

COMMENTARY ON MODEL FORMS OF SUBLEASE AND CONSENT

Introduction

Nearly every real estate lawyer discovers early in his or her career that subleasing office space is a lot more complicated than many attorneys -- and clients -- seem to think.

In a typical scenario, a young lawyer receives a call like this: "I need a sublease right away...And keep it simple!" A brief summary of "business terms" soon arrives by fax, inspiring an anxious search for a sample sublease. Relief appears to be at hand when an office mate volunteers a sublease that he or she once used, or is able to recall where one can be found in the file room. The sense of relief from having a form in hand proves short lived, however, for as soon as the actual drafting begins, the "form of sublease" leads only to confusion, if not despair.

The main reason for the difficulty of subleasing is that drafting or reviewing a sublease requires mastery of three interrelated documents. First there is the Sublease itself, an occupancy agreement between the Sublandlord (actually the tenant under the prime or underlying lease, here referred to as the "Overlease") and the Subtenant. Next there is the Overlease between the building landlord, or Overlandlord, and the Sublandlord, which imposes many constraints upon the Sublandlord and Subtenant. Finally there is the "Overlandlord's Consent" a document which can be much more than a simple consent, and which may modify the Sublease, the Overlease, or both.

A further complication is that for brevity's sake many of the operative provisions of a sublease are not commonly set forth in the sublease itself. In effect, these provisions are borrowed from the Overlease, sometimes with modifications agreed to by the parties, using a technique known as "incorporation by reference".

The purpose of this commentary on the Model Form of Sublease and on the Model Form of Overlandlord's Consent which follows it is to lend some assistance, not only to the young lawyer grappling with a first sublease, but to the seasoned lawyer (and there are many) who has never found a form of sublease or overlandlord's consent he or she truly likes, nor felt entirely comfortable drafting or reviewing a sublease. The Model Forms are intended to provide a practical, user-friendly starting place for drafting. The commentary seeks to alert the lawyers for both parties, Sublandlord and Subtenant, to

some of the quirks and potential pitfalls of subleasing, as well as to point out key interrelationships among the sublease documents.

Before proceeding further, however, a word of caution: the critical first step for any lawyer preparing to draft a sublease is to obtain the Overlease (including all amendments) and to review it carefully. No matter how rushed the circumstances, a lawyer who plunges headlong into drafting a sublease, without first reviewing the Overlease, will inevitably be forced to start over.

The Model Form of Sublease: Assumptions and Context

Any model form will be most useful if the key assumptions underlying it, and the context for which it is intended, are made clear at the outset.

The most basic assumption underlying the Model Form of Sublease is that it is almost always the Sublandlord's lawyer who will be drafting the Sublease. This means that a model form of sublease must be -- and this Model Form is certainly intended to be -- a form that a Sublandlord's attorney will feel comfortable using. It does not mean, however, that the Model Form is entirely Sublandlord-oriented or that the proper concerns of the Subtenant have been neglected. Such an approach would not be appropriate, since the Sublandlord is most often a typical office tenant, not a professional landlord, and since the parties to a sublease negotiation are usually equally sophisticated (or unsophisticated) and have roughly equal bargaining power. It does mean that the Sublandlord's concerns are more often reflected in the language of the Model Form itself, while the Subtenant's concerns are more often noted in the commentary.

The "typical" sublease that the drafters of the Model Form had in mind is one for up to 20,000 rentable square feet of office space in the New York metropolitan area. While the Model Form will be useful for larger deals as well, a fully negotiated sublease for a much larger block of space will likely contain numerous additional provisions tailored to the terms of the particular transaction.

The Model Form may also be used whether or not all of the space occupied by the Sublandlord under the Overlease is to be sublet. The commentary will note concerns that the Sublandlord or Subtenant may have depending on whether all or only part of the space covered by the Overlease is to be sublet.

Finally, although many issues that arise in subleasing are similar to those that must be addressed in drafting or reviewing a prime lease, the commentary which follows has largely -- and intentionally -- been limited to concerns peculiar to subleasing.

Structure of the Commentary

In order to provide the user of the Model Form with the greatest possible guidance at the outset, Article 1 (“Definitions and Basic Terms”) requires “filling in the blanks”. Accordingly, the commentary begins with detailed instructions for completing certain of the blanks in Article 1.

The remaining sections of the commentary focus exclusively on sections of the Model Form of Sublease and the Model Form of Overlandlord’s Consent which, in the drafters’ view, require explanation or are otherwise worthy of comment. Each section of the commentary is thus intended to be read side by side with the corresponding section of the Model Form.

