

## Whose Space is it Anyway?: Top Issues in Subleasing in a Post-Pandemic World

*Presentation to RPLS - California Lawyers Association – Annual Retreat*

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Introduction: With the current glut of subleased space on the market, negotiations among sublandlords and subtenants are at a fever pitch. In addition, landlords are taking an increasingly active role in subleases through the master landlord consent. This presentation will focus on the goals of all parties to the sublease transaction and suggest useful solutions to the challenges facing completion of the transaction.

### Outline:

#### **I. Introduction: Timing/Complexity [Jo Ann]**

- NB: difference between assignment & sublease
- Permitted Transfers [No landlord consent required] [*sample language #7*]

#### **II. Top Issues**

##### (1) Risks of Subtenancy [Laura]

- Loss of tenancy due to Sublandlord default/bankruptcy
- No privity with master landlord (so have to go through sublandlord for everything)
- Other issues if it is a sub-sublease
- Transaction costs/length of time to review
- Experience of counsel involved in negotiating sublease

##### (2) Due diligence/Sublease Negotiations [Catherine]

- Parties (both subtenant and sublandlord)
- Condition of premises
  - Industry sector: retail, office, industrial, life science
  - Is there any pre-delivery sublandlord work required? E.g., do the premises have to be demised?
  - Is any FF&E included?
    - If yes, will FF&E transfer to subtenant or remain with sublandlord
  - Security system/internet
- Permitted Use
  - Is proposed use consistent with use set forth in master lease?
- Historical records of OpEx
  - Prop C (in San Francisco)[Subtenant usually pays] – double taxation [Laura]
- Disparate base year
- Are the subleased premises ALL of master premises or a portion
- Holdover [consequences for Subtenant holdover]
- Subtenant not in privity with master landlord (consequences for both subtenant and sublandlord)
- Sublandlord needs to understand they are now in the landlord business

- Sublease term/surrender obligations
    - Subtenant should not have master tenant surrender obligations
    - Sublease term should end before master lease term (even if only 1 day)
      - Sublandlord to determine its time for de-commissioning of premises and sublease term should terminate so that Sublandlord has time to perform its surrender work
      - Subtenant to determine time for its de-commissioning of premises on surrender
- (3) Review of Master Lease [Jo Ann]
- Incorporation [*sample language #13*]
  - Exclusion
    - Is the sublease for all or just a portion of the premises?
    - Sublandlord v. landlord obligations
  - Are any modifications of the master lease necessary
    - Pre-approval of alterations
    - Pre-approval of signage
    - Any new rights
- (4) Subtenant's Negotiation points [Laura]
- Loss of tenancy risks
  - Non-disturbance/Attornment
  - Cure periods; Subtenant cure rights of Tenant defaults [*sample language #1*]
  - Sublandlord obligations to perform its obligations under the master lease [*sample language #11*]
  - Sublandlord agreeing not to terminate master lease or amend in a way that adversely affects Subtenant's rights to subleased premises [*sample language #12*]
  - Sublandlord indemnification – losses incurred by subtenant for sublandlord's default under the master lease [*sample language #2*]
    - Service interruption – if rent abates under master lease, rent should abate under sublease - In such circumstances, Sublandlord shall use commercially reasonable efforts to promptly obtain all available abatement under the Master Lease. [*sample language - #4*]
    - Sublandlord will exercise audit right at Subtenant's request [*sample language - #5*]
- (5) Master landlord consent [Jo Ann]
- Reasonableness
    - California Civil Code Section 1951.4
    - Longs Drug Stores Cal. v. DS Westgate, 2022 Cal. App. Unpub. LEXIS 529, 2022 WL 260641
  - Process for obtaining sublease consent [*sample language - #6*]
  - Is there sublease profit & how is it calculated [*sample language #15*]
  - Non-disturbance
  - Additional time following termination of master lease for subtenant to vacate [*sample language - #14; probably appears in master landlord consent*]
  - Process & Time period for landlord to respond to request for consent [*sample language - #6*]
  - Is there a deemed consent provision in the master lease? [*sample language - #10*]

- Make sure Sublandlord has provided all necessary information regarding subtenant
- Does Landlord have a recapture right? [*sample language - #9*]
  - Is lender consent required?

