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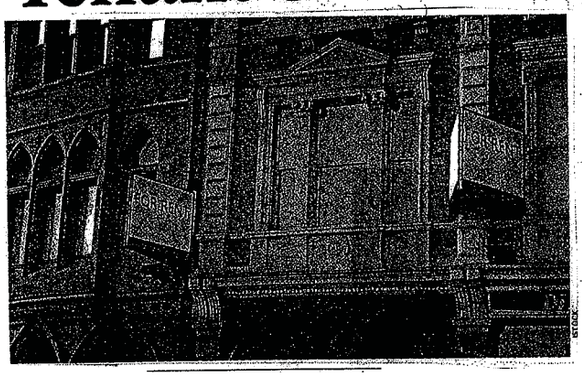
LANDLORD/TENANT LAW

No Surreptitious Sublet When Tenant Surrenders Lease



A subtenant concerned about protecting its right of continued occupancy in the event the tenant/sublessor surrenders its lease, needs to interact with the over-landlord before taking occupancy.

Leased premises frequently present a jigsaw-puzzle-like array of parties—over-landlord, tenant, subtenant—all claiming rights. A recent decision by Civil Court, New York County Judge Arlene P. Bluth in *Johns v. AMC Beauty Salon*[1] addresses issues that can arise when a tenant surrenders to its landlord possession of its leased premises, and a subtenant claims rights.

In or about August 2006, Sol Goldman Investments, LLC, (the Over-landlord) entered into a lease with AMC Beauty Salon (the Tenant) for the basement, ground floor and second floor at 465 Lexington Ave. in Manhattan. On or about Jan. 1, 2010, the tenant sublet the front part of the second floor to Angelo Johns (the Subtenant), for use as a "psychic." On June 2, 2010, the tenant surrendered possession of the entire premises back to the Over-landlord. In a writing accompanying the return of the keys, the tenant specifically represented that "There are no occupants in the premises as of today."

The Subtenant claimed that he was on vacation on June 2, 2010 and when he returned he discovered that the premises was locked up and a "for rent" sign was posted. He sued to be restored to possession of that portion of the commercial premises he had sublet. In a decision and order after hearing, the court denied the Subtenant's petition and granted judgment for the Over-landlord.

The court summarized the relevant testimony from the hearing. An employee of the Over-landlord testified that she had done a walk-through of the premises on the day of the surrender and "saw no indication that a sublet had occurred or that a psychic had opened in the premises." All she saw were salon-related items, i.e., items related to the tenant's business.

The Subtenant testified that the Over-landlord never gave its required approval of the sublease, that he never paid rent to the Over-landlord, and that he never spoke to anyone in the Over-landlord's office about anything. The court noted that the Subtenant did not even know the Over-landlord's name, and had mis-stated it in the caption of the case because he had taken the name from the handwritten naming of the Over-landlord on the sublease, which was not clear.

The court found various parts of the Subtenant' case not credible or not substantiated. He claimed that he spoke to a worker in the building and occasionally tipped him to keep the floor clean. However, he did not produce or subpoena that the Over-landlord's worker he claimed knew that he was operating in the premises as a psychic. He claimed that the Over-landlord knew he was there because of an illuminated sign but, according to the court, "produced no proof thereof." He claimed the Over-landlord would have known of his presence because of the foot traffic to his business, but then stated that he saw only three or four customers a day and sometimes none. The court concluded that two women who worked in the salon and who the Subtenant had produced as witnesses did not support his claim of being a continuous daily presence.

The court summarized as follows its conclusion from the evidence as to the nature of the Subtenant's occupancy:

> ...[W]hile this Court believes that the Subtenant [Subtenant] may have had an unapproved sub-lease with [the tenant], he did not work regularly during the day from those premises. ...[I]f the Subtenant was there for five months, then he worked primarily at night, when he could turn on an illuminated sign, when the salon employees would not see him, and, more importantly, when the Over-landlord and its on-site employees would not see him either.[2]

As to what the Over-landlord knew or should have known, the court concluded as follows from the evidence:

> ...[Over-landlord] had no idea that [the Tenant] had sublet a portion of the space, and even after doing a walk-through upon vacatur, nothing visible at the premises indicated to [Over-landlord] that anyone other than [the Tenant] occupied the space. Finally, this Court finds that [Over-landlord] had no reason to have any knowledge of the subtenancy because it was purposely hidden from it.[3]

subleased to the plaintiff/sublessee a portion of the leased premises. In consideration of $300 received from the landlord, the tenant cancelled his lease, waived notice to quit and agreed to vacate. Claiming the right of possession under that surrender, the landlord commenced summary proceedings against, inter alia, the sublessee, obtained a warrant and removed the sublessee's property, including tearing down a building the sublessee had constructed on the property. Those proceedings were thereafter reversed and the subtenant sued for damages. The Court of Appeals affirmed a judgment in favor of the subtenant.

