TAKE A BREAK

A review of recent decisions and developments relating to break clauses including validity of notices, service and estoppel, compliance with conditions and giving vacant possession.

Introduction

1. The purpose of tonight's seminar is to review of some recent decisions relating to the exercise of break notices. The form of the talk will take two parts. Part 1 will summarise some of the mechanics of break clauses that often arise for consideration. Part 2 contains a digest of recent break clause cases.

2. Given the current state of the property market, it is more usually the case that break clauses are being exercised by tenants rather than landlords. Tenants are cost conscious and are either alert to the possibility of competitive rents at alternative sites, or, for example, in the case of retailers are scaling down the size of the presence on the high street. HMV is a case in point. The talk tonight therefore focuses on tenants' break clauses as opposed to the landlords', although the principles are generally the same.

Part 1: Break clauses – an overview

Is there a break clause?

3. In most leases this is the simplest question to answer. The break clause is usually express, and will state whether it is a landlord or tenant only option, or both. In addition, where there is an express break clause but it is silent as to who may exercise it, then it is treated as a tenant only option (*Dann v Spurrier* (1803) 3B&P 399).

4. Complications may arise where there is no express break clause but the language describing the length of term suggests that there is more than one possible fixed period under the lease. Consider a lease where the term was described as follows:

> "*The premises are hereby demised for a term of seven, fourteen or twenty one years*".

It was held that this created an option to break on year seven or fourteen, before certain determination after twenty one years; as it was silent as to who had the benefit of the option the tenant alone was entitled to exercise it (*Dann v Spurrier* (1803) 3B&P 399).

5. A different result followed where the wording was:

> "*The premises are hereby demised for a term of 21 years, determinable nevertheless in seven or fourteen years if the said parties hereto shall think fit."*

The court held that this did not even qualify as a break clause, as it required the agreement of both parties, and a break option is by definition a unilateral right (*Fowell v Tranter* (1864) 3 H&C 458).

Who gives the notice?

6. The ordinary case of a single specified landlord and single specified tenant raises no complications in answering this question. Equally simple is the principle that the notice is only exercisable by the tenant for the time being – beneficial ownership is not enough (*Stait v Fenner* [1912] 2 Ch 504). Where a lease is assigned, and unless the break option was expressly stated to be personal to the tenant, the benefit of the option will pass to the assignee. This is true even if the "tenant" under the lease is not defined as including heirs, assigns and successors in title. An interesting case dealing with a case where the original tenant, who had a personal break option, assigned the lease and then took it back by a re-assignment, is considered in Part 2 below (*Aviva Life and Pensions v Linpac Mouldings Ltd* [2010] L&TR 182).

7. More complex issues may arise in cases such as these:

7.1 Joint tenants: All of the tenants must exercise the option in order for the break to be effective, otherwise it fails – *Hounslow LBC v Pilling* [1993] 2 EGLR 59.

7.2 Subsidiary or related company: Where the tenant is a company, and notice has been served by a subsidiary or related company, the notice may be construed as having been given by the tenant if the reasonable recipient would have understood the notice as such. This is a reflection of the now well established principles regarding the interpretation of notices as per *Mannai Investment Co Ltd v Eagle Star Insurance Co Ltd* [1997] AC 749. This means that the outcome will vary from case to case depending on the individual facts; there is no hard and fast rule. Application of the same principle had opposite outcomes in *Lemmerbell Ltd v Briatnnia LAS Direct Ltd* [1998] 3 EGLR 67, where *Mannai* did not save a notice, and *Havant International Holdings Ltd v Lionsgate (H) Investments Ltd* [2000] L&TR 297, where it did. This point will be discussed in more detail in Part 2.

7.3 More complex questions may arise when categories (a) and (b) above combine. Consider the possibility of ABC Ltd and DEF Ltd, sister companies, as joint tenants of GHI Ltd. ABC Ltd serves a break notice. It may be that in the right circumstances the notice could be construed as being given in its own capacity as one of joint tenants, and at the same time as on behalf of its sister company, which would render the notice effective.

