

ASSIGNMENT AND SUBLETTING: CONCERNS IN AFFILIATE TRANSFERS

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Landlords often readily concede that a lease may be transferred to a tenant's affiliate when negotiating assignment and subletting provisions. Logically, the manner in which a tenant's business is run would not likely be diminished if an associated company with basically the same ownership takes over the premises. However, a landlord should be aware of certain key issues and protect itself from a seemingly harmless transfer.

The lease should define an "affiliate" to avoid a loose interpretation of the term. An affiliate generally is defined as a parent, subsidiary or sister company of the tenant. The definition should contain language restricting the transfer to an affiliate under the same ownership and possibly also the same control as the present tenant.

Any major change in control in the affiliate should also be dealt with in the provision. For example, a change in the majority ownership of the parent may lead to a change in control of the tenant and any sister company. Landlords should address this possibility by defining a change in majority ownership or significant change in management of an affiliate as an event giving the landlord the right to reasonably reject the proposed assignment or possibly giving the landlord the right to recapture the space after a specific period of time if the affiliate's control has deteriorated the quality of the operation of the premises and/or decreased gross sales.

If the affiliate does not share substantially the same management, a landlord should allow the transfer only if the affiliate's net worth is equal to or greater than the tenant's net worth. Even if the ownership or control is substantially the same, the net worth standard should also be required by the landlord. This will ensure that the affiliate at least has the same financial means as the tenant to pay all rents under the lease, as well as protecting the landlord against the tenant transferring its interest in a low performing store to a less financially stable affiliate.

Even if an affiliate's net worth is comparable to that of the tenant, the affiliate's financial health can deteriorate throughout the term of the lease. This is a more likely risk if the transfer is done early in the term of a long term lease. A landlord can protect itself against this risk by requiring that the tenant remain liable for all obligations under the lease. This way, not only is the affiliate obligated under the lease, but the landlord can also seek relief against the original tenant.

Landlords should also insert language requiring that the affiliate's use be the same as that of the tenant. Although the lease may contain a restrictive use clause, failure to restrict the affiliate's use could lead to ambiguity in the interpretation by a court. If the landlord is willing to forego restricting the affiliate's use, it should at least negotiate language requiring that the affiliate's use does not conflict with any exclusive granted to any existing tenant or the use of any potential tenant with whom the landlord is currently negotiating.

In summary, a landlord should consider these key concerns in affiliate transfers to determine if the landlord and its lender can live with the outcome of an affiliate transfer. Care in defining an affiliate, together with restricting the conditions for an affiliate transfer, will help protect the landlord from potentially undesirable consequences and retain the landlord's right to control its tenant mix.