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Enhancing the Value of Your Business: Planning Your Exit Strategy

by Catherine Gryczan

There is more to selling your business than finding a buyer. Business owners either plan for their exit strategy, or face losing the value they worked long and hard to create.

By planning ahead with your team of professional advisors, you can maximize your ability to capture the right price, contain the due diligence process and minimize your exposure to post-sale losses. We invite you to consider the following questions.

Are you aware that the scope and nature of the representations and warranties you give to the buyer can affect how much of the purchase price is at risk after the sale of your business? Buyers want to be assured of what they are buying and be protected against unknown and unforeseen risks. One of the ways a buyer accomplishes this is through asking the seller to represent and warrant the accuracy of information about the business that is typically identified through the due diligence process.

How familiar are you with the terms of your key contracts? Are you sure they align with the representations the buyer is asking you to make? Representations and warranties often make up a significant portion of the purchase and sale agreement. When advising the seller, we seek among other things to negotiate a time limit to the duration of the warranties made and a cap on the amount the buyer may recover for a breach of warranty claim. Another consideration is whether the representations you are being asked to give are overly broad or tailored to your industry and business.

Are your business records current? If you do not have documented vendor or customer agreements, or if your corporate minute books are out-of-date, this will slow down a buyer's due diligence and can result in a demand for a broader seller indemnity or a higher escrow (a portion of the purchase price set aside for a period of time against which a buyer may assert a claim post-sale from a breach of a representation or warranty) as a means of offsetting the risk inherent in poor recordkeeping.

This is particularly true if the parties desire to structure the deal as a transfer of equity - in which case

the buyer will carry out the due diligence review with an increased level of scrutiny of all corporate records, as the buyer will in effect inherit the business with its full records history. Even a purchase price that contains an earn-out component, often touted as a method to reward the seller for increased sales activity on the horizon, can be a tool for a buyer to penalize a seller for pre-sale risks that develop into post-sale problems.

Don't overlook the value of having negotiated written contracts that memorialize relationships with your vendors and customers. A potential purchaser of your business will evaluate how your contract terms fit with their strategic plan. Will your successor be able to perform your contracts? If you are about to document or modify your core agreements, you should consider your ability to assign key contracts or to terminate them on written notice. Do you know if you are entitled to be notified if the ownership or control of your customer or vendor changes?

Are your key employees an asset that a buyer would want to retain as part of the acquisition of your business? Are you satisfied that you can retain your best employees during an announced sale of the business? Carefully constructed employment agreements can prohibit a departing employee from taking your company's valuable trade secrets and other proprietary information to a competitor. Conversely, if your employment agreements contain restrictive covenants that are overly broad, they may not be enforceable - leaving your business vulnerable.

If you have multiple shareholders/owners, do you have a shareholders' or other buy-sell agreement? If you do, this agreement should specify the relative rights of all the owners with regard to making or accepting an offer to sell the business. If not, your legal advisor will need to assist you in determining what rights the majority and minority owners have in connection with the proposed sale. If you are at the business formation stage, now is the best time to identify how to address a future sale of the business.

If you wait and one of the owners dies or becomes

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Office Lease Provisions Require Careful Consideration

By Edward Copeland

INTRODUCTION

An office lease represents a major commitment and an important financial transaction for a business. It is therefore essential for every business person to thoroughly and carefully consider several very important provisions of their lease.

DESCRIPTION OF PREMISES AND TERM

A lease agreement should contain a clearly stated description of the premises, with a floor plan. Commencement and termination dates should be certain when possible. Sometimes a commencement date is uncertain because the building or the premises are still under construction. If so, adequate written notice of occupancy availability and protection for delayed possession should be required. Another important issue to consider is the ability to cancel the lease if the delay continues beyond a specific number of days. As a tenant of an office lease, you will also want to have a clear understanding of when the lease terminates. You will not want to stay in the premises after the termination date, since most leases have a penalty clause of double rent charged to the tenant for staying in possession of the premises after the termination date.

RENT

Most rental charges are divided into a standard or “base rent” amount that remains constant during the initial term of the lease and an “additional rent” amount that usually is scheduled to increase periodically. Additional rent increases usually are based on increased operating expenses and taxes for the building, by reference to a consumer price index, or by some fixed percentage per year. Every effort should be made to at least get a good estimate as to the additional rent based upon operating expenses and taxes you will need to pay the landlord as a tenant of office space. Imagine the shock of receiving an unexpected bill from the landlord for these expenses after you move into the building.

