Terminating a retail or commercial lease early

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After entering into a retail or commercial lease, a lessee may seek options to end the lease earlier than the terminating date. If a lessee wants to get out of a retail or commercial lease early, then it is not a simple matter of returning the keys to the lessor and walking away.

What happens if a lessee tries to terminate a commercial lease early?

If a lessee attempts to return the keys and terminate the lease early, they are generally responsible for:

1. money owed but not paid prior to the attempted termination;
2. money due to be paid from the date of termination up to the terminating date of the lease;
3. the lessor's costs in re-letting the premises; and
4. the lessor's reasonable legal costs.

Depending on how far behind the lessee is in their rent and other payments due under the lease, and how long the lease term has left to run, this can be a significant amount of money.

Amount owed on early termination of a commercial lease may exceed any security deposit

Under most leases, the lessee is required to provide a security bond or bank guarantee, which is usually calculated as a multiple of month's rent plus outgoings. This security deposit amount does not limit the amount that the lessee may owe to the lessor, and the actual amount owed may exceed the security deposit amount.

The security deposit is merely the sum that could be first used to satisfy the liability owed to the lessor, and the lessor could then sue the lessee, and any guarantors, for any amount exceeding the security deposit.

Lessor has a duty to mitigate losses

The lessor is under a duty to mitigate any financial losses that were due to be paid by the lessee, from the actual date of termination up to the terminating date of the lease. This means that the lessor needs to make 'reasonable' efforts to find a replacement tenant and re-let the premises. The lessor cannot merely wait and collect rent from the lessee until the terminating date of the original lease, collecting rent for the balance of the term.

What constitutes 'reasonable' efforts by the lessor to re-let the premises is difficult to determine and often a source of dispute between lessee and lessor.

Further, if a lessee relies upon the lessor to mitigate their losses, to limit their liability to the lessor, then the lessee will be relying upon the lessor to find a replacement tenant. The lessee would have little control over the process and disputes frequently will arise around the extent of the lessee's liability.

If the lessor is considered to have 'taken their time' or engaged no sense of urgency to mitigate their losses, a lessee will often claim that the lessor did not make 'reasonable' efforts to mitigate their losses, which is often a difficult claim to prove by the lessee or defend by the lessor.

Other options open to the lessee

A lessee's other options include:

1. Negotiating an exit

A lease may be surrendered by negotiation if both the lessee and lessor agree. This may involve a surrender payment being made by one party or the other, or with no additional payment being made depending on what is in the commercial interests of the parties.

If the lessor does not want the premises back or does not have any other reason to want to terminate the lease early, then there will often be a fee payable by the lessee to surrender the lease. The benefit of this, compared to simply attempting to walk away, will be the certainty of the fee that is to be paid by the lessee.

1.Transferring the lease

The lessee may seek to transfer the lease to another lessee. This will often occur as part of a sale of business but could occur if the lessee seeks to find their own replacement.

Many leases will include restraints on the lessee transferring the lease without the lessor's prior consent, so a lessee will need to comply with the terms of the lease in this respect. A new lessee would also be bound to the terms of the current lease, so if they are proposing to use the premises for a purpose outside of the permitted use under the lease, then further negotiation with the lessor may be necessary. The lessee is also usually responsible for paying the lessor's legal costs in attending to the assignment of lease.

Under a retail lease, if the lessee seeks the assignment of lease to a new lessee, then the lessor can only withhold/refuse their consent to the assignment in limited circumstances under the *Retail Leases Act*.

The lessor can only refuse their consent to the assignment if the new lessee has financial resources or retailing skills that are inferior to the original lessee's. If the new lessee's financial resources and retailing skills are equal to or better than the original lessee, then the lessor would be expected to consent to the assignment of lease.

1. Sub-lease or sub-licence

If the lessee is unable to maintain the whole of the leased premises and seeks to reduce the rent they pay, they could seek to sub-lease or sub-licence the premises. The lessee would remain a party to the original lease and would be liable for any rent and expenses under that lease, but by sub-leasing or sub-licencing the premises, the lessee may be able to also obtain rent or fees from a sub-tenant or licensee.

The key difference between a sub-lease and a sub-licence is whether the original lessee provides the sub-lessee or licensee the exclusive use of all or only part of the premises.

If the lessee provides a sub-lease, then the sub-lessee will be entitled to the exclusive use of all or part of the premises. If the lessee provides a sub-licence, then the licensee is not entitled to use all or part of the premises exclusively, but they will usually have defined rights over what areas they may use during what times.

Under most leases, a lessor would need to consent to the lessee sub-leasing or sub-licensing any part of the premises. The lessee would also usually be responsible for payment of the lessor's legal fees for the proposed sub-lease or sub-licence.

Conclusion

Before a lessee tries to terminate a retail or commercial lease early, they need to consider their options carefully to understand the potential repercussions and to make an informed decision. Returning the keys and leaving the premises will not end the lessee's liability under the lease.

Need help with your retail or commercial lease?

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Contacting a family lawyer

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