



Breaking Free: Considerations for Tenants on Exercising Break Clauses

The last report of the bi-annual CBI/GVA Grimley Real Estate Survey [1] published in November last year showed that businesses across almost all sectors continued to cut their property holdings in the six month period up to 26th August last year. A further 15% cut in holdings was predicted over the following six-month period, which will come to an end shortly.

The cuts are understandable against the backdrop of the UK's weak return to economic growth and a prolonged need for many businesses to continue to reduce costs to survive in difficult markets. In our August 2009, briefing we considered the pitfalls of subletting unwanted premises at below market rent and the following month, we looked at surrenders of premises back to Landlords. Some tenants, however, might not need to pursue either of those routes to divest themselves of financial liability under leases: they may have the benefit of a right to break, which is often the simplest way to bring an unwanted tenancy to an end.

Exercising a right to break is not, however, without its dangers and we look in this briefing at two of the established pitfalls, service of the break notice and compliance with break conditions. While it will usually be tenants that are most concerned about the exercise of break rights, it is also often in the Landlord's best interest to ensure that a break clause is well drafted.

If the Tenant purportedly exercises the break clause, the Landlord will want to be certain that the lease will be properly brought to an end on the break date so that plans can be made for the future of the premises.

Service of the Break Notice

The lease will set out the procedure that must be followed by the tenant for the valid exercise of the break right. A tenant that wishes to exercise the break right will need to be sure that it has complied with the terms of the lease in order to bring the lease to an end on the specified break date. In particular, service of the notice itself must not be defective and time limits for service must be complied with.

The notice must be given by the person (or persons) entitled to exercise the break right and must be served on the Landlord. The lease will contain provisions regarding the service of notices. In last year's case of *Prudential Assurance Co Ltd v Exel UK Limited and another* [2] ("Prudential") the Court looked again at which parties need to give the break notice and when a defective notice might be "saved".

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Prudential's warehouse in North London was occupied by joint tenants, Exel and another. Exel's solicitors served a notice on Prudential purporting to exercise a break right contained in the lease and although the notice identified both tenants, it stated that the solicitors acted on behalf of Exel and made no mention of their acting on behalf of the joint tenant. The Court held that the notice must be viewed objectively and asked whether a reasonable recipient, in light of the background, would have understood the notice. The Court found that the reasonable recipient might have doubted whether the joint tenant had intended to terminate the lease. The notice was therefore held to be invalid.

The Court had previously applied the same test in the 1999 case of **Havant International Holdings Limited v Lionsgate (H) Investment Limited** (Havant), but reached the opposite conclusion. In Havant, the error was in the name of the tenant giving notice, which was expressed to be Havant International Limited and not Havant International Holdings Limited. The Court decided that a reasonable recipient of the notice would not have been misled by the error and that the notice was valid.

