

A Business Lawyer's Guide to getting out of a Lease, or how it may end...

1. Introduction

A lease is a vital part of (and a regular, substantial outgoing for) a lot of businesses. A lease can be the difference between success or failure, as it is usually central to the goodwill, value, and future sale of that business.

A lease is a legally binding contract that may materially affect the value of your business. When you sign a lease you commit to paying rent and outgoings and fulfilling all other obligations in the lease for a specified term, as well as when it ends.

The term of a lease is usually fixed which can create difficulties, particularly where the rent in the lease does not reflect prevailing market conditions (i.e. rental values drop but the rent under the lease is locked or increased due to ratchet clauses and rent reviews).

2. Getting out of a Lease

There are a number of reasons why a lessee may wish to get out of their lease – they may no longer require the premises, or they may need to relocate or downsize due to financial issues (e.g. the business has gone into Voluntary Administration).

The worse thing for a lessee to do is to 'walk away' from a leased premises – this rarely resolves the issue and will constitute a fundamental breach of the lease. It is also likely to create greater loss for the lessee and the guarantor (usually a director of a corporate lessee).

If a lessee walks away from a lease and leaves their property (e.g. fittings such as projectors, cool rooms, kitchens, other plant & equipment etc.) behind, there is a risk that this property can:

- be deemed to be forfeited under the lease. This would entitle the lessor under the lease to claim the lessee's assets, sell them and pocket any sale proceeds. It can often be the case that the lessee's property left on the premises is of no value and there is an increase in costs payable under the breached lease for removal of the property and make good of the premises; or
- be stored by the lessor, at the lessee's expense.

If you wish to get out of a lease, you should get legal advice before talking to the lessor to ensure you know your rights and understand all obligations. It's surprisingly often that hear some lessees say: "I never read the lease" or, my favourite, "isn't it just a standard lease..."

(a) Surrender of Lease

One of these options may be the "surrender" of the lease (i.e. bringing the lease to an end before the expiry date specified in the lease). A surrender of lease is likely to:



- minimise your costs, though a lessor may require you to make good the premises and pay a lump sum representing the lessor's loss arising from the earlier termination of the lease; and
- ensure the lease is terminated in such a way that neither party has any further claims against each other for failing to comply with their obligations under the lease.

(b) Default / Breach

Where a lessee breaches the lease (i.e. fails to comply with its obligations under the lease) then the business may be served with a "Default Notice". If the lessee does not remedy the breach in accordance with the Default Notice, they may be served with a "Termination Notice".

A Termination Notice entitles the lessor to terminate the lease and repossess the premises (known as "forfeiture"). This may occur suddenly and result in the lessee being locked out of the premises, unable to trade. This can have immediate and devastating consequences for a business.

In addition to the above, the lessor may:

- call on a bank guarantee provided by the lessee in order to remedy a breach under the lease. A bank guarantee is an undertaking from a banking institution to make a payment to the lessor (up to the amount nominated in the guarantee), without reference to the lessee (at whose request the guarantee has been issued); and/or
- pursue, for example, the directors of a corporate lessee if they have provided personal guarantees under the lease. Under a personal guarantee, the guarantor personally guarantees the performance of the lessee's obligations under the lease, which means that the guarantor's assets may be at risk.

Notwithstanding any breach, the lessee may be entitled to claim "relief against forfeiture" which is a discretionary Court order reinstating the lessee to the leased premises. However, relief from forfeiture is normally granted on the condition that the breach is firstly fully remedied by the lessee.

(c) Voluntary Administration / Winding Up

Most leases will contain a clause that enables the lessor to terminate the lease upon the happening of an "insolvency event".

If a business is unable to pay its debts as and when they fall due, the business is deemed to be insolvent within the meaning of the Corporation Act 2001. If a business is operated by a company, the directors of that company have a duty to ensure the company does not incur any debts at a time when the company is insolvent.

There are a number of options available to insolvent businesses depending on the entity through which the business operates. A business operated by a company may (amongst other things):

- simply cease trading and wait for a creditor (or other party) to take action;



- attempt to informally negotiate with each of its creditors in an attempt to turn the business around without formally appointing an insolvency practitioner (i.e. a Voluntary Administrator or a Liquidator);
- appoint a Voluntary Administrator with a view to putting a proposal to creditors whereby creditors will accept less than the full amount of their debt but more than they would receive in Liquidation. The main aim of a Voluntary Administration is to attempt the “save” the business; or
- appoint a Liquidator with the view to the Liquidator collecting all of the assets of the company, selling those assets and distributing the proceeds amongst creditors. The main aim of Liquidation is to close the business and provide a return to creditors. A Liquidator can be appointed either voluntarily or by court order.

During a Voluntary Administration, there is a moratorium on unsecured creditors of the lessee commencing or continuing with proceedings against the insolvent lessee and its property (except in certain circumstances). A moratorium is a “protective financial and legal cloak” that is placed around the lessee whilst the Administrator and creditors decide whether a rescue package for the lessee can be put together and implemented.

Upon their appointment, an Administrator or Liquidator of a company must decide whether they wish to “disclaim” a lease or take on personal liability for the lease. The effect of a disclaimer is:

- to bring the lease to an end (discharge the Administrator or Liquidator from further personal liability); and
- the liability of the lessee to pay rent is terminated. However, the lessor may have a claim in damages against the lessee and/or any guarantors in damages for the balance of the term of the lease and any make good or reletting costs.

(d) **Assignment & Sub-leasing**

During the term of the lease, a lessee may wish to:

- sell their business and assign the lease to the purchaser; or
- lease the premises out to another person or entity by sub-leasing the premises.

Most leases contain a clause which provides that a lessee cannot assign, sub-lease, transfer or otherwise part with possession of the premises without the consent of the lessor.

Under the *Commercial Tenancy (Retail Shops) Agreements Act 1985* (**Retail Shops Act**), a lessor must not 'unreasonably' withhold their consent to an assignment or sub-lease.

What is “unreasonable” will depend on the circumstances. However, case law has provided some clarity as to when it would be reasonable for a lessor to withhold its consent. For example:



- where the character and personality of the proposed assignee/sub-lessee is questionable (e.g. where references provided by the assignee/sub-lessee are inadequate or not satisfactory to the lessor);
- when the proposed assignee/sub-lessee has failed to meet specific requirements set out in the lease;
- where the financial position of the proposed assignee/sub-lessee is in question; or
- where the proposed assignee/sub-lessee's use of the premises is not permitted under local laws, or is likely to devalue the premises.

Another advantage of the Retail Shops Act is that it provides additional protections for an assignor (i.e. the current lessee who wishes to assign the lease) and their guarantor. For example, under the Retail Shops Act, the lessor cannot hold an assignor and their guarantor liable for monies owing by the assignee (i.e. the person or entity who acquired the lease from the assignor) under the lease. Unfortunately, this is not the case for assignors and guarantors under commercial leases – they commonly remain liable even after leaving the premises.

Accordingly, it is important for directors of corporate lessees to be released from any guarantors granted under a lease (or any third party supply agreements) upon termination or assignment.

(e) Make Good / Yield Up

Most leases contain a clause requiring the lessee to “make good” the premises upon the expiry or earlier termination of the lease.

The requirement to “make good” is rarely defined, but may require the lessee to:

- return the premises to the condition it was in at the commencement of the lease – it is a good idea to have a property inspection documented at the commencement of the lease so the parties are clear on the condition of the premises at the commencement date;
- re-paint and re-carpet the premises – this can be expensive;
- remove its property (i.e. plant and equipment and fixtures and fittings; including alterations they may have made) and fix any damaged caused in doing so; and
- generally leave the premises clean and tidy.

Key Points

At the end of the day, a lessee does usually have options when it comes to getting out of a lease.



However, it is important that a lessee:

- before entering into any lease, fully understands the terms of its lease and takes a commercially proactive approach to dealing with issues that will affect its position as lessee; and
- promptly obtains appropriate legal advice to reduce their costs and minimise their exposure to unnecessary legal and/or financial consequences.

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