

## BREAK CLAUSES

In the context of any company restructuring or reorganisation, the presence of a break clause in one of the company's leases is a valuable thing indeed. This will enable the tenant to move out of unwanted or over-rented space. At the very least, if the premises are over-rented, the presence of a break clause will give the tenant a negotiating platform to seek a variation of the existing lease.

However, the converse of this is that no tenant can realistically expect the landlord to assist with the exercise of the break clause. The courts have consistently held that the pre-conditions of the break clause must be strictly adhered to and so an unwilling landlord will seek to take advantage of anything they can to defeat the break. The operation of this principle was recently illustrated in *Avocet Industrial Estates v Merol* [2012] 1 EGLR 65. The tenant's right to break was conditional upon payment of all sums due under the lease by the break date. While the rent was paid up to date there had, in the past, been arrears. The court held that, on a proper construction of the lease in question, the tenant's liability for default interest was not conditional upon the landlord making a demand. Default interest had not been paid and accordingly the landlord had not received all sums due under the lease by the break date. The delays and therefore the amount of interest was not huge: in the event the purported break failed for an overlooked interest liability of a mere £130, which had never been demanded.

Unfortunately recent case law suggests that needless errors are being made by tenants which prevents the successful exercise of the break. Against this

background we address the following issues which frequently arise in practice:

- (1) the question of “material” compliance with the tenant’s covenants;
- (2) whether the tenant is entitled to make a proportionate payment of rent down to the break date; and
- (3) the practicalities of making the requisite payment and its consequences.

Of course break clauses come in all shapes and sizes: typically a break notice will need to be served; typically conditions such a payment of rent and other sums and performance of covenants will need to be performed before the break can be successful. Depending upon what the lease says, these conditions will need to be fulfilled at specific dates (typically at the date of service of the break notice and/or the break date itself). This article is concerned with what needs to be done to ensure the performance of the break conditions, whatever the time for performance.

### **The standard of compliance**

It used to be common to see break clauses which stipulated that the tenant must comply with all the tenant’s covenants prior to the break date. These days the well-advised tenant would try to avoid signing up to such a condition since, try as it might, human error and oversight means that there is no absolute guarantee that all the tenant’s covenants will have been complied with. The landlord’s surveyor can be expected to be much more observant when it comes to noticing any wants of repair on the break day. Accordingly such conditions are often tempered with words like “material” or

“reasonable”. This will give valuable room for argument where minor matters of repair may have been overlooked.

Even where words like “material” are not present, there are three occasions where defects may be forgiven:

(1) The courts have held that the breach complained of must be a subsisting breach in the sense that the landlord must have an existing cause of action for nominal damages. Thus spent breaches which have been remedied will not count.

(2) The second category of breaches which should not matter are disrepairs which have escaped a competent survey honestly made with a view to rendering up the premises in full repair. In such a case the Court of Appeal held, as long ago as 1876, that the court “would lean towards holding the condition precedent has been complied with” (*Finch v Underwood*).

(3) The third category of breaches which should not matter are in fact not breaches at all: where the physical condition of the property has deteriorated due to some unforeseen event at the last moment and there has not been time to effect repairs. Thus if an overnight storm or vandals cause damage to the property and there has not been time for the reasonable tenant to effect the repairs prior to the break date, there is in fact no breach of the covenant to repair. The covenant to repair is not an absolute warranty that the demised premises are at every moment in time in good repair: *West Middlesex Golf Club v London Borough of Ealing* (1994) 68 P&CR 461.

However, unless one of the above three exceptions applies, the effects on an absolute covenant on a tenant are potentially harsh. For example, in *Bairstow Eves v Ripley* [1992] 2 EGLR 47 there had been a failure to comply with a pre-condition that the premises should be painted in the last year. They had in fact been painted just before the beginning of the last year and there was no practical difference between what had been done and what ought to have been done. Nonetheless, there was no defence to the assertion of a failure to comply with the pre-condition.

Where however the lease only stipulates “material” or “reasonable” compliance with covenants the tenant has much more latitude. However we would not recommend that any comfort is drawn from these words: instead all known breaches should be remedied so as to avoid any argument. Thus the painting of one coat of paint instead of two (as required by the covenant) may be reasonable or immaterial in the circumstances. However a total failure to comply with an important obligation could not be said to be reasonable compliance. Thus in *Reed Personnel Services v American Express* the failure to decorate and replace a carpet which (in 1996) would cost £8,000 and £7,000 to remedy was held not to be reasonable compliance with the repair and decoration covenant.

Of course if it is possible to engage the landlord and have a constructive discussion as to what needs to be done and what can be safely left then this should be done. However we would sound two notes of caution. First, if (as is to be expected) the landlord replies half-heartedly or not at all assume that no co-operation is forthcoming and go ahead and get on with complying with the lease in good time. Secondly, ensure that any agreement that certain

matters might be dealt with in a certain way or simply left in writing and is clear and unconditional in its terms.

**When is a “proportionate” rent justified?**

The liability of the tenant for rent payable “*yearly and proportionately for any part of a year*” appears in many standard form leases. Often the break date will fall midway through a quarter. This begs the question of whether the tenant is entitled, on the last rent day, to pay a proportionate rent down to the break date or whether the tenant is obliged to pay the full quarter’s rent. One could have a situation where the last rent day is 24<sup>th</sup> June and the break date is 30<sup>th</sup> June. Must a tenant then pay 7 days’ worth of rent or a whole quarter’s rent?

