether there was an undisputed lease which the debtor claimed took the tenant out of the protection of 363 (f). The landlord claimed the fact that rent was solely percentage rent pushed for recharacterization of the lease as partnership. The dissent stepped back and noted "Under 11 U.S.C. § 363(e), an entity with "an interest in property" that is proposed to be sold can request the bankruptcy court to "prohibit or condition such ... sale ... as is necessary to provide adequate protection of such interest." 11 U.S.C. § 363(e). The trustee, however, may sell the property "free and clear" if, among other things, "such interest is in bona fide dispute." 11 U.S.C. § 363(f)(4)." Subsection 363(f) provides that a debtor can sell its assets free and clear of "any interest" (such as a lease or a recognition agreement or a re-entry agreement) if any of five conditions are met[11] (1) applicable non-bankruptcy law so permits, which then begs the question whether a recorded recognition agreement or re-entry agreement provides that protection and prevents a sale "free and clear", (2) the interest holder consents, thus if the transferee consents to the sale, it cannot also complain it is at risk of divestiture against its will, (3) the interest is a lien and the price at which the debtor's assets are being sold is greater than the value of all the liens on its property, for real estate lawyers, a lease is an encumbrance, but not a lien[12] because it is not discharged by a payment of money upon a sheriff's foreclosure sale.] (4) the validity of the interest is in bona fide dispute, this would not expect to be an issue where there was a clear writing of the obligations, or (5) the interest holder, whether in a legal or equitable proceeding, could be compelled to accept a money judgment for its interest, but similar to the analysis of the lien, the real property interest of the lease is not fungible with cash.[13]] . The *Revel* court further mentioned in passing the issue of adequate protection and rejected the general assumption that adequate protection for a lease means possession because in the case at hand, the perpetuation of the lease for a failed hotel-casino facility would have not been feasible. [14]

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[9] *In re Revel AC, Inc.,* 2018 U.S. App. LEXIS 34028 (3d Cir. Nov. 30, 2018), a recent decision of the Third Circuit Court of Appeals appears to be in accord with the majority view.

[10] 11 U.S.C. § 365(h) : "provides a lessee of real property under a rejected lease with the option of either retaining the estate, including, among other things, the continued right to possession or to treat the lease as terminated."

[11] 11 U.S.C. § 363(f)(1)-(5).

[12] In *Dishi & Sons v. Bay Condos, LLC*, 510 B.R. 696, 704 (S.D.N.Y. 2014) the tenant's lease was preserved. The court set out to harmonize 363(f) and 365(h). The Court leaned toward accepting that the tenant appeared to have received notice of the sale after the auction and before the order was entered. The tenant moved to retain possession either under 365(h) or as adequate protection under 365(e). The court noted that the adequate protection as a prerequisite to permit the divestiture of an interest could take the form of cash or possession; though in the end it saw no alternative but possession as the requirement in the case of the leasehold. In the course of its opinion, the court further concluded "TGM [tenant] clearly has not consented, the lease is not a lien, and the validity of the lease is not in question." Dishi at 32.

[13] "And as Dishi has not suggested any other [outside of a foreclosure] hypothetical proceedings by which the trustee could compel TGM to accept a money satisfaction in exchange for extinguishment of its interest, the Court holds that paragraph (5) does not authorize a sale free and clear of TGM' s rights." Dishi at 41.

[14] : "The District Court came to the same conclusion regarding whether Revel satisfied § 363(e)'s adequate protection requirement. IDEA had argued that adequate protection means continued possession of its lease, not merely money damages, as the Code provides that "adequate protection may be provided by ... granting such other relief ... as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." 11 U.S.C. § 361(3). But the Court thought otherwise, declaring that rejection damages were an adequate substitute for continued possession. See In re Revel, 525 B.R. at 31 (noting that "it is more than arguable that granting possession to [IDEA] in the present circumstances of a catastrophically failed casino-hotel concept would be no more 'adequate' than what [it] received, namely, the right to assert [a] claim[ ] for rejection damages or other relief as [an] unsecured creditor [ ]"). It also minimized the Bankruptcy Court's failure to make any findings on whether IDEA's interest would be adequately protected. In the District Court's view, because the Bankruptcy Court found that § 363(f) was satisfied, it "necessarily found the interests of [the various tenants] adequately protected."

