

## Assignments and Collateral Assignments Of Commercial Leases

### *What Tenants and Landlords Should Know*

By Terrence M. Dunn

There are differences between assignments of leases and collateral assignments of leases, and each has aspects that parties to these agreements should expect and look out for. Let's discuss some of these issues.

#### COMMERCIAL LEASE ASSIGNMENTS

An assignment of lease agreement is a contract to effectuate a transfer to an assignee of title and rights to certain real property held by a lessee or tenant pursuant to a lease. There are varying reasons why a tenant may want to assign the lease. Most often, a tenant will look to assign its lease in the event that its business is failing and they can no longer pay rent, or the tenant is selling its business and the purchaser would like to take over the commercial space to operate the business (sometimes the reason may be a combination of these). While it may seem that a landlord would not object to an assignment so long as the rent is still being paid, land-

lords often want control over lease assignments, to protect themselves from incoming assignees that may not be credible tenants.

Assignment provisions in a commercial lease are usually coupled with subletting provisions, though the two concepts are not one in the same. When a tenant sublets its premises to a subtenant, privity of contract is not created between a sublessee and a landlord. In the case of an assignment, the assignee assumes the lease as the new tenant and privity with the landlord is created. In some cases, but not all, the assignor may be released.

The language dictating a tenant's assignment rights is typically drafted to require landlord's prior written consent to an assignment; a breach of such clause would be a default under the lease and the assignment would be invalid. In addition to this consent buffer, a landlord may reserve for itself the right to review an assignee's financials and proposed assignment of lease agreement prior to its consent. Reviewing financials helps a landlord make an informed decision about a potential assignee and assess if they would be a good fit as a tenant in its building. Reviewing

the proposed assignment of lease agreement allows the landlord to assure that the incoming tenant is assuming all obligations and liabilities under the lease.

Tenants will want to counter a landlord's unilateral decision-making regarding the assignment of lease to impose upon landlord an obligation to accept certain assignments. Landlords are often amenable to incorporating a "reasonableness" standard for its consent to assignments. The reasonableness standard will typically read as: "Landlord's consent shall not be unreasonably withheld, conditioned or denied."

Sometimes, a tenant may be able to negotiate a requirement that a landlord's approval shall only be withheld under predetermined conditions or circumstances. For example, the parties may agree that the landlord may only withhold its consent to an assignment if the proposed assignee is lacking a certain net worth. Other times, a landlord and tenant may agree to preapproved assignees, so that a landlord's prior consent is not required for those specific assignments. This type of scenario may arise when the commercial tenant is a franchisee of a certain

---

**Terrence M. Dunn**, a member of this newsletter's Board of Editors, is a founding partner of Einbinder & Dunn, in charge of the firm's business, real estate, trusts & estates and fashion law practices.

business and would like to freely assign the lease to another franchisee or its franchisor (oftentimes due to the tenant's sale of the business). A landlord may be willing to agree to this outright, or subject to further conditions, such as the net worth standard mentioned above.

As further discussed below, a collateral assignment of lease differs from the typical assignments found in a commercial lease mentioned above because the lease itself is used as collateral for the performance of a separate agreement, leaving the landlord with less control than it normally possesses.

#### **COLLATERAL ASSIGNMENTS OF LEASE**

Separate from a traditional assignment of lease is a collateral assignment and assumption of lease whereby a landlord and tenant agree that a certain third party has a security interest in the lease pursuant to a separate agreement. Typically, this scenario will arise when a tenant's business is subject to mortgage financing or subject to a franchise agreement.

In a financing situation, a collateral assignment is typically used to secure obligations in the event the tenant defaults on their loan. "The collateral assignment of a lease for security purposes generally will only create a lien not an assignment." *2185 White Plains Rd. LLC v. G & G Pelham Food Corp.*, 58 Misc.3d 1227(A), 98 N.Y.S.3d 503 (N.Y. Civ. Ct. 2018). In *2185 White Plains Rd.*, the collateral assignment at issue noted that the lender did not undertake responsibility for performance of tenant's obligations under

the lease. *Id.* "[T]he collateral assignment for security purposes gives [a lender] no right to possession of the [s]ubject [p]remises." *Id.*

Another financing collateral assignment situation, which is beyond the scope of this article to analyze, is when a landlord provides its lender with a collateral assignment of leases and rents to its building(s). In the event of landlord's default under its loan, the lender would have the right, *inter alia*, to collect and receive the rent from the building's ten-

---

***The rights afforded to the franchisor in a collateral assignment [allow the franchisor] to take possession of the tenant's space in the event of tenant's default on either its franchise agreement or under the lease itself.***

---

ants, lessees or parties in possession. Additionally, the collateral assignment may allow for the lender to lease any space in the building not occupied and to then collect rent under such lease(s).

A franchisor's collateral assignment is signed simultaneously with the lease. It is unlikely that a franchisor will negotiate the terms of the collateral assignment with the franchisee-tenant because a franchisor will want to reserve as much control for itself as possible in the event of the franchisee-tenant's default. The rights afforded to the franchisor in a collateral assignment differ from those of a lender's rights in their collateral

assignments because a franchisor will be allowed to take possession of the tenant's space in the event of tenant's default on either its franchise agreement or under the lease itself. If the tenant defaults under its franchise agreement, the collateral assignment becomes effective immediately following the franchisor's exercise of its rights under the franchise agreement to terminate and take over the business. It is common for the franchisor to not utilize the collateral assignment to assume the lease for itself. The franchisor may not be in a position, geographically or financially, to take on the business. In this case, the franchisor will assign the lease to a new franchisee so that it does not incur any liability for itself.

#### **LANDLORD'S RISKS AND NEGOTIATIONS**

In signing any commercial lease with a tenant, all landlords bear the risk of having to deal with potential defaults and lease terminations (or even legal action and eviction proceedings) stemming from the tenant's failed business. When a landlord agrees to execute a collateral assignment, it takes on the added risk that in the event a tenant defaults on not only the lease, but a separate agreement with a third party, that third party may come into the space and assert rights under the lease. Whether that third party will occupy the premises or not, the landlord may still be in a position that most do not ideally bargain for. Some collateral assignments will even impose obligations directly on the landlord that could require, for example, the landlord to take all necessary action to allow

for the third party to take possession of the premises. Such actions may include commencing an eviction proceeding or taking other legal action. Some franchise collateral assignments require the landlord to terminate the lease in the event of tenant's default, in which case, a franchisor would not assume the lease, but would step into the shoes of the expelled tenant for purposes of entering the premises to, for example, remove all articles that display franchisor's proprietary marks (signs, stationery, advertising materials etc.).

As one may expect, entering into a lease with a tenant that is subject to a collateral assignment is not a situation into which all landlords are willing to put themselves; at least, not without negotiating some favorable terms for itself. Some third parties may not be willing to negotiate their standard collateral assignment agreements with landlords; but for those who are willing to negotiate, a landlord should request some level of control over which assignee, if any, will physically occupy the space in the event of an assignment and assumption of lease. For example, a landlord can predetermine certain criteria that an incoming tenant must meet. As discussed earlier, in a scenario where a landlord is negotiating a franchisor collateral assignment, the landlord may request to review financials of an incoming replacement franchisee tenant before such party takes possession of the space. Ideally, if the financials are below a certain threshold that the landlord would not typically accept, the landlord can deny the assignment.

### RELEVANT CASE LAW

It is worth noting that certain courts have determined that a tenant may enter into a collateral assignment of its interests in a lease without violating an express prohibition against assignments, even without landlord's consent in the lease. In *Stone v. Simmons*, No. 91-CH-125 (2nd Dist.1999), *disposition aff'd*, 301 Ill. App. 3d 1103 (1999), a commercial tenant assigned its interests in its lease to a certain bank as security in exchange for a \$6,000,000 loan for its business. The court noted that the collateral assignment to the bank did not allow for the bank to take possession of the property unless a default occurred under the loan. Further, the lease itself did not specifically prohibit collateral assignments without landlord's permission. This court drew a clear distinction between traditional assignments of lease and collateral assignments of lease that act as a security interest and decided that a covenant against one is not a covenant against the other.

Building on the notion that traditional assignments differ from collateral assignments, courts have also found that a collateral assignee who is not in possession of a premises can avoid liability in actions against the assignor. In *Fitzgerald v. 667 Hotel Corp.*, 103 Misc. 2d 80, 426 N.Y.S.2d 368 (Sup. Ct. 1980), actions were brought for injuries and property damage following the collapse of a hotel. A mortgagee, who held a collateral assignment of the hotel's lease as security for mortgage debt, was a named defendant in one of the actions. Evidence in the case showed

that the hotel was not in default under its mortgage payments and so there was no reason that the mortgagee would exercise any of its rights pursuant to the collateral assignment — and it did not. Based on this, and the fact that the mortgagee did not, at any point in time, possess the premises, as they were prohibited to by the language of the collateral assignment, the mortgagee could not be held liable for damages sustained due to the hotel's collapse. *Id.* The court there explained, "Until a default, a mortgagee has no opportunity, much less an obligation, to keep the premises in good repair. Moreover, the assignment at issue specifically limits the mortgagee's rights until there was a default by the owner." *Id.* at 368.