The first thing to say is that, unless the lease makes it absolutely plain that a proportionate payment can be paid in these circumstances and the break preserved, the tenant should pay the full quarter’s rent, assuming that the priority is to break the lease rather than to preserve cash flow. Not only is this the safe course but it is also one which is in line with the three recent cases on the subject. The matter was due to be considered authoritatively by the Court of Appeal in *Canonical UK v TST Millbank* [2012] EWHC ... [Ch] and *PCE Investors v Cancer Research UK* [2012] 2 P&CR 5 in February 2013. However the appeals did not proceed and so the profession has been denied a reconsideration of the matter by the Court of Appeal. However at least all the authorities speak with one voice.

The starting point is a Court of Appeal decision in the context of forfeiture. In *Capital & City Holdings v Dean Warburg* [1989] 1 EGLR 90 the landlord sought judgment for the quarter’s rent due on 25<sup>th</sup> December even though the

lease was forfeited shortly thereafter on 8<sup>th</sup> January. The Court of Appeal held that the landlord was entitled to judgment because the reference in the lease to “proportionate” payments was only concerned with the initial period from the first day of the lease down to the first quarter day and the corresponding period at the end of the lease. The above two recent High Court decisions together with a further High Court decision (*Quirkco Investments v Aspray Transport* [2012] L&TR 19) followed this decision in the break clause context. The judges all make the point that at the quarter day neither the tenant nor the landlord will in fact know that the lease is coming to an end on the break day (other conditions may fail to be satisfied). Accordingly there is simply no grounds upon which a tenant could justify making a proportionate payment on this quarter day because no-one could say, at that point, that it was the last quarter day.

This reasoning is plainly formidable. However there is also much to commend the contrary argument: unlike the case of a forfeiture (which although provided for, is not expected by anyone) the lease here contains a break clause and the prospect of the tenant availing himself of this is to be expected. One would not ordinarily imagine the parties to provide for the payment of rent (and insurance and service charge) for the period beyond the contractual term of the lease. Since the prospective break date is known it can properly be argued that it must have been within the contemplation of the parties that only a proportionate payment of rent would be paid on the last rent day. Indeed, that so what they have provided for in stipulating “proportionate payment”.

However, for the moment, this latter argument has been consistently rejected and, as we say, the only safe course for a tenant in an ordinary case is to make the full payment.

[Recovery of the ‘overpaid’ money: see *Canonical*: comments per Vos J]

### **Method of payment**

At common law the general rule is that any debtor (including a tenant) must pay his debt by tender of legal currency. Theoretically that would include cash but, more practically, would cover an effective BACS transfer. commercial leases often stipulate exactly how rent is to be paid or they state that an option as to the method of payment is given to the landlord.

In practice difficulties are only likely to arise where there has been a course of payments by cheque. Often a managing agent’s demand will expressly deal with payment by cheque (stipulating to whom it is to be made out and where sent). If payment is made by cheque and is accepted without protest then any common law rule or express provision in the lease may be displaced.

The practicality of payment is something which tenants need to be very aware of when attempting to break the lease. Whatever the previous history of dealing, the safest course of conduct is to ensure that any payments which the landlord is entitled to receive are paid into the landlord’s bank account by the due date. Then there can be no argument. If a cheque is to be tendered it must be tendered in good time and it would be wise to monitor its progress because the landlord may of course choose not to bank the cheque for the time being so that he can claim that no payment has been made. The tenant

will then be left arguing that (a) there was a sufficient express or implied agreement to the effect that payment could be made by cheque and that (b) that the agreement was such that payment was deemed to be made on the day of despatch/receipt as appropriate. As the recent *Avocet* case shows, the courts are used to assessing whether or not there has been a course of conduct which justifies payment by cheque. However it is much more difficult to infer an agreement to the effect that payment is deemed to be made upon the day of posting the cheque as opposed to the day of receipt.

It is also wise for the tenant to ensure that any payments made are correctly described so that the payments are appropriated to the things which the tenant wishes to pay for. In *Canonical* the issue was whether or not the tenant was due to pay a full quarter's rent on the final rent day. The tenant was also due to pay a reverse premium of one month's rent as an exercise of the break. The tenant did not purport to make that payment but did pay the full quarter's rent. The tenant was left arguing that, since it was only obliged to pay a proportionate rent on the rent day, the balance of the full payment in fact made stood as payment of the reverse premium. The court held that even if a proportionate payment was only due on the rent day because the tenant had purported to pay the full quarter's rent it had appropriated its own payment to the landlord's demand for full payment and so the landlord was entitled to receive the money as such.

What the tenant should have done is to either send two payments (one for the proportionate rent and one for the reverse payment) or to make it clear at the time of payment how it was treating the single payment. (In the event the question was academic since the tenant was not entitled to make a proportionate payment in any event.)



### **Practical tips for tenants**

Drawing the strands of this article together, we would recommend that anyone acting for a tenant hoping to break a lease bear in mind the following:

- (1) Assess the date at which compliance with the relevant conditions must be made (date of break notice, break date or both).
- (2) If the right to break is dependent upon compliance with the tenant's covenants then make an early assessment of what needs to be done, taking no comfort at all from any qualifying words such as "material breach" or "reasonable performance".
- (3) Seek agreement from the landlord but, should the landlord not co-operate, leaving sufficient time to ensure compliance with everything prior to the due date; only act on concessions from the landlord if they are in writing.
- (4) Reassess the physical state of the premises in the last few days before the break.
- (5) Absent very clear wording to the contrary, pay the full quarter's rent on the last quarter day. Take control of any accounting/administration/payment procedures to ensure that there is no question that whatever sums need to be paid by whatever date are received by the landlord.