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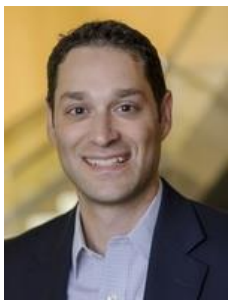
Unique Office-Leasing Issues For Tech Companies: Part 2

By **Daniel Suckerman** (March 20, 2018, 5:46 PM EDT)



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This is the second part of this article.

Assignment and Subleasing

Assignment and subleasing is of utmost importance to a tech company tenant. The business life cycle of a tech company is often in hyperdrive, and the company's lease should not be an impediment to any business moves.

General Considerations

When representing a tech company, you should exercise vigilance to ensure that the standard assignment and subleasing provisions are as reasonable as possible. Rely on your client's broker to learn what landlord protections are market. More so than most users, it is likely that the tech company tenant will look at this provision sometime during the lease term, hopefully because they have outgrown the space and are moving to larger space. (Though they may also need to assign or sublet because their business has failed.) The details of negotiating an assignment and sublease provision generally also apply to tech company leases but are beyond the scope of this article.

Desk Sharing, Incubators and Permitted Occupants

Tech companies often allow other companies to occupy space in the premises. As discussed below, this often happens through a desk-sharing arrangement or use of a portion of the premises as incubator space. The tenant will probably not even realize that occupancy by a user other than the tenant is likely to be deemed a transfer under the lease, requiring the landlord's consent. As the tenant's counsel, you should ensure that the lease's treatment of these rights is tailored to your client's needs and that the lease explicitly excludes them from the requirements and restrictions placed on a transfer (i.e., sublease).

Desk sharing is essentially a sublease-lite. It is not a true transfer of a leasehold interest; rather, it is a limited license to use and occupy a small portion of the premises. Consider these issues with regard to a desk share:

- How much of the premises would the tenant potentially want to use for desk sharing? The landlord may cap the percentage of the premises that can be used for this purpose.

- The desk sharer cannot have separately demised space. That moves it into a sublease construct.
- Does the tenant intend to charge the desk sharer a fee (not rent, since it is not sublease)? The landlord may prohibit this. At the very least, the tenant should be able to charge the desk sharer its share of the rent the tenant pays under the lease plus its proportionate share of shared services.
- Will desk sharers have access to any shared services like reception or IT?
- Will the tenant create a form of desk-sharing license agreement? The landlord may insist on review and approval rights, which the tenant should push back against.
- Will the desk sharers be affiliated in some way with the tenant? A simple way to think about this relationship is a "friend of the company," like a consultant or some other vendor. The landlord may insist on this relationship.

A similar construct is to allow a third-party or parties that are in the early stages of developing a business to use a portion of the premises as "incubator" space. As with desk sharing, the users are given a license to occupy a portion of the premises and do not have a true leasehold interest. Here, the users are typically companies that the tenant has a financial investment in. While desk sharing is more of a flexibility tool to allow the tenant to have its unused space put to work in the future, incubator space is designed from the outset to be used by the tenant for this purpose. You will need to understand the details of the tenant's intended use to explain to the landlord that the lease does not limit the tenant's business operations in any detrimental way.

You must also find out if any other companies that are affiliated with the tenant (e.g., a subsidiary) will use the premises as permitted occupants. The use may be as limited as using the address on a regulatory filing, but the tenant may also want signage for the permitted occupant. This right should be explicitly stated in the lease. The landlord may be concerned that other users are occupying the premises when they are relying on the credit of the tenant. You must understand the relationship between the permitted occupant and the tenant to explain effectively to the landlord that the landlord's risk profile is not adversely impacted.

Change in Control

You should be mindful of whether a change in control of the tenant will be deemed an assignment under the lease that will require the landlord's consent. This provision is ubiquitous in leases (e.g., a transfer of 50 percent or more of the tenant's equity interests is deemed an assignment of the lease), but the ramifications are less often fully described and could be materially detrimental to a tech company.

Determine whether the lease deems a change in control transaction an assignment. If not, then there is nothing more to negotiate by the tenant's counsel on this point. If it does, then there are numerous ways the tenant's counsel should address the concern. Ideally, it should be struck from the lease. After all, following a change in equity ownership, the tenant is still the tenant. The entity has not changed at all. If the landlord will not delete the provision, it must be limited and the ramifications must be fleshed out. Much depends on the precise language of the lease here. The tenant will want the language to provide that, before a transfer is deemed a change in control, both over 50 percent of the direct equity interests in the tenant and control over the power to direct day-to-day business operations have been transferred. If the same people are still controlling day-to-day business operations, then the landlord

should not have an interest in the change in equity control.

