Assignments Pro Tanto, And Why To Avoid Them

Thomas C. Barbuti

Sublease?

Assignment?

Assignment pro tanto?

Maybe a sublease or an assignment, but an assignment pro tanto is an invitation to fracture occupancy (and a few other things).

A LEASE is both a contract and a conveyance. It is a conveyance of a real property interest for a term of years involving the possession, use, and enjoyment of a defined area of space subject to payment of rent and the continued performance of duties affecting such space and, in most commercial leases, additional contractual promises.

When a tenant wants to put a third party in possession of all or part of the leased space, it must choose the method most advantageous to it, considering all the circumstances. Assuming, and it is a significant assumption, there are no restrictions on assignment or subletting in the lease, a tenant may:

- Assign its entire interest in the lease for the whole premises to another;
- Sublease all or part of the leased premises to another; or
- Grant concessions, licenses, or other limited rights to another.

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UNDERSTANDING THE DISTINCTION • The main distinction between a sublease of all or part of the premises and an assignment of the lease is that:

- In a sublease, the tenant becomes a sub-landlord and maintains a reversionary interest, placing it in a position between the new occupant and the prime landlord. Under a sublease, the tenant/sub-landlord has a "reversion" in that it has not divested itself of its interest in the leased premises for the entire remaining duration of the term of the lease and it will again resume possession when the term of the sublease ends. The subtenant does not have direct liability to the prime landlord for the payment of rent or performance of other covenants;
- In an assignment, however, the new occupant steps into the shoes of the tenant and therefore has privity of estate with the landlord, and the tenant/assignor divests itself of all of its right, title, and interest under the lease, thereby severing the privity of estate. Under an assignment, the tenant/assignor no longer has a reversionary interest in the space since it does not have the right to retake possession because the assignee's rights end simultaneously with the end of the term of the lease. The new occupant does have liability for the payment of rent while it is in privity of estate with the prime landlord.

The Realities

Regardless of what the parties call it, most courts will re-characterize a "sublease" that ends on the last day of the term of the prime lease as an "assignment" and will re-characterize an "assignment" pursuant to which the tenant/assignor has not divested itself of its entire temporal interest in the space as a "sublease." In each case, there will be unanticipated consequences for the parties. Logic might suggest that a transfer of possessory rights to less than all of the tenant's premises would always be a sublease since the tenant has not transferred its entire interest "in the lease" to another. There are several cases that hold precisely that. "The rule is well-settled that if a lessee underlets the premises for a shorter term than that for which they are to him granted, or if he underlet a part only of the premises, the original lessor cannot sustain an action for rent against the sublessee." *Shannon v. Grindstaf,* 40 P. 123, 124 (Wash.1895). "It seems to be settled, that where a lessee assigns his lease for any shorter period of time than that for which the lease was granted, the lessor cannot sustain an action of covenant against the assignee upon the lease; because this is considered, not an assignment of the whole term, but an underletting. The principle applies with at least equal force to the case of an assignment, or underletting of part of the premises only." *Fulton v. Stewart,* 2 Ohio 215 (Ohio 1825).

The Characterization Follows The Effect

A majority of states continue to follow the common law rule that distinguishes assignments from subleases by their legal effect, rather than by their form or the parties' intentions for the transaction. If a lessee conveys all of the property interest in the estate for the entire duration to a third party, then the transaction is construed to be an assignment of the lease; but, if the lessee retains some interest in the estate, such as a reversion before the expiration of the original lease, then the transaction is construed to be a sublease. 52 C.J.S. *Landlord and Tenant* §43 (2003); 49 Am. Jur. 2d *Landlord and Tenant* §1077 (1995). The effect of transferring less than the entire physical premises to a third party for the entire balance of the term of the lease creates interesting and difficult problems for the parties. The following chart illustrates a comparison of several elements of assignments, subleases, and "assignments pro tanto":

ITEM	ASSIGNMENT	SUBLEASE	PARTIAL ASSIGNMENT
Space	All of the space	May be all or less than all of the space	Less than all of the space
Privity of Estate	Assignee has privity of estate as to all of the space	Subtenant never has privity of estate	Partial assignee has privity of estate but only as to the space assigned
Privity of Contract	Depends on whether assignee has "assumed the lease"	Subtenant does not "assume" the lease	Depends on whether assignee has "assumed the lease." Can an assignee only "assume" part of a lease?
Rent	Assignee liable for 100 percent of the underlying rent; and for any additional sums payable to tenant/ assignor, in a lump sum or over time	Subtenant only liable for rent specified in the sublease, not liable for underlying rent	Assignee only liable for a share of the underlying rent under the prime lease; and for 100 percent of any additional consideration payable to tenant/assignor, in a lump sum or over time
Term	100 percent of balance of term of prime lease	At least one day less than balance of term under prime lease	100 percent of balance of term under prime lease, but only as to the portion of the premises so assigned
Landlord's remedies for rent	May sue assignee for 100 percent of rent and may sue tenant/assignor for 100 percent of rent	May not sue subtenant for rent; may only sue tenant/sublandlord for rent	May sue assignee for its pro rata share of rent; may still sue tenant/assignor for 100 percent of the rent
Landlord's remedies for possession	May evict assignee for breach of lease	May evict subtenant if prime lease provision is breached by tenant/sublandlord or by subtenant	May evict assignee from its portion of the space for breach of lease; can landlord evict tenant/assignor and others from other portions of the space if there is no breach regarding other portions of the space?
Tenant's remedies for breach by transferee	May sue assignee for damages, but not to recover possession or for rent	May sue subtenant for rent and for recovery of possession	May sue partial assignee for damages, but not to recover possession or for rent
Transferee's liability	Assignee's liability for rent ends when it assigns the lease to another and no longer has privity of estate.	Subtenant's liability to sublandlord does not end if subtenant assigns or further sublets (i.e., privity of contract)	Partial assignee's liability for rent ends when it assigns its interest to another and no longer has privity of estate

