

How to break – right

Many commercial leases will contain a contractual right for either the tenant, or sometimes the landlord, to break the lease prior to the end of its contractual term if certain conditions are met. In the current economic uncertainty created by the coronavirus pandemic, tenants may be considering exercising these rights. This article examines the issues to be borne in mind by tenants when hoping to rely on their right to break the term of the lease.

Break rights – overview

Break rights can take several forms. A right to break the lease throughout its term is known as a rolling break right. Those which can only be exercised at certain times are commonly described as fixed break, or one-shot break rights.

This article focusses on fixed, or one-shot, break rights available to tenants of commercial premises. Many may not previously have planned to exercise them during 2021, but may now be reviewing that decision, given the current uncertainty and economic impact caused by the coronavirus pandemic.

In times of economic uncertainty, an unanticipated break of a lease by a tenant will present its landlord with the dilemma of having to unexpectedly re-let the then vacant premises in adverse market conditions. Unsurprisingly, landlords and their solicitors will now be scrutinising break notices and the provisions of break clauses very carefully to check if a purported exercise of a break can be challenged.

Break conditions

The conditions set out in a lease concerning a tenant's break right will be strictly interpreted by a court, and, as a consequence, must be rigorously complied with by tenants. Certain conditions may need to be met prior to service of a break notice, others prior to the break date, or in some cases, both.

Break right conditions in new leases, whose landlords agree to adopt the 'Code for leasing business premises, England and Wales', published by the Royal Institution of Chartered Surveyors, ("Lease Code"), should – unless the parties agree to the contrary

– be “... conditional only on the tenant paying all basic rent payable on any date before the break date, giving up occupation and leaving no subtenants or other occupiers ...”.

However, many landlords have not and do not intend to adopt this voluntary Lease Code and many leases, especially older ones, may contain much stricter conditions – which may extend to material, or even full compliance, with all of the tenant covenants of the lease.

Proof of payment of rent or other sums may be straightforward but compliance with other covenants may be more difficult to evidence. Most commercial leases will, for example, require tenants to keep and return their premises in a certain state of repair and condition, or to reinstate alterations works carried out during the term.

In the absence of contrary wording in the lease, landlords are not under an obligation to advise tenants of whether they believe them to be compliant or not – and a well-advised landlord will not prejudice its position by responding to such a request. If they do, then landlords will normally take care not to make any representations which tenants may subsequently argue they relied upon to their detriment when claiming that the landlord be estopped from contesting the validity of a break notice.

Tenants should therefore consider instructing a specialist surveyor to carry out a compliance audit. This surveyor will review the tenant covenants under the lease, carry out a detailed inspection of the premises and advise of remedial steps to be taken so as to ensure compliance with any required break conditions.

If it appears that breaches of conditions have occurred which cannot be remedied, or there are big question marks over compliance, then a tenant may alternatively choose to progress negotiations with its landlord to agree to a formal surrender of the lease, on terms to be agreed between the parties.

Payments due prior to break date

Aside from any specified sums which a tenant may need to pay as a condition of validly exercising their right to break – which are known as break penalties – most commercial leases require tenants to pay their rent in advance, either quarterly, or monthly.

Even Lease Code compliant leases will need tenants to continue to pay rent as and when it falls due up to the break date, even if the payment in question relates to a period after the break date. A well-drafted lease should include provisions whereby the landlord can be required to reimburse the latter, but in the absence of such, a landlord is not normally under any duty to do so. However, given the need for strict compliance with break conditions, a tenant will still need to pay such sums nevertheless.

In such cases, tenants are also not usually able to off-set amounts of rent or other sums falling due against rent deposits held by their landlords. Many tenants commonly make the mistake of doing this rendering the exercise of their break right ineffective.