5.3. Landlord Defenses.

A landlord can defend against the enforcement of the recognition agreement with the traditional defenses of a party to any contract such as coercion, duress, mistake, fraud in the inducement, lack of authority, or lack of consideration. In addition, the recognition agreement may be a mere contractual relationship rather than a real property relationship, and consequently the landlord's liability for breaches may result only in damages, not specific performance. In the assignment, by comparison, because the landlord is not usually a party to the assignment, the landlord has few defenses other than the violation of the conditions contained in the prime lease that is being assigned.

5.4. Differences between Sublease Recognition Agreement and Direct Assignment.

5.4.1. *Subtenant Protections*. Because the recognition agreement only confirms a late-occurring assignment, it still falls short of providing protections to the subtenant which would be identical to what it would have had if the subtenant had a direct relationship with the prime landlord from the outset. One response to overcome this could be to include a prime landlord covenant of non-disturbance as to prohibiting divestiture and expressly recognizing the sublease terms, thereby entitling the subtenant to enforce its sublease rights directly against the prime landlord in the event of any landlord suspension or termination of the prime. In tandem with that, the subtenant may also look for a concurrent non-exclusive assignment of the prime tenant's rights and defenses under the prime lease expressly recognized by prime landlord so that if the subtenant's claim to recognition of the sublease, it could in the alternative elect to pick up the rights of the prime tenant under the prime lease. Rights that benefit the prime tenant, but which the subtenant needs as well, would include both procedural rights and substantive rights. Procedural rights could include rights such as to notice. Substantive rights could include rights to terminate for prime landlord's breach of the covenants such as quiet enjoyment; rights to compensation otherwise payable to the prime tenant, such as condemnation awards or reimbursement for tenant improvements; rights to essential services and amenities, services that sublandlords generally disclaim any liability to provide; and, rights to contest impositions for which the subtenant would otherwise indirectly be responsible. Defense rights that the subtenant may look for include rights to notice, to audit operating expenses, to cure prime landlord defaults, and to participate in responses to governmental actions such as road widening, taxes, and special assessments, and alleged notations of law. Not only would the subtenant seek an assignment of the prime tenant's rights, but depending on the strength of the subtenant's bargaining position, it would want the prime tenant to make the assignment without reservation of rights, whether by waiver or subordination, and to defer its exercise of those rights in deference to the subtenant, such as rights to adjust insurance payments, to prosecute condemnation awards, rights to terminate, and rights to assert continuing possession in the event of prime landlord's bankruptcy and rejection of the prime lease

5.4.2. *Prime Landlord Protections*. Just as in the case of the successor landlord's view of the SNDA, the prime successor landlord does not expect to be liable for personal covenants or for covenants that impose extra expense such as expansion options, or perpetuation of loss-leader amenities. Sublandlord would seek to disclaim liability to provide such services as trash removal, property management benefits and security as well as physical supports such as signage, parking and project amenities, commissary, health club, or nursery and childcare.

6. CONSENTS.

6.1. Prime Landlord Conditions.

6.1.1. *Subtenant as Assignee*. A prime landlord may refuse to grant a non-disturber to the subtenant but instead call upon the subtenant to assume an assignment of the prime tenant's interest in the prime lease, or more properly enter into the equivalent as a new lease, as the condition for recognizing the subtenant's possessory right after a prime tenant default. Then the prime landlord is assured of getting its stipulated rent, as well as its bargained for covenants. Its major risks are setting standards to qualify the subtenant as a direct tenant, and to manage the exposure caused by existing lease violations. The prime landlord may also need approval of its lenders, rating agencies and similar parties to which the landlord may be subject. The prime landlord and its mortgagee frequently condition their acceptance of assumption or privity with a subtenant on various requirements. The subtenant may be required to possess credit qualifications at least as good as the prime tenant (measured at the date of lease commencement and at the date of assignment) or landlord's then current leasing requirements for new tenants, such as good business reputation, experience in the business it proposes to conduct, numerosity of locations, appropriate guaranties, and similar use of premises. Conditions which applied to the prime tenant would also apply to the subtenant: that it shall not have caused any default or any material adverse effect to the detriment of landlord or its mortgagee, that it has made a timely request for consent, or that it is not soliciting the

same potential occupants the prime landlord is soliciting for its other available space. In some cases there is a requirement that subtenant cure those prime tenant defaults that are not personal to prime tenant.