### **III. CONCLUDING THOUGHTS**

**SAMPLE LANGUAGE:**

**1) SUBTENANT CURE RIGHTS OF TENANT DEFAULTS**

In the event that Sublandlord receives a notice of default from Master Landlord under the Master Lease, Sublandlord shall promptly deliver a true and correct copy of the same to Subtenant. If Sublandlord is unable or unwilling to so cure such default, Sublandlord shall deliver such notice to Subtenant, who shall have the right, but not the obligation, to so cure such default and offset any related costs under this Sublease; provided, however, that any such actions to cure shall comply in all respects with the terms and obligations of Sublandlord as tenant under the Master Lease.

**2) SUBLANDLORD INDEMNIFICATION – LOSSES INCURRED BY SUBTENANT FOR SUBLANDLORD’S DEFAULT UNDER THE MASTER LEASE:**

; provided further, that if the Master Lease terminates as a result of a default or breach by Sublandlord under this Sublease and/or the Master Lease, then Sublandlord shall indemnify and hold Subtenant harmless from any claims arising in connection with such default or breach, and shall be liable to Subtenant for all actual, direct damages suffered by Subtenant as a result of such termination.

OR

If the Master Lease is terminated due to a default by Sublandlord thereunder and as a result of such default Landlord elects to terminate the Master Lease, then so long as Subtenant is not in default of its obligations under this Sublease, *Sublandlord shall be liable to Subtenant (and shall reimburse Subtenant for) all reasonable costs and expenses incurred by Subtenant to relocate from the Subleased Premises to a new location.*

**3) SUBLANDLORD’S OBLIGATION TO OBTAIN MASTER LANDLORD’S CONSENT:**

Sublandlord shall use commercially reasonable efforts to obtain the Master Landlord’s consent as soon as reasonably possible following the execution of this Sublease by Sublandlord and Subtenant. It shall be a condition precedent to the effectiveness of this Sublease and each of Subtenant’s and Sublandlord’s obligations hereunder that: (i) Sublandlord has obtained the written consent of Landlord, and (ii) Landlord has executed the Consent Agreement substantially in the form of Exhibit E attached hereto, which Consent Agreement shall include, among other things, Landlord’s agreement: (x) *to recognize the rights of Subtenant to occupy the Premises on the terms of the Sublease notwithstanding any default by Sublandlord as tenant under the Master Lease or any termination of the Master Lease as a result of Sublandlord’s default thereunder*, and (y) the modifications to the insurance provisions of the Master Lease set forth herein. Sublandlord shall provide prompt written confirmation of receipt of Master Landlord’s consent. Sublandlord shall be responsible, at Sublandlord’s sole cost and expense, for all costs associated with obtaining Master Landlord’s consent to this Sublease.

**4) ABATEMENT OF RENT:**

If Sublandlord receives an abatement of rent payable under the Master Lease for any reason (e.g., casualty or pursuant to Section \_\_\_ of the Master Lease) which affects the Premises, then Subtenant shall receive a corresponding abatement, which share shall be calculated in the same manner as the abated rent was calculated under the Master Lease. In such circumstances, Sublandlord shall use commercially reasonable efforts to promptly obtain all available abatement under the Master Lease.

**5) SUBTENANT AUDIT RIGHT:**

Audit Rights. Upon written request from Subtenant, Sublandlord shall exercise the right to audit Landlord’s books and records with respect to Operating Expenses and Taxes for Subtenant’s benefit, provided Subtenant shall be responsible for the reasonable costs of such audit.

or

Audit. Following Sublandlord’s delivery to Subtenant of a copy of Landlord’s statement of Operating Expenses and Taxes together with Sublandlord’s calculation of Subtenant’s Share of Operating Expenses and Taxes (the “**Annual Operating Expense Statement**”), if Subtenant reasonably disputes any amount set forth in the Master Landlord’s statement upon

