Beware Break Clauses

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Attempted exercises by tenants of break clauses continue to be challenged by landlords before the Courts. PCE Investors v Cancer Research [2012] EWHC 884 is the latest in a long line. As in others before it the tenant failed. The result serves to emphasise the need for extreme care both when negotiating the terms of the clause and when considering its exercise. The price of failure is high. Rather than determining the tenant's rental and repair burden will unexpectedly continue. Whilst for the tenant's solicitor there is the risk of a professional negligence claim. The benefits to the landlord particularly when the rental market is poor encourages challenges to such notices.

1. Option – the starting point for all these cases is the characterisation of the ability to determine a lease unilaterally as a form of option. As such any exercise must comply strictly with the terms of the break clause and failure to do so will cause any notice to be ineffective.

Often express requirements will need to be satisfied to achieve an effective exercise of the power. Commonly these will be variations on three standard conditions – rent paid; vacant possession given; performance and satisfaction of tenant's covenants. The reason for inserting these requirements is to protect the landlord's position. Once the lease is determined the landlord will not have the remedy of distraint so the rent must be paid. The landlord will want to have the ability to relet without either delay or having to incur additional expenditure so it is important that the tenant's covenants have been complied with and there is nothing interfering with the ability to fully enjoy the premises. The recent case concerns the first requirement that all rent has been paid in full.

2. PCE Investors case – the ground for challenging the notice in this case was simple but raises an interesting point. The particular break clause specified that the "Tenant must have paid the rents reserved and demanded by this Lease up to the Termination Date." Rent was payable quarterly in advance. A break notice was served on 25th September 2009 to take effect on 11th October 2010. For the September quarter day in 2010 the tenant paid not the whole quarter's rent but a proportion up to the 11th October 2010. On the ground that the full quarter's rent had not been paid the landlord challenged the break notice.

This raised the issue whether there are circumstances in which rent could be apportioned when the lease determines during the quarter for which rent has been paid in advance or whether a full quarter's rent must always be paid in advance regardless of whether the lease is going to determine before the expiry of that quarter. Under English law the position has always been stated in clear terms that the full amount is payable in advance as apportionment is not possible under either the general law or the Apportionment Act 1870 (Ellis v Rowbotham [1900] 1 QB 740).

A challenge to this statement of the law was mounted in this case based in part on the position under charter parties and hire contracts and in part on contrary Australian authority. In Ocelota Limited v Water Administration Ministerial Corp (2000) NSWSC 370 a claim for repayment of the portion of rent paid in advance attributable to the period after the determination of the tenancy was successful. Hodgson CJ reached this decision on each of two separate grounds. The first ground was that there had been a total failure of consideration

as regards that period after determination. The second was that there was an implied term entitling the tenant to repayment. The learned judge distinguished Ellis v Rowbotham supra on the basis that in Ellis the lease had been determined by the landlord due to the tenant's breach of covenant. Mr. Justice Peter Smith rejected this approach as he did not consider that the bundle of rights comprising the lease could be segregated so as to treat the part of the rent for the period the tenant does not use the premises as representing a total failure of consideration.

The decision reasserts that rent payable in advance must be paid in full even if the lease will determine during the period for which the rent has been paid. This is the case when the lease has been brought to an end by the exercise of a break clause. When rent must be paid before the termination date to achieve an effective exercise of the break clause then it is important to ensure that it is the full amount due in advance and not an apportioned amount.

3. All sums due – not only must the payment be made in full but it must be made so that the landlord holds cleared funds before the expiry of the break notice. In Avocet Industrial Estates LLP v Merol Limited the sum of £130 defeated the break notice. A cheque was hand delivered the day before the expiry of the notice. Morgan J. held that this was permissible because of a course of dealing notwithstanding the terms of the lease. However, funds would not be cleared until after the expiry and so interest accrued which had not been paid. Leaving payment to the last moment is extremely dangerous.

4. Vacant possession – as well as requiring the rent to have been paid the break clause may require vacant possession to be given by the termination date. This may cause problems when attempts are made to reach arrangements for the handing over of the premises but no concluded agreement is reached. There may be repair work running over past the termination date. There may be subsisting security arrangements which if not continued may place the premises at risk of trespassers or vandals. All such matters will give rise to the question as to what is to be done by the expiry of the break notice. Should the repairs be completed? Should the security arrangements be continued? The answer is simple. The premises should be vacated. This is assuming that there is no subsisting breach which prevents compliance with the requirements of the break clause. If the workmen or the security guards stay on then it is likely that the vacant possession requirement will not be treated as satisfied.