There are several precautions that can be taken to minimize unnecessary operating expenses. First, all utilities should be separately metered. Second, the lease should contain a clause obligating the landlord to keep books and records in accordance with generally accepted accounting principles. Further, the lease should provide the right to inspect the landlord’s books and records at least once a year.

In many areas, the office rental market is relatively soft. Because of the plentiful supply of office space, rent concessions can be negotiated. Even in modern, first-class office buildings, landlords often will offer free rent or large construction allowances to attract tenants.

SERVICES

The standard lease obligates a landlord to provide services, including utilities. All office leases should provide for electricity, heating, ventilating and air conditioning, water and janitorial services. Electric service should be charged to the tenant. If

payment for electricity is made to the landlord, it should not be at a higher rate than if it were made directly to the utility company. Optional services include telephone, security, parking and storage. A lease should provide for rent abatement to mitigate damages caused by these service interruptions. Most landlords will not agree to have the rent abated in the event of a service interruption but it is something to think about before signing your lease and it is better to try to deal with this situation before it happens.

REPAIRS AND ALTERATIONS

Before the lease is signed, you need to have a clear understanding as to what improvements are to be made to the premises before you move in, if any, and who will pay for them. Make certain that sufficient time is provided for all work to be completed before you need to move in the premises. Imagine having the lease commence with rent needing to be paid and you are not able to move into the premises because improvements have not been completed.

Your landlord should be responsible for major repairs and your lease should require these repairs to be done with reasonable promptness or within a specified amount of time after receiving notice.

At some point during a lease term a tenant may want to alter or improve the leased premises. This will have to be done in compliance with the alteration clause of the lease. Landlords usually insist on approving all proposed alterations in advance. This consent process involves the landlord’s review of detailed plans and specifications submitted by the tenant.

Leases can provide that all alterations to the leased premises become the landlord’s property once the lease term ends or they can provide that the tenant remove all alterations and restore the premises to their original condition before vacating. Common sense and a healthy perception of possession will convince tenants of the desirability of a clause that gives tenants the right to take improvements they’ve made and paid for with them at the termination of their lease.

INSURANCE

A business person needs to have insurance coverage and limits that meet the requirements of the landlord under the lease.

Many leases contain clauses providing for what is known as a “waiver of subrogation,” a mutual waiver on the part of both landlord and tenant stating that neither will allow its insurance carrier to have any rights of action against the other party under the terms of its insurance. Tenants should verify that in fact this waiver is a waiver by both parties, and that both parties’ insurance policies permit the waiver.

Leases frequently require a tenant to indemnify and hold harmless the landlord from all claims, damages or injuries arising out of the tenant’s occupancy of the premises. It is crucial to know

the scope of this liability. Some leases make the tenant responsible for any and all claims against the landlord, while others exclude situations in which the landlord's intentional or willful act or misconduct has caused the potential liability, and still others purport to make the tenant liable only to the extent of the tenant's fault. It is crucial that you obtain all required insurance coverage. The last thing you need as a business person with an office lease is to have an uninsured loss for property or liability damage.

DAMAGE

In the case of natural disasters such as fire, tornado or earthquake, most leases provide that the landlord is responsible for repairing major damages to the premises, but the time in which the landlord is expected to make these repairs can vary. Tenants should negotiate a commitment more specific than "as soon as reasonably possible," or with "due diligence." Tenants should make certain that their rental obligations abate in proportion to the damage, and from the date of the damage, and throughout the duration of the damage. A right to terminate the lease if a landlord fails to repair and restore the damage to the premises within a reasonable time, such as 90 days, should be negotiated. You do not want to think negatively, but what would you do if some catastrophe occurred and you could not use your office premises for an extended period of time. Think about this before you sign your lease and make certain you are protected either in your lease and/or by proper insurance coverage.

ASSIGNMENT AND SUBLETTING

Sometimes it is necessary to assign or sublet leased premises. Often, leases require prior written consent of the landlord before assignment and subletting. Make sure that such a clause is modified by language stating that the permission of the landlord will not be unreasonably withheld or delayed. Let's say things do not go as well as you originally planned and business

has not been as good as you hoped. You will want to be able to dispose of your lease responsibilities with as little resistance as possible.

OPTION TO RENEW

A careful tenant will negotiate in the original lease the option to renew. How the increase in base rent is to be calculated is an important consideration. Possibilities include increasing by a fixed percentage, or dollar amount by an amount based on the local consumer price index, or by the "prevailing market rate." Let's now say that things go as you originally planned, business is good and you want to stay in the premises. Don't wait for the time when your lease terminates and you have no bargaining power to consider extending the term of your lease. The time to consider this provision is before you sign your original lease.

