

If You Don't Recognize Your Tenant, It May Be Time To Revisit The Assignment Provision In Your Lease

By Donna A. McBarron, Esq.

A recent Appellate Division decision serves as a strong reminder to landlords to make sure that the tenant they sign on with remains the tenant on the lease, unless the landlord otherwise consents to the change. In Berk and Berk at Cherry Tree, LLC v. Nelson, Brown, Hamilton & Krekstein, LLC et al., Docket No. A-1878-17T3 (N.J. App. Div. 2019), a landlord learned this lesson the hard way.

In the Berk case, the landlord signed a five-year and five-month lease with a law firm commencing on June 1, 2011. The tenant was a limited liability company (LLC), and the landlord did not obtain any personal guarantees. Through a series of departures from the law firm, what was originally "ABCD, LLC" morphed into "XYZ, LLC." In other words, of the four named attorneys comprising the original LLC entity which signed the lease, only one named attorney remained. In 2015, XYZ, LLC ceased operations and stopped paying rent.

Without an operating LLC to sue for the unpaid rent, and having failed to obtain personal guarantees from any of the lawyers, the landlord tried to assert a number of claims against some of the original members of ABCD, LLC, but to no avail. The Berk case goes on to evaluate - and reject - each of the legal theories advanced by the landlord, but the landlord ultimately lost the case (and the promised rental stream).

What could this landlord have done differently to protect itself? The first obvious answer would have been to obtain personal guarantees. The less obvious answer was that this landlord



failed to include a strong assignment provision in its lease or, if one existed, it failed to utilize that provision to its fullest.

In New Jersey, a lease can be freely assigned (or subleased) unless there is specific language in the lease prohibiting such assignment or sublease. Typically, leases will provide that an assignment or sublease cannot occur without landlord's consent. Sophisticated tenants will look to carve out exceptions to that rule and limit the landlord's discretion in rejecting a request. But landlords should still aim to retain as much control as possible over who their tenant is.

Aside from requiring tenants to seek consent from the landlord on an assignment, "assignment" must also be broadly defined. It should not just cover the situation where P Corp. is assigning the lease to Q Corp. What if P Corp. is still called P Corp., but all of the owners have changed? A carefully drafted assignment provision should include assignments that occur by operation of law, merger, consolidation, reorganization or transfer of business of operations. It should include direct and indirect

assignments, as well as voluntary or involuntary assignments. It should include any change in ownership, or at least changes in ownership of 25% or more. The more broadly assignment is defined, the less chance a landlord will end up with a tenant it does not recognize because its consent was not required on that type of assignment.

The Berk case did not discuss whether the lease in question had an assignment provision or whether the landlord's consent was sought or obtained. If a strong assignment provision had been included and utilized, the result of the Berk case could have been very different. If consent had been required and requested, the landlord could have done its due diligence on X, Y and Z who were to replace B, C and D. If the landlord was not satisfied that the new entity had the same or better creditworthiness than the original LLC, the landlord could have said no. Better yet, this would have been a perfect opportunity to revisit the lack of personal guarantees, and the consent could have been conditioned on the receipt of personal guarantees or some other additional security or consideration.

There are lessons to be learned from Berk. Those fond of lawyer jokes may conclude that landlords should simply avoid leasing to lawyers. Perhaps the better lesson to glean from Berk is that landlords should have their leases reviewed by a competent, commercial leasing attorney who will ensure, among other things, that the tenant so thoroughly vetted by the landlord isn't replaced with an X, Y or Z.

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