Last year the Court of Appeal in Ibrend Estates BV v NYK Logistics (UK) Limited [2011] EWCA Civ 683 held that such a requirement was not satisfied when workmen remained for four days working after the expiry of the notice and the tenant's security guards remained to protect the site. It was accepted that if asked the men would have gone but that is not enough. The landlord has to receive actual unimpeded enjoyment of the premises which is not substantially impeded by the user of another or by physical impediments which should not be there. No reference was made in that case to the decision in John Laing Construction Limited v Amber Pass Limited [2004] 2 EGLR 128 in which it was held that a tenant had yielded up premises on the expiry of a break notice even though the tenant's security barriers and guards remained in place and the keys were retained by the tenant. They were not regarded as a hindrance but it is questionable whether it is correct in the light of the recent decision in Ibrend Estates supra.

The only safe course is to stop all the tenant's work and security arrangements and to tender the keys unless there is a prior concluded and well evidenced arrangement to continue works or security. Once removed then an offer to go back can be made to the landlord.

5. Performance of tenant's covenants – the advantage to the landlord of securing full performance and observance of the tenant's covenants is that it ensures the landlord may if it wants to relet immediately upon the best terms without incurring expenditure. In the past such a requirement was often couched in absolute terms with the draconian result that even trivial breaches will prevent a valid exercise. Apart from disregarding spent breaches (Bass Holdings Limited v Morton Music Limited [1987] 1 EGLR 214) there is no qualification of such harsh treatment and in particular it is not necessary that the breach is such that substantial damages will be awarded (Bairstow Eves (Securities) Limited v Ripley [1992] 2 EGLR 47). Honest attempts by the tenant to comply will be insufficient if there is an actual breach. It does not mean that the occurrence of trivial repairing defects shortly before the expiry of the notice will automatically invalidate the break notice as usually it is the failure to repair rather than the existence of the defect which constitutes the breach. In consequence unless the tenant places no value on the break clause no tenant can be advised to enter a lease containing such a requirement in absolute terms.

Qualifications of the requirements are the norm. The absence of substantial or material breaches at the expiry of the notice are regarded as interchangeable requirements. Both exclude trifling breaches. Whether the tenant has acted reasonably or the landlord unreasonably will still be irrelevant. The test in either case is by reference to the landlord's ability to relet and the terms of the new lease. Outstanding repairs which will neither prevent a reletting nor extend significantly any rent free period for the new tenant will not be substantial nor material. If on the other hand they result in a significant delay in reletting or cause the new tenant to negotiate a longer rent free period then the breach is substantial and material (Fitzroy House Epworth Street (No 1) Limited v Financial Times [2006] 2 EGLR 13).

An alternative qualification is to require reasonable compliance which is a different test to material or substantial. It permits the Court to take account of the behaviour of the tenant and the landlord with regard to the letting. Failure by the tenant to respond to the landlord's communications counts against a tenant as does total non-compliance of a covenant (Reed Personnel Services plc v American Express [1997] 1 EGLR 229). In contrast one coat of paint rather than the stipulated two might be justifiable as might leaving a carpet which is in good condition instead of replacing with a new carpet. Honest and considered attempts by the tenant to comply will be a factor taken into account.

6. Manner of service – to add to the hurdles facing the tenant the break clause may stipulate the manner in which the notice is to be served. If this is regarded as mandatory then failure to comply will cause the notice to be effective. In Orchard (Developments) Holdings plc v Reuters [2009] 1 EGLR 13 the break clause stipulated the formal manner of service required but also permitted informal service if acknowledged by the landlord. The Court of Appeal held that to satisfy the service requirement the landlord's acknowledgment had to be before the commencement of the clause's six month notice. Compliance with the stipulated manner of service is the only sensible approach to adopt.

7. Professional negligence – failure to warn a tenant as to the requirements that

need to be satisfied in order to effectively terminate a lease runs the serious risk of a claim if an invalid break notice is served. In Credit Lyonnais SA v Russell Jones & Walker [2002] 2 EGLR 65 the tenant's solicitor instructed to serve a break clause failed to warn the tenant that the break clause required a payment to be made. No payment was payment but a successful claim for negligence was.

Aside from satisfying the requirements in the break clause there will be potential issues over timing, wording and the standing of the server. A simple concept but a myriad of complications which require careful professional advice to avoid the lurking traps. The most recent case is yet another reminder of those problems and the price that is paid if any one of the hurdles is not safely cleared by the tenant.