



BREAK CLAUSES¹

Introduction

A break clause in a lease is a provision entitling either party to determine the lease prior to expiry of the contracted term by notice served in advance. It is usually given only to a tenant to exercise as an inducement to enter the lease but can be by either party. The terms of a break clause are a matter of commercial negotiation between the parties and their advisers. In a strong property market, landlords will generally be reluctant to concede break clauses at all and where they do, they will be looking for lengthy notice periods and also likely a break compensation amount equivalent to six/twelve months rent and outgoings. From each party's perspective great care needs to be taken in the drafting of break clauses and in particular from the landlord's perspective as they will generally be construed strictly by the courts and where there is untidy or ambiguous drafting the consequences could be significant for either party and possibly also their advisers.

Notice Provisions

The notice provisions in the lease need to be very clear. When either party comes to serve a notice, (and in particular a break notice), an unclear notice provision can present an unnecessary challenge. The notice provision should specify the method of service (i.e. registered post, ordinary post, by hand, etc) and, quite critically, where it is to be served. The notice provision may also specify if the notice can be served on an agent, solicitor or representative of the landlord or by an agent on behalf of the tenant. If the landlord is a company, it is likely that the notice provision will specify service on the registered office of the company. It is important to ensure that the provision in the lease relating to the service of the break notice clearly specifies when it must be served. It will usually specify that it must be served "**at least** six months/nine months/twelve months before the Break Option Date". There is no mandatory notice period for a lease break option and as with the remainder of the break option it is a matter of negotiation between the parties. If it does not specify "at least" or "not less than" a tenant will then be left in the tricky predicament of having to serve the break notice on exactly the date that is six months/nine months/twelve months before the break date, as appropriate. Whether a break notice once served is irrevocable without the consent of the Landlord is a matter for negotiation.

Conditions to Exercising a Break

This is probably the most controversial issue arising in the negotiation of break clauses. In a landlord's world, full covenant compliance by a tenant exercising a break option should be a precondition. This would have serious implications for a tenant seeking to exercise a break given that even a minor breach of covenant could jeopardise the tenant's ability to break. It is probably fair to categorise the current accepted position in practice as being that the only preconditions to exercise of a break are compliance with the notice provisions in the break clause itself, compliance with the rent

¹ This note does not deal with any tax issues arising whether VAT, stamp duty or otherwise in relation to break options. Practitioners should be aware that there may be tax consequences arising from the exercise of a break option and appropriate advice should be taken when the lease is being negotiated.

and other financial covenants and delivery of vacant possession on the break date. The sample clause below also requires as a precondition return by the tenant of the original lease and a release of any charge or other encumbrance registered against the lease. This would be a pretty standard requirement. A tenant may want to cover off the loss of the original lease and provide that a statutory declaration in reasonably standard form setting out the circumstances of the loss will suffice in lieu. The break will otherwise be without prejudice to the rights of either party to pursue the other after the break date for any other covenant breaches.

Vacant Possession

A landlord will generally be very anxious to obtain full vacant possession of the demised premises on the break date. It is not unreasonable that a tenant should be required to deliver full vacant possession on the break date and if there are sub-tenants or licensees in occupation of any part of the demised premises the tenant will be obliged to arrange for their vacation of the premises to comply with this obligation. This is all clear. Where the matter can become unclear is in relation to tenant's plant, equipment and installations. A landlord will generally want a tenant to remove all of its own fittings and equipment and leave the premises clean and tidy, etc and ready for a speedy re letting. Often times there can be a dispute as to the extent to which the tenant is required to go in order to deliver vacant possession and it might be prudent to consider including a definition of vacant possession in the context of compliance with the break clause. There may be specific cases where a landlord will be happy to assume responsibility for sub tenants and licensees and collect their rent post a break but this will very much be an exception and again the break clause will need to specifically cater for this if it arises.

Yield-Up

Closely aligned with vacant possession is the question of compliance with the yield-up covenant. As mentioned, it is generally accepted that compliance with covenants other than the obligation to deliver vacant possession and to pay all outgoing are not generally pre-conditions to the valid exercise of a break option. A landlord however may wish to specify the extent to which he expects the premises to be delivered on the break date. It may suit a tenant also to understand precisely its liability for dilapidations on the break date and it is not unusual to find provisions in a lease whereby well before the break date the landlord and tenant are required to engage with each other to agree a dilapidations settlement amount and in the event of a dispute provision for the matter to be adjudicated by a third party. This will give certainty to each of the landlord and the tenant in relation to the extent of the tenant's liability on the break date for dilapidations.

Personal Break

Again, it is a matter for commercial negotiation, but the landlord may seek to negotiate that a break clause is personal to the first tenant named in the lease and that the benefit of the break does not travel to the tenant's successors and assigns. This will likely be strenuously resisted by a tenant but is a matter for negotiation. From a tenant's perspective, it is preferable that the break clause is not personal and is contained in the lease. In such circumstances, the right to break the lease will be available to successors of the tenant, making the lease much more marketable unless the landlord has specified in the lease that it is personal. A landlord will typically want the right to break to fall away once the lease is assigned. If the break is personal, it is important in the case of a corporate tenant to ensure that it can be assigned to a group company in the event of a group company assignment.

