

## OTTEN JOHNSON ALERT: SUBLEASING - MAYBE NOT AS EASY AS IT SEEMS

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The Denver office leasing market has had significant activity in the last few years with several large tenants either entering the market or expanding the spaces they occupy. There have also been many new smaller entrants into the market. With such activity, subleasing becomes a possibility for tenants who might have taken on more than they need for the short term but who want to preserve their long term flexibility. Subleasing space might also be a preferable option for a newcomer to the area who wants to open a location, but does not necessarily want to commit to a long-term arrangement. Subleases, however, will often not directly benefit the owner of a building or project, and they can present additional problems for a landlord and the prime tenant if the sublease conflicts with the prime lease.

**Should a Landlord Consent?** Generally, although not always, a sublease requires the landlord's prior consent. When a landlord is approached about a sublease, it should consider whether the prime lease gives the landlord the right to take the space back. This is sometimes called a "recapture" right. If the tenant is in financial trouble or if the landlord would like a direct lease with the proposed subtenant, this may be a possibility.

**If a Landlord Will Consent, How?** Subleases will often just include a signature block for a landlord to consent to the sublease. Landlords should be wary of this type of shorthand consent. If the sublease contains provisions that conflict with the lease, the landlord may be deemed to have modified the prime lease to be consistent with the sublease. The landlord can control this risk by requiring a more thorough consent that takes into account the specifics of the sublease. Here are a few things to consider in a landlord's consent to a sublease:

- ◆ The sublease term should not extend beyond the term of the prime lease, and the landlord should carefully consider whether the subtenant should have the right to exercise extension options on behalf of the tenant.
- ◆ If the prime tenant has the right to audit the landlord's expenses and taxes, consider limiting the subtenant's ability to exercise this right.
- ◆ Obtain the same benefits from the subtenant's insurance as from the tenant's insurance under the prime lease, including being named as an additional insured on the subtenant's liability insurance policies. The sublease should include a waiver of both claims and the right to subrogation, and the landlord should be a beneficiary of those waivers from the subtenant.
- ◆ Have the subtenant indemnify the landlord to the same extent the prime tenant indemnifies the landlord under the prime lease.
- ◆ If the prime lease is terminated because of a tenant default, should the landlord agree to recognize the subtenant's ongoing occupancy? This is sometimes called "recognition" or "non-disturbance." Strong subtenants may require this. If the subtenant is strong enough, this may be acceptable to the landlord. If there is such a termination of the prime lease, be specific about what the arrangement between landlord and subtenant will be. Will the subtenant step into the shoes of the tenant under the prime lease, or will the landlord take over the terms and conditions of the sublease (with potentially lower rent)?

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The Tenant's Perspective. The primary reason for a tenant to enter into a sublease is to limit its obligations for rent and other obligations for space it does not need. Tenants should be aware that even though the subtenant is paying a portion of the rent, the tenant will likely remain liable for the entire obligation under the lease during the sublease term. Thus, the sublease is the document that will allow the tenant to control the subtenant and minimize the risk of the subtenant causing a default under the prime lease.

- ◆ Be sure that if the subtenant causes a violation of the prime lease, then the violation would be a default under the sublease as well.
- ◆ Be clear that the subtenant does not have the right to exercise other beneficial rights under the prime lease, such as renewal rights and expansion rights. The exercise of these rights would likely further increase the tenant's liability under the prime lease.
- ◆ Tenants should avoid agreeing to provide something to the subtenant that the prime lease does not provide to the tenant. Examples might include parking or maintenance obligations.
- ◆ If the landlord's consent is required, be sure that the landlord has provided advance consent to the sublease or that the tenant's obligations under the sublease are specifically contingent on obtaining the landlord's consent.
- ◆ Consider what will happen if the landlord fails to perform under the prime lease (for instance, if the landlord fails to make certain repairs). Should the tenant be liable to the subtenant? Should the subtenant have the right to pursue remedies against the landlord? (Will the landlord agree to let the subtenant exercise those remedies?)
- ◆ Be sure the subtenant vacates the space before the prime lease expires; otherwise the tenant may be liable to the landlord for holdover rent and potentially other damages.
- ◆ Track the prime lease's surrender provisions in the sublease so that you do not have to scramble to restore the premises at the end of the sublease.

Subleases provide flexibility for tenants and subtenants alike. However, because they involve three different parties - the landlord, the tenant and the subtenant - they are often more complex than direct leases and present additional risks to all parties.

***The attorneys in our Real Estate practice group can help you understand and navigate issues involving sublease documents and leasing transactions. For more information on this Alert or for help evaluating your current situation, contact any of the attorneys in the Real Estate practice group ([click here](#)).***