The tenant should negotiate to exclude the following equity transfers from the definition of an assignment:

- Transfers between or among existing shareholders
- An initial public offering or sales on an over-the-counter or public exchange
- Transfers for estate planning purposes

Confirm with the tenant if there are any other known or contemplated transactions in the future (like a venture capital equity round). If so, you must also exclude those transactions.

If a change-of-control transfer does not fall into one of the above exclusions and will be deemed an assignment under the lease, ensure that the transfer fits into the lease's permitted transfers exclusion. Typically, a lease will have a provision that permits the lease to be transferred in certain scenarios (e.g., merger, reorganization, transfer of substantially all of the assets) as long as the resulting tenant entity passes a "net worth test." Be mindful of the language used, as often the landlord's lease will not contemplate how a deemed assignment following a change in control will fit into the permitted transfer exclusion.

In a deemed assignment resulting from a change in control, there is no assignor and assignee (it only exists because the lease says it does), meaning there is no assignment and assumption agreement, and the tenant cannot be obligated to provide the same to the landlord as a condition of the permitted transfer. Similarly, the net worth test should be considered by looking at the tenant immediately before the change in control transaction and then again immediately after. A change in equity, without any change in the debts or assets of the tenant, should not have an impact on the tenant's net worth.

Often leases give the landlord the right to share in assignment or sublet profit that the tenant obtains from a transfer. For any transfer that would not require the landlord's consent, like a permitted transfer, profit sharing should be excluded. There should never be any discussion on whether the landlord shares in the profit the tenant obtains from a corporate transaction like a merger or equity raise (that the lease deems an assignment).

Whatever rights you negotiate for the tenant as to permitted transfers should also be negotiated for a future sublessee. Often a lease will expressly state that any sublessee cannot sub-sublease the lease or assign its sublease without obtaining the landlord's prior approval. However, a sublessee, especially in the tech company space, will likely have the same concern as the tenant: that it may go through a change-in-control transaction during the term of this sublease and cannot have the sublandlord or the overlandlord in its way. So, the lease should expressly state that the landlord's right to consent to a sub-sublease or sublease assignment does not apply to transactions to which the landlord would not have a right to consent if the tenant were to engage in the transfer.

Replacement Guarantor

If a tech company tenant is required to provide a separate guaranty of its lease obligations, the guaranty will likely be from its founder or principal. The tenant's counsel should negotiate for flexibility to replace this guarantor in the event of an assignment of the lease. Ideally this will be based on an objective standard (i.e., the landlord will accept a replacement guarantor that equals or exceeds the financial

wherewithal of the outgoing guarantor). Typically, if the lease is assigned, the assignor tenant entity remains jointly and severally liable with the assignee tenant entity. But without any separate agreement by the landlord, the assignor tenant's guarantor also remains liable. In many situations, such as if the company is sold, this will not be ideal for the assignor tenant guarantor. This could be, using the example of a sale of the company, resolved within the corporate transaction (with the assignee tenant (or its credit-worthy guarantor) agreeing to indemnify the assignor tenant guarantor, for example), but the cleanest and most advantageous solution for the assignor tenant guarantor is to be released by the landlord.

Term Provisions; Renewal, Expansion and Contraction Options

Term Provisions

As noted, the guiding principle for a tech company lease is flexibility. This is especially true with the lease term duration. A tech company tenant benefits from a shorter term with more renewal options. The more flexibility over term, the less likely the premises will need to be subleased or that the duration of a sublease will be long. Outside of a booming market, the rent paid by a sublessee to the tenant will likely be lower than that paid by the tenant, and the shortfall can be substantial.

If the landlord will not agree to flexibility with a shorter term and more renewal options, consider negotiating for an early termination right. If exercised, the landlord will likely insist that the tenant pay back the landlord's unamortized transaction costs, but, even with those costs (which should be in liquidated amount included in the lease itself so the tenant can successfully engage in a cost-benefit analysis), this could be a smarter option than keeping a contractual obligation the tenant no longer needs.

Expansion and Contraction Options

You should also suggest that the tenant consider expansion options. These typically take the form of a right of first refusal (ROFR) or right of first offer (ROFO). Whether the landlord will offer any expansion right to the tenant is dependent on bargaining power, primarily tied to the size of space the tenant initially takes. There is only upside to the tenant to having these rights. There is no detriment to having them and then not exercising them.

Less commonly, the tenant receives an option to give back a portion of the space upon a date in the future or the occurrence of certain events. This is not something a landlord will often agree to, because it basically presupposes a downturn in the tenant's business and space needs. That said, if there is a fact pattern to draw from (e.g., a government contract expiring), then this is worth exploring.

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