
Shopping centre lease – operating obligation versus early termination

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Introduction

In Switzerland, commercial lease agreements for shopping centres are typically entered into for an initial fixed term of five to 15 years with renewal options to allow the lessor to adapt the agreed rent to the Swiss consumer price index. Commercial leases with an indefinite term are rather uncommon.

Long-term lease arrangements are generally to the benefit of both parties, as they allow for long-term planning security. However, following a general trend, in Switzerland

the market situation for shopping centres is rather difficult. The popularity of Swiss shopping centres is not comparable to those in neighbouring countries. The price level is generally higher due to the Swiss market conditions and the strong currency. Additionally, Swiss legislation provides for a prohibition of Sunday work. In the immediate past, the increase in online trading has also taken its toll on the profitability of shopping centres. Thus, many Swiss shopping centres struggle with large numbers of vacancies.

As a result, early terminations of long-term commercial lease agreements are a hot topic.

Transfer of lease

As an early termination is generally considered as *ultima ratio*, tenants tend to investigate whether milder alternatives, such as a transfer of lease, are available. If the tenant is able to propose an acceptable new tenant (ie, is solvent and willing to accept the same terms and conditions of the lease agreement) to the lessor, the tenant may return the rental property to the lessor before the agreed termination date and will be released from his contractual obligations.

Whereas transfers of leases are quite common for private lease arrangements, they are very rare when it comes to commercial lease agreements in shopping centres. A tenant in a shopping centre with many vacancies is hardly ever going to find an acceptable tenant who would be willing to accept the same terms and conditions of the lease agreement. Generally, a potential tenant would be offered better lease conditions if the tenant negotiated directly with the lessor, as the market value of the shopping centre would be lower at this stage than when the original tenant has entered into the lease agreement.

Swiss law also provides the tenant with the option to assign the lease to a third party. However, the tenant that wishes to assign the lease to a third party due to poor customer frequency of a shopping centre faces the same difficulties as the tenant who is looking to return the leased premises prematurely by presenting a new tenant. The lease would be transferred as is.

Early termination

Generally, commercial lease agreements do not provide for early termination options. However, the lease agreement may include a list of essential grounds, entitling both parties to an early termination of the lease. A termination due to unfulfilled expectations is generally not permitted. In addition, it is disputed whether the freedom of contract applies to the negotiation of early termination options in the lease agreements.

Under certain conditions, Swiss law provides for a right of early termination of a fixed term lease agreement. Justified grounds for an early termination relate to delays in payment or insolvency of the tenant, neither of which can be invoked by the tenant.

In the event of a negative business development of the shopping centre, it is not uncommon that tenants (try to) terminate the lease agreement based on good reasons. However, such termination is generally not successful as neither a negative business development nor the bad economy qualifies as sufficient reason for an early termination. Only extraordinarily serious circumstances that were not predictable at the conclusion of the long-term lease agreement allow for a termination based on good reasons. Any developments a prudent manager would take into account before concluding an agreement are considered predictable. In the event that the tenant is part of a chain of stores and thus able to cross-finance a poorly performing business, the court's assessment of the good reasons is generally stricter. The same applies to tenants that qualify as established companies and as such are not at risk of bankruptcy if they had to comply with the terms of the lease agreement despite the low performance.

Thus, without a good reason that does indeed qualify as such, in practice, an early termination of the long-term lease agreement by the tenant is generally considered void.

Operating obligation

Statutory law does not provide for an operating obligation. However, it is permissible to agree on such obligation in the lease agreement. Such obligation can include an agreement regarding opening and operating hours, as well as the composition of the product range. Where the non-use of business premises may harm the economic interests of a lessor, the operating obligation of the tenant may result from his statutory duty of care pursuant to article 257f Code of Obligation. It is disputed whether this applies in general in shopping centre leases.

Failure to comply with a contractual operating obligation qualifies as material breach of the duty of care. Continuation of this breach despite a reminder from the lessor allows the lessor to terminate the lease agreement extraordinarily. However, when it comes to shopping centre leases, the lessor generally does not have any interest in terminating the lease agreement prematurely.

In practice, the lessor would rather seek interim measures to enforce the operating obligation and claim damages (article 261 Code of Civil Procedure). The lessor is well advised to take action immediately. The sooner the lessor applies for interim

measures, the better are the chances that they are granted. However, to obtain the interim measures, the lessor not only has to demonstrate that the tenant has committed a material breach of the lease agreement and that the interim measures are required to prevent imminent harm, but also has to advance the court costs.

When applying for interim measures, the lessor should request the court to impose a disciplinary fine not exceeding CHF 1,000 for each day of non-compliance pursuant to article 343 para 1c Code of Civil Procedure. Even though the lessor is not the beneficiary of the fines paid by the tenant, the fine serves as a good means of pressure to comply with the operating obligation.

Further, the lessor may claim damages in case of a loss of earnings if a turnover-linked rental was agreed or, in case of claims of other tenants of the shopping centre, based on a decline in sales. If the operating obligation is linked to a contractual penalty, which is

often the case, the lessor may further claim payment of the contractual penalty.

Conclusion

Long-term lease agreements in shopping centres should not be concluded without seriously evaluating the risks and benefits, as an early termination of the lease agreement is generally not possible. Small enterprises often face bankruptcy if a shopping centre does not develop in the expected way. Even for financially sound companies, a long-term lease agreement under such conditions may result in a significant burden.

If the tenant is forced to cease operations on the leased premises due to the high operating costs, the tenant risks interim actions by the lessor and severe disciplinary fines. However, whereas the early termination of the lease agreement would in most cases be considered void, a cessation of operations may be the only way out.