

Navigating Break Clauses in Commercial Leases: How to Avoid Breaking Bad

July 22, 2024

Exercising break clauses in commercial leases can often prove to be a legal minefield for any tenant (and, in some cases, a landlord) seeking to do so. Strict adherence to any conditions and notice requirements for the operation of the break will be paramount, as the Courts of England and Wales have historically taken a very strict interpretation against any failure to comply.

What are break clauses?

Break clauses are typically included in leases in order to allow the tenant or sometimes the landlord (and occasionally both parties) to terminate the lease prior to the natural end of its contractual term.

Compliance with conditions

In recent times, the Courts have tended to rule *against* a party who has failed to comply with the conditions attached to a break clause, so it is currently common practice for break clauses in commercial leases to be heavily negotiated (particularly on the tenant side) so as to contain as few conditions as possible, thereby making compliance with their terms easier to satisfy. Common types of conditions that are generally accepted include:

- **That the notice is to be in writing and served by post (rather than email):** Parties looking to serve a notice by a particular date should beware of sending it by email or on the break date itself. Standard notice clauses in leases will fall back to the standard postal delivery position – namely, that service is only deemed to have occurred on the second day after posting, rather than the date written on the actual notice. Therefore, time should be allocated to allow for posting the notice at least three to five working days prior to the notice period.
- **Time is of the essence:** As crucial as the method of service is to break notices, timing is also key. Break clauses often state that “time is of the essence”, which predictably means that if the deadline for service of the notice has been missed, the right to exercise the break will have been lost unless there is a rolling break option.
- **Vacant Possession:** Often a source of contention, break clauses are sometimes worded to say that the tenant must return the premises to the landlord with **Vacant Possession**. The recent Court of Appeal decision of *Capitol Park Leeds v. Global Radio Services* reinforces the principle that a break clause can be frustrated if a tenant leaves behind too many of their own personal chattels or fixtures and fittings at the break date. The decision in *Capitol Park Leeds v. Global Radio Services* ruled that the break clause had been validly executed even where the tenant had been accused of being too aggressive in its strip out – leaving the premises in an un-occupiable state by doing so. The best practice when agreeing to the break clause wording would be for tenants to only agree to return the premises free from occupiers so as not to fall foul of a potentially onerously high standard of strip out, which could ultimately frustrate their break clause.
- **A Break Premium:** This is usually a fixed sum payable by the tenant upon exercising the break and represents a repayment, sometimes in part, of a rent-free period that the tenant has benefitted from. Failure to pay this premium on the break date or on any stipulated date can also frustrate the break clause.

Some leases contain even more strenuous terms, requiring, for example:

- **Payments of all sums due:** This typically encompasses all payments due under the lease, including service charges, insurance and any other charges. Whilst payments of rent and potentially insurance (if demanded far enough in advance of the break date) can be reasonable payment conditions to accept on behalf of a tenant, service charges should be resisted because the amounts payable by the tenant often vary from month to
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month and may not have been properly communicated to the tenant, which again can frustrate the break option. Further, payment of **all rents** can also include, to the surprise of a tenant, interest amounts on overdue rents even if a landlord had not previously demanded them.

- **Compliance with other covenants:** This typically encompasses all tenant covenants, most notably repairing and decorating covenants, which have in some instances tripped up tenants. Given the difficulty of complying with it, this is far too onerous on the part of the tenant and should therefore be resisted by tenants.

It is also worth bearing in mind that the *Code for Leasing Business Premises, England and Wales 2020* (Code), sets out a number of requirements of expectations for Royal Institution of Chartered Surveyors (RICS) members and regulated firms (i.e., firms that have chosen to be RICS regulated) concerning the manner in which they provide services and/or the consequences of their actions. With respect to break rights, although the Code does recognise that parties may have agreed to stricter conditions, it stipulates that tenant break clauses should only be conditional on:

- the tenant paying the basic rent up to the break date; and
- the tenant giving up occupation and leaving no subtenants or other occupiers.

Accordingly, if you are a landlord and an RICS member, it may be worth considering whether any stricter conditions are necessary at the heads of terms stage.

Serving the notice:

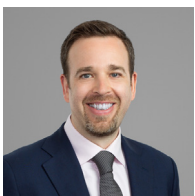
Correctly serving a break notice can mean the difference between a valid termination of the lease or a costly mistake. Failure to validly exercise the break could mean being stuck with the lease until its ordinary expiry date or until the next available break date.

As mentioned above, break rights will need to be exercised to comply with the correct notice period – typically between three to six months, more or less – depending on the commercial importance of the lease.

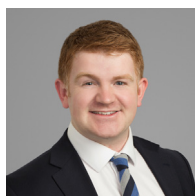
The importance of adhering to the notice requirements contained in the lease cannot be overstated. To quote *Lord Hoffman in Mannai Investment Co Ltd v. EagleStar Life Assurance Co Ltd* [1997] AC 749, “If the clause had said that the notice had to be on blue paper, it would have been no good serving a notice on pink paper, however clear it might have been that the tenant wanted to terminate the lease”.

Conclusion

Break clauses continue to be an area of real estate law that is filled with pitfalls and traps that could be easy for a layperson to fall into, often with costly consequences. If you have a break clause approaching, then we would recommend that you contact any of the following Real Estate lawyers for further information and advice:



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