Transfer of a commercial lease to a third party (Art. 263 SCO): refusal for good cause

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In this case, the Federal Supreme Court confirmed the mandatory nature of Art. 263 SCO: parties to a lease agreement cannot agree on more stringent conditions for a commercial lease transfer than those provided by the law.

Judgment of the Federal Supreme Court of 29 August 2023

Case Reference: 4A_453/2022

Facts

Since July 1, 1986, B. and C. (the "**Lessees**") have been renting commercial premises of approximately 55 m^2 (hereinafter referred to as the "**Premises**") located in Geneva. The lessees fully equipped and maintained the premises as a hair salon.

Article 6 of the rental agreement provides that '[…] [t]*he transfer of the lease shall only be authorized for good cause and only if the transferee exercises the same business activity as the lessee and possesses the moral, professional and financial capacity to ensure that the business continues to operate normally. The tenant may request documentation of the assignment terms.*[1] The lease expires on March 31, 2013, with tacit renewal every five years. The annual rent amounts to CHF 13,220, excluding ancillary fees.

On September 27, 2019, the Lessees requested from A. (the "**Tenant**") the authorization to transfer their lease to D. (the "**Transferee**") with effect as of November 1, 2019. The request included the business transfer agreement signed that same day between lessee B. and the Transferee. This agreement specified a purchase price of CHF 40,000. The Lessees submitted additional documentation regarding the Transferee. These documents showed that the Transferee was a Swiss national with a net monthly income exceeding CHF 7,500 and assets of more than CHF 60,000. The documents also confirmed that no legal proceedings or deeds of default had been instituted against him. The Lessees further confirmed to the property management company that they had intentionally reduced their business operations due to their age, which should be taken into account when calculating their turnover.

The Tenant refused the transfer of the lease, arguing that the amounts quoted did not correspond to the bookkeeping records of the business and claiming that the amount of CHF 40,000 should be understood as *key money* ('*pas-de-porte*'), rather than compensation for the residual value of the business and goodwill. The Lessees then had an inventory drawn up by E., detailing the market value of each piece of furniture in the hair salon, totalling CHF 56,530. They shared it with the Tenant and set him a deadline to accept the transfer of the lease. The Tenant reiterated her refusal, adding that the Transferee had never worked as a hairdresser and was forecasting an excessive turnover in comparison to the results achieved by the Lessees. She argued that the price at which the business was sold was directly related to the very low rent for the premises.

The Lessees filed a petition before the Geneva *Tribunal des baux et loyers*,[2] seeking a court ruling confirming the reasons given by the Tenant to refuse the transfer of the lease were not justified and authorizing the transfer of the lease. They submitted a new estimate of the value of the furniture in the hair salon, drawn up by another third party. The Geneva *Tribunal des baux et loyers* authorized the transfer of the lease. The Geneva Court of Justice dismissed the Tenant's appeal. In essence, it ruled that the Tenant had not demonstrated the existence of good cause for refusing to consent to the transfer of the lease.

The Tenant appealed the judgment before the Federal Supreme Court, which also upheld the decision to dismiss the appeal.

Issue

The Federal Supreme Court had to determine whether the Tenant could claim the existence of good cause to withhold her consent to the transfer of the commercial lease within the meaning of Art. 263 SCO.

Decision

The Federal Supreme Court started by addressing the question of the right to evidence (Art. 8 SCC), confirming that the previous instance could (i) refuse the Tenant's request for a judicial expertise to set the fair market value of the business and (ii) make an anticipated assessment of the facts on the basis of the two inventories drawn up by third parties without this being constitutive of arbitrary. Moreover, the Federal Supreme Court confirmed that it was not unusual for the inventory to be drawn up after the Tenant refused the transfer of the lease.

On the merits, the Federal Supreme Court reviewed the conditions for the transfer of the lease within the meaning of Art. 263 SCO, pointing out in particular that these rules are absolutely mandatory.

When the conditions set forth by Art. 263 SCO are met, the original lessee has a subjective right to transfer their commercial lease to the transferee. The tenant may object to the transfer only on good cause. Some circumstances in particular are considered to constitute good cause, such as the insolvency of a transferee or an agreement on a key money payment between a former lessee and a transferee, i.e. a payment compensating the mere transfer of the right to use the premises. The tenant's freedom of contract is thus limited, based on the interest of the lessee to impose a specific transferee in cases where the lessee has an opportunity to transfer assets it created itself on the leased property (e.g. a customer base) or stocks of goods on terms which are favorable because the sale happens under the transfer of the lease. As a counterpart for the tenant's inability to freely chose its new contractual partner, the former lessee is jointly and severally liable with the lessee taking over for a specified period (Art. 263 para. 4 SCO).

