

# The Fundamentals of Subleases and Lease Assignments

## Summary:

In the context of an economic recession, having the option to sublease space, assign one's lease or acquire space by lease assignment may prove to be most valuable. But what must the parties consider when choosing between a sublease or an assignment? Unfortunately not everyone stops to consider the subtleties and differences between a sublease and an assignment before signing their documents which can lead to surprises later on.



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**P**ursuant to article 1870 of the Civil Code of Quebec ("CCQ"), a tenant has the right to sublease all or part of the leased premises or to assign his lease. As such, the sublease can be a useful scenario for a tenant wanting to downsize its operations and only sublet a portion of his leased premises whereas the lease assignment will transfer the whole of his lease and leased premises to assignee.

## Lien de droit with the landlord

The most notable difference between the sublease and the lease assignment is the absence of "lien de droit", that is contractual tie, between the landlord and the subtenant. In an assignment, the tenant transfers all of his rights and obligations under the lease to the assignee who assumes same and becomes the "tenant" under the lease entered into with the landlord. The sublease however does not in any way affect the lease entered into between the landlord and tenant. Rather it is an accessory contract entered into between the tenant and the subtenant. The tenant retains all of his rights and obligations under the lease entered into with the landlord (the "head lease") but now assumes the role of sub-landlord toward his subtenant. To be noted, the courts have confirmed the head landlord's consent to the sublease does not create any lien de droit between the head landlord and the subtenant.

The Civil Code of Quebec does however provide for a few exceptions in this regard:

1. The first and foremost exception for eventual subtenants to bear in mind is article 1874 of the CCQ which states that where a head landlord brings an action against the head tenant, the head

landlord may not retain the subtenant's liability except for the amount of rent he owes to the head tenant under the sublease. In addition, this article stipulates that the subtenant may not oppose any payments made in advance. If the payment is made as and when it becomes due under the sublease (i.e. generally on the 1st of the month) it is not considered made in advance. The best way for a subtenant to protect his rights in this regard is to avoid paying any rent in advance and better yet, have the sublease provide that he pay his rent directly to the head landlord.

2. Article 1875 of the CCQ grants the right to the head landlord to apply for the resiliation of the sublease where the nonperformance of the obligations of the subtenant causes serious damage to the head landlord. To be noted, if the subtenant causes damage, the head tenant can be held liable under the head lease.

3. Article 1876 of the CCQ allows the subtenant to exercise the rights and recourses of the head tenant against the head landlord where the head landlord fails to perform his obligations, such as for example, should the head landlord fail to perform its maintenance and repair obligations under the head lease. It is however frequent for the head lease to contain a provision requiring that the tenant have the subtenant waive and renounce to these rights without which head landlord will not consent to the proposed sublease.

Other word of advice for subtenants, as the sublease is an accessory contract to the head lease, if the head lease is terminated, the sublease will also automatically be terminated even if there is no default on the part of

the subtenant. Although entirely at the head landlord's sole discretion, the subtenant can always ask for

the head landlord's to undertake to respect the sublease should the head lease be terminated prior to expiration of the term of the sublease, provided of course the subtenant is not in default of his obligations under the sublease. This type of request can be appropriate where a subtenant will sublease the entire premises and substantially invests in leasehold improvements

as without this clause his term and the amortization of his investment could be abridged. Alternatively and provided this is an economically viable solution for the subtenant, the subtenant can request that the head landlord notify him of any defaults by the head tenant under the head lease and allow the subtenant to cure same. Again this request will be at landlord's sole discretion as landlord, having no

lien de droit with the subtenant, has no obligation to do so.

As for landlords, so as to not be limited by the exceptions listed above, they can (and most likely but not always) require that the sublease include a clause which provides for the subtenant to undertake to be bound directly to the landlord with respect to the subleased premises save and except those obligations of the head lease not pertaining to the sublease.

#### Release and discharge of the

##### Tenant

As the sublease cannot exist without a head lease, the head lease continues to produce all its effects and the tenant remains liable for all of its obligations under the head lease. However article 1873 of the C.C.Q. provides that the assignment of lease discharges the tenant of his obligations under the lease unless the parties agree otherwise in the

head lease. This article really should read unless "the Landlord agrees otherwise". This article not being of public order for commercial leases allows the tenant to ask for his release. Yet most if not all commercial leases contain a provision specifying the assignor (initial tenant) remains solidarily liable with the assignee (new tenant) of all obligations under the lease, without benefit of division or discussion, meaning for the whole of all obligations under the lease, for the remainder of the term and any extensions and renewal thereof. Furthermore, such leases will typically include a provision stipulating that if the lease is terminated by reason of the assignee's insolvency, the assignor (initial tenant) will be deemed to have entered into a new lease with the landlord for the remainder of the term. Note that this will most likely also apply to the guarantors of the initial tenant so best to negotiate

these clauses at the outset of the lease.

Although rare are those landlords who will release a tenant upon an assignment, the landlord's first and foremost consideration is financial strength and covenant of the proposed assignee. In fact, this applies to the landlord's consent to the proposed assignment in the first place so tenants make sure your proposed assignees are of equal if not better financial strength.

A compromise which might be useful for an assignor is to propose that he remain liable only for the remainder of the term in effect and be discharged for any renewal options the assignee (new tenant) may exercise.

