

# COMMERCIAL LEASE ASSIGNMENTS: A TALE OF TWO LEASES AND A LANDLORD'S RIGHT TO RECAPTURE

In today's high-velocity leasing environment, careful scrutiny of fine print is all the more important.

By Lindsey Postula of Gray Reed

Commercial leases typically contain standard protections for landlords that may be potential pitfalls for tenants seeking to assign or transfer interests in a lease. A lease recapture provision permits a landlord to terminate a lease and "recapture" the leased premises when the tenant requests landlord's consent to assign, sublease or transfer the lease. These recapture rights, which are frequently overlooked, can actually have shocking results for tenants.

In order to assign a lease, the landlord's consent is required. The Texas Property Code provides that leases, unlike certain other commercial contracts, are not assignable without a landlord's prior written consent. Many leases enlarge the obligation to get consent by expressly preventing the tenant from selling or changing ownership interests in the tenant without landlord's consent. These



**Lindsey Postula**  
Partner,  
Gray Reed

provisions can frustrate tenants in their efforts to expand, increase capital, perform corporate restructuring or to sell equity or assets of their companies. In some cases, the language is so broad that it could be construed to prevent certain collateral assignments that are ancillary to tenant financing.

## Negotiating Strategies

Savvy commercial tenants carefully negotiate assignment and transfer language to include flexibility for future changes in the company. Brokers will often request that landlords consent to an assignment, sublease or other transfer not be "unreasonably

withheld, conditioned or delayed."

Landlords frequently follow this language; however, with a long list of circumstances in which the landlord may reasonably withhold, condition or delay the consent to a transfer.

Depending on the nature of the tenant's business and the owner's long-term plans for the direction of an entity, permitted transfer language should be well-thought out to include asset sales, restructuring, taking the tenant public, transfers of stock or interests to key family members or trusts and other transactions that may be necessary to the long-term success of a corporation. Some commercial tenants have even become bold enough to request that a permitted transfer include a "single-transaction assignment." Careful landlord's counsel will quickly realize that such language would turn the landlord consent requirement on its head.

In any case, the transfer provisions in a lease can have a profound impact on a business owner's growth, development and exit strategy. If the recapture right remains in the lease or if it is not carefully addressed, a permitted transfer definition alone may not be sufficient to adequately protect a tenant's interests.

## Recapture Rights Examples

When a landlord exercises a recapture right, the consequences may seem unduly onerous to tenants. Take, for example, the following cases:

**Case #1:** In a substantial shopping center in the greater Houston area, an operating restaurant that was primarily a casual lunch location was not thriving. The landlord had determined that it didn't fit with the contemplated tenant mix and had been seeking to replace the tenant for more than a year. When the shop-

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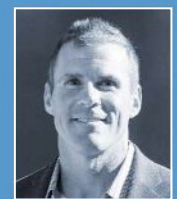
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ping center landlord received a letter requesting its consent to assign the lease to a new franchisee, little did the tenant know what was in store.

**Case #2:** An industrial tenant was selling its assets for hundreds of millions. The tenant sent a number of letters to landlords with a standard form letter requesting for consent: "This transfer probably doesn't require your consent, landlord, but please sign and return the attached evidencing that you have consented." Because a particular landlord had a right to terminate the lease upon a request for consent to assign the lease, the landlord had leverage to try to extract a substantial payment for its consent.

Both tenants received an unwelcome surprise. In the first case, the tenant received a notice of lease termination. "We are hereby terminating your lease and you are required to surrender the premises in ten (10) days." There was no doubt about the landlord's response. Although the response meant that a key location could not be transferred as part of an asset sale, there was nothing to be done.

The tenant threatened to sue, but ultimately vacated before the deadline in the landlord's letter and no consideration was paid. In the second case, the landlord didn't terminate the tenant's lease. It just demanded several million dollars in exchange for its consent. Ultimately, the end result was that the tenant withdrew its request for consent and kept the location.

The irony of these examples is that the tenants in both cases probably thought that the language that they had negotiated was good enough. The tenants had negotiated the assignment and transfer language, but the changes were not helpful in the applicable circumstances. In the first case, there was one sentence that said that the recapture right would not apply in the event of a permitted sublease. However, that provision did not protect the tenant in case of an assignment.

Frequently, tenants remove recapture rights from leases or negotiate a right to rescind the request for consent so that the tenant can avoid lease termination. However, even the right to rescind can adversely affect timing and cost in a significant transaction. In the second case, there was a right to rescind the request for consent. So the tenant got to keep the lease, but it could not sell its interest to the buyer of its assets.

The tenants were surprised by the plain language of their leases. There was no equitable doctrine that could circumvent the assignment language and there was no tortious interference with contract. The lease language simply cost them a significant sum of money.

## Lessons Learned

The lesson from these examples is (1) after discussing plans for the business entity, tenants should have counsel carefully review a lease prior to execution; and (2) deal lawyers should partner with real estate counsel to ensure that the lease language will not be an obstacle to the tenant's long-term goals. Because the language frequently needs parsing out, assignment provisions should be handled with the caution. If a tenant fails to pay adequate attention, the lease can unravel a great deal and the circum-

stances can change from the best of times to the worst of times.

Lindsey Postula is a partner at Texas-based commercial law firm Gray Reed. She represents clients across Texas in the acquisition, development and management of a broad range of commercial properties. In addition to ongoing representation of landlords, developers and major corporate clients, she handles all real estate aspects of asset and equity purchases, sale-leasebacks and complex financing arrangements. Lindsey is Board

Certified in Commercial Real Estate Law by the Texas Board of Legal Specialization. She has served three terms on the Real Estate Legislative Affairs Committee for the Real Estate, Probate and Trust Law Section of the State Bar of Texas — a committee charged with monitoring and summarizing legislation to keep section members current on potential developments in real estate law. Lindsey can be reached at [lpostula@grayreed.com](mailto:lpostula@grayreed.com).



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