6.1.2. *Landlord First Right of Recapture*. Sometimes the prime landlord will reserve rights of recapture, as mentioned above. The prime landlord and its mortgagee would look to the recognition agreement as a means of scrubbing off any special concessions that the prime landlord afforded the prime tenant or the prime tenant conceded to the subtenant. In addition, the prime landlord would want the subtenant to (1) commit to pay rent commensurate with the base and additional rent requirements of the prime lease, or provide an adequately subsidizing enhancement to protect the prime landlord from shortfall; and (2) be subject to relocation if the subtenant occupied less than all of the prime leased space so that the most attractive qualities of the remainder of the prime leased space that enhance its value are preserved, such as configuration, visibility, and contiguity.

6.2. Landlord's Mortgagee Conditions.

To address the risks of unintended loss of rent revenue, the prime landlord's mortgagee imposes restrictions on the prime landlord consents to transfers. Whether the sublease or the assignment were the chosen vehicle, the mortgagee would look for (1) right to approve any prime landlord (a) consent to assignment, (b) consent to sublease or (c) new recognition agreement; (2) collateral assignment of prime landlord's rights in the recognition agreement; (3) pre-approval of any modification that would impair or prejudice the prime landlord mortgagee's rights, (4) prohibition against assignment or sub-subleasing of the subleasehold without mortgagee consent, and, (5) as with the SNDA model, extinguishment of the subtenant's right to recognition if 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.

6.3. Prime Tenant Condition.

In any event, a tenant would seek an exemption to the prime landlord's right of consent, such as for transfers (1) by operation of law through merger or consolidation, (2) by affiliates, (3) of all or substantially all assets, stock or control, directly or indirectly, to a third party, and (4) by way of securities offerings. Sometimes tenants avoid the explicit restriction by engaging in transfers that are not expressly addressed such as stock sales, when only asset sales are prohibited.

6.4. Subtenant Conditions.

Subtenants would seek similar freedom on transferability as tenants on restrictions. But additional issues arise when the sublease and prime lease do not have the same effect, such as when the sublease space is less than the prime lease space, or the rents are not matched.

6.4.1. *Relocation*. From the subtenant's point of view, similar issues for relocation that apply under a prime lease would apply to the unintermediated sublease: the landlord, or successor landlord, would need to be responsible for providing

6.4.1.1 an equivalent location as to aesthetics, sight lines, height, proximity, and prestige;

6.4.1.2 subtenant's relocation costs including fit-out for equivalent tenant improvements, interior demising walls, sufficient HVAC, segregable security, independent entry and delivery sites, submetered utilities or equable allocations, use of restrooms, signage, parking and similar amenities;

6.4.1.3 subtenant's incidental costs such as substitute letterhead and calling cards, providing formal notice to all customers, vendors, consultants, regulators and the like; and

6.4.1.4 refiling organizational documents with regulators, service companies, lenders and other creditors.

6.4.2. *Excess Space.* If the subtenant assumes the prime lease with its excess space, then either the subtenant as substitute prime tenant subleases the excess space, or the prime landlord effects a recapture of the excess space. The subtenant would want the prime landlord to agree in advance to release the subtenant from direct or secondary liability related to that excess space upon subtenant achieving agreed upon conditions. Looking for early withdrawal, the subtenant would generally seek more liberal rights of assignment if it were required to take over more space than it had originally subleased. The prime tenant, if not released, would, just as an assignor would, at least want acknowledgment that its liability is secondary and in the nature of a guaranty for collection not payment.