7.4 Questions of agency may arise as well, where a notice is purportedly given on behalf of the tenant. As a matter of practice it is preferable to avoid serving notice on behalf of a tenant, even if the notice states "We, XYZ on behalf of ABC Ltd., hereby give notice...". If the tenant has asked for your assistance in preparing the break option it would be safest for the notice to come from the tenant itself. Agency arguments can however sometimes assist in saving a notice. In *Stait v Fenner* [1912] 2 Ch 504 a

notice was treated as having been given on behalf of the real tenant even though the notice had been served by someone with a beneficial interest in the lease, contrary to the basic principle set out in paragraph 6 above. In practice one often encounters cases where managing agents have given a notice on behalf of a party to a lease. Specific agency may have been granted, and if the landlord is made aware of that, then it seems unlikely that the notice could be challenged. However general agency is also possible, and although less easy to establish, it can also be a proper basis for serving a notice on behalf of tenant, even if the tenant is not disclosed in the notice. The principles relating to agency were explained by Peter Gibson LJ in *Lemmerbell,* and can be summarised as follows:

7.4.1 Generally the notice must be given by the lessee or lessor. A notice given by someone who is not the lessee or lessor is invalid: see *Lemon v Lardeur* [1946] KB 613; *Divall v Harrison* [1992] 2 EGLR 64.

7.4.2 A notice may be validly given by an agent acting on behalf of the lessee or lessor. If it states that it is being given by X on behalf of Y and X is duly authorised, it is valid: see *Lemon v Lardeur*; *Divall v Harrison*.

7.4.3 If the notice is given by somebody other than the lessee or lessor without stating that that person is acting as an agent, it will be valid if:

7.4.3.1 The giver was in fact duly authorised to give it; and

7.4.3.2 The circumstances are such that the recipient can act upon the notice safely in the knowledge that it will be binding on the principal of the giver: see *Jones v Phipps* (1868) LR 3 QB 567.

7.4.3.3 Those circumstances include cases where:

7.4.3.3.1 The recipient knows that the giver was authorised to give the notice;

7.4.3.3.2 The principal has held out the giver of the notice as authorised to give the notice;

7.4.3.3.3 The recipient has been led to believe that the giver of the notice is the principal: see *Jones v Phipps*; *Harmond Properties Ltd v Gajdzis* [1968] 3 All ER 263.

7.4.3.4 Otherwise, a notice given by a person who is not the lessee or lessor is bad.

8. The above principles were applied in *Hexstone Holdings Ltd v AHC Westlink Ltd* [2010] 2 EGLR 13. Looking at these categories it is apparent that *Mannai* arguments and agency arguments are two doctrines that can prove useful in trying to save a notice. In practice they are often run in the alternative (as indeed they were in *Lemmerbell*), and it is necessary therefore to keep them distinct. The agency argument normally works on the basis that the notice contains no error at all, but correctly identifies the giver. The *Mannai* argument concedes that the notice is inaccurate in that it failed to identify the correct party, but asserts that the error was so obvious that no reasonable recipient could have been doubt as to who had in fact served the notice.

9. For the sake of completeness it is noted that estoppel, acquiescence and waiver by the recipient may also be useful points to consider when the effectiveness of a notice is in issue. Although as a number of the cases digested in Part 2 show, these concepts are by no means a general panacea for tenants who have botched their break notices.

Conditionality

10. The central theme which runs through almost all the cases dealing with the exercise of break options is that conditions of exercise are strictly construed and must be strictly complied with. Cases may raise questions of better or worse compliance, and on occasion find a basis for saving a notice for one reason or another, but the touchstone of strict compliance remains. In *Mannai* Lord Hoffman famously (at least insofar as fame relative to landlord and tenant lawyers is concerned) commented that "*if the 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*". When advising in advance of the exercise of a break option therefore this must be treated as the guiding principle.

11. Examples of common conditions are as follows:

    12.1 Conditions as to form, usually requiring notice to be writing. Verbal notice will then not be sufficient; this is long established, see e.g. *Legg d. Scott v Benion* (1738) Willes 43.

    12.2 Conditions as to service – specifying who is to be the recipient and to where it must be delivered.

    12.3 A condition requiring the up to date payment of rent.

    12.4 A condition requiring there to be no subsisting breaches of covenants under the lease. A condition not to be in breach is a condition precedent and must be strictly complied with.