In this case, the Tenant unsuccessfully argued that the consideration for the takeover should be considered key money and that contractual obligations relating to the personal operation of the business were breached.

First, the Federal Supreme Court confirmed – relying on third parties inventories and valuations – that the amount paid by the Transferee was commensurate with the property on offer: the hair salon did in fact have a customer base and other valuable intangible assets, such as a 'brand' and a telephone number, which were the subject of the business takeover, and the lower turnover from the past years could be explained by the Lessees' intentional decision to reduce their workload in light of their age and health conditions. The Tenant had failed to demonstrate the contrary.

Second, the Federal Supreme Court dismissed the Tenant's argument pertaining to the fact that the Transferee, who had no experience as a hairdresser, would not be operating the business himself, as foreseen in the lease's provision about any transfer and that this would constitute good cause to refuse the transfer. The court relied on the fact that the profession did not require official authorization and on the fact that the Transferee had shown his intention to surround himself with qualified people, since he had the entrepreneurial skills required to manage the salon. Importantly, the Federal Supreme Court ruled that the requirements of the lease agreement could not be more stringent than the legislation in force, which is mandatory in nature.

Based on the above, the Federal Supreme Court excluded the existence of good cause to refuse the transfer of the lease and dismissed the Tenant's appeal.

Key takeaway

Parties to a commercial lease agreement may not agree validly on conditions for a transfer of the lease which would be more stringent than those set forth in Art. 263 SCO.

Comments

The question of the transfer of a commercial lease often comes up in practice, particularly when a tenant is handing over their business, and a transfer of leases is, as a matter of principle, commonly used. In this context, a distinction must be made between the application of Art. 263 SCO, which allows the tenant to impose a transferee, and that of Art. 264 SCO, which only aims to release tenants from their contractual obligations in advance, without however obliging the tenant to take on the proposed candidate. The choice between these two options will depend primarily on whether the outgoing tenant transfers their lease in the broader context of a business transfer (in which case they will opt for Art. 263 SCO).

This decision by the Federal Supreme Court reiterates an important point in this regard, namely that Art. 263 SCO is mandatory and that the parties are therefore not at liberty to agree that the tenant may object to the transfer outside of the conditions set out in this provision. It points out that this is the result of a deliberate choice by the legislator, who deliberately limited tenants' contractual freedom (they may be forced to take on a lessee they had not chosen) in favor of the lessee's interest in being able to transfer their lease to a specific third party, with whom they may agree on special conditions such as a takeover price for equipment or goodwill.

The classification of the takeover price often raises questions, insofar as it is sometimes difficult to distinguish between a real consideration and a key money payment. In this case, the Federal Supreme Court did not need to specifically examine this issue, as it was able to dismiss the appeal due to insufficient arguments against the lower court's decision and based on the rules of evidence. f. In any event, the transferring tenant should be cautious, as the Federal Supreme Court confirmed the prohibition on key money, such type of payments being constitutive of good cause to refuse the transfer.

In the view of the Federal Supreme Court, Art. 263 SCO is absolutely mandatory (with the exception of para. 4, which is not relevant here, cf. 4A_30/2020). Consequently, no derogation to the detriment of the tenant is possible. The nature of this provision has long been a matter of discussion among scholars and the absolute mandatory nature could also be questioned as a matter of policy, keeping in mind that the legislator wanted to facilitate business transfers. It also appears debatable in circumstances where lease agreements would provide for more flexible conditions for intra-group transfers, which are provisions frequently requested by commercial tenants of a certain size when group reorganisations are required.

This decision by the Federal Supreme Court confirms established case law on the mandatory nature of Art. 263 SCO. In practice, tenants also address the issue of lease assignments by other means, in particular by provisions cancelling tenants' renewal options when the lease has been transferred to a third party, which – without allowing them to oppose a transfer even if they consider that the interest in taking over the lease is based primarily on favorable rent conditions (as the tenant argued in the case at hand) – opens up the possibility of renegotiating a new lease upon expiry as the transferee does not have an option to extend the lease.

Other comments on this judgment

Eron Gjukaj / Dario Galli/Markus Vischer, Übertragung des Mietverhältnisses im Rahmen eines Betriebskaufs, in: digitaler Rechtsprechungs-Kommentar (dRSK), published on August 27, 2024

[1] The original provision in French reads as follows: "[…] [l]a cession du bail ne sera autorisée que pour de justes motifs et seulement si le cessionnaire exerce la même activité que le locataire, et s'il possède les capacités morales, professionnelles et financières pour assurer la marche normale de l'entreprise. Le bailleur peut exiger la production des conditions de la cession."

[2] A specialized court that deals specifically with disputes concerning lease contracts.

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