7. MORTGAGES IN SUBLEASE AND ASSIGNMENT TRANSACTIONS.

The presence of mortgages is a complicating element for the transferee in analyzing the differences between a sublease and an assigned lease, or which of them to select if it has a choice. The two primary causes for differences are based on whether the recognition agreement for the sublease would be deemed a future assignment or a novation of the transferee's estate, and whether the leasehold or fee mortgages occur earlier or later in priority than the sublease or assignment.

7.1. Landlord Mortgage.

7.1.1. *Senior to Prime Lease as Assigned.* A prime landlord's mortgage that is prior to a prime lease would be prior to the prime lease even if it is assigned. Consequently, the prime tenant, or its assignee would be motivated to obtain a non-disturbance agreement from the mortgagee to maintain the superiority of the lease provisions over conflicting mortgage provisions, and to preserve the lease from divesture upon foreclosure of the mortgage. Similarly, the subtenant would also be motivated to obtain a non-disturber to anticipate the need to sustain its prevailing rights and preserve it from divesture if the subtenant takes over the position of the prime tenant.

7.1.2. *Subordinate to Prime Lease as Assigned.* A mortgage on the prime landlord's interest that is subordinate to a prime lease would be subordinate to the prime lease as assigned. Consequently, the mortgagee, rather than the tenant, would be motivated to obtain a direct assignment of rents from the landlord and an attornment agreement from the tenant or its assignee, whichever is the current holder of the lease.

7.1.3. *Senior to Prime Lease as Subleased.* If a landlord mortgage is senior to a prime lease, it will also be senior to a sublease. Then the prime tenant and subtenant are subject to the mortgagee's rights and each would seek a non-disturber; the prime tenant to avoid divestiture if the mortgage is foreclosed and the subtenant to avoid divesture if the prime lease is terminated and the landlord enters into a direct lease with the subtenant. The subtenant would also seek confirmation that its rights under the recognition agreement would not be disturbed upon a foreclosure of the senior mortgage.

7.1.4. *Subordinate to Prime Lease as Subleased.* If a landlord mortgage is subordinate to a prime lease, it will also be subordinate to a sublease whether the sublease is earlier or later in time than the landlord mortgage, because the rights on which the sublease depends are already senior to the mortgage. The mortgagee takes subject to all grants by the prime tenant, such as subleases, easements, and leasehold mortgages. However, regardless of the lease being prior, it is likely that under the terms of an SNDA, the mortgagee would impose restrictions on future assignments or subletting of the lease. Consequently, the landlord's mortgagee would look for a subordination agreement by tenant to reaffirm tenant's obligation to pay mortgagee upon a foreclosure, and to otherwise reorganize mortgagee's rights to approve amendments or postpone remedies by tenant for landlord defaults. If the prime tenant rights were deemed assigned to the subtenant, or the sublandlord rights were deemed assigned to the prime landlord, following the same logic, the later occurring fee mortgage is subject to that.

7.1.5. *Novation.* But if the relationship between the prime landlord and subtenant were a novation, such as when a leasehold mortgagee enters into a new direct lease with the prime landlord, or the assigned lease were a novation because the assignor were expressly released, then the break in the relationship-back could make the novated lease subordinate to what otherwise would have been the later-in-priority landlord mortgage.

7.2. Leasehold Mortgage.

7.2.1. *Leasehold Mortgage Priorities*. A mortgage by the prime tenant on its leasehold would follow similar logic as the preceding analysis of the landlord's mortgage, as to interests among mortgagees, landlords, and tenants, even though they are leasehold mortgagees, sublandlords and subtenants. The change is that the overlay of the prime lease and the landlord's mortgage adds more risk of termination, more stress, by those outside forces. In the case of a prime lease default by the prime tenant, a prime landlord right of termination would divest the leasehold mortgage unless the leasehold mortgagee had an agreement allowing it to be substituted upon its cure or overcoming the prime tenant default. In that case the sublease may remain in place, if the leasehold mortgagee were an assignee of the prime tenant's leasehold. But if the prime lease were instead replaced with a new prime lease, the sublease may be divested which is a significant risk increased in the case of the prime tenant bankruptcy. For that risk, the subtenant would seek a recognition agreement directly with the leasehold mortgagee, and re-affirmation by the landlord that the grant to enter into a direct relationship with subtenant is senior to the leasehold mortgagee's right to divest the sublease.