    12.5 Payment of a liquidated sum.

12.6 Vacant possession at the break date. There are various cases on this issue issues, including one discussed in Part 2 below. The main principle is that the premises must not contain a substantial physical impediment to their use by the landlord. They should be clear of personnel and chattels and the keys should be returned.

12. Many leases contain a combination in some form of all of the above. The wording of any condition should be scrutinised carefully and broken down into any constituent parts in order to best ensure that each requirement is met. The precise steps necessary for the drafting, service and timing of the notice are not likely to be the most difficult to comply with; the requirement that there be no existing breach of covenant often requires more of an effort, especially where, for example, the tenant has been in occupation for a long time and there is a catalogue of disrepair work that needs to be carried out.

13. Construing end of term dilapidation obligations is therefore often important. Consider, for example, a lease with a 20 year term, which requires the tenant to paint every five years and in the last year of term, and provides a break clause in year six, eleven, and sixteen. The tenant may end up having to paint two years running if he has complied in year ten, and then decided to break in year eleven (*Bairstow Eves (Securities) Ltd v Ripley* (1993) 65 P&Cr 220 is an example of this). If a tenant is considering exercising a break option he should be mindful of any existing breaches and allow enough time to ensure that he is compliant before the break date in order to avoid being caught out. Minor breaches can also defeat the exercise of the option, but regard should also be had to the wording of the condition. If, for example, the break condition requires that there be no "subsisting material breach" of covenant that qualifies the nature of breach and may permit trivial or minor breaches.

14. On the other hand, it is not usually a requirement of a conditional break clause that there has been precise compliance with the terms of the lease throughout the term. Thus, spent breaches are not usually capable of preventing the exercise of the break option. So if, for example, the fact that a tenant has from time to time been in arrears of rent, this will not usually deprive the tenant of the entitlement to exercise the break. So too, it is suggested, that in the example given above, even if the tenant had not painted in year ten, but did paint in the final year of term, the failure to paint in year ten has been remedied and should not be allowed to defeat the exercise of the option. But, inevitably, these are questions of construction which fall to be determined on the precise terms of the relevant lease.

15. The question is whether there are any existing breaches of covenant at the relevant date. The requirement was put as follows by Clauson J in *Simons v Associated Furnishers Ltd* [1931] 1 Ch 379:

> *"…the condition [of compliance with the covenants in the lease] must be understood as 'requiring that the account between the parties must, both as to rent and covenants, be clear; the rent need not have been always paid on the day; but all arrears, if any, must have been paid up; the covenants must have been strictly kept, or if broken, must have been satisfied."*

This approach was affirmed in the context of an option to extend the term of a lease in *Bass Holdings Ltd v Morton Music Ltd* [1988] 1 Ch 493.

16. It follows that as regards most conditional break clauses, a trawl to indentify historic breaches of covenant by the tenant will not avail the landlord. The principal difficulty in this context will be to identify whether a previous breach of covenant has been "spent" or whether it is still subsisting at the relevant date. This will not necessarily be entirely straightforward, but it is suggested that a practical approach to the question is whether the landlord could bring proceedings (for damages, even if only nominal, or forfeiture) in

respect of the breach in question at the relevant date. If the tenant has rectified the breach by e.g. carrying out repairs to the requisite standard, it will be irrelevant that there has been a history of non-compliance.

17. In some cases there may be uncertainty as to what is required in order to achieve proper compliance. Examples may be where there are disputed service charge sums outstanding, or where there is doubt as to the interpretation of any given covenant. In the first instance, and assuming there is more value in determining the tenancy than in the sums in dispute, it is likely to be sensible from a commercial perspective to pay the sums of money demanded in order to render the break notice effective. Where contractual interpretation is an issue it might be possible to ask the landlord to confirm an agreed understanding in writing, but a shrewd landlord would probably reserve his position and leave it to the tenant to take an independent view. If the tenant wishes to pre-empt future argument, and assuming time allows, it could choose to bring Part 8 proceedings for a declaration on interpretation which would clarify what is necessary for compliance.