which Sublandlord's Annual Operating Expense Statement is based, and provided that: (A) Sublandlord has not previously exercised its right under the Master Lease to inspect Master Landlord's books and records with respect to Master Landlord's statement (and such right is otherwise available under the Master Lease); and (B) Subtenant notifies Sublandlord, within thirty (30) days following Sublandlord's delivery of Sublandlord's Annual Operating Expense Statement to Subtenant (and in any event prior to the date that an inspection is permitted under **Section \_\_\_\_** of the Master Lease), of Subtenant's desire to cause Sublandlord to exercise such inspection right, then Sublandlord will notify Master Landlord pursuant to the provisions of **Section \_\_\_\_** of the Master Lease that Sublandlord desires to cause Landlord's records with respect to the Annual Operating Expense Statement to be inspected (with respect to such disputed amounts only). The independent, certified public accounting firm for such inspection shall be designated by Subtenant (and approved by Sublandlord) and shall meet the requirements of **Section \_\_\_\_** of the Master Lease. Sublandlord will promptly provide Subtenant with any report prepared by such accounting firm. All costs associated with any such inspection (including any cost or charges imposed by Master Landlord) shall be solely borne by Subtenant as Additional Rent hereunder unless as the result of such audit, either: (x) Sublandlord is reimbursed for such costs by Master Landlord pursuant to **Section \_\_\_\_** of the Master Lease, or (y) Sublandlord also receives the benefit under the Master Lease of any cost savings revealed by such audit, in which case Sublandlord shall share equally in the cost of such audit (provided that in no event shall Sublandlord be required to pay any costs of such audit to the extent not reimbursed or otherwise benefitted from as provided in (x) and (y) above). If, on the basis of any such inspection or on the basis of an inspection initiated solely by Sublandlord, Sublandlord receives a credit of Operating Expenses and Taxes previously paid by Sublandlord to Master Landlord that is attributable to an overpayment by Sublandlord of Operating Expenses and Taxes, then any such credit shall be applied (i) first, to Sublandlord, to the extent of any costs associated with such inspection that have been incurred by Sublandlord and that have not to date been reimbursed to Sublandlord by Subtenant, (ii) second, to Subtenant, to the extent of the costs incurred with respect to such inspection that Subtenant has previously paid (either directly or by reimbursing Sublandlord) and (iii) third, as between Sublandlord and Subtenant as may be equitably necessary to adjust for any overpayment of Operating Expenses and Taxes by either Sublandlord or Subtenant, in any case after deducting costs due to Sublandlord under this **Section \_\_\_\_** (including, if pursuant to an inspection initiated solely by Sublandlord, the costs thereof shall be deducted from any amount that would otherwise be applied for the benefit of Subtenant). For avoidance of doubt, if, as of the date that Subtenant notifies Sublandlord of Subtenant's desire to require Sublandlord to review Master Landlord's books and records, Sublandlord has already notified Landlord of Sublandlord's exercise of the inspection right described in **Section \_\_\_\_** of the Master Lease, then Subtenant shall have no independent right to require any such inspection of Master Landlord's books and records, but Sublandlord agrees to: (A) promptly provide Subtenant with any report prepared by Sublandlord's accounting firm or accountant and, (B) equitably allocate to Subtenant any credit of Operating Expenses and Taxes attributable to an overpayment by Sublandlord of Operating Expenses and Taxes to the next payments of Rent and Operating Expenses and Taxes coming due, following Sublandlord's recovery of all costs associated with such inspection, as may then be equitable given any corresponding overpayment of Operating Expenses and Taxes by Subtenant and in such event, Subtenant shall have no obligation to reimburse Sublandlord for the costs of the inspection initiated solely by Sublandlord. If Sublandlord receives a credit of Operating Expenses and Taxes at any time that relates to the Premises during the Term, whether pursuant to an inspection conducted pursuant to **Section \_\_\_\_** of the Master Lease or otherwise, Subtenant shall be entitled to its proportionate share of such credit (subject to this **Section \_\_\_\_**).

**6) A. MASTER LEASE REQUIREMENTS FOR OBTAINING CONSENT TO SUBLEASE:**

If Tenant desires Landlord's consent to any Transfer, Tenant shall notify Landlord in writing, which notice (the "**Transfer Notice**") shall include (i) the proposed effective date of the Transfer, which shall not be less than thirty (30) days nor more than one hundred eighty (180) days after the date of delivery of the Transfer Notice, (ii) a description of the portion of the Premises to be transferred (the "**Subject Space**"), (iii) all of the terms of the proposed Transfer and the consideration therefor, including calculation of the Transfer Profit, in connection with such Transfer, the name and address of the proposed Transferee, and a copy of all existing executed and/or proposed documentation pertaining to the proposed Transfer, including all existing operative documents to be executed to evidence such Transfer or the agreements incidental or related to such Transfer, provided that Landlord shall have the right to require Tenant to utilize Landlord's standard Transfer documents in connection with the documentation of such Transfer, and (iv) current financial statements of the proposed Transferee certified by an officer, partner or owner thereof, business credit and personal references and history of the proposed Transferee and any other information reasonably required by Landlord which will enable Landlord to determine the financial responsibility, character, and reputation of the proposed Transferee, nature of such Transferee's business and proposed use of the Subject Space.