CONCLUSION

Every business person should consider a well-constructed, thoroughly understood office lease a top priority. Careful consideration is necessary to achieve an optimum commercial office lease. Before signing this critical document, consult with your attorney to ensure that the provisions, terms and conditions allow maximum freedom and use, and maximum protection, for you, the business person.



EDWARD COPELAND is a Shareholder at Schuyler, Roche & Zwirner, P.C. In nearly 50 years of practicing law, Mr. Copeland has amassed a wealth of experience in commercial real estate transactions. He counsels and represents both businesses and individuals regarding real estate law, including the purchase, development, financing, construction, leasing and sale of office buildings, shopping centers and retail, industrial and residential properties.
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Planning Your Exit Strategy *continued*

very ill or significantly injured, you could be confronted with having your business partner's heirs or representative as your partner.

What is the tax status of your entity? If you have a corporation, have you elected to be taxed as an S corporation? It is important to review the tax implications of your business structure not only for a future sale but also for the limitations on amounts you take as salary as compared to dividend distributions. Similarly, your estate planning should take into account your business holdings and divestitures.

Sometimes a seller is asked to sign a letter of intent with a buyer. Although a letter of intent may be short in length and may not appear to be a document requiring legal review, a seller who signs a letter of intent first and seeks legal counsel later may be in for a rude awakening. Did you know that a letter of intent can be binding on you and can limit your ability to refine the terms

of the sale later?

If you dedicate the appropriate time and resources to address these issues now you will save time and reduce your transaction costs in the future when executing your business plan and you will enhance your prospects for success.



CATHERINE GRYZCAN is a Partner at Schuyler, Roche & Zwirner, P.C. She counsels corporations, partnerships, limited liability companies and individuals on international and domestic business transactions, including real estate transactions and private placement offerings of securities. Ms. Gryczan's experience includes forming new business entities for entrepreneurs and established enterprises, assisting business owners with succession planning, and helping clients seeking to sell their businesses and evaluate offers from strategic buyers.
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SRZ Highlights

Congratulations are extended to the following attorneys who were recently promoted within the firm:

Shareholder – Steven P. Pherson; Partners – Andrew M. Geier, Laurie A. Martin Montplaisir, Rachel T. Nguyen

SRZ WELCOMES NEW ATTORNEYS

As the firm's newest shareholder, **ERIC D. MARSHALL** brings to SRZ's Business Enterprise practice group over 23 years of experience in a wide range of corporate law matters. Eric's practice focuses on non-public M&A transactions, outsourcing and commercial contracting for manufacturing and distribution businesses. He draws on his prior experience as in-house corporate and commercial counsel at BP Amoco, a multinational oil and chemicals company. With his knowledge and breadth of experience, Eric will be a tremendous addition to the SRZ team.

ROBERT D. SNOW joins us from Kirkland & Ellis LLP, where he worked as a litigation associate on complex litigation and alternative dispute resolution matters. Robb has substantial experience in electronic discovery issues and computer forensics, two areas that are becoming increasingly important in the litigation arena. We are confident that Robb's expertise will benefit the clients of SRZ's litigation practice.

We also welcome **JAMES J. MCNAMARA** to SRZ. A 2005 graduate

of the Seton Hall School of Law, Jim joins us from a small firm where he was in court almost daily. Jim thus brings to SRZ considerable hands-on experience for a young lawyer. As an associate at SRZ, Jim has now turned his attention to securities arbitration and commercial litigation. We look forward to Jim's growth and contributions to SRZ's litigation practice.

FOGEL & GEIER ARTICLE QUESTIONS IMPACT OF INDEPENDENT DIRECTORS

SRZ attorneys Eric M. Fogel and Andrew M. Geier co-authored a recently published article entitled "Strangers in the House: Rethinking Sarbanes-Oxley and the Independent Board of Directors." Published in the Winter 2007 issue of the Delaware Journal of Corporate Law, the article examines whether independent director domination of a company's board improves or hinders the company's financial performance. The article challenges the common perception within the field of corporate governance that independent directors make better monitors of a company's management team. Fogel & Geier examined 254 public companies in 50 industries and found no evidence that outside board members increased financial returns to shareholders. In fact, they recommend that shareholder owners represent a majority of board members since they have a self-interest in monitoring management. The full article can be accessed at http://www.srzlaw.com/pdf/Strangers_in_the_House.pdf

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