Break clauses in commercial leases

This note highlights the practical issues that a tenant should consider when exercising a break clause in a commercial lease.

What is a break clause?

A break clause can be included in a fixed-term lease allowing either the tenant or landlord to terminate the lease early. Exercising a break clause brings the lease to an end. However, where the landlord breaks the lease, legislation is in place that may allow the tenant to remain in the property after the lease has ended. Depending on how the lease has been drafted, the right to break the lease may:

- arise on one or more specified dates; or
- be exercisable at any time during the term of the lease on a rolling basis.

A break clause may only be exercised if any conditions attached to it have been satisfied (for example, providing vacant possession). A break clause will be strictly construed by the courts and any conditions must be strictly performed. The Code for Leasing Business Premises in England and Wales 2007 recommends that:

“The only pre-conditions to tenants exercising any break clauses should be that they are up to date with the main rent, give up occupation and leave behind no continuing subleases. Disputes about the state of the premises, or what has been left behind or removed, should be settled later (like with normal lease expiry)”

Practical issues for tenants to consider when exercising a break clause

The following is a list of practical issues for tenants to consider when exercising a break clause:

- Once a break notice has been served, it cannot be withdrawn unilaterally, so a tenant must be sure that they intend to break the lease. Any mutual waiver of the notice will be deemed to constitute the grant of a new lease, which takes effect from the date of expiration of the break notice.

- Tenants should comply with all the relevant requirements in the break clause and keep evidence of their compliance to help protect their position. The break notice should be served in good time and strictly in accordance with the terms of the lease.

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• Evidence of service should be kept, particularly where there are specific provisions in the lease relating to the method of service required. In the absence of specific service provisions in the lease, the tenant could request that the landlord acknowledges receipt. If the notice is being served by an agent, make sure the landlord is aware of the existence of the agency and its authority.

• Consider carrying out a compliance audit with a surveyor's advice before serving the break notice. A tenant can then take steps to remedy any breaches to ensure compliance with its covenants.

• Pay any outstanding sums due, even if these are in dispute. Payment can be made on a “without prejudice” basis and the matter disputed later.

• Check whether default interest may be due on past arrears. Unless the tenant has received a demand from the landlord, they may have difficulty knowing precisely how much default interest is due. Therefore, tenants should try to estimate the amount due and err on the safe side. The cost of doing so is likely to be far less than the cost of remaining bound under the lease.

• Ask the landlord for confirmation of the steps required to comply with any conditions. Ask the landlord to prepare a schedule of dilapidations in relation to any repair works. A schedule of dilapidations is a list of items that are in need of repair and that the tenant has responsibility for, due to the repairing obligations under a lease.

• Tenants carrying out works to the property before the break date need to be careful to ensure that the works are completed and vacant possession can be given by the break date. Vacant possession will not be given if contractors are still working in the premises.

• Consider asking the landlord to accept the break notice on payment of an agreed amount as liquidated damages for any outstanding breaches of covenant. Liquidated damages are a fixed or determined sum agreed by the parties to a contract to be payable on breach by one of the parties. This would provide clarity that any breaches are resolved but it needs to be done carefully and without making an open admission that there have been breaches.

• Ensure that any waiver of a condition by the landlord is not made “without prejudice” and that it is clear to which condition(s) the waiver applies.
While the above is a useful checklist of issues to consider when exercising a break notice, there might be other practical and legal issues that may need to be considered depending on the terms of a particular lease. We would be happy to advise on issues relating to the exercise of a break clause, as well as the drafting and negotiation of commercial property leases.

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