7.2.2. *Leasehold Mortgagee Remedies*. If the prime tenant is in default under the sublease then the leasehold mortgagee would foreclose and take over the leasehold estate. Either the sublease is senior and not divested or the subtenant would seek an SNDA with the leasehold mortgagee to be contractually protected; just the same as a fee mortgagee were foreclosing where a tenant has a leasehold. A much more remote outcome would be the prime landlord's effort to divest the prime lease for default without the leasehold mortgagee taking recovery action. One could imagine a leasehold mortgagee delaying its recovery if there were embedded diligence issues, such as liabilities for environmental or physical conditions, or there were complex structuring issues, such as battles among loan participants in the leasehold mortgage loan, or a collapse in the credit market stultifying lenders generally in what would otherwise be predictable foreclosures. The reluctance to exercise remedies would further weaken Leasehold Mortgagee rights compared to subtenant's rights under its recognition agreement.

7.2.3. *Assignment to Subtenant of Sublandlord Interest in Leasehold Subject to Leasehold Mortgage*. An assignment to the subtenant of the sublandlord's interest as prime tenant then may result in the leasehold mortgage being preserved because the assignee take subject to the liens against the assigned asset.

7.2.4. *Assignment to Landlord of Sublandlord Interest in Sublease subject to Leasehold Mortgage*. On the other hand, if the sublandlord's interest were assigned to the prime landlord, the sublandlord's mortgagee would try to use the same argument but it would be weaker: that the sublandlord's rights under the sublease and its liens against the prime leasehold were together deemed assigned to the prime landlord. Sublandlord's mortgagee would assert it should be treated as it would be in any assignment and the assignee takes subject. The prime landlord would counter that the prime leasehold estate by assignment to the prime landlord merged into the prime landlord's estate and no further leasehold interest survived.[15] To avoid that conflict, the prime landlord would need to expressly confirm that the implementation of any recognition would be free and clear of mortgages and other encumbrances against the assigned lease where prime landlord assumes the position of the sublandlord. In this negotiation among the prime landlord, subtenant, and leasehold mortgagee, relative priority of the subtenant and leasehold mortgagee estates would have a strong effect. In any case, the subtenant's mortgagees would need waivers and access agreements from the prime landlord unless they had been granted and were assigned as incidents to the rights under the prime lease, and the prime landlord assumed and took subject to those grants.

7.3. Landlord Mortgagee's Recognition.

Leasehold Mortgagee As attenuated as the leasehold mortgagee's relationship is with the prime landlord, the leasehold mortgagee's relationship is even more tenuous as to the prime landlord's mortgagee. The prime landlord's consent and affirmation agreement to meet the leasehold mortgagee's requirements does not by itself bind the prime mortgagee. Nor does the prime mortgagee's SNDA, by itself, either adopt the protective provisions of the prime landlord's consent and affirmation agreement with the leasehold mortgagee or spread its internal protections directly to the leasehold mortgagee. Some commentators recommend preserving these provisions in a landlord estoppel. But estoppels can be attacked for various reasons such as having limited contractual effect because they stand only for the proposition that the estoppel giver cannot later repudiate, not that the estoppel giver has covenanted to perform any task. It would be more prudent to have a separate and express agreement among the prime landlord, its mortgagee, and the leasehold mortgagee.

7.4. Subleasehold Mortgage.

7.4.1. *Subleasehold Mortgagee Double Upstream Recognition and Nondisturber*. A mortgage on the subtenant's leasehold is a more difficult analysis and a more remote occurrence; and, the analysis shadows the leasehold analysis, except it includes the possibilities of a fee mortgage and a leasehold mortgage so there are