The Court of Appeals stated that, by the sublease, the subtenant had acquired a valid term and a right to possession of the subleased premises for the agreed upon term "subject, only, to be defeated by the expiration of the term of [the Tenant], or a re-entry by the owner of the fee, and supreme landlord, for some condition of the demise broken." The court stated that neither of those circumstances had occurred. The Court of Appeals enunciated the voluntary surrender doctrine as follows:

> The defendants [landlord] claimed the right of possession and to dispossess the plaintiff [subtenant] under a surrender of the term by the original lessee, without the knowledge or assent of the plaintiff [subtenant]. The surrender, and the consequent merger of the greater and lesser interests terminated the original lease, and the term created thereby, as between the parties to the lease and the surrender. ...But it was not competent for the lessor and lessee to affect the rights of third parties by a formal surrender of the lease. The interests and the terms of the subtenant of the lessee continued as if no surrender had been made. The defendants, the surrenderees and owners in fee, became the immediate landlords

> of the plaintiff [subtenant], with only such rights as his lessor would have had to the possession of the premises before the expiration of the term.[6]

Another case cited by the Civil Court in *Johns* in regard to the voluntary surrender doctrine is *Duane Reade v. I.G. Second Generation Partners, L.P.*,[7] a 2001 Appellate Division, First Department decision. Demonstrating how established the voluntary surrender doctrine has become in the more than a century since *Eten*, the court in *Duane Reade* referred to:

> "...the *undisputed principle* that a sublessor's voluntary surrender of the main lease does not impair the sublessee's rights but transforms the sublessee into the landlord's immediate tenant" [emphasis added].[8]

In *Duane Reade*, the Appellate Division did not find the voluntary surrender doctrine to be applicable because it concluded that "Duane Reade never became a sublessee but remained merely a potential sublessee whose interest in the premises was expressly conditioned upon consent by the landlord." The unambiguous terms of the agreement between the lessee and Duane Reade recognized that the landlord's consent was a condition precedent to creation of sublessee rights in *Duane Reade*, and that consent was denied. Since Duane Reade was not a sublessee at any time, when the landlord and the tenant negotiated the surrender of the lease, there was no relation between the landlord and Duane Reade created by such surrender.

As in *Duane Reade*, so, too, the court in *Johns* referred to the voluntary surrender doctrine but found it inapplicable given the facts of the case. Judge Bluth stated that in cases applying this doctrine, "the landlord has known about the subtenancy and consented, either expressly or by a course of conduct to the sublease." That was not the situation in *Johns*, where, as the court pointed out, quite to the contrary, the Over-landlord "never consented to the sublease, never knew that a sublease was executed, and never even knew anyone but [the Tenant] was in the premises operating a salon-spa."

The court also noted that the Tenant "only had the authority to sublet with the consent of [Over-landlord], its landlord." Citing *Millicom Inc. v. Breed, Abbott & Morgan*,[9] the court stated that, given that restriction in the Tenant's lease, "the sublease is unenforceable without the consent of the landlord."[10]

In *Johns*, the court pointed out that the purpose of the voluntary surrender doctrine is to prevent landlord and prime tenant from "colluding to deprive an *innocent* subtenant from the benefit of his bargain" [emphasis added]. It is clear that the Civil Court viewed the Subtenant as anything but "innocent." That is evident from the court's description of his course of conduct:

> Here, by failing to get [the Over-landlord's] approval, and by purposely avoiding detection by [the Over-landlord], the petitioner/subtenant took a calculated risk; if the landlord were to evict the Over-Tenant, the subtenant would not be named in the proceeding (other than as a 'Doe' respondent) and if the Over-Tenant voluntarily surrendered the space, the petitioner would have no right to stay.[11]

That is also evident from the court's reiterating that the Over-landlord had done nothing wrong:

> Petitioner [the Subtenant], having decided to surreptitiously sublet part of the premises, cannot now complain that [the Over-landlord] did anything improper by accepting the surrender, free and clear of all occupants, from [the Tenant], the only entity it knew to be on the premises. To rule otherwise would reward an illegal subtenant for staying under the landlord's radar and give rights where none ever existed.[12]

Accordingly, the Civil Court dismissed Mr. Johns' petition and granted judgment for the Over-landlord. The following are additional points to consider in reviewing the reasoning of the *Johns* case:

In setting forth its findings of fact, the court in *Johns* stated that:

> ...[T]he court credits Ms. Singh's testimony [the testimony of the Over-landlord's employee who was responsible for collecting the rent for the building] that when [the Tenant] voluntarily surrendered possession, it was in violation of its lease due to non-payment and faced trouble with the authorities for operating an illegal bottle club (or allowing an illegal bottle club to be operated in the premises).[13]

Leases generally have clauses requiring the tenant's compliance with law. Thus, it is likely that the Tenant's bottle law problem, like its rent non-payment, may have constituted a violation of its lease.