Comments on The Model Form of Sublease

Article 1: Basic Terms. The Model Form has been prepared so that the basic business terms can be inserted in Article 1. Most of the blanks are self-explanatory. Below are instructions for the others.

1.1 The Sublease Date is an arbitrary date selected by the parties for purposes of reference. The Sublease Date need not be the date the Sublease is actually executed and delivered, nor need it be the date the term commences.

1.9 In order to avoid recharacterization of the Sublease as an assignment (or assignment pro tanto if less than all of the Overlease Premises are subleased), the Expiration Date should be not later than the day prior to the scheduled expiration date of the Overlease.

1.10 Use aggregate amounts, not per square foot amounts.

1.11 Use the ratio of the rentable area of the Sublease Premises to the rentable area of the Overlease Premises.

1.13 If Subtenant will pay additional rent based on increases in real estate taxes, check this Section and complete Sections 1.13.1 and 1.13.2. In Section 1.13.2 insert the term used in the Overlease to refer to real estate taxes; this term is commonly “Real Estate Taxes”, “Taxes” or “Impositions”. This Section assumes that the Subtenant will pay additional rent equal to its share of increases in real estate taxes above real estate taxes during a base year. If the Subtenant will pay additional rent equal to its share of real estate taxes (without the benefit of a base year), Section 3.2 will need to be modified.

1.14 If Subtenant will pay additional rent based on increases in Building operating expenses, check this Section and complete Sections 1.14.1 and 1.14.2. In Section 1.14.2 insert the term used in the Overlease to refer to Building operating expenses; this term is commonly “Operating Expenses”, “Expenses” or “Basic Costs”. This Section assumes that Subtenant will pay additional rent equal to its share of increases in Building operating expenses above Building operating expenses taxes during a base year. If the Subtenant will pay additional rent equal to its share of Building operating expenses (without the benefit of a base year), Section 3.3 will need to be modified.

1.15 If the Subtenant will pay additional rent based on increases in the porter’s wage rate, check this Section and complete Sections 1.15.1 through 1.15.3. In Section 1.15.3 insert the term used in the Overlease to refer to the porter’s wage rate; this term is commonly “Porter’s Wage Rate” or “Wage Rate”. In Section 1.15.2 insert the applicable multiplier; for example, if the deal is “penny for penny”, the multiplier would be 1; if the deal is “penny and a half for penny”, the multiplier would be 1½.

1.16 After reviewing Exhibit D, check the applicable method of charging for electricity. If Option D or E is chosen, insert the initial electric charge to be paid by the Subtenant. Use aggregate amounts, not per square foot amounts.

1.17 If any personal property is being leased, insert a fair rental price. This amount will be subject to New York State and City Sales Taxes, but will be exempt from New York City Commercial Rent and Occupancy Tax.

Section 2.2: Commencement Date Conditions — Time Limits. Note that obtaining the Overlandlord’s consent (Section 2.2.1) is the sole condition precedent which if not satisfied within a specified time (30 days, see Article 15) would allow either party to terminate the Sublease.

If the Sublease Premises is presently occupied (see Section 2.2.2), Subtenant may want to stipulate a deadline for the present occupant(s) to vacate the Sublease Premises.

Similarly, if Sublandlord’s Work (see Section 2.2.3) consists of more than repainting, recarpeting or other very minor alterations (see Section 4.3 and Exhibit B), Subtenant may want to stipulate a deadline for substantial completion of Sublandlord’s Work.

In each case, the parties should consider their respective rights and remedies if the deadline is not met.

Section 3.5: Operating Expenses — Audit Rights. The Overlease will commonly afford Sublandlord (as tenant thereunder) the right to audit or contest the Overlandlord's statements of Operating Expenses. If the Sublease covers all or substantially all of the Overlease Premises, however, Sublandlord will have little incentive to audit or contest such statements, since Operating Expenses are effectively being passed through to Subtenant. In such circumstances, Subtenant may want the right to stand in the Sublandlord's shoes, as nearly as possible, for the purpose of auditing or contesting the Overlandlord's statements of Operating Expenses.

Section 4.2: "As Is" Clause; Demising Walls. Notwithstanding the "as is" provision in Section 4.2(a) and the disclaimers in Section 4.2(b), if Subtenant is subleasing less than all of any full floor of the Overlease Premises (or less than all of the Overlease Premises if the Overlease Premises is less than a full floor), it is customary for Sublandlord, at Sublandlord's expense, to construct demising walls and a separate entrance to the Sublease Premises. In such a case, this work should be added to Exhibit B.

Section 4.3: Sublandlord's Work. In many instances subleased space is already fitted out for office use and the existing fit out is largely usable by the subtenant. Accordingly, this clause assumes that apart from the construction of demising walls and a separate entrance (if required), Sublandlord's Work will consist of little more than repainting, recarpeting and minor repairs. If this is not the case, the parties should consider adding more detailed provisions comparable to those which appear in many prime leases.

In addition, Subtenant's attorney should note that pursuant to Paragraph 7 of the Model Form of Overlandlord's Consent, if the Overlease is terminated by reason of Sublandlord's default and Subtenant is required to attorn to Overlandlord, Overlandlord will have no obligation to perform Sublandlord's Work.

Section 5.2: Incorporation by Reference. Since every overlease is different, since every sublease deal is different, and since the structure of the sublease form itself affects the analysis, there is no universally applicable rule or reliable shortcut for determining which additional provisions of the overlease should be excluded from the Incorporated Provisions and listed in Item 8 of Exhibit D. The attorneys for the parties must review the Overlease to identify provisions which, if incorporated in the Sublease by reference (or if excluded from the Sublease, or if incorporated in the Sublease by reference without having been appropriately modified), would lead to unintended consequences or to inappropriate rights or obligations (or to the absence of appropriate rights or obligations) for Sublandlord or Subtenant.

For example, by incorporating a renewal or termination option contained in the Overlease, Sublandlord's attorney may inadvertently be giving the same rights to Subtenant.

Or Subtenant's attorney, by failing to object to incorporation of the "compliance with law" provisions of the Overlease, or by failing to insist on appropriate modifications to such provisions for the purposes of incorporation, may inadvertently be imposing a duty on Subtenant to cure violations predating its occupancy of the Sublease Premises.

As a starting point, the drafters of the Model Form have listed on Exhibit D several provisions of the Overlease which users of the Model Form should ordinarily consider excluding. Even these listed exclusions should be approached cautiously, however.

For example, although for reasons discussed below in connection with Article 10, Item 4 of Exhibit D excludes most of the provisions of the Overlease relating to tenant alterations, if Subtenant will in fact be permitted to perform alterations in the Sublease Premises, then Sublandlord's attorney may wish to incorporate in the Sublease many of the provisions of the Overlease governing alterations.

In sum, there is simply no substitute for thinking about the interrelationships between the Overlease, the Sublease, the specific deal terms and the actual circumstances of the parties.

Section 5.3.1: Services and Utilities. The Model Form provides in Section 5.3.1 that Sublandlord will not be obligated to provide to Subtenant any of the services or utilities that Overlandlord has agreed in the Overlease to provide to Sublandlord. This is based on the assumption that all services and utilities to be provided to the Sublease Premises are the sole responsibility of Overlandlord.

In some circumstances, however, Sublandlord is providing certain services or utilities (e.g. supplemental air conditions or cleaning). In such circumstances, unless Subtenant will be undertaking to provide those services itself, the Sublease should require Sublandlord to provide them.

Section 5.4.1: Enforcing Overlandlord's Obligations to Provide Building Services. Section 5.4.1 of the Model Form requires Sublandlord only to "use reasonable efforts (excluding litigation), at Subtenant's expense, to cause Overlandlord to provide" Building Services. If the Sublandlord will continue to maintain a substantial presence in the Overlease Premises, it will often be reasonable to expect as a practical matter that Sublandlord, by protecting its own rights with respect to Building Services vis-a-vis

Overlandlord, will effectively protect the rights of Subtenant. If Sublandlord will be an absentee sublandlord, however, this mutuality of interest will be lacking and Subtenant may want to obligate Sublandlord to litigate against Overlandlord if necessary, or otherwise to take additional affirmative steps, in order to insure an uninterrupted flow of Building Services to the Sublease Premises.

Section 5.5: Obtaining the Consent or Approval of Overlandlord. Section 5.5 acknowledges that in many cases Subtenant's rights will be conditioned on obtaining the consent or approval of Overlandlord. Subtenant's attorney should note, however, that under Section 5.4.1, if Overlandlord should fail to give any consent or approval needed by Subtenant, Sublandlord's sole obligation (even if Overlandlord's failure would constitute a breach of the Overlease) is to use reasonable efforts to obtain such consent or approval, excluding litigation.

Section 8.1: Assignment of the Sublease and Subsubletting. Section 8.1 requires Subtenant to obtain the consent of both Sublandlord and Overlandlord for any assignment of the Sublease or subsubletting. It does not require Sublandlord to be reasonable in withholding its consent. Because of the wide variety of possible subsubletting clauses, the drafters of the Model Form concluded that it would be impossible to devise a single provision which would be acceptable in most transactions and decided to include only this simple prohibition. The smaller the Sublease Premises and the shorter the term of the Sublease, the more acceptable Section 8.1 may be to Subtenant.