**B. TIME FOR LANDLORD TO RESPOND**

Landlord shall respond to Tenant's request to assign the Lease or sublet the Premises within 30 days following receipt of such request accompanied by all documents required by Landlord as set forth in Section \_\_\_.

7) **PERMITTED TRANSFER:**

Notwithstanding anything to the contrary contained in this Lease, (A) an assignment or subletting of all or a portion of the Premises to an affiliate of Tenant (an entity which is Controlled by, Controls, or is under common Control with, Tenant as of the date of this Lease), (B) an assignment of the Lease to an entity which acquires all or substantially all of the stock or assets of Tenant, or (C) an assignment of the Lease to an entity which is the resulting entity of a merger or consolidation of Tenant during the Lease Term, shall not be deemed a Transfer requiring Landlord's consent under this Section (any such assignee or sublessee described in items (A) through (C) of this Section hereinafter referred to as a "Permitted Transferee" and any such assignment or sublease, a "Permitted Transfer"), provided that (i) Tenant notifies Landlord at least ten (10) days prior to the effective date of any such assignment or sublease (provided, however, that if Tenant is prohibited by Law from providing such information to Landlord prior to the occurrence of such Permitted Transfer, Tenant shall provide such notice to Landlord promptly following the occurrence of same) and promptly supplies Landlord with any documents or information reasonably requested by Landlord regarding such Permitted Transfer or Permitted Transferee as set forth above, (ii) such assignment or sublease is not a subterfuge by Tenant to avoid its obligations under this Lease, (iii) such Permitted Transferee shall be of a character and reputation consistent with the quality of the Building, (iv) other than an assignee or sublessee described in item (A) of this Section, such Permitted Transferee shall have a tangible net worth (not including goodwill as an asset) computed in accordance with generally accepted accounting principles ("Net Worth") at least equal to \$500,000, (v) no assignment or sublease relating to this Lease, whether with or without Landlord's consent, shall relieve Tenant from any liability under this Lease, and (vi) the liability of such Permitted Transferee under either an assignment or sublease shall be joint and several with Tenant. An assignee of Tenant's entire interest in this Lease who qualifies as a Permitted Transferee may also be referred to herein as a "Permitted Transferee Assignee." "Control," as used in this Section, shall mean the ownership, directly or indirectly, of more than fifty percent (50%) of the voting securities of, or possession of the right to vote, in the ordinary direction of its affairs, of more than fifty percent (50%) of the voting interest in, any person or entity.

8) **LIMITATION OF TENANT REMEDIES FOR DENYING CONSENT**

Notwithstanding anything to the contrary in this Lease, if Tenant or any proposed Transferee claims that Landlord has unreasonably withheld or delayed its consent or otherwise has breached or acted unreasonably, their sole remedies shall be a declaratory judgment and an injunction for the relief sought without any monetary damages, and Tenant hereby waives all other remedies, including, without limitation, any right at law or equity to terminate this Lease, on its own behalf and, to the extent permitted under all applicable Laws, on behalf of the proposed Transferee.

9) **LANDLORD RECAPTURE RIGHT:**

Landlord may, within 30 days after submission of Tenant's written request for Landlord's consent to an assignment or subletting, cancel this Lease as to the portion of the Premises proposed to be sublet or assigned as of the date the proposed Transfer is to be effective. If Landlord cancels this Lease as to any portion of the Premises, then this Lease shall cease for such portion of the Premises, Tenant shall pay to Landlord all Rent accrued through the cancellation date relating to the portion of the Premises covered by the proposed Transfer, and Rent shall be reduced proportionately based on the remaining square footage in the Premises. Thereafter, Landlord may lease such portion of the Premises to the prospective transferee (or to any other person) without liability to Tenant.

10) **DEEMED CONSENT:**

If Landlord fails to timely deliver to Tenant notice of Landlord's consent, or the withholding of consent, to a proposed Transfer, Tenant may send a 2nd notice to Landlord, which notice must contain the following inscription, in bold faced lettering: "SECOND NOTICE DELIVERED PURSUANT TO ARTICLE \_\_ OF LEASE - - FAILURE TO TIMELY RESPOND WITHIN 5 BUSINESS DAYS SHALL RESULT IN DEEMED APPROVAL OF ASSIGNMENT OR SUBLEASE." If Landlord fails to deliver notice of Landlord's consent to, or the withholding of Landlord's consent, to the proposed assignment or sublease within 5 business days following receipt of such second notice, then Landlord shall be deemed to have approved the assignment or sublease in question.