As for subtenants, they must beware of provisions that make them solidarily liable for tenant's obligations under the head lease. As previously mentioned, the subtenant will only benefit from those rights he is granted under the sublease which may not correspond to all of tenants rights under the head lease. So caution if you are asked to be made liable for more than the rights you are acquiring under the sublease. For example a subtenant subleasing only a portion of the leased premises could with such a provision find himself responsible for the rent of the whole leased premises in the event of the head tenant's default.

#### Rights personal to the Tenant

As mentioned above, the subtenant only acquires those rights specifically provided under the sublease. In addition, landlords will often stipulate in the lease that certain rights are "personal to the tenant" such that they cannot be transferred in the event of a sublease or an assignment. These rights may include renewal options, rights of first offer or first refusal on additional space, signage rights and cases in which landlord's consent would not be required for subleases or assignments. Subtenants and assignees must read through the lease attentively to note such rights which will not be passed onto them. For example even if a sublease does contain a renewal option or other particular right which under the head lease is stipulated as being personal to the tenant, the provisions relating to such rights under the sublease will be invalid.

#### Landlord's Consent

This is a requirement which both the sublease and lease assignment have in common pursuant to article 1870 of the CCOQ. Although

this article only requires the tenant to provide the landlord with the name and address of the proposed subtenant or assignee, in practice landlords have extended this list to include by way of example, financial statements, business history, corporate information and even the written agreement between the tenant and the proposed subtenant or assignee. Although the tenants may not be pleased with having to provide a copy of the agreement contemplated with the subtenant or assignee, this is landlord's way of insuring the tenant is not making money off of the landlord's back either by collecting a higher rent or by selling off leasehold improvements in the transfer. In fact most landlords will insert a clause in their standard commercial leases providing that all profits generated from any transfer, be it by way of sublease or assignment, be payable to the landlord and not the tenant. Important for the tenant to bear in mind, the tenant must make certain provides all the information required in its request for consent to the landlord as the delay for the landlord has to provide or refuse it's consent will only start running upon landlord's receipt of all information required.

Pursuant to article 1871 of the CCOQ, the landlord cannot refuse to consent "without a serious reason" and if he refuses, he is bound to inform the tenant of the grounds for his refusal within 15 days following his receipt of tenant's request. As this delay is not of public order landlord's will typically extend this delay to 30 or even 45 days which may in certain circumstances be too long to keep some proposed subtenants or assignees interested. So tenants must pay attention to this clause at the outset of their lease negotiations with the landlord.

Landlords beware of not responding within the required delay as article 1871 stipulates that if you do not provide your reasons for refusing within the required delay, you will be deemed to have consented. Some landlords prefer stating in their lease that if they do not respond, they are deemed to have refused. This however raises the question as whether a landlord with such a clause is not indirectly reserving the right to simply arbitrarily refuse his consent which is not accepted under Quebec law. In addition to article 1871 pursuant to which a landlord may not refuse without a serious reason, the Civil Code of Quebec also imposes an obligation of good faith and fair dealing pursuant to articles

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6 and 7. The Quebec Court of Appeal in a decision rendered in 2000 also held that a landlord may not arbitrarily refuse his consent as same renders the condition of obtaining landlord's consent dependant upon the sole discretion of the landlord (une condition purement potestative) which is null pursuant to article 1500 of the CCQ.

To avoid the debate of what constitutes a "serious reason", landlords can include in the lease a list of reasons which are deemed to be "serious reasons". By tenant accepting such reasons as "serious", the Quebec Superior Court in 1998 held that landlord is not required to demonstrate such reasons are indeed serious as tenant acknowledged same in the lease. Examples of such pre-established serious reasons can include the financial strength and covenant, conflict with pre-existing exclusivities, amendments to the use clause, the nature of the proposed subtenant or assignee (such as consulates, embassies, trade commissions), the type of operations to be conducted by the proposed subtenant or assignee being incompatible with the nature and destination of the building or the rules and regulation of the building. For further protection, landlords should also draft such lists as being non-exhaustive, i.e. "without limitation", leaving the possibility of raising other "serious" grounds for his refusal.

Other point worth noting for landlords: the doctrine as well as a decision rendered by the Court of Quebec in 2006 have held that the landlord's consent need not be explicit. If a landlord is aware there is a new occupant of the leased premises without the tenant having requested and obtained landlord's consent when required to do so under the lease, by landlord tolerating such a situation long enough, such as by accepting the rental payments of the new occupant, he will be deemed to have tacitly consented to the sublease or assignment.

#### Landlord's option to Terminate the Lease

Last but not least, many commercial leases include provisions allowing the landlord to terminate the lease instead of giving or refusing its consent to the proposed sublease or assignment. Although many tenants immediately object to such clauses, contrary to retail leases where a

tenant may want out of its obligations but the lease to remain in effect to keep its competitors from taking over the space, office tenants may find this to be a viable solution if their is inrent is indeed to downsize and landlords keep control over the leased premises. Alternatively, if the tenant wants added protection, he can negotiate this clause to include an option for him to elect to withdraw his request for consent.

In conclusion, our recommendation is to take the time to properly read and

negotiate all agreements, starting with the lease agreement so each party knows exactly what to expect should the tenant need to sublease the premises or assign the lease. As for the subtenants and assignees, they must obtain and read through the lease and pay particular attention to any requirements and limitation the lease may impose (i.e. personal right of the tenant) and from there negotiate their respective sublease and assignment agreements bearing in mind the specific aspects and rules which apply to each context. •