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Breaking up is hard to do

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John considers three recent cases about the validity and effect of break notices:- *Friends Life Ltd v Siemens Hearing Instruments Ltd* [2014] EWCA Civ. 382, *Marks & Spencer plc v BNP Paribas Securities Services* [2014] EWCA Civ. 603 and *Friends Life Management Services Ltd v A&A Express Building Ltd* [2014] EWHC 1463 (Ch)

Introduction

Landlords and tenants generally attach a great deal of value to break clauses because they can be a "get out of jail free" card for the party entitled to exercise it. For example a tenant may want to leave early because his plans change or the premises are over-rented; a landlord may want to sell, redevelop or let to a better tenant or for more money. However it is often the case that if one party wants to end the lease early the other will oppose that, if only to try to secure a ransom payment.

For those reasons and because of the technical approach the courts have taken to getting notices right, break clauses tend to generate a relatively large amount of litigation. Three cases have been decided in the last few months concerning the validity of a purported exercise of the break and the effect of doing so on the parties' rights and obligations.

Friends Life Ltd v Siemens Hearing Instruments Ltd [2014] EWCA Civ. 382 (3rd April 2014)

Typically the break is made subject to conditions e.g. serving a particular form of notice, complying with the lease covenants (e.g. as to rent/service charges, repairs, etc.) and/or paying a break premium. In Siemens, the clause (cl.19) said the tenant's notice "*must be expressed to be given under section 24(2) of the Landlord & Tenant Act 1954*". The actual notice however merely said that it was given "*in accordance with clause 19*".

Both the trial judge and the Court of Appeal agreed the notice was non-compliant. The trial judge decided the notice was nevertheless effective on the basis not every failure to comply with the break clause terms was fatal. If the lease was silent, that had to be decided by assessing the parties' intentions. He concluded that strict-compliance was not always necessary in relation to the form of break notice as it is for other conditions (e.g. compliance with the lease terms).

The Court of Appeal allowed the appeal and held the notice was ineffective. It reiterated that strict compliance is generally required in relation to the break clause terms. Whilst it is possible that a term, properly construed, may be merely directory or permissive (in which case compliance – strict or otherwise – is unnecessary), the court should not strain to find that. That was not a permissible construction here given the use of "*must*" in cl.19. If – as here – the provision was a term of exercise of the break clause, it had to be strictly complied with.

Whilst some might consider the result harsh, the law is, at least, coherent and certain. As Lewison LJ said at [66]: "*The clear moral is: if you want to avoid expensive litigation, and the possible loss of a valuable right to break, you must pay close attention to all the requirements of the clause, including the formal requirements, and follow them precisely.*" Not to do so is foolish/risky if not negligent/catastrophic.

Let's assume you have complied, what then? How does that impact on your other rights and obligations?

Marks & Spencer plc v BNP Paribas Securities Services [2014] EWCA Civ. 603 (14th May 2014)

Specifically where a break occurs in the middle of a rent period, can the tenant who has paid the last instalment in full later recover the proportion of it which is referable to the period after the break date? In general the answer is: no; the tenant is liable for the full period. So if, as is usual, the break clause contains a term requiring the rent to be paid in full a tenant who only pays rent for the period up to the break date will not have validly exercised it.

In Marks & Spencer it was accepted the break had been validly exercised. The tenant paid rent in full and then tried to recover the excess on several bases, including restitution and total failure of consideration. Morgan J held it was entitled to do so, but on the basis of an implied term. Two main reasons were given. First, the parties

intended the position would be the same as if the lease had ended automatically by effluxion of time, where rent is only due up to the term date ("the same position conclusion"). Second because it was to be inferred they had agreed the break premium was all the "compensation" the landlord would be entitled to if the tenant exercised the break ("the full compensation conclusion").

The Court of Appeal allowed the landlord's appeal and held no such term could be implied. Its starting point was that there was no general principle that a tenant should only pay rent – as distinct from service charges – for what he actually received i.e. the right to use the premises for only part of the period.

The Court rejected the "same position conclusion" on the basis the two scenarios were in fact different. Where the lease ended automatically by effluxion of time, it was certain on the last payment date that it would end and when. But that was not the case in relation to most break clauses, including here, because on the rent payment date the tenant had not yet satisfied all the other requirements for its exercise viz. payment of the break premium. The same would be true in cases where the break clause requires the tenant to comply with the lease covenants up to the break date.

Interestingly the Court thought, without deciding, that the position might well be different if the tenant had in fact previously complied with all those other requirements i.e. if it was certain on the rent payment date that the break would take effect. In that case the tenant might be able to pay only a proportionate share of the instalment up to the break date or later recover the excess.

That will not be the case however if – as is more usual – there are unsatisfied conditions in the break clause at the payment date e.g. to leave the premises in repair, etc. However if before then the parties compromise the tenant's terminal liabilities e.g. by accepting a sum in lieu, then the point left open in Marks & Spencer may be arguable.

The Court did not consider that the description of the quarterly payments as "instalments" and the obligation to pay "proportionately for any part of the year" in the reddendum justified implying the term, since they were construed as only applicable to rent payments for the periods when the fixed term started and ended.

The Court also rejected the "full compensation conclusion" on the basis that it did not follow the parties had agreed the break premium would be all the landlord was entitled to if the tenant terminated early.

Gallingly, then, it seems the tenant may have lost the right to recover the post-break rent simply because it had not paid the break premium by the rent payment date, even though it did not have to under the lease terms. The moral of the case for tenants is clear: if possible, ensure all preconditions are met before the last instalment of rent is due; in that case (only) you may arguably be able to avