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Exercising Break Clauses

In the next few years it is anticipated there will be a lot of cases on break clauses, following the pandemic and businesses wanting fewer or cheaper premises.

Unlike rent review, time is usually of the essence in a break clause, with the disastrous consequence that if you miss the break day by a single day you are stuck with the premises until either the next break, if there is one, or until the end of the term. For this reason alone, this is a very litigious area. But the exercise of break clauses is made yet more complicated by the requirement to comply with conditions precedent and the giving of vacant possession at the end of the break.

These will be dealt with in turn:

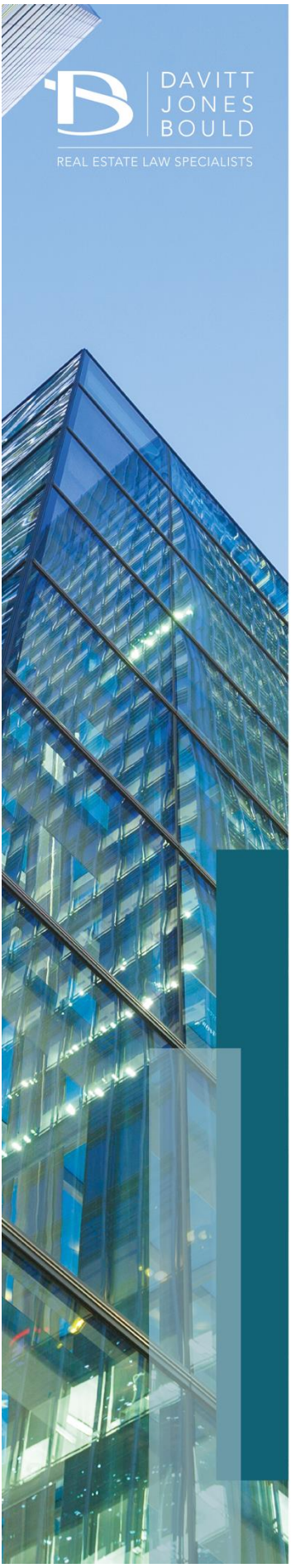
CONDITIONS PRECEDENT

It is common for an option to break provided that the tenant has paid all the rent and performed all the covenants in the lease. But this means even a trivial breach of covenant will defeat the tenant's option. In almost all cases an obstructive landlord will be able to find some subsisting beach of covenant on the tenant's part and thereby defeat the option. Conditions precedent may, therefore, work against a tenant wishing to break. For example, in ***Osbourne Assets v Britannia Life (1997)***, a tenant who had decorated using two coats of paint instead of the three coats required by the lease, lost his right to break as a result. Or, more recently, in ***Sirhowy Investments v Henderson [2014] EWHC 3562***, a second hand car business based in Caerphilly in South Wales called Dan's Bangers, lost their right to break because a small amount of picket fence had fallen down and they were therefore in breach of the covenant to keep the premises in good and substantial repair.

Perhaps better would be for the tenant's adviser to insist that the requirement be that the tenant shall have *reasonably* performed his covenants. In such a case the exercise of the option will be valid if the tenant has performed his covenants 'to the extent that a reasonably minded tenant would have done' ***(Gardner v Blaxill [1960] 2 All ER 457)***. The inclusion of the word 'reasonably' gives the court a discretion to find in the tenant's favour where, for example, he has made one or two late payments of rent, but not where he has been persistently in arrears throughout the term: ***Bassett v Whiteley (1982) 54 P & CR 8***.

Alternative wording to strict compliance and often seen as a halfway house between strict and reasonable, are the requirement for *material* or *substantial* compliance with the terms of the lease. But these terms can be equally damaging, from a tenant perspective. In ***Fitzroy House, Epworth Street v The Financial Times [2006] EWCA Civ 329,*** a break clause was dependent on material compliance with the terms of the lease.

The tenants had a schedule of condition drawn up by a surveyor and complied with all their suggestions, none of which were structural. But snagging problems with the contractors led to the works not being satisfactorily completed before the break date. The court at first instance stated that not every defect had to be remedied: regard should be had to the age, type, location, and use of the premises in determining what was expected.



In their opinion, the landlord could only refuse consent if it was fair and reasonable to do so and the purpose of limiting the right to break was to enable a landlord to preserve its legitimate interest in being able to re-let speedily thus maintaining the value of the reversion. However, the Court of Appeal partly reversed this decision, saying there is a difference between reasonable compliance, where a reasonably competent surveyor's report may be relied upon, and material or substantial compliance, where this is not so.

In ***Avocet Industrial Estates LLP v Merol Ltd and another company [2011] EWHC 3422*** a condition precedent to exercise the break clause was that the rent had to be up to date. Over the previous six years the tenant had on a few occasions been late in payment of the rent and interest had accumulated, although the landlord had not demanded this. This was not an insolvent tenant – it was just cases where the bank had paid the money a day late because of a bank holiday, for example. Nevertheless, the court found in the Landlord's favour – money was owed, and so the break conditions hadn't been complied with. As the interest had not been paid at the break date the tenant had not effectively brought the lease to an end. The outstanding interest amounted to £130; the cost to the tenant in extra rent was £300,000. This was no insignificant consequence.

As an aside, it is worth mentioning that, following the Regulatory Reform (Fire Safety) Order 2005, and Control of Asbestos Regulations 2012, if a tenant must materially or substantially comply with the terms of the lease, they should make sure they have up to date fire and asbestos risk assessments at the date of the break. Otherwise, they will be in breach and this could be used by a landlord as a reason to refuse it.

Perhaps a better solution all round, and one which is becoming increasingly acceptable to landlords, might then be to allow the tenant to break the lease without any conditions at all. If needs be, the tenant may still be sued for antecedent breaches.

Apportionment of Rent on a Break

In ***PCE Investors Ltd v Cancer Research UK, [2012] EWHC 884 (Ch)*** the break date fell between rent payment days, which were quarterly. The tenant served their break notice, but only paid rent up to the date of the break, and not for the whole quarter in advance as required by the lease. The Court of Appeal held that the break could not be exercised because the whole quarter in advance had not been paid.

Marks & Spencer v BNP Paribas [2015] UKSC 72. Here the tenant, Marks & Spencer, had to pay rent quarterly in advance, together with an insurance charge and a car parking licence, also in advance. It was a condition precedent for exercising their break clause that all monetary payments owed to the landlord should be paid. The break did not correspond with a quarter day. The tenant paid the rent and other monetary payments in advance and then claimed that it must be implied that they could recover back money relating to the period beyond the break date. The Court of Appeal and the Supreme Court both disagreed, holding that there is no scope for implication of such a term.

As the above case highlights, whilst the RICS Code for Leasing Business Premises from September 2020 states that good practice is to return rent due after a break date to the tenant, this is only a code of practice, and so the terms of the individual lease take precedence over it. It is therefore vital that you expressly include an apportionment provision, if the break date doesn't correspond with the rental payments.

VACANT POSSESSION

Another common condition is that the tenant must give vacant possession at the end of the break. This might seem obvious but, if not done correctly, again it can cause the break to be invalidated. In ***NYK Logistics (UK) Ltd v Ibrend Estates [2011] EWCA 683,*** the break clause required vacant possession. The tenants gave notice and cleared the premises. Arrangements were made to surrender keys and the tenant agreed to carry out some repairs. However, the contractors, who were running behind schedule, did not complete the repairs until six days after the break date, and both they and security staff remained present at the premises during this time. The court held that the tenant had not given up occupation and could not break the lease.

In ***Riverside Park Ltd v NHS Property Services [2016] EWHC 1313*** The tenant (the NHS) was required to give up vacant possession of offices as a condition of exercising the break clause. The premises contained a large number of demountable partitions that had been installed by the tenant, but which were not removed at the end of the break. The court decided that as they were not substantially attached and could readily have been removed they were fittings belonging to the tenant who had therefore failed to vacate and could not exercise the break. The court went on to say that, even if they had been fixtures, there was no provision in the lease whereby they had been part of the demise. They were therefore tenant's fixtures which should have been removed.

Perhaps even more surprising is the contrasting case of ***Capitol Park Leeds plc v Global Radio Services (2020) EWHC 2750.*** Here, it was held that a condition precedent as to vacant possession had not been complied with when the tenant vacated, taking with him ceiling tiles, window frames and lighting grids belonging to the landlord.

