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Drinks, Hospitality & Leisure

Break clauses: don't lose your rights

A best practice guide

Our hospitality team specialises in advising pub companies, late night operators, restaurants, hotels and brewers. A specialist team means specialist advice from lawyers who understand the issues that you face.

Best practice guide: break clauses

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Pitfalls for tenants to avoid

Break clauses in leases can be hard to get and easy to lose. The rule of strict compliance means break notices need to be drafted and served, and break conditions complied with, to the letter.

Even very minor errors can invalidate a valuable break right. The whole break process is an adversarial contest between the landlord and the tenant, especially in the current economic climate. It is a process where the landlord's and tenant's interests are diametrically opposed – the landlord does not want to be left with empty premises with rates and other liabilities, and the tenant will be looking for an exit to reduce its property liabilities.

Negotiating break clauses

Care needs to be taken in making any break right clear and unconditional. Absolute break conditions requiring the tenant to have paid "all rents" or complied with "all covenants" are almost impossible to comply with.

An "all rents" condition requires not only principal rent, but also service charge, insurance rent, penalties such as default interest on any late payments and any other sums due under the lease to be settled. Such sums will need to be settled even if not demanded or in dispute.

An "all covenants clause" would require the tenant to ensure in particular that the property is returned repaired, decorated and reinstated exactly as required by the lease. A landlord could use very minor details (for example, a decorator having applied two coats of paint instead of three) to invalidate a break right. A landlord is under no duty to assist a tenant in complying with break conditions. In fact, often landlords may stay silent, serve a schedule of dilapidations at the last minute or serve a rent demand at the property once the tenant has vacated. The landlord's motive is irrelevant to the court.

Unconditional break rights

Tenants and their legal advisers should therefore negotiate hard for an unconditional break right. If conditions are accepted, these should be limited to the payment of principal rent demanded and the handing over of the property free of third party occupiers.

Beware 'vacant possession'

In relation to the latter, the landlord may require "vacant possession". The tenant should be aware, if this wording is accepted, that this condition can be breached if chattels and rubbish are left behind.

Or (as happened in a recent case) workmen employed by the tenant access the property after the break date, with the knowledge of the landlord, to finish off dilapidation works – which will of course ultimately be to the benefit of the landlord.

Initiating the break process

A tenant with a break right coming up should start thinking about this well in advance. Often between 6-12 months' notice will need to be given to exercise the break and time will be of the essence.

Care needs to be taken to ensure the break notice is drafted and served exactly as required by the lease. The notice will need to be served by the legal tenant on the legal landlord – if a group or subsidiary company serves the notice, because it actually occupies the property or manages the affairs of the legal tenant, a break notice will be invalid – even if the landlord is fully aware of the arrangements. It is also possible that the original landlord may have changed; your legal advisers must check the identity of the current legal landlord. This will involve carrying out searches at the Land Registry and Companies House. Tenants have lost break rights serving notices on landlords' agents or landlord group companies issuing rent demands.

Keep to the letter of the lease

Bear in mind: *"if the [notice] clause had said that the notice had to be on blue paper, it would have been no good serving a notice on pink paper, however clear it might have been that the tenant wanted to terminate the lease."*
Lord Hoffman in a leading House of Lords case

Saving a defective break notice

This is not easy to do. The tenant can rely on the leading case of *Mannai* which stated minor defects in notices will not invalidate the notice, if the reasonable recipient, with knowledge of the factual and contextual background, would not be perplexed by the error.

Although this is an objective principle of law, success will depend on the particular facts of the case and this principle has not always been consistently applied by the courts. The other defences available are to argue that the landlord, on the facts, has waived a strict compliance condition or is "estopped" from relying on a strict legal right because it has given a contrary assurance to a tenant which the tenant has relied on to its detriment. While there is no certainty any of these defences would succeed, they have been successfully used to save break clauses or reach a settlement with the landlord. However, you are now in litigation territory which is ideally not where you want to be.

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Some practical tips

- Diarise when a break notice needs to be served and get in touch with your legal adviser well in advance of this date to do an audit of your lease terms and draw up a check list of what action is required. Provide your legal adviser with copies of the latest rent demands served for the purposes of the legal due diligence in relation to the service of the break notice.
- If a break is conditional on compliance with repairing, redecoration and reinstatement obligations, instruct an independent building surveyor to prepare a schedule of necessary works in advance of critical dates.
- Check your own records to make sure you are up to date with rent and all arrears and also any interest accrued on arrears have been settled. Ask the landlord for a financial statement – though bear in mind the tenant cannot rely on the landlord to get this right. If there is any doubt overpay and do not apportion sums if the break date falls between rent payment dates (i.e. make a full quarter's payment in advance). Then try and recover overpayments after the break date.
- It is important the landlord receives all payments due in cleared funds on or before the break date.
- Make sure the process of vacating the premises, clearing rubbish and chattels, returning keys and handing the site with vacant possession are well managed and done in advance. Take steps to protect the premises from squatters but any security shutters or caretaker will need to be removed on the break date.

To find out how we can help you please contact our Drinks, Hospitality & Leisure specialists:

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