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# Lease Renegotiation: Legal and Commercial Elements

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1. We are one of the world's leading law firms headquartered in the City of London, with 14 offices in 12 jurisdictions.
2. We have over 900 lawyers, a third of whom work in countries outside the UK.
3. We focus on four key sectors:
  - Financial Institutions
  - Energy, Transport and Infrastructure
  - Real Estate & Retail
  - Technology, Media and Telecoms
4. We have a leading presence in emerging markets:
  - CIS – Offices in Moscow, St Petersburg (associated), Almaty, Tashkent and Turkmenistan (associated)
  - Middle East – one of the largest law firms in the Middle East
  - Africa – one of the largest association of law firms across Africa

## Definitions

- **Lease Termination:** Termination of the Lease may be initiated by one or both of the parties and is intended to terminate all of the Landlord's and/or Tenant's rights and obligations under the Lease.
- **Lease Renegotiation:** Amendment of the Lease may be initiated by one or both of the parties and is intended to amend all of the Landlord's and/or Tenant's rights and obligations under the Lease.

# Options for terminating the Lease

Specific clauses in the Lease itself:

- There may be a provision allowing for the termination of the Lease by mutual agreement of the parties;
- There may be a 'break clause' in the Lease, allowing early termination by either of the parties in specific circumstances without a court procedure;
- Termination due to a material breach of a party's obligations:
  - Notice requirement;
  - Period to cure the breach (15, 30, 60 days);
  - Ability to terminate the Lease ceases after breach is cured.
- Termination on the grounds set out in the Civil Code.

## Legal grounds for the Tenant to terminate the Lease

- The Landlord has failed to provide, or has created obstacles to, the use and occupation of the property (Articles 611 and 620 of the Civil Code).
- The property has defects, which were not disclosed to the Tenant, impeding its use and occupation in full or in part, and the Tenant could not have discovered these defects during the Tenant's inspection of the property on conclusion of the Lease agreement (Articles 612 and 620 of the Civil Code).
- The Landlord failed to notify the Tenant about the existence of any third party rights in respect of the leased property (e.g. mortgage) (Article 613).

## Legal grounds for the Tenant to terminate the Lease (continued)

- Landlord fails to make capital repairs which the Landlord is obliged to do (Articles 616 and 620).
- The property turns out to be unfit for use and occupation due to circumstances outside the Tenant's control (e.g. the building was damaged because of works on an adjacent construction site etc) (Article 620).

## Substantial change of circumstances

- Substantial change of circumstances from those existing at the time the agreement was concluded (Article 451):
  - A change of circumstances can be classified as substantial when the changes are so extensive that, had those circumstances existed at the time, the parties would not have concluded the agreement at all or would have concluded it on substantially different terms;
  - Four conditions must be met;
  - This provision is usually excluded from the Lease.

## Legal grounds for terminating the Lease by the Landlord

### **Legal grounds for terminating the Lease under the Civil Code (Article 620):**

- Tenant uses the leased property in violation of the terms of the Lease agreement (also, Article 615);
- Tenant causes material damage to the leased property;
- Tenant has failed to pay the rent for two consecutive periods;

Tenant has failed to make capital repairs when the Tenant is obliged to make them.

# Tenant's options to renegotiate the Lease

1. If the Tenant has a right to terminate the Lease, then it has a stronger bargaining position to renegotiate the Lease.
2. Key terms: property, lease period, lease payment.
3. What rights does the Tenant have to renegotiate the lease?
  - any clauses allowing renegotiation in the Lease itself would be very unusual.
  - There are the following rights to amend the Lease, set out in the Civil Code.

# Tenant's right to amend the Lease terms

## **Legal grounds for amendment are similar to those for termination of the Lease:**

- The Landlord has failed to provide the property for use and occupation or has created the obstacles to such use and occupation (Article 611);
- Subsequent defects have been discovered with the leased property, even though the Landlord was not aware of them at the date of completion of the Lease (Article 612);
- The Tenant shall have a right to request a reduction of rent if the property has deteriorated for reasons outside the Tenant's control (Article 614);
- The Landlord breached an obligation to do capital repairs and they were made by the Tenant (Article 616);
- Substantial change in circumstances (Article 451) – if not excluded.

## Commercial options

- Obviously if the Landlord/Tenant has a legal right to terminate or renegotiate the Lease then it enjoys a stronger bargaining position.
- However, it is likely that such rights will not be clear cut and may require the use of court procedure to enforce.
- As such, any renegotiation is going to be closely linked to commercial realities.

## Commercial options

### **The "one bird in the hand, two in the bush" argument**

- The Tenant has been a very good tenant in the past, paid his rent on time and it is much better to have a reliable tenant paying a lower rent than trying to find a new tenant (particularly considering the current state of the market).
- Evicting the tenant would mean the property would be empty whilst a new tenant was sought and the Landlord would also have to pay an agent's commission to find a new tenant.
- It is unlikely that any new tenant would be prepared to pay a higher rent than the rent the existing Tenant is offering to pay.
- The new tenant may not be as good or as reliable.
- The Landlord and Tenant may have had a good working relationship.

## Commercial options

### **The "if you do not reduce the rent, I will go insolvent" argument:**

- If the rent is not reduced, the Tenant may shortly become insolvent and would be unable to pay the rent in any case.
- Whilst this will technically allow the Landlord to claim all rent until the end of the Lease, etc – this is worthless if the Tenant is insolvent.
- As above, reducing the rent allows the Landlord to avoid having an empty building etc.
- The Landlord may want the Tenant to verify its parlous financial circumstances.

## Commercial options (3)

### **The "hardball" argument:**

- The Tenant simply says that if the Landlord will not renegotiate the Lease then it will simply stop paying the rent and walk away, leaving the Landlord to pursue the Tenant in the courts.
- The Tenant will try to rely on some of the above arguments to terminate the Lease.
- Any court proceedings are likely to be lengthy and costly for the Landlord and in the present climate it is unlikely that the Landlord will be able to find a better tenant (especially if the rent payable under the lease is below the current market rate).

## Commercial options

### **Landlord's Arguments**

- The Lease terms have been agreed upon by the parties and any amendments should also be agreed by both parties.
- The Lease should not be amended or terminated when the Landlord is not in breach of the Lease.
- The rent is below market rate anyway and the Landlord would have no problem finding alternative tenants.
- The court procedure may be not as long and costly as the Tenant suggests. Also, in addition to rent the Tenant will pay Landlord's expenses and penalties.

## Certain issues relating to preliminary agreements

- A preliminary agreement must be concluded in written form.
- It must identify the property to be leased and the fundamental terms and conditions of the main Lease.
- The long-term lease must be concluded within the term specified in the preliminary agreement, or if the term is not fixed, within 1 year
- A preliminary agreement to enter into a Lease is not subject to state registration.
- A preliminary agreement may contain conditions precedent for concluding the long-term Lease (e.g. completion of the building/premises by a certain date, readiness for fit out by a certain date etc).
- In the current circumstances, the likelihood of the Landlord achieving its original construction timetables is unlikely and this will allow the Tenant to break the preliminary agreement and renegotiate a new one on more favourable terms.

## How to document an amendment/termination

- Documents amending or terminating the Lease before expiration of its term must be in written form.
- Amendment or termination of a long term lease (exceeding one year) must be registered.
- When the term of a sublease agreement exceeds one year, this sublease agreement must also be registered.

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**Thank you for your attention!**

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