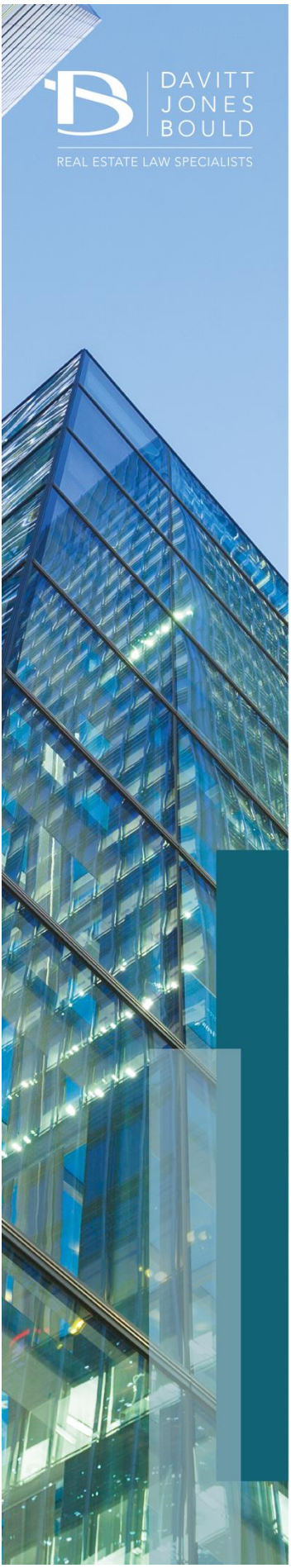
On the basis of the above, it is suggested that perhaps occupation should be the condition precedent, not vacant possession.

TIMING OF THE BREAK

The very recent case of ***Wigan Borough Council v Scullindale Global Limited [2021] EWHC 779*** concerned a landlord break. The Council had granted a 199-year lease of Haigh Hall to the tenant, who intended to convert the premises into a hotel. The Council had the right to serve a two-month break notice if works allowed under a planning permission were not completed by 31 March 2018. The works were not completed but it was not until 18 months later that the Council served notice. The tenant argued that it must be implied that the break would be served within a reasonable time. Finding for the landlord, the court did not accept this argument. The break notice could be served at any time when the breach was subsisting.

Incorrect dates on the Break Notice

In ***Micrografix v Woking 8 Ltd [1995] 37 EG 179***, the break clause to determine lease was exercisable on 23 June 1995. The tenants in the notice referred to the relevant clause in the lease but erroneously stated that the lease would determine on 23 March 1994. The court held that the mistake was obvious to someone with the landlord's knowledge and that the landlord would not be misled by the wrong date. The notice was therefore valid.



In ***Mannai Investment Co v Eagle Star Life Assurance Co Ltd [1997] 2 WLR 945, HL***, the tenant entered into a ten-year lease of office premises subject to a right to exercise a break clause terminating on the third anniversary of the commencement date. The commencement date was 13 January. The notice to break was expressed to terminate on 12 January. The House of Lords held that, so long as a reasonable receipt of the notice made clear what was intended, the notice was valid. It was sufficiently clear that the tenant intended to exercise the option to break.

Reference to the clause allowing the break would presumably be sufficient, at least in the case where the lease contains only one break. Mistakes are still made, however, for example where breaks are served in the name of the wrong tenant, in particular where there is an associated company in occupation.

In ***MW Trustees Ltd and others v Telular Corporation [2011] EWHC 104***, a lease provided for a tenant to terminate by giving six months' written notice by hand or special delivery to the landlord. The reversion was sold during the term and, when the tenant served the break notice, it was addressed and sent to the former landlord by mistake.

The tenant subsequently emailed the new landlord attaching a copy of the original notice and explaining what had happened. The landlord forwarded the email to its managing agents, who confirmed to the tenant that they accepted the notice and were happy for the tenant to terminate the lease. However, they asked the tenant to re-address the notice to the landlord.

The tenant prepared a replacement notice, but it was not received by the landlord. The landlord argued that no effective break notice had been served, but the High Court founding favour of the tenant on the grounds that:

- Applying the principles in ***Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1997] UKHL 19***, a reasonable recipient would not have been misled as to the tenant's intention to terminate the lease even though the notice was addressed to the wrong person. On the court's construction of the lease, although notice had to be given to the landlord, it did not need to be addressed to the landlord.

- Although the lease did not permit service by email, the landlord was estopped from challenging the validity of the notice.

STAMP DUTY LAND TAX AND LAND TRANSACTION TAX (WALES)

One final point to mention is the position regarding SDLT/LTT on the grant of long leases. In both cases, the tax payable is based on the lease as it stands at the time of grant. Therefore, a 5 year lease with an option to renew for a further five years will be taxed as a 5 year lease; but a 10 year lease with an option to break after 5 years will be taxed as a 10 year lease. Consequently, leases with break clauses will attract the higher rate of tax, regardless of whether the break is subsequently exercised. There is no way to apply for a rebate after the event.

On this basis, given the litigious nature of break clauses, it would perhaps be better to have a short lease with an option to renew, than a long lease with a break clause.

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