More recently, there have been "a few timid efforts" to break with the common law rule and construe transfers of leases according to the intentions of the parties. 1 Milton R. Friedman & Patrick A. Randolph, Jr., *Friedman on Leases* §7:4.3 (Practising Law Institute, 5th ed. 2004) (hereinafter "Friedman"). These jurisdictions have considered the duration of the sublease as only one factor to consider in determining the intentions of the parties. *E.g. Jaber v. Miller*, 239 S.W.2d 760, 764 (Ark. 1951) (holding that the intention of the parties should govern whether an instrument is an assignment or a sublease); 49 Am. Jur. 2d *Landlord and Tenant* §1077 (2005). Although some commentators have criticized the application of feudal property principles to contemporary leases, the great majority of states, including Maryland and Virginia, still follow the common law.

What Makes It A Sublease, Not An Assignment (Or Vice-Versa)?

There is a divergence of opinion in some American jurisdictions over what reservations in a transfer of a lease, other than a reversion, constitute interests sufficient to make a transfer less than a total assignment of the lessee's property rights. Different states have considered provisions different from those in the original lease, such as a reservation of greater rent, or the insertion of different covenants, to be reservations that make a transaction a sublease rather than an assignment. *E.g. Morrisville Shopping Center, Inc. v. Sun Ray Drug Co.*, 112 A.2d 183, 187 (Pa. 1955) (stating that a transfer for different rent or upon different terms or conditions is a sublease); 1 Tiffany *Real Prop.* §123 (Callaghan & Co., 3d ed. 1939 & Supp. 2006). Some states have even held that a provision for a right of re-entry on breach of condition is a reversionary interest. *E.g. American Community Stores Corp. v. Newman*, 441 N.W.2d 154, 159 (Neb. 1989) (holding that a right of re-entry was a reversionary interest); 1 Tiffany *Real Prop.* §123 (2004); Friedman, supra, §7.4.3.

Even if the transfer of a lessee's entire interest in an estate is for only a part of the premises leased from a lessor, the transfer is construed under the common law as an assignment pro tanto, and not a sublease. Friedman, supra, §7:4.3. The lessee retains no reversionary interest in the estate for that portion of the premises, and privity of estate exists between the lessor and the assignee pro tanto. *Id*. Normally, an assignee pro tanto is liable to the lessor for the amount of rent for the assignee's part of the space that is in the same proportion to the rent that was owed by the lessee for the entire premises. Friedman, supra, §7:4.2. This is still the rule irrespective of whether the transfer of the part of the premises was intended to be a sublease, so long as the lessee retains no interest in that portion of the estate. *Id*.

Maryland closely follows the common law rule for distinguishing assignments from subleases. The Court of Appeals of Maryland restated that rule in *Italian Fisherman, Inc. v. Middlemas*, 545 A.2d 1 (Md. 1988):

"If the instrument purports to transfer the lessee's estate for the entire remainder of the term it is an assignment, regardless of its form or the parties' intention; however, if the instrument purports to transfer the lessee's estate for less than the entire term—even for a day less—it is a sublease, regardless of its form or the parties' intention."

Id. at 4. The court held in *Italian Fisherman, Inc.*, that the transfer of all the plaintiff's "right, title, and interest" for the remainder of its lease was an assignment and not a sublease. *Id*. at 4, 6.

More recently, the Court of Special Appeals of Maryland applied the rule stated in *Italian Fisherman, Inc*. to hold that a transfer agreement was a sublease because the duration of the transfer ended two days before the end of the

lessee's term. *Maxima Corp. v. Cystic Fibrosis Foundation*, 568 A. 2d 1170, 1177-78 (Md. Ct. Spec. App. 1990). There are no published Maryland court opinions on the issue of whether a change in the conditions of the original lease or the reservation of a right of re-entry on breach of condition constitute a reserved interest in the estate. However, it is clear that, under Virginia law, they do not.