As the court's statement in *Johns* of the voluntary surrender doctrine demonstrates, the doctrine applies to the surrender of a prime lease by a "non-defaulting" prime tenant. In determining that the voluntary surrender doctrine was not applicable, the court in *Johns* did not in any way base that finding on a determination that the prime tenant's surrender was not voluntary because of the matters of the allegedly illegal bottle club and non-payment of rent.

Presumably, that is because any such lease violations were not breaches of a conditional limitation immediately terminating the lease. Rather, they were likely alleged breaches of lease covenants and the Over-landlord had not taken any steps to enforce any right of termination for such alleged breaches, let alone obtained a warrant based upon an exercise of a right of termination and a finding of a breach. Accordingly, the surrender could still be considered voluntary and not "re-entry...for some condition of the demise broken" as referred to in *Eten*.

Non-Disturbance Agreement

Although beyond the scope of this article, it should be noted that a subtenant concerned about protecting its rights in the event of the tenant's default under, or surrender of, the prime lease will often try to obtain from the over-landlord a non-disturbance agreement. Such an agreement "provides generally that if the prime lease ends before its specified expiration, except possibly as a result of condemnation, fire or other catastrophe, the prime landlord shall waive his right to cut off the sublease and that the sublease shall continue as if the prime landlord, as lessor, and the subtenant, as lessee, had entered into a lease for the unexpired term of the sublease, on the same terms, covenants, etc., including rights of renewal, as those of the sublease."[14] Of course, since a non-disturbance agreement is an agreement between the prime landlord and a subtenant, where, as the court found to be the case in *Johns*, a subtenant hides its occupancy from the prime landlord, a non-disturbance agreement is not a pragmatic possibility.

Conclusion

In short, as reading the *Johns* case demonstrates, a subtenant concerned about protecting its right of continued occupancy in the event the tenant/sublessor surrenders its lease, needs to interact with the over-landlord before taking occupancy. There may be reasons the prospective subtenant does not want to take such steps. As with so much in real estate, that determination involves an always uncertain calculus of risk and reward.

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1. 29 Misc.3d 342, 905 N.Y.S.2d 501 (Civ. Ct. N.Y. Co. 2010), NYLJ, Aug. 4, 2010, at p. 26 col. 5.
2. 29 Misc.3d at 345, 905 N.Y.S.2d at 503-504.
3. 29 Misc.3d at 346, 905 N.Y.S.2d at 504
4. Id.
5. 60 N.Y. 252 (1875).
6. 60 N.Y. at 259.
7. 280 A.D.2d 410, 721 N.Y.S.2d 42 (1st Dept. 2001).
8. 280 A.D.2d at 411, 721 N.Y.S.2d at 43.
9. 160 A.D.2d 496, 554 N.Y.S.2d 160 (1st Dept. 1990).
10. But see *Ocean Grille Inc. v. Peli*, 226 A.D.2d 603, 641 N.Y.S.2d 373 (2d Dept. 1996), where the court stated: "Alternatively, Peli [the prime landlord] argues, the sublease was void because it violated the provision of the paramount lease which required his written consent to a sublease. However, the provision at issue merely rendered the sublease voidable, not void... Thus, Ocean Grille [the subtenant] possessed a valid sublease as against Peli during all relevant periods." 226 A.D.2d at 605, 641 N.Y.S.2d at 375. In *Ocean Grille*, unlike *Johns*, the prime landlord knew of the subtenant, even though he never gave his written consent to the sublease.
11. 29 Misc.2d at 347, 905 N.Y.S.2d at 505.
12. Id.
13. 9 Misc.2d at 345-346, 905 N.Y.S.2d at 504.
14. 1 Friedman on Leases §7.7.5 at 7-144 (5th ed. 2009). According to the authors of the treatise, the "reason for excluding a serious fire or condemnation is an assumption that in these events the prime landlord may prefer to call everything off."