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[15] "Where a leasehold estate for years merges in a greater estate * * * the relationship of landlord and tenant which had been created by the estate is extinguished." Annotation (1943), 142 A.L.R. 93, 124. See, e.g., *In re Chambers Development Securities Litigation*, 912 F. Supp. 822, 843 fn. 15 (W.D.Pa. 1995) ("[I]n Pennsylvania, whose laws govern the lease, the general rule is that purchase of the fee simple by the tenant results in the merger of the leasehold with the fee. *Waldron v. Wahl*, 286 Pa. 237, 133 A. 252 (1926) (general rule is that where a person holds a term for years and subsequently acquires the fee, 'the former is lost and merged in the latter'); *see also* RONALD L. FRIEDMAN, PENNSYLVANIA LANDLORD-TENANT LAW AND PRACTICE, § 3.5(a) (3rd Ed. 2001): 'The sale of the leased premises by the landlord should have no legal effect upon the continuation of the lease agreement, unless the leased premises was sold to the tenant, in which case the lease terminates by operation of law.' *See also Kershaw v. Supplee*, 1 Rawle 131, 132 (1829) ("[B]y the purchase of the fee simple of three fifths, the term for years for those three fifths is extinguished; for nothing is better settled that that where a term for years, or life, exists in a person in his own right, and he subsequently acquires the fee in his own right, the former is lost and merged in the latter. Where the term and the fee unite in the same person, but in different rights it is otherwise. . .").

three levels of concern. If the prime lease predates prime landlord's mortgage, as mentioned above, the sublease and recognition agreement could be senior to the prime landlord's mortgage, and survive its foreclosure. If the prime lease is after the prime landlord's mortgage, then all derivative rights of tenants and subtenants are at risk of foreclosure without a direct non-disturber and, in the case of the subtenant, recognition agreement. If the prime leasehold mortgage predates the sublease, by the same logic, the sublease and its subleasehold mortgagee, as derivative rights, are at risk of the prime leasehold mortgage foreclosure, unless the prime lease expressly provides otherwise: the subleasehold mortgagee would seek a direct agreement that it would have the right to notice and cure for prime tenant/sublandlord's prime lease and sublease defaults, and in any event upon the bankruptcy of the prime tenant/sublandlord, notification and rights to elect possession if the prime tenant/sublandlord rejects the sublease. Similarly, the sublease mortgagee would negotiate for the right to require a new sublease in the case of a subtenant bankruptcy. If the prime leasehold mortgage arises after the sublease, then the rights of the subleasehold mortgage surviving a foreclosure are much like the rights of a prime leasehold mortgage surviving a prime landlord's mortgage foreclosure: the prime leasehold mortgagee takes subject to the subleasehold mortgage. If the prime lease is terminated, then the issue for the subleasehold mortgagee is whether the new relationship between the subtenant and the prime landlord is by way of a new lease, in which case the subleasehold mortgagee could be divested and would need a new mortgage, or by way of an assignment. If the prime tenant is deemed to have assigned its interest to the subtenant, there may be theories that the estates merge and the subleasehold mortgage may be deemed extinguished. Similarly, if the sublandlord is deemed to have forfeited its interest to the prime landlord so that it is considered merged back into the reversionary interest, the sublease and the sublease mortgage could be extinguished; but if instead it is deemed an assignment to the prime landlord, then the estate of the subtenant should remain unaffected, and consequently the subleasehold mortgage would be equally unaffected. These layers of differences and divergences collapse where he transfer is to an assignee rather than a subtenant, and the assignee would take subject to a pre-existing subleasehold mortgage. If it sought another subleasehold mortgage, that would be lien subordinate to the first subleasehold mortgage against the same subleasehold estate.

7.5. Aligning Approvals.

The subtenant would look for consistency and alignment among the three prime parties-in-interest, meaning sublandlord, prime landlord, and the prime landlord's mortgagee. So that, for example, it would negotiate that if subtenant received from any of them a consent to an act, a waiver, or an amendment, it would be deemed to satisfy consent requirements as to all parties. In those instances, the fee mortgagee is frequently the locus of qualifying approval.

CONCLUSION

Though the lease assignment and sublease seem to be equivalent in allowing a third party the use and occupancy of currently demised premises, there are significant differences in formation, operation, liabilities, and bankruptcy. The effect of accessory agreements, such as recognition agreements, non-disturbance agreements, subordination agreements and attornment agreements, can readjust by contract the rights and responsibilities set by case law and real estate law. When the latent characteristics of the various strategies are understood, and whether the direct goal would have unwanted and unintended consequences, then the client can be advised more successfully.