For larger Sublease Premises or longer terms, Subtenant may want to modify Section 8.1 as well as Sections 5.4.1 and 5.5. In some transactions the assignment and subletting clauses of the Overlease can provide guidance. In addition, in such cases modifying Item 3 of Exhibit D may be appropriate.

Whether or not Subtenant is granted any broader rights to assign the Sublease or to subsublease, at some point during the term Subtenant may need to subsublet or to assign the Sublease to its own affiliate or to a successor — a right which is generally granted, without requirement for Overlandlord's consent, to a tenant under a prime lease. Accordingly, Subtenant's attorney may want to consider obtaining both Sublandlord's advance consent and Overlandlord's advance consent to such subsubletting and assignment to Subtenant's affiliates. See discussion below of the Model Form of Overlandlord's Consent.

Finally, Sublandlord's attorney will want to review the subletting and assignment provisions of the Overlease carefully for yet another reason: In many cases the Overlease specifies one or more provisions which must be included in any sublease, either verbatim

of in substance. Failure to include such provisions may be grounds for Overlandlord to withhold its consent to the Sublease.

Section 9.1: Charges for Electricity. There are many possible methods for charging for electricity in a sublease, depending on the method used by the Overlease (e.g. submeter, direct meter, rent inclusion), whether the Sublease Premises or the Overlease Premises is separately metered, and the business arrangements preferred by Sublandlord and Subtenant. The drafters of the Model Form have not tried to cover every possible permutation nor deal with every complication, but instead have provided, in Exhibit E, five basic options for charging for electricity. In the great majority of subleases, at least one of the five options should satisfy the needs of the parties.

Section 10.1: Subtenant's Alterations. Similarly to Section 8.1, which deals with assignment and subsubletting, this provision differs markedly from the typical overlease in that it permits Sublandlord to withhold consent in its sole discretion.

Sublandlords frequently want to prohibit Subtenants from making alterations because doing so can result in additional liability for the Sublandlord (e.g. for removal of such alterations at the end of the term or for removal of mechanics liens arising from Subtenant's work), because the Sublandlord may intend to reoccupy the Sublease Premises at the end of the term, or for other reasons. If the Sublease Premises is in condition acceptable to the Subtenant and the Sublease term is short, the Subtenant may accept not having the right to make alterations. On the other hand, if this is not the case, the Subtenant may want the Sublandlord to agree not to unreasonably withhold consent to alterations or even to agree that its consent shall not be needed if the Overlandlord consents.

Of course, if Subtenant must perform substantial alterations to prepare the Sublease Premises for Subtenant's occupancy, then Subtenant should obtain both Sublandlord's and Overlandlord's approval in advance for Subtenant's plans and specifications. Overlandlord's approval would most likely be set forth in Overlandlord's Consent — see discussion below.

Comments on the Model Form of Overlandlord's Consent

Since the overlandlord's consent is generally a condition precedent to the effectiveness of any sublease, negotiation of the form of consent can become a critical last minute obstacle to completion of a sublease. The drafters of the Model Form have observed a trend in recent years for landlords' counsel in the New York metropolitan area to propose forms of consent which are longer than necessary, repetitive, sometimes inconsistent with the overlease, and which sometimes expose the parties to the risk of unintended consequences. In an effort to counteract this trend and to make subleasing go

more smoothly for all three parties, the drafters have provided a Model Form of Overlandlord's Consent.

As is the custom, the Model Form of Overlandlord's Consent provides in Paragraph 4 that nothing in Overlandlord's consent shall be construed to modify, waive, impair or affect any of the terms or conditions of the Overlease, or to enlarge or increase the rights or obligations of Overlandlord or Sublandlord under the Overlease. In some cases, however, a modification of the Overlease may be essential to the feasibility of the Sublease transaction. A simple example is where Subtenant uses substantially more electricity than Sublandlord and accordingly must obtain an increase in the electrical service made available to the Sublease Premises (and by extension, to the Overlease Premises) by Overlandlord.

Generally, an Overlandlord has no obligation to modify an Overlease to accommodate a Subtenant. If Overlandlord does agree to such modifications, they would often appear as additional provisions added to Overlandlord's Consent, although in some circumstances it may be more appropriate to include them in a separate amendment to the Overlease.

If the Overlease terminates prior to the scheduled expiration date of the Sublease because of Sublandlord's default under the Overlease, Paragraph 7 of the Consent gives Overlandlord the option, but not the obligation, to continue the Sublease as a direct lease between Overlandlord and Subtenant.

Conclusion

The drafters have tried to create Model Forms which are easy to use and suitable for most sublease transactions. The drafters hope that the Model Forms and this Commentary will prove a valuable resource for the bar.