



BUYNAK LAW FIRM

COMMERCIAL LEASE CLAUSES

THE VALUE OF YOUR COMPANY – YOURS OR YOUR LANDLORD’S?

(Business Advisory 2007 – 13)

Your premises lease may determine the salability and sale value of your company. Is the lease transferable; if it is, who gains the “value” of the lease --- the company owner or landlord? If there is a lease recapture by the landlord, or excess rent or transfer premium clauses in the lease, the value of the lease (and a good portion of your company) belongs to the landlord.

This Advisory highlights the need for proper negotiation of lease clauses by company owners. These clauses are important; they should not be treated as “boiler plate.” When you are selling your company/business, it is important that you receive its full value. This Advisory is not exhaustive. You should discuss your situation with us or with your own attorney. Our representation is only undertaken through a written engagement letter and not by the distribution of this Advisory.

Initial Lease Negotiation – Time for Consideration of an Appropriate Approach for Sale of Your Business/Company. At the time of establishing your company at a location, it is important to ensure that the lease for the company’s premises is best for your current operation --- and for your and your company’s future. All too many times, the future salability and value of the company/business is overlooked. In the end, the value of your company/business, along with the lease’s value, should be that of the owner(s) who has toiled many years to establish its viability, reputation and good will. That valuation should not be split with the landlord unknowingly.

Assignment of Leases. Recognizing these principles, the California Supreme Court in *Kendall v. Ernest Prestana, Inc.* determined that commercial leases are freely assignable by the tenant, unless there are clearly identified standards and restrictions governing lease transfers. California law (i) requires contractual good faith and fair dealing in every contract, including leases and (ii) restrict unreasonable restraints in alienation. Applying these in *Kendall*, the California Supreme Court held that a landlord may refuse consent to an assignment only if there is a “commercially reasonable objection,” agreed upon in advance

Landlord Clauses. Since rent under commercial leases is many times not consistent with market rent for the same premises upon transfer of the lease/business, landlords have generally incorporated clauses into the commercial lease to redeem the value of their lease, all consistent with the *Kendall* case. Such clauses usually take the following approaches:

- **Transfer Premiums.** These are clauses that require some or all of excess rent to be paid to the landlord upon lease transfer. When the rent charged to a transferee by a tenant exceeds the rent paid by the tenant to the landlord, such a clause takes the excess rent and

transfers it to the landlord. Because of the restrictions of Civil Code Section 1951.4, it is normal that such excess rent be split in some manner between the landlord and tenant.

- **Right to Recapture.** These are clauses that give the landlord a right to terminate the lease upon the tenant's request to transfer the lease. Such clauses are valid, *Carma Developers v. Marathon*, placing the landlord in a control position on whether the company/business may continue in its location.

Besides the transfer premium excess rent and recapture clauses, it is suggested that companies pay attention to at least two other clauses in standard commercial leases:

- **NNN Taxes.** Tenants typically pay all real property taxes for their premises under triple net commercial leases. Because of Proposition 13 and its reappraisal/reassessment of property taxes only upon a change of ownership, real property taxes may increase significantly due to changes of the landlord during the term of a commercial lease. Particularly, the landlord may sell the premises, may die, or transfer control of the landlord entity, all of which trigger the reappraisal of the property and increase property taxes. Since landlords gain the value of these transfers, it is appropriate for tenants to negotiate for relief in this area --- that the tenant, and its requirement to pay taxes under triple net clauses, is not required to pay increased taxes due to voluntary activities by the landlord.
- **Compliance with Laws.** This clause in a commercial lease always sounds so simple, as everyone will obviously comply with the law. However, such provisions are used to determine whether the landlord or tenant is liable for major, statutorily required upgrades to the leased premises (e.g. seismic or asbestos removal). Such a clause should be negotiated for equitable treatment, so that if there is a change of use by the tenant, the tenant is liable for legal compliance caused by the change of use; but straight statutory upgrades that will remain with the building forever, are typically at the cost of the landlord.

Hopefully, this Advisory will help you in negotiating a lease for your company, so that you will gain a majority of its value upon its sale or other transfer in the future. As always, you should be sure that additional legislation has not been enacted, or court decisions rendered, that would change the above advisements. This Advisory is neither exhaustive nor is it tailored to your specific situation. You should discuss your individual situation with us or your own attorney.

Lana J. Clark and
S. Timothy Buynak,
Business Attorneys

This Advisory is one of a series of business, real estate and tax advisories prepared by the attorneys at the Buynak Law Firm. Should you have further questions regarding the information provided in this Advisory, please contact the author at the number listed above.

Buynak Law Firm provides business legal services to individuals, business entities and nonprofit organizations from entity formation and start up, through day-to-day operations and exit strategies.