

"MASS TRANSFERS AND TENANT CHAIN SALES: ADVICE FOR LANDLORDS"

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In the Spotlight

Tenants Must Act Prudently When Executing Estoppel Certificates

By William Crowe

Tenant estoppel certificates are generally perceived by most tenants as an occasional innocuous annoyance, and in most cases they are just that. There are certain instances, however, where the careless execution by a tenant of an estoppel can lead to serious potential legal difficulties in the future.

Upon receiving a request by a landlord for an estoppel, a prudent tenant must do two things. First, review the lease to determine what the tenant is required to certify. Landlords (and their lenders, prospective purchasers, and their respective counsel) frequently like to add various provisions to the estoppel that amount to modifications of the lease or disguised subordination and attornment provisions. If the lease does not require the tenant to deliver the additional requested provisions, there is no reason for the tenant to comply unless the tenant receives some benefit for doing so. Second, the tenant must carefully review the provisions of the estoppel to make sure that it is factually correct. Landlords and/or their managing agents or attorneys frequently take the form estoppel and fill in the blanks based on a rent roll or lease abstract without necessarily

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Mass Transfers and Tenant Chain Sales: Advice for Landlords

By Jeanne Banka

The rumor that the retailing giant, Target Stores, may be taking over one of Canada's oldest and most venerable department store retailers, the 334-year-old Hudson's Bay Company ("The Bay"), and/or its junior department store discount division, Zellers, has left many Canadian landlords scrambling to review their leases in order to ascertain their rights. Many landlords will find that Target may be able to slip into The Bay's shoes without the necessity of having to obtain the landlords' consent to the transaction. Target's entry into Canada may prove to be as seamless and effortless as Wal-Mart's successful entry into the Canadian market a decade ago through its subleasing of stores from F.W. Woolworth & Company, a feat that was achieved for the most part without the necessity of landlord consent.

Purchasing a chain of stores or locations provides a retailer with instant entry into new markets, or a means of expanding within existing markets, on either a regional, statewide or federal basis. The retailer's goal is to complete the purchase transaction totally unhindered by the requirement to obtain the landlords' consent to the lease transfers and not to do anything more than notify landlords (usually after the fact) that the leases have changed hands. Conversely, the landlord's goal is to ensure that it maintains control of its real estate, its merchandise mix and receives a strong financial covenant from the transferee.

HASTE IS WASTE

Many landlords make the mistake of devoting too little time to consideration of the ramifications of chain sales or "mass transfers" by tenants. They often assume that if the purchaser has enough money to buy the locations, then it has enough financial strength to fulfill its obligations under the leases, and that in any event, two covenants are better than one, as both the transferor and transferee will be bound under the lease. The fact is that after the sale, the transferor may have totally depleted itself of all assets and other value or been wound up, leaving the landlord with only the transferee to look to in the case of subsequent default under the lease.

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A prudent landlord will want to examine the business experience of the purchaser, its strategic plan and long-term objectives for these locations, whether there is a possibility that percentage rent will decline or not be payable at all as a result of the changeover in ownership, and whether, after having paid for the purchase, the transferee will have sufficient financial means to fulfill its obligations under the lease for the balance of the term without default. The only way that a landlord can satisfy itself with respect to these matters is to ensure that it gets a seat at the negotiating table, which in turn will only be achieved if the landlord reserves to itself a consent right under the lease or other protections under a well-drafted lease.

LEASE REVIEW TIPS

A landlord who has been informed of an upcoming chain sale or mass transfer of locations by a tenant should immediately review the following areas of the lease in order to determine its rights:

1) *Transfer Clause* — Is the landlord's consent required or is this a "no consent" situation? As chain sales/mass transfers are sometimes effected through a number of legal steps, it is important to obtain in writing exact details of the various steps in the transaction, so that the landlord can determine whether it is dealing with an assignment of lease, a share sale, an amalgamation, or a combination of any of the foregoing.

2) *Use Clause* — Is the use clause specific or broad? Will the existing use clause accommodate the purchaser's proposed use? Will any restrictive covenants or exclusives currently existing in the shopping center be infringed once the purchaser takes over? A use clause that

allows the tenant to carry on "any lawful use" may facilitate the transfer of high-end ladies' wear stores to a dollar store operator.

3) *Trade Name* — Is the landlord's consent required to a change of trade name? A lease that allows the tenant to carry on business under "the name which the tenant uses in a majority of its other locations without the landlord's consent" will facilitate a chain sale/mass transfer by the tenant.

4) *Operating Covenant* — Is there an operating covenant? Lack of an operating covenant will facilitate the closing of underproductive stores by the chain acquirer.