Part 2: Recent Cases

PCE Investors Limited v Cancer Research UK [2012] EWHC 884

18. **Facts:** The break clause required T to pay the rents reserved by the lease up to the termination date. Rent was payable quarterly in advance under the lease. T served the break notice and the termination date fell on 11th October. When it came to paying the 29th September quarter, T paid an apportioned amount, equivalent to the rent up to 11th October, rather than the full quarter. L then wrote to T demanding the full quarter. T then sought confirmation from L that it had paid the right amount for the purposes of the break clause, but L kept quiet. When proceedings were issued both parties sought summary judgment against the other on the issue of the validity of the break notice. T also sought permission to amend to include an argument that L was estopped from denying the efficacy of the break (in the event that it summary judgment application did not succeed). **Held:** The break notice was invalid. The break clause required payment of the full amount of the rent and the full September quarter had fallen due on the 29th September quarter day. Permission to amend so as to include T's estoppel argument was refused on merits grounds. T plainly knew that L considered the full quarter's rent had to be paid from L's demand and its subsequent refusal to confirm that T had paid everything. There was no duty on the part of a landlord to correct a tenant who makes a mistake in its break notice.

Avocet Industrial Estates LLP v Merol Ltd [2011] EWHC 3422

19. **Facts:** The break clause provided that a break notice was only effective if, by the break date, T had paid all the rent due under the lease and a premium equivalent to six months rent. T served a break notice and the day before the break date delivered a cheque for an amount equivalent to six months rent to the landlord and communicated its belief that it had paid everything else due under the lease. In the proceedings which ensued, the issues were whether the six months rent had been "paid" by the break date; whether as at the break date T was liable to pay contractual interest on late payments of rent and, if so,

whether L was estopped from relying on that liability to defeat the break. **Held:** T had regularly made payments of sums due under by cheque and an agreement by L to accept payment by this method could therefore be inferred. An agreement to accept payment by cheque displaced the old common law rule that only legal currency was good payment. T was liable to pay contractual interest on late payments of rent at the break date. L was not estopped from relying on those arrears because it could not be shown that L knew that T was mistaken when it made the statement that there were no arrears.

NYK Logistics Ltd v Ibrend Estates BV [2011] EWCA 683

20. **Facts:** The break clause provided that vacant possession must be given by the break date for a break notice to be effective. T served the notice and two days before the break date met L at the demised premises. It was agreed that a minor programme of works was required to be undertaken to comply with T's repairing obligations under the lease. L agreed that it would send someone along to collect the keys from T. In the event, T's contractors did not in fact complete the works until six days after the break date. In the proceedings, T argued that it had given vacant possession because T was not intending to exclude L during the six day period and their presence was not inconsistent with L's right to possession. Alternatively, T said that L's statement that it would send someone for the keys amounted to a waiver of the requirement for vacant possession. **Held (by CA):** There had been vacant possession. Vacant possession means what it says – the property must be empty and the landlord must be able to enjoy immediate and exclusive possession. It mattered not that T's contractors did not intend to exclude L or that they might have left if L had asked them to. Moreover, the statement by L that someone would be along to collect the keys was far removed from that which would be necessary to amount to waiver of the vacant possession requirement and T had in any event not relied upon it.

MW Trustees Ltd v Posel [2011] EWHC 104

21. **Facts:** The break clause required T to give six months notice in writing to the landlord. Unbeknownst to T, the reversion was transferred by L1 to L2. When T served their break notice on L1 they were told to send it to L2's managing agent. T duly did so and received a reply from the managing agent that the break notice was "accepted" by L2. In the proceedings, L2 contended that its managing agent was really only acknowledging receipt of the break notice and that the break notice, having been served on the wrong landlord, was invalid. **Held:** The statement that the break notice was "accepted" could only be taken as an acknowledgment that T had sufficiently indicated their intention to terminate the lease. T had therefore assumed that the break notice was valid and acted accordingly. L was therefore estopped from challenging the validity of the break notice.

