



PAUL WOOD, AUGUST 2013

EXERCISING LEASE BREAK OPTIONS

ADEQUATE PREPARATION CAN AVOID COSTLY MISTAKES



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LEASE BREAK OPTIONS

It is not uncommon for modern commercial leases to contain a break clause option, often in the tenant's favour. In the prevailing economic climate it is essential that parties exposed to a break clause be suitably prepared. Break clauses are commonly only exercisable when clearly defined conditions are achieved. It is vital the parties pay close attention to these conditions.

Usually, they consist of vacant possession (VP), payment of rents arrears or other sums due under the lease, service of written notice and compliance with set lease covenants. Failure to adhere to these conditions can result in invalidation of the break, which can be a costly mistake.

VACANT POSSESSION

If the lease provides that VP be given, then the tenant must cease occupying the property on, or before the relevant break date. Effectively, VP at the property should allow the landlord to physically and legally 'enjoy' it and make it available for letting. Failure to give VP can render the break notice ineffective. In the case of *Ibrend v NYK (2011)* the operation of the break clause was conditional upon VP. The tenant engaged contractors to carry out decorating and repairs. The tenant vacated, but the workmen remained at the premises after the break date. The Court found that the tenant had failed to give VP and granted the landlord a declaration that the break had failed, thereby the lease continued.

RENT AND OTHERS SUMS DUE UNDER THE LEASE

Failing to pay rent and all associated sums up to the break expiry date is another common pitfall when exercising a lease break. This was highlighted in the recent case of *Avocet v Meroi (2011)*. In this case, the break clause was subject to several conditions, including any payment due under the lease, to have been paid on or before the break date and the tenant paying a sum equal to six months' rent on, or before the break date. The High Court found that the tenant had occasionally been late with the payment of rents and interest of around £130 was owed, which had not been paid by the break date. As a result, the tenant was held to be in default of the terms of the break, and that the break had not been validly exercised, leaving the tenant bound by the terms of the lease for the remaining five years of the term at a rent in the region of £67,000 per annum.

Similar issues can arise in relation to arrears or other sums due under the lease. Further recent case law has confirmed the importance of this. In *Quirkco v Aspray (2011)*, the tenant's break was invalidated because the tenant was in arrears of insurance rent. This case further highlights the need for tenants to comply with all payments due under the terms of the lease, and that they perform all investigations necessary to establish potential outstanding sums, without reliance on the landlord (who are not obliged to assist!).

NOTICE

The correct method of serving notice to exercise the break is critical. Missing the deadline for serving the break notice or serving the notice on the wrong person/address, or serving the notice in an inappropriate form, can prove fatal. The importance of this was highlighted in the case of *Hotgroup v the Royal Bank of Scotland (2010)*. Here, the break date was the 3rd July 2010 and the break clause required not less than nine months prior written notice to the landlord. The break notice was served to the landlord on 14th September 2009 within the timescales specified, however, the required copy notice was served onto the property manager on 3rd December 2009. The Court held that the break was not effective due to the delay in serving the copy notice.

Drafting errors in notices need to be avoided, but mistakes do happen and depending on the extent of the error, they do not always invalidate a break as in *Peer v Cleanwash (2005)*. The Court held that the intention of the notice was clear and that there was merely a mistake as to the break date specified and therefore the notice was valid. Despite this, it is vital that parties strictly comply with the lease terms when serving notices.



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ABSOLUTE OR QUALIFIED CONDITIONS

Compliance with break conditions can be either 'Absolute' (strict) or 'Qualified' (material, reasonable or substantial).

An 'Absolute' condition can prevent the tenant exercising the break clause if there is a single breach of covenant or condition, no matter how trivial. This was identified in '*Osborne v Britannia Life (1997)*', where it was found that an applied single coat of paint was enough to invalidate the break due to absolute compliance required under a clause in the lease.

A 'Qualified' condition is one that the tenant is only required to have reasonably, materially or substantially complied with its obligations. Identifying the difference between the two is key and is highlighted in the case of '*Fitzroy v Financial Times (2005)*'. In order to fulfil a material compliance condition the tenant undertook a £1 million repair programme and invited the landlord to inspect on numerous occasions. The landlord refused to inspect prior to the break date and after the break date it was found that there were still outstanding repairs worth in the region of £20,000. The Court of Appeals view on this was that 'Material compliance' was more than what was 'reasonable' but less than 'Absolute compliance'. The tenant was held to have 'Materially complied' with its obligations and the landlord could re-let the premises without difficulty, all validating the break.

'Absolute' compliance is also important in the timing of notices. It is important to identify within the lease whether 'time is of the essence'. The general rule is that time limits in a rent review or a corresponding break clause are not strict (of the essence), unless 'expressly' stated within the lease, as in the case of '*United Scientific v Burnley Borough Council (1978)*'. The underlying principle from this case is that, time is dependent on the wording in the lease, if time is 'expressly' stated for a procedure such as a break clause, if you fail to meet those timings, you will lose out as a consequence.

CONCLUSION

Lease breaks are increasing in use due to the current economic climate, giving tenants further insurance and flexibility with their lease terms. It is vital that all parties affected by a break clause be wary of specific wording of the clause and relevance to the lease. The emphasis is generally on the tenant to ensure it has undertaken sufficient due diligence when preparing to exercise a break, but all parties involved need to take advice from experienced surveyors and lawyers in order to protect their interests.