5) *Personal Rights* — Does the lease contain any rights that are stated to be personal to the existing tenant, and hence, fall away upon any transfer of the lease? These rights may include renewal options, exclusive use rights, early termination rights and rights of first refusal.

6) *Documentation* — Regardless of whether the landlord's consent is required, does the lease provide the landlord with the right to have the transferee sign an assumption agreement prepared by the landlord, acknowledging that the transferee will abide by the tenant's obligations under the lease for the balance of the term? This document will provide the landlord with a direct contractual relationship with the transferee.

7) *Landlord's Legal and Administration Fees* — Does the lease entitle the landlord to be reimbursed for its legal fees incurred in reviewing the lease documentation and negotiating any form of agreement evidencing the landlord's consent or acknowledgment of the transfer? Is the landlord entitled to be paid an administration fee for considering the request to transfer?

8) *Estoppel Certificates* — Does the lease require the landlord to provide the tenant with an estoppel

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referring back to the original lease document. This process often leads to errors in basic lease status such as rent, term, renewal options, etc.

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certificate, at the tenant's request, confirming, among other things, that there are no defaults under the lease or any claims or set-offs against the tenant? If so, how detailed must the estoppel certificate be, and is the landlord entitled to receive payment from the tenant for its time and effort spent in researching information to complete it, as well as any legal fees incurred in negotiating the form?

A prudent landlord will also investigate the status of the tenant's rental account, as it may have some leverage at this time in collecting any outstanding rent arrears or year-end adjustments owed by the tenant.

The landlord should also review the status of any outstanding leases and lease-related documents at the properties involved in the proposed lease transfers, as the landlord may have some leverage in requiring the tenant to finalize these as a prerequisite for the landlord's cooperation in this sale. (If the purchaser is also a tenant in the landlord's portfolio of properties, the landlord may also be in a position to clear up any rent arrears or outstanding lease documents at those properties as well, as part of the spirit of cooperation.)

LANDLORD'S LEVERAGE

The reward for a landlord who has managed to get a seat at the negotiating table based on astute wording of relevant lease provisions is that it will then have some leverage to address issues pertaining to the landlord/tenant relationship that the tenant may have ignored up until this point in time.

For example, the landlord's "wish list," in exchange for cooperating with the tenant in its proposed sale

A tenant does not want to certify to incorrect information. Another potential serious pitfall for the tenant is inadvertently neglecting to recite in the estoppel all lease modifications and amendments, including any letters which arguably alter the terms of the lease. Unless these documents are specifically referred to in the estoppel, the

tenant may later be estopped from asserting any rights pursuant to such documents.

From the tenant's perspective, a landlord request for an estoppel certainly can be an annoyance. With just a little bit of care and preparation, it can be easily kept to a minor annoyance.



transaction, may include items such as the following: 1) a commitment by the purchaser to agree to an extension of the term or early exercise of upcoming lease renewal options; 2) an agreement to renovate a tired looking store when the lease does not otherwise require this; 3) an agreement to insert in the lease a landlord's relocation right or lease termination right to facilitate the landlord's planned renovation or re-merchandising of a shopping center; and 4) the landlord's agreement to transfer to the purchaser certain rights which were stated in the lease to be personal to the existing tenant and hence, not transferable.

Although the tenant cannot be forced to accept any items on the landlord's "wish list," it is common for the parties to engage in debate on these issues in the spirit of give-and-take, where the tenant requires cooperation from the landlord in order to facilitate the closing of the transaction.

IMPORTANT LEASE PROVISIONS

Careful attention to a number of lease provisions at the lease negotiation stage may assist the landlord in gaining some control in a chain sale/mass transfer situation.

Definition of 'Transfer'

It is imperative that the lease contains a comprehensive definition of what constitutes a transfer under the lease. A comprehensive definition reads as follows:

In this Lease "Transfer" means (i) an assignment, sale, conveyance, sublease, disposition, or licensing of this Lease or the Premises, or any part of them, or any interest in this Lease (whether or not by operation of law) or in a partnership that is a Tenant under this Lease or a merger or an amalga-

mation of the Tenant with another corporation, (ii) a mortgage, charge, lien or debenture (floating or otherwise) or other encumbrance of this Lease or the Premises or any part of them or of any interest in this Lease or of a partnership or partnership interest where the partnership is a Tenant under this Lease, (iii) a parting with or sharing of possession of all or part of the Premises, and (iv) a transfer or issue by sale, assignment, bequest, inheritance, operation of law or other disposition, or by subscription of all or part of the corporate shares of the Tenant or an "Affiliate" of the Tenant which results in a change in the effective voting control of the Tenant. "Affiliate" means an affiliate within the meaning of the _____ Business Corporations Act, as it exists on the date of this Lease. "Transferor" and "Transferee" have meanings corresponding to the definition of "Transfer" set out above (it being understood that for a Transfer described in subparagraph (a)(iv), the Transferor is the Person that has effective voting control before the Transfer and the Transferee is the Person that has effective voting control after the Transfer).

