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PUBLICATION

Getting Full Value For Your Business: Make Sure Your Lease Can't Get in the Way

Date: June 03, 2013
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Original Newsletter(s) this article was published in: Blaneys on Business: June 2013

You own a business. You operate from rented premises. You work hard, take the risks, take the lumps, and have a successful enterprise. One day, for whatever reason, you may want to sell. Are you going to realize full value?

Maybe not. You may find that your lease stands in the way. If it does, now is the time to ensure that it will contain a reasonable balance between your interests and your landlord's so that you can realize full value if and when the time comes to sell your business.

This is especially important when a meaningful portion of the goodwill that your business is developing depends on its specific location or where it has multiple establishments or high relocation costs.

As a business owner, you strive to build value by ensuring that all of the factors that contribute to success are in place. Location is often vital to this success. Oftentimes, customers appreciate the convenience of a location or simply become used to obtaining products or services at it.

When combined with the other factors that generate the goodwill associated with your business, location has much to do with the inherent value of the business. Likewise, with multiple establishments or high relocation costs, a specific location, once selected, can be significant.

So, if you are unable to ensure that you can transfer your business' premises to a new owner when you sell, you may find yourself unable to realize upon your years of hard work building the business.

Almost every commercial lease contains restrictions on assigning, subletting or otherwise transferring the leased premises to another party. These restrictions are necessary and reasonable from a landlord's perspective. Your landlord obviously has a right to ensure that any

successor of your business, or of your lease, has a reasonable chance of being able to continue to pay the rent.

Such restrictions often go far beyond simply obtaining the reasonable consent of the landlord, however, and may, in rare cases, allow for that consent to be withheld arbitrarily. These additional restrictions are what can cause impediments to the sale of a business and deprive you of the full value that you have earned.

A determination of what is, and what is not, a reasonable basis for a landlord to withhold consent to the assignment, subletting or transfer of a lease may often be dealt with specifically by the terms of the lease, but can also be a subject of dispute, delay and uncertainty. While the onus may lie with the landlord to prove it is being reasonable, by the time any final determination is made, the deal in question may be long gone.

Furthermore, commercial leases contain provisions which provide that when the tenant is a corporation, any change to the ownership of the shares of the tenant or to the farther-reaching "effective voting control" constitutes a transfer to which the assignment and subletting provisions, including obtaining the landlord's consent, will apply.

These restrictions, again, are, reasonable in concept from the perspective of the landlord, so as not to have tenants circumvent landlord control of the premises. However, a review of the specific provisions is required before the lease is entered into to ensure that landlord-control provisions are not unreasonable.

Any failure to negotiate reasonable assignment, subletting and change of control provisions in a lease before a business' value increases as a result of its premises can lead to difficulty in obtaining the benefit of these rights later on.

Some landlords also require that any portion of any payment allocated to the leased premises be paid over to it as part of the terms of its consent. This can lead to differences of opinion as to what, if any, portion of the purchase price of a business is allocated to leased premises. Landlords are sometimes entitled to increase the rent which, in the case of a sublet, a tenant might otherwise be able to realize.

A final remedy that may be available to a landlord in the event of a request for assignment or subletting is the right to terminate the lease. For those businesses with customers for which the location is convenient or established, the risk of having a landlord use these additional rights to obtain additional compensation arising out of the transaction is unacceptable.

Landlords and tenants must, from the outset, find a balance of their respective interests in order to ensure that difficulties don't arise in the context of a contemplated transaction by the tenant at some point in the future.

Landlords need the ability to control the premises, ensure all rents are paid and generally realize the value of the real property which it owns.

Tenants, on the other hand, need the ability to ensure the transferability of their business without overly onerous restrictions. In the event that a business owner has complete control of its premises, such an owner would be in a position to negotiate freely any transfer or further leasing of the business premises as it negotiated the sale of the business.

Unless care is taken to ensure that an appropriate landlord-tenant balance is negotiated at the time that the lease is entered, a business owner may be giving control of the business' premises to the landlord beyond what is in the tenant's best interest and what is reasonably required.

Commercial leases tend to be viewed as long and onerous documents which, when signed, need not be looked at again so long as the tenant pays the rent and is able to operate from the premises. Such leases, however, contain significant provisions that become applicable in many specific circumstances, which are often unlikely to occur.

In such circumstances where such provisions do become relevant, however, it is imperative that a party's rights have been clearly protected from the onset to the greatest extent possible. The time and effort spent now ensuring that satisfactory leasing arrangements are entered into can be more than justified by potential savings, should one of those circumstances arise.

While landlords are reluctant to accept modifications to their "standard" form leases, particularly in the case of smaller tenants, if one long-term possibility or goal is the sale of your business, you need to consider the assignment clauses carefully.