Break Options in a Side Letter

It is not unusual to find that the terms of a break clause are contained in a side letter between the parties. This can be fraught with danger from the perspective of each of the landlord and the tenant. There have been situations where a landlord has sold the investment interest in a building the subject of a lease where the break clause was contained in a side letter and through oversight omitted to disclose the break clause to a purchaser of the landlord's interest. Subsequently, the tenant exercised

the break leaving the selling landlord open to a claim in damages for mis-representation from his purchaser. Unless there is a compelling reason not to do so, a break clause should be set out in the lease itself.

Mechanism for Determining Rent and Outgoings Due or Amount of Break Penalty

If the break is conditional on compliance with financial covenants, it is important from the tenant's perspective to include an express clause that provides that any prepayments of rent, service charge, etc beyond the termination date must be refunded to the tenant. If the break date is, say, 15 March 2020 and, assuming proper notice was served in accordance with the break option terms, if a quarter's rent falls due for payment on 1 March 2020, the tenant will have to discharge the full quarter's rent on 1 March 2020 and not only 15 days rent for the period 1 March to 15 March. If the tenant has not paid the rent in full as it fell due it is open to the landlord to argue there has not been compliance with a financial covenant at the break date and this is what was held by the UK courts in the case of Marks and Spencer plc v BNP Paribas Services Trust Company (Jersey) Limited and another (2015) UKSC 72. Having exercised its right to break several leases on 24 January 2012, M&S claimed a refund from its landlord of part of the December 2011 quarter's rent and other outgoings that were attributable to the period after the break date. There was no express provision in the leases entitling M&S to a refund in those circumstances. M&S therefore had to persuade the court that there should be implied into the leases a provision entitling it to reclaim these sums from the landlord. The UK Supreme Court found in favour of BNP. The court found that the bar is very high for it to imply a term not included in a contract and, in essence, a term can only be implied if, without it, the contract would lack commercial or practical coherence which was not the case in this instance.

Landlord Break Options

Landlord break options are reasonably rare and are not the focus of this note. Suffice it to say that where a landlord is seeking to include a break option in its favour it should be coupled with the tenant executing a deed of renunciation at lease commencement.

Release of Guarantors

Where a lease includes a guarantee, care should be taken by the tenant/guarantor to ensure that the guarantee provisions provide that the guarantor is released from its obligations under the guarantee on a valid exercise of a break option save in respect of any antecedent breach of covenant by the tenant.

Sample Break Option Clause

(Note this is not a recommended or precedent break clause but a sample for guidance purposes only)

1. Tenant's Break Option

1.1 The Tenant shall have a right to terminate this Lease on the last day of the [●] year of the Term (the **Termination Date**) subject to compliance with the following conditions:-

- (a) the service by the Tenant on the Landlord of not less than [●] calendar months written notice before the Termination Date of the Tenant's intention to terminate the Lease pursuant to this provision [which notice, once served shall be irrevocable without the written agreement of the Landlord];
- (b) The payment by the Tenant to the Landlord with the notice at 1.1(a) of a sum equal to [●] months' rent² payable under this Lease;
- (c) the-payment by the Tenant of all rents, service charges, insurance premiums and other outgoings in respect of the Demised Premises (plus VAT as applicable) up to the Termination Date subject to the Landlord providing a written statement of all amounts due not less than [] days prior to the Termination Date ;
- (d) save where the Landlord has previously waived this requirement in writing vacant possession³ of the entire of the Demised Premises free from encumbrances being provided to the Landlord on or prior to the Termination Date; and
- (e) delivery of the original of the Lease⁴ together with a release of any charge or encumbrance registered against the Lease on the Termination Date.

1.2 In the event of the Tenant exercising its right to terminate this Lease the Tenant shall if required by the Landlord (and assuming the requisite deed is provided by the Landlord to the Tenant in sufficient time) on or prior to the Termination Date execute a surrender or if required by the Landlord an assignment in favour of such third party as the Landlord may nominate of its interest in the Demised Premises free from all encumbrances and will hand over to the Landlord on or prior to the Termination Date the said surrender or assignment duly executed by the Tenant.

² Landlords may wish to include other outgoings in the break penalty such as service charges, insurance premia etc. Again, this is a matter for negotiation.

³ A tenant might consider inserting a definition of vacant possession as follows:

"In this context and for the purposes of this Tenant's Break Option, vacant possession shall mean:

- (i) that none of the Tenant's personnel, licensees, invitees and persons authorised by the Tenant including any sub-tenants or others with whom the Tenant shares possession of the Demised Premises (but not, for the avoidance of doubt, the Landlord or its servants agents, employees, invitees and licensees) remain in the Demised Premises on the Termination Date;
- (ii) all occupational interests in the Demised Premises created by the Tenant have been terminated; and
- (iii) all personal effects, furniture and equipment installed by the Tenant its servants agents or invitees have been removed".

⁴ Tenant might consider including provision of a statutory declaration in lieu where original lease is lost.

- 1.3 Any termination of the Lease under this clause shall be without prejudice to any antecedent breach of the terms of this Lease by either the Landlord or the Tenant.
- 1.4 In the event of the Tenant having made any payments of rent, service charges, insurance premia, or other outgoings for any period beyond the Termination Date, these will be refunded by the Landlord to the Tenant within 14 days of written demand.

Conveyancing Committee

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