Virginia has also adhered to the common law rule. In *Moskin Stores v. Nichols*, 177 S.E. 109 (Va. 1934), the Supreme Court of Appeals of Virginia quoted what it considered the correct rule:

"The fact that the lessee, in making the transfer to another, reserves a rent greater or less than he himself has stipulated to pay the landlord for the premises, or that he reserves a right of re-entry for breach of new conditions imposed by him, does not prevent the transfer from being treated as an assignment, at least so far as concerns the original landlord, if the interest transferred by the lessee is his whole interest in either the entire land or in part thereof."

Id. at 110. (quoting *1 Minor on Real Prop.* 540 (2d ed. 1928). In *Moskin Stores*, the court held that the transfer was an assignment and the landlord had privity of estate to sue the assignee for failure to pay rent, even though the lessee had reserved a higher rent and a right of re-entry, as the transfer was for the duration of the lessee's interest in the estate. *Id*. at 110, 111.

Conversely, in *Tidewater Investors, Ltd. v. United Dominion Realty Trust, Inc.*, 804 F.2d 293, 295 (4th Cir. 1986), the Fourth Circuit used the court's holding in *Moskin Stores* to hold that a purported subtenant had the right to sue the landlord for violating the conditions of its lease from the lessee. The Fourth Circuit held that, even though the transfer from the lessee was labeled a sublease and provided for a right of re-entry in the event of a default, the legal effect of the transfer was an assignment, as the lessee had transferred its entire interest in the estate for the duration of the original lease. *Id*.

ALL OR NOTHING AT ALL? • Many practical difficulties and uncertainties result when a transfer of possession encompasses less than all of the space, and the transferee has the right to occupy the space until the end of the term of the prime lease. Consider the following questions:

- If the partial assignee breaches a covenant to pay its pro rata share of the rent, is the landlord's remedy limited to evicting the partial assignee, or may the landlord evict other occupants of the property, whether under the original lease or under similar partial assignments?
- If a partial assignee breaches a covenant to pay rent, is the landlord still entitled to recover 100 percent of the rent from the original tenant?
- If a partial assignee breaches a covenant of the lease other than a monetary covenant, what are the landlord's remedies?
- If a partial assignee breaches a monetary or non-monetary covenant of the lease, does the original tenant, or other partial assignees, have a cause of action against the breaching partial assignee?
- If the lease calls for the payment of percentage rent, how is the breakpoint apportioned among partial assignees?
- Does a partial assignee have a right to sue the landlord for a breach of the lease directly?
- If a partial assignee assigns its interest in the lease to yet another party, in the absence of any express assumption agreement, is the partial assignee no longer liable for any covenants under the lease?
- If the original tenant has reserved a right of re-entry for breach of the lease by the partial assignee, might the partial assignment be re-characterized as a sublease?

• In doing an assignment of the lease, a non-disturbance or recognition agreement for the assignee is not as critical as a non-disturbance or recognition agreement is when a party subleases all or a portion of the space. Should a partial assignee be concerned about a non-disturbance or recognition agreement from the landlord? What happens to the rights of the partial assignee if the tenant/assignor breaches the lease? What happens to the rights of the partial assignee if the tenant/assignor elects to voluntarily terminate the lease?

• Is it possible for a partial assignee to assume only a pro rata portion of the tenant's obligations under the lease without assuming all of the lease obligations?

• In a partial assignment, is the tenant/assignor entitled to resume possession of the space so assigned if there is a breach by the assignee?

CONCLUSION • Jurisdictions differ on their treatment of assignments pro tanto. But the best thing to do? Avoid them at all costs! This is in large part because of the vagaries and uncertainties of how a trial court might interpret the transaction. With the rights of the parties to enforce an agreement in question from the inception, partaking in such an agreement is hardly advisable. If, however, for your client to become an occupant of less than an entire leased premises, you must sanction an "assignment pro tanto," then try your best to get the landlord's cooperation and consent.

PRACTICE CHECKLIST

Assignments Pro Tanto, And Why To Avoid Them

The distinction between a sublease and an assignment is pretty well established. But what happens when the arrangement that a client has in mind falls somewhere between the two?

• First check to see if the jurisdiction follows the basic common law rule. Most states still distinguish assignments from subleases by their legal effect, not by form or the parties' intentions. Even the slightest retention of interest, such as a reversion before the expiration of the original lease, is likely to invite interpretation as a sublease.

• Although it is best to avoid partial assignments because they are likely to be interpreted as subleases, at a minimum, the landlord should acknowledge the following:

__ That the transaction is a partial assignment and not a sublease;

__ That the landlord will not have the remedy of eviction against the partial assignee if another occupant breaches a provision of the lease;

__ That the partial assignee has privity of estate with the landlord with respect to the portion of the premises occupied by the partial assignee, and does not have privity of contract with the landlord with respect to the entire lease, but only with respect to so much of the lease as is expressly assumed by the partial assignee;

__ The liability of the partial assignee for rent and past due charges under the lease is limited to an amount that bears the same ratio as the space occupied by the partial assignee bears to the entire premises subject to the lease; and

__ That unless the partial assignee has expressly assumed any portion of the lease and thereby created privity of contract with the landlord, such partial assignee's liability for rent ends when it assigns its interest to another and no longer has privity of estate.