For those tenants whose leases require full compliance with tenant covenants particular care should be taken to review past payments to the landlord too, to identify if any were made late. In such cases, the lease will no doubt specify that interest is due in relation to such late payments, whether demanded by the landlord, or not. If any such cases are identified, the amount of interest due to the landlord under the lease should be carefully calculated and paid, so as to avoid this constituting a breach of the break conditions.

Valid service of break notices

In addition to compliance with other break conditions, tenants must take special care to comply with the requirements for valid service of their break notice under their lease. If the lease prescribes that a notice in a form annexed to the lease must be used then this must be done. Any other specified rules governing the service of the notice must be strictly complied with.

Many leases will only permit the original tenant party to be able to validly break the lease, and not its successors in title, so this should be checked.

The break notice must correctly describe the premises in respect of which it relates. A right to break the lease in respect of part only of the premises is possible, if expressly provided for in the lease, but particular care should be taken in such cases.

The break notice must also be served on the correct person. A check should be made at the **Land Registry** that the **presumed 'landlord' remains the registered proprietor** of the reversionary interest in the let premises and checks made that any address for service specified in the lease remains correct. In the case of a corporate landlord, the up to date registered office address should be checked from Companies House records.

Proof of service

A tenant will need to prove that any break notice has been validly served. In the absence of specific requirements to the contrary in the lease, it is recommended that they are served personally at all current addresses for the landlord, together with its managing agents and solicitors. Tenants should consider employing a reputable firm of professional process servers for this task, who should be instructed to provide a sworn certificate of service as evidence.

Where possible, recipients of the break notice should be asked to acknowledge receipt and of the validity of the notice. If they do so, and, in reliance of this confirmation a tenant proceeds to act to its detriment by buying or letting new premises, for example, then a landlord may be estopped from subsequently denying valid service of the break notice (assuming that any remaining break conditions are complied with).

Time of the essence

Time is of the essence in respect of the service of a break notice and compliance with conditions relating to it. Consequently, any time limits set out in the lease for a valid exercise of the break right must be strictly adhered to.

Break notices should be served with time to spare – so that if valid service is challenged there may be the possibility of re-serving a valid break notice, before any time limit to do so expires.

During the current coronavirus pandemic, when most businesses will have a significant proportion of their work force working remotely from home, or absent from the workplace on furlough arrangements, there is a real danger that forthcoming break dates may have been forgotten, overlooked and subsequently missed. Tenants should therefore take steps to review their leases and centrally diarise all future break dates.

Exercise of break right irrevocable

Given that break notices periods in leases are quite long – typically at least six months or more – it is not uncommon for a tenant to change its mind about staying in its premises after serving a break notice. Indeed, a retail or restaurant tenant whose business may now be struggling as a result of the current lockdown and social-distancing rules stemming from the current coronavirus pandemic may be tempted to serve a break notice now, only to regret that it has done so when these restrictions are lifted and the inevitable economic recovery begins.

However, once served a break notice is irrevocable and cannot be nullified, even if both landlord and tenant would be agreeable to this. Instead, if the tenant remains in the premises and paying rent after the break date, then a new, albeit unwritten, tenancy will arise and the position is best regularised by completion of a new, written lease.

There are risks for both parties if this is not done. In the case of the tenant, the landlord may subsequently seek to recover possession of the premises at short notice, arguing that the tenant has no security of tenure that it is a tenant at will, or even a trespasser. **From the landlord's perspective, such a lease may result in a tenant claiming security of tenure, when the previous lease was not a protected business tenancy under the Landlord and Tenant Act 1954. Such a new lease may also have needed a mortgagee's consent, or, if the landlord is itself a tenant, that of a superior landlord.** In addition, such a new lease would not be binding on any previous guarantor.

If you need advice

A party seeking to exercise a break right under a lease is strongly advised to seek legal advice – and to do so in good time prior to the date by when any notice needs to be served.

Every lease and situation is different and therefore specific advice on your own lease and the options available should be taken.

Daniel Woodcock

Partner

01606 334 309

dwoodcock@butcher-barlow.co.uk