Hexstone Holdings Ltd v AHC Westlink [2010] EWHC 1280

22. **Facts:** Prior to the exercise of the break clause, T informed L that it would be changing its name to that currently used by a parent company and asked for rent demands to be issued in the new name. L complied with the request, but T failed to effect the name change. T then served a break notice which was sent on letterhead of the parent company and expressed to be given for and on behalf of the parent company. L later argued that the break notice was not served by T and was therefore invalid. **Held:** The break notice was invalid. It was expressed to be given by the parent company rather than T. The parent company did not have express authority to act on T's behalf and, on the evidence, none was to be implied. Moreover, the absence of any indication of the parent company's agency on the face of the notice meant that L could not safely act in the knowledge that the notice was binding on T.

Hotgroup plc v Royal Bank of Scotland [2010] EWHC 1241

23. **Facts:** The break clause required the break notice to be served not only on L, but also on the property management company for the purposes of the lease. T served the break notice on L, but not the property management company. T later argued that the failure to serve on the property management company was not fatal to the validity and that the lease had to be construed *contra proferentem*. **Held:** The lease did fall to be construed *contra proferentem*, but that did not mean that T was exempt from complying with one of the conditions of the break clause.

Standard Life Investments Property Holdings v W&J Linney Ltd [2010] EWHC 480

24. **Facts:** A break clause required T to give a break notice to L. L later granted an overriding lease to IL and from that point on T paid rent to IL. T's break notice was expressed to be given to L. A copy of the break notice was served on IL. But IL later contended that, as it was T's landlord, the break notice should have been expressed to be given to IL. T argued that L remained the party to on whom the break notice should be served; alternatively, the reference to L was a mistake that would have been obvious to IL and the break notice was therefore valid and effective. **Held:** On a true construction of the lease, IL was the party to be served. Someone like L who was no longer the immediate landlord would have no interest in checking that the break clause conditions had been complied with. Moreover, vacant possession could only be given up to IL. The parties would plainly have contemplated that the landlord might change. Therefore a construction which places IL as the party to be served makes far more commercial sense. T's alternative argument also failed because the reasonable recipient of the letter containing a copy of the break notice would not have understood that the reference to L was a mistake.

Aviva Life and Pensions v Linpac Mouldings Ltd [2010] L&TR 182

25. **Facts:** L was T's landlord in respect of three leases. One lease contained a break clause, the break clause for other two were contained in licences to assign which were granted in

1986. All three break clauses were expressed to be for T's benefit only. T, with L's consent, assigned all three leases to an associated company, E. Shortly afterwards, however, E went into administration and ceased to be a member of the T group of companies. E sought, and was refused, L's consent to re-assign to T. L was (rightly) concerned that if the leases were re-assigned T would attempt to determine them by exercising the break notice. Despite the refusal of consent E executed an assignment to T, and T served break notices. L issued proceedings to determine (1) whether its refusal to consent had been reasonable and (2) whether T could exercise the break options (a) at any time after it had assigned the leases to E and before it had re-acquired them or (b) after it had re-acquired them. L succeeded on all three issues at first instance before Lewison J. T appealed the whole of the decision, but at trial limited its appeal to issue 1(a). **Held, approving Lewison J's decision:** The Court of Appeal expressed, *inter alia* the following principles: (1) Interpretation of the leases must give effect to the intention of the parties to be ascertained in light of the commercial purpose and context of those documents, and the factual setting known to the parties. (2) The right to bring a tenancy to an end is an incident of the relationship of landlord and tenant, which ordinarily pass with the reversion of the term. (3) An express provision that a party who was no longer the tenant could exercise the break option would be extraordinary, even if technically possible – not only because it is so far removed from the basic principles of such an option but because of the practical difficulties in obtaining vacant possession from the actual tenant. (4) There was no case where the Court had interpreted a break option as conferring a right to break even at a time when the beneficiary was not a tenant. (5) It followed that if there ever were such an intention between the parties it would have to be made expressly and unambiguously clear. These considerations led to the "inevitable rejection" of T's arguments. For the sake of completeness, it is noted that T lost issue 2(b) in front of Lewison J, and did not revive the issue on appeal, on the basis that it made no commercial sense to impute to L and T an intention that right should revive if T were to subsequently re-acquire the leases. If T wanted to retain the right it

had the option of choosing to sub-let instead of assigning. It had not done so and the right was irretrievably lost – *Equinox Industrial (GP2) Ltd v Sketchley Ltd* [2003] EWHC 2 (Ch) applied.