**11) SUBLANDLORD OBLIGATIONS TO PERFORM ITS OBLIGATIONS UNDER THE MASTER LEASE**

... the parties contemplate that Landlord will, in fact, perform its obligations under the Lease and in the event of any default or failure of such performance by Landlord, Sublandlord agrees that it will, upon request from Subtenant, make demand upon Landlord to perform its obligations under the Lease and to take such other commercially reasonable efforts to compel such performance on behalf of Subtenant. Sublandlord, however, shall have no obligation to take other legal action against the Landlord on Subtenant’s behalf (unless Subtenant agrees to pay all costs and expenses of Sublandlord reasonably incurred in connection therewith and to indemnify, defend and hold Sublandlord harmless from and against all liabilities, claims, expenses, losses and damages arising from such action).

or

Upon receipt of written complaint from Subtenant, Sublandlord shall make demand upon Master Landlord to take all appropriate action for the correction of any defect, inadequacy or insufficiency in Master Landlord's provision of Landlord's Services.

**12) SUBLANDLORD AGREEING NOT TO TERMINATE MASTER LEASE OR ADVERSELY AFFECT SUBTENANT’S TENANCY ...**

Sublandlord agrees that it will not terminate the Master Lease or modify or further amend the Master Lease in any manner without the prior written consent of Subtenant and any such modification or amendment without consent shall be void and of no force or effect as between Sublandlord and Subtenant.

or

Sublandlord agrees that it will not voluntarily terminate the Lease prior to the Expiration Date without the prior written consent of Subtenant, nor will Sublandlord agree to any amendment of the Lease which would affect Subtenant’s ability to use the Premises or change the amounts payable by Subtenant hereunder or otherwise increase Subtenant’s obligations hereunder or diminish Subtenant’s rights hereunder without the prior written consent of Subtenant, in its sole discretion.

**13) MASTER LEASE PROVISIONS – INCORPORATION/EXCLUSION**

The following provisions of the Master Lease shall not apply to this Sublease:

Basic Lease Provisions (other than Permitted Use and Project), Section \_\_\_ (Delivery; Acceptance of Premises; Commencement Date), Section \_\_\_ (Base Rent), Section \_\_\_ (Tenant Audit Right), Section \_\_\_ (Security Deposit), Section \_\_\_ (Holding Over), Section \_\_\_ (Brokers).

References in the following provisions of the Master Lease, as incorporated into this Sublease, to “Landlord” shall mean “Landlord” only:

Section \_\_\_ (Utilities; Services), Section \_\_\_ (Landlord’s Maintenance Obligations), Section \_\_\_ (Landlord’s Insurance), Section \_\_\_ (Damage & Destruction), Section \_\_\_ (Condemnation), Section \_\_\_ (Rules and Regulations), \_\_\_ (Limitation of Liability), and Exhibit \_\_\_ (Rules and Regulations).

**14) MASTER LANDLORD CONSENT – TIME TO VACATE**

In the event Tenant defaults (beyond applicable notice and cure periods) in the performance of its obligations to Landlord under the Master Lease (whether or not Landlord terminates the Master Lease), then Landlord may, at its option, by notice to Tenant, either (i) *terminate the Sublease upon no less than 30 days’ prior written notice*, (ii) elect to receive and collect, directly from Subtenant, all rent and any other sums owing and to be owed under the Sublease, as further set forth in Section 4.1, below, or (iii) elect to succeed to Tenant’s interest in the Sublease as sublandlord and cause Subtenant to attorn to Landlord, as further set forth in Section \_\_\_ below.

**15) SUBLEASE PROFIT:**

If Landlord consents to a Transfer, as a condition thereto which the parties hereby agree is reasonable, Tenant shall pay to Landlord fifty percent (50%) of any Transfer Profit as that term is defined in this Section, received by Tenant from such Transferee. "**Transfer Profit**" shall mean all rent, additional rent or other consideration payable by such Transferee in connection with the Transfer in excess of the Rent and Additional Rent payable by Tenant under this Lease during the term of the Transfer on a per rentable square foot basis if less than all of the Premises is transferred, after deducting the reasonable expenses incurred by Tenant for (i) any changes, alterations and improvements to the Premises in connection with the Transfer, (ii) any free base rent or other economic concessions reasonably provided to the Transferee, and (iii) any brokerage commissions and reasonable attorneys' fees in connection with the Transfer.



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