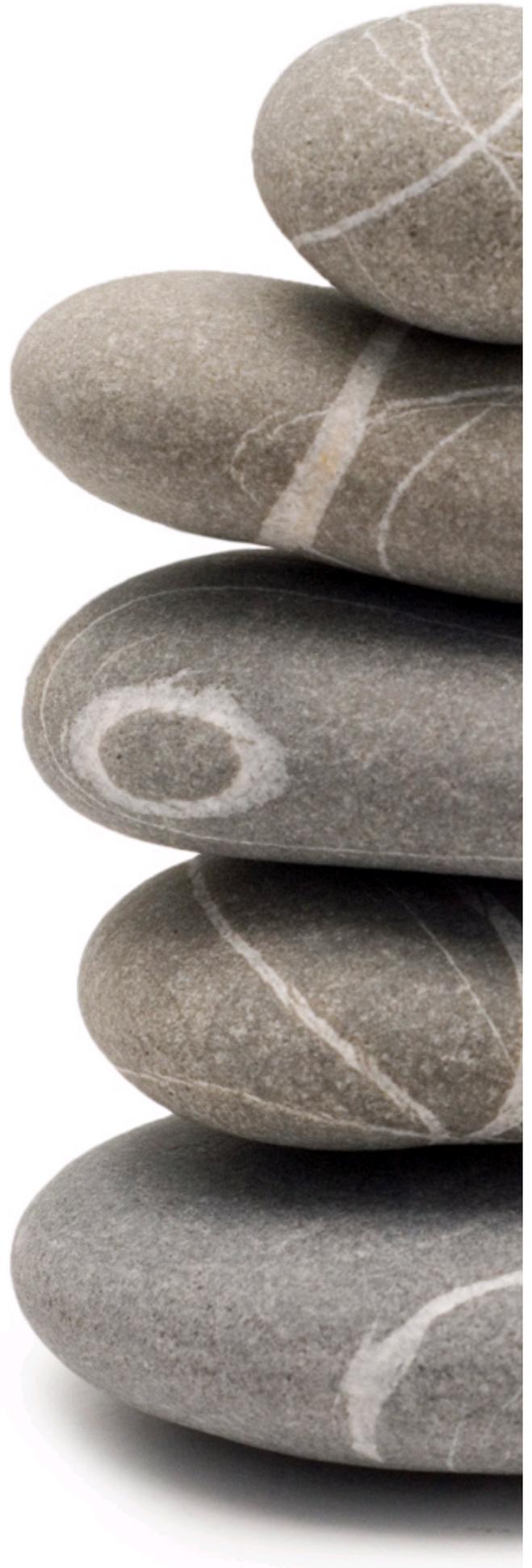
Compliance with Break Conditions

The Code of Leasing Business Premises in England and Wales 2007 ("the Lease Code") provides that leases should only specify three pre-conditions that must be satisfied before a tenant break clause can be validly exercised. Firstly, the principal rent must be paid, secondly, possession must be given up on or before the break date and thirdly, no sub-tenancies must be left. Notwithstanding that many leases still make compliance with covenants (particularly the tenant's repairing covenants) and payment of service charge pre-conditions.

It is settled law that any conditions attached to the exercise of the break right must be strictly performed and time is of the essence in respect of any time limits in the clause. The conditions that give particular difficulty to tenants are the requirement to be in compliance with all tenant covenants in the lease and to give vacant possession.

Tenant Covenants

The requirement that tenants are in compliance with the covenants in the lease is often qualified by a requirement that such compliance need only be "material". In **Fitzroy House Epworth Street (No 1) Ltd v The Financial Times Ltd** [3] the Court of Appeal held that not all breaches, however minor, would preclude the exercise of the break clause and that it could not be implied that the parties had agreed that trivial breaches would frustrate the right to break.



The Court held that the tenant had materially complied with its repairing covenant in its attempts to obtain from the Landlord details of the dilapidations work required during the conduct of its relationship with the Landlord before the break clause was exercised.

It may, however, still be advisable for both parties for conditions that require material or reasonable compliance with covenants to be avoided. There is a great deal of scope for uncertainty and neither party can be confident that the lease has been properly brought to an end.

Vacant Possession

The Lease Code provides that only a condition requiring the tenant to give up occupation (as distinct from vacant possession) will be code compliant. There may be a difference and from a tenant's perspective the latter is preferable. In **Legal & General Assurance Society Limited v Expeditors International (UK) Limited** [4] the Court of Appeal held that the requirement to give vacant possession will be construed strictly against the tenant. It is now clear that for vacant possession to be effectively given the premises must be vacated, all tenant's items removed and the keys handed back. It seems that even if trespassers then take up occupation the exercise of the break clause might be frustrated.

Summary

A tenant wishing to exercise a break clause needs to read the wording of the clause carefully within the context of the lease. All conditions must be complied with, including, time limits and those for service. If errors are made then it could affect the validity of the break and the lease will continue.

It is, in our view, in the interests of Landlords and Tenants to ensure at the lease negotiation stage that break clauses function properly and conditions on their exercise are clearly set out.

It may be in the Landlord's interests to frustrate the exercise of a break right by the tenant but it will seldom be in either party's interest for there to be a period of uncertainty during which it is not clear if the lease still exists, which could result in litigation.

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Footnotes

- [1] See www.CBI.org.uk or www.gvagrimley.co.uk
- [2] Prudential Assurance Co Limited v Exel UK Limited & anor [2009] EWHC 1350 (Ch)
- [3] [2005] EWHC 2391
- [4] [2007] EWCA Civ 7

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