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COMMERCIAL LEASE NEWSLETTERS

**RENTAL RECAPTURE PROVISIONS ON SALE OF
BUSINESS AND/OR ASSIGNMENT OF LEASES**

This month's commercial lease newsletter addresses an area of commercial leases which can have some significance in the event of a sale of an ongoing business and/or an assignment of a lease or subletting of a lease.

Rental Recapture Provision:

Given today's economy, the market reality is that many businesses are being sold. Many tenants need to assign or sublease their premises based upon their inability to maintain a viable business.

From this standpoint, there are a number of factors to consider which include the Consent to Assignment of Lease, Assumption of Lease, as well as Recapture Provision.

We previously discussed the Consent to Assignment in the July 2007 Newsletter, these points are as follows:

1. **Consent to Assignment:**

In Florida a landlord cannot unreasonably withhold consent to assignment of lease. This dates back to a case called *Fernandez v. Vasquez*, 397 So. 2d 1171 (3 DCA 1981) which adopted the "Good Faith and Commercial Reasonable Rule" involving commercial leases in Florida. Some of the factors that the Court identifies in the *Fernandez* case (which is still good law today-see discussion below of recent case law) is that the trier of fact, (be it judge or jury), can apply the following standards of Good Faith and Commercial Reasonableness:

- (A) The financial responsibility of the proposed subtenant or assignee.

(B) The identity or business character of the subtenant or assignee. (That is the suitability for the particular building or premises).

(C) The need for alterations of the premises.

(D) The legality of the proposed use.

(E) The nature of the occupancy. (That is office, factory, clinic, etc.)

2. **Good Faith Standard of Assignment and Reletting:**

The Courts also have imposed an additional good faith standard for assignment and reletting utilizing the good faith standard as a gap filling mechanism in order to make sure that all parties conduct themselves in an appropriate good faith and businesslike manner.

A case involving this very factor and was just decided in the State of Florida (April 20, 2007) in the case of *Speedway SuperAmerica, LLC. v. Tropic Enterprises, Inc., 2007 Florida Appellant Lexis 5799 (2DCA 2007)*. This decision was rendered by the Second District Court of Appeals.

In this case, a Sarasota County Court ruled that the landlord had the unfettered right under lease to withhold consent to the assignment of the lease made by the tenant to an assignee and its affiliate. In that case the Appellate Court overruled the Trial Court and indicated that the implied covenant of Good Faith exists in virtually all contractual relationships inclusive of commercial leases.

The Court indicated that, notwithstanding the language in the contract, there is a “gap filling default rule” which comes into play when a question is not resolved by the terms of the contract or when one party has the power to make a discretionary decision without defined standards. *Publix Supermarkets v. Wilder Corporation of Delaware 876 So. 2d 652, 654 (Fla. 2d DCA 2004)*. The second DCA went on to say that the applied covenant of Good Faith and Fair Dealing is designed to protect the contracting party's reasonable expectations. *Cox v. CSX Inter-model, Inc., 732 So. 2d 1092, 1097 (Fla. 1st DCA 1999)*. The Court further went on to indicate that “[W]here the terms of the contract afford a party substantial discretion to promote that party’s self-interest, the duty to act in good faith nevertheless limits that party’s ability to act capriciously to contravene the reasonable contractual expectations of the other party.”

3. **Recapture Provision:**

Oftentimes in leases there is a provision contained in the lease which indicates that the landlord has the right to recapture either a percentage or all of the lease rentals by way of an assignment or subletting.

By way of example and not limitation, assume that a tenant has a below market lease for a

retail space (for example, a lease which calls for the rentals to be \$20.00 per square foot). Assume also that the tenant wants to assign this lease to a third party by way of an assignment or, alternatively, by subletting. Occasionally in commercial leases there is a provision contained in the lease which indicates that the landlord has the right to recapture all or a portion of the increase in rentals. Using our example, the tenant who assigns the below market lease to a third party by way of an assignment or subletting for a greater amount of rent per square foot so that the new tenant would be required to pay a one (1) time assignment fee to the existing tenant or, in the form of a sublease, the subtenant would pay a larger sublease payment to the existing tenant than the tenant would have to pay to the landlord.

By application of the recapture provision, the existing landlord could recapture all or a portion of that increase so that in the event of a below market lease the landlord could share in this below market lease and benefit from the assignment for a higher sum. Generally the recapture provision range from the landlord sharing fifty percent (50%) of the recapture amount or, alternatively, in certain situations, the landlord recapturing one hundred percent (100%) of this amount.

Caution should be taken to identify the specific terms and conditions of this recapture provision so that in the sale of the underlying business it is delineated in the Purchase Agreement whether any of the consideration given for the sale went to the assignment of the lease or simply whether there was any amount allocated towards the purchase price as an assignment fee or assumption fee of the existing lease.

This would prove to be significant in light of an existing recapture provision in the lease. A drafter of the purchase agreement involving a sale of a business and assignment of lease needs to thoroughly review the underlying lease to determine if any recapture provision exists and if so, address it accordingly in the Purchase Agreement.