Change of Control Pitfalls

It is universally agreed that the landlord's consent should not be required to a change of voting control that occurs in a company as a result of trading of the stock on a state or federal stock exchange. However, the landlord's consent should be required if the change in control occurs in a subsidiary or affiliate of the publicly traded company, unless such change

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of control in the subsidiary or affiliate company occurred as a result of the trading activity of the parent company on the public stock exchange. Suggested wording to plug this loop-hole is as follows:

The Landlord's consent to a Transfer specified in subparagraph (a)(iv) is not required when the sole Tenant in occupation of the Premises is a corporation (a "Public Corporation") whose shares are traded and listed on a stock exchange in the United States or Canada, or a Transfer that occurs when (1) the sole Tenant in occupation of the Premises is a "subsidiary body corporate" (as that term is defined on the date of this Lease under the Canada Business Corporations Act, R.S.C. 1985, c.C-44) (or insert applicable statute) of a Public Corporation and (2) it is the shares of the Public Corporation and not of the Tenant that are transferred or issued.

Non-Consent Transfers

Strong tenants are often able to negotiate their way out of having to obtain the landlord's consent to certain types of transfers. The most common of these "exempt transfers" are as follows:

1) *Related Company Transfers* — The tenant wants the right to transfer the lease to a parent, subsidiary or affiliate without having to obtain the landlord's consent. The intent of this amendment is to give the tenant some flexibility in income tax related matters. Unfortunately, this right is often used to facilitate a chain sale/mass transfer by the tenant. Accordingly, the right to transfer to a related company without landlord consent should be made personal to the existing tenant, be exercisable on a "one time only" basis, apply only so long as the tenant is operating its business in the whole of the premises and is not in default under the lease, and the related company continues to remain a parent, subsidiary or affiliate, as the case may be, of the tenant. The tenant should covenant

that it will provide the landlord with prior written notice of the transfer, the use clause and trade name will remain unchanged, the transferor will not be released from its obligations under the lease, and the transferor, transferee and landlord will sign the landlord's tripartite agreement acknowledging the transfer and confirming the matters set out above.

2) *Chain Sale Exemption* — A strong tenant may be successful in negotiating for itself the right to

***Good lease drafting on
the landlord's part may
win the landlord a seat
at the negotiation table,
even though it may not
have a specific right to
consent to the transfer.***

transfer the lease without the requirement of landlord's consent if the transfer forms part of a transaction involving numerous locations. In this case, the lease should specify that the transfer is in favor of a purchaser of all or substantially all of the stores *operating under that specific trade name* in the country or the state, comprising at least 10 [or whatever] stores. Avoid referring to the "Tenant's stores" in case the tenant has been utilizing different corporate names for its various locations. (Some retailers hold their leases in a different corporate name for each location.)

The lease should require the transferor to satisfy the landlord that the transferee has a history of successful business operations in the business to be conducted in the premises, has a good credit rating and a substantial net worth, and is able to finance its acquisition of its interest in the premises without a material risk of defaulting under the lease.

The lease should specify that the same prerequisites as are listed above under "Related Company

Transfers" should apply in the case of a chain sale (*ie*, personal to the existing tenant, "one time" only, tenant not in default, prior notice to be provided, same use to continue, landlord's tripartite agreement to be signed, etc.).

The lease should also entitle the landlord to implement an increase in minimum or basic rent payable by the transferee after the transfer, based, for example, on the greater of effective rent (being the aggregate of the minimum and percentage rent payable by the tenant for, say, the 2 years (averaged) immediately preceding the transfer) or the change in the Consumer Price Index. Where the landlord does not have a consent opportunity, it is comforted by the ability to bring the minimum rent up to market rates and to insulate itself from any decrease in percentage rent which it may suffer due to the change in store ownership.

CONCLUSION

Good lease drafting on the landlord's part may win the landlord a seat at the negotiation table, even though it may not have a specific right to consent to the transfer. Rights, such as the landlord's ability to increase the minimum rent upon the completion of the transfer, the non-transferability to the transferee of certain rights that are stated to be personal to the existing tenant, a concisely drafted use clause and strict controls on trade name changes, will inevitably give rise to a dialogue between the landlord, the tenant and the proposed transferee, and thereby afford the landlord an opportunity to address its "wish list."



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