

## How to Break A Commercial Lease©

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Being successful in business is difficult. The business may fail because the product or service lacks demand, the market or marketing is wrong, the location doesn't work, or the economy enters a recession. For these and other reasons a business may find itself unable to pay the rent. It would seem that the common sense solution is to shut down the business and move on. But, unfortunately, a commercial lease is different from most other contracts.

### A. Tough Law and Tough Clauses

The Lease is the “tail that wags the business dog.” Many clients are shocked with the one-sided and unfair nature of the typical commercial lease. Here are some of the things a commercial tenant is up against:

1. **The Doctrine of Independent Covenants.** Under standard contract law, a party cannot breach a lease and sue to enforce it. The breach of one material (important) covenant (contract term) bars a legal claim on another covenant by the same party. This is the “material” or “first breach” rule. Under non-real property contract law in the event one party breaches the contract, the other party may suspend performance and sue for damages. For example, one would not have to pay full price, or even pay at all, for a defective service or product.

But real property law is not like this. Commercial leases and their legal environment go back to the times of feudalism with land barons and their tenant farmers.<sup>1</sup> Unless the lease says otherwise, a landlord can fail to provide something important, say air conditioning, and still sue you for the rent.

2. **The Landlord's Lien.** Under Arizona law and the law of many states the landlord has a lien against the property of the tenant, e.g. trade fixtures, computers, cash registers and equipment. This lien is effective when the lease is signed. It is triggered by the tenant's breach of the lease. If the tenant fails to cure the breach, then the landlord may seize the property. The lien becomes important if the tenant seeks to close the business and take the furniture and fixtures. Because of the lien the property now belongs to the landlord.

3. **Rent Acceleration.** Breach of the lease “accelerates” the rent such that all rent to be paid under the lease becomes immediately due and payable. For example, if one has a lease at \$5,000 a month for 60 months and defaults after 30 months, the tenant will receive a demand from the landlord for the remaining 30 months, i.e. \$150,000, plus marketing costs, realtor commission, attorneys' fees, etc.

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<sup>1</sup> After the black plague reduced the number of serfs below that need to maintain the estate. A result of the plague was the change from serfdom to private enterprise.

**4. Personal Guaranty.** Most business owners must sign a personal guaranty of the lease. They may assume that “guaranty” means that they become personally liable if the landlord cannot collect from the tenant. But most guaranties do not work that way. They are an “independent obligation,” which means the landlord can just ignore the business and sue the owner personally from the date of the breach.

## **B. Dealing with the “Tail.”**

Here are some things to know and do to break or limit damages under a commercial lease:

### **1. Use a Business Lawyer**

**a. To Review and Revise the Lease Before he Lease is Signed.** As stated above, leases are the “tail that wags the business dog.” Commercial leases are tough, both in their application, and their breach. But some terms can be negotiated upfront, so it is important that the tenant do so. This is what I call my “Landmines Speech:” We can negotiate some terms to be more in our favor. And, while we may not be able to remove all the “landmines” with review and discussion of the Lease, we can know where they are. This helps avoid inadvertent breach. And,

**b. When the tenant is in trouble or wants to leave.** The lawyer can advise you, deal with the landlord and its attorney, and apply information like that below.

**2. Be Current on the Lease When You Make Your Move.** The landlord’s lien is triggered by default and once triggered the tenant loses control over the personal property on the premises. Moreover, moving property after default on the lease is a fraudulent transfer which can be set aside as void and punitive damages awarded. Conversely, however, if the Lease is current the tenant can remove furniture, fixtures and equipment and there is not much the Landlord can do about it. (This does not mean they will not try.)

**3. Be Aware of the Landlord’s Duty to Mitigate Damages.** Under contract law one cannot just “sit on a breach” and allow damages to accumulate. This is called the “doctrine of avoidance” or more commonly “the duty to mitigate.” For example, if a supplier fails to ship a good per the purchase contract, but the buyer can buy the same product at the same price on the same day, then the buyer has the duty to do so. Under the Uniform Commercial Code (UCC) this is called “cover;” that is going into the market place to replace undelivered or defective the goods. If the buyer has to pay a higher price for the “cover goods,” then the buyer would have a damage claim against the seller for the difference.

When applied to a commercial lease the duty to mitigate means the duty to take reasonable commercial steps to re-lease the premises. This means the demand for the balance due under the Lease, \$150,000 + in our example in section A (4) above, is almost never enforceable. Because the landlord can usually release the premises with reasonable effort with a few months, then a few months’ rent would be the extent of the landlord’s actual claim. As a result, a tenant may buy itself out of a Lease by paying from two to six months’ rent. This is huge because most tenants do not know this, so are terrified by the landlord’s letter demanding the rest of the rent due under the Lease.

This settlement would also release the tenant's liability under the personal guaranty.

**4. Explore the “Impossibility” Defenses.** In times of pandemic, government ordered quarantine and economic shutdown, or other unforeseeable catastrophic events one might be able to break the lease or achieve forbearance or rent for a period of time. There are a number of contract defenses, which almost never apply and are not worth the time and cost to make them, that apply when things are virtually impossible to do. For example, how can a restaurant pay the rent if it is ordered to be closed and its customers ordered to stay home. “Impossibility” doctrines include *force majeure* (unforeseen catastrophe), impossibility, impracticability (which mean what they say) and frustration of purpose (reason for contracts goes away due to unforeseeable change of events).

I have written about these “disaster defenses” in my articles “Covid-19, Forbearance and Contract Defenses,” and “The Corona Virus and Contracts.”<sup>2</sup>

**5. Bankruptcy.** If worse comes to worse one can break the Lease in bankruptcy. A lease is what is called an executory contract; thus, it can be cancelled in bankruptcy. But because of the personal guaranty, both the business and the owners personally would have to file. Personal bankruptcy can be an extreme negative, so should be discussed with a qualified business bankruptcy attorney.

### C. “Catch 22:”

One needs money to break a Lease. Most tenants are in default and out of money when they attempt to break a Lease. This does not work very well for at least four reasons:

1. Any complaint loses credibility if the tenant is already in breach of the Lease. “I moved out because the air conditioning did not work” is not a credible defense unless there is a prior history of notice and request to fix.
2. The tenant needs money to buy its way out of the Lease, typically 2 to 6 months' rent.
- 3 Landlords are using to having their way so negotiations are typically longer than other contract negotiations. And
4. The tenant needs money to hire the attorney to assert the necessary facts supporting a breach of the Lease. Because of # 3 above this is typically at least one- or two-months' rent.

### Conclusion

Dealing with landlords can be tough. They have the law, the contract, and the money on their side. But there are ways to get a better lease and to break a bad one, especially during bad economic times. It is best to start early before the tenant is broke, but the reality is most tenants wait too long so do not have the resources to take on the landlord. It is typically “worth the try” to negotiate an exit. This is particularly true if bankruptcy is the next option.

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<sup>2</sup> Available at [azbuslaw.com/Publications/Articles](http://azbuslaw.com/Publications/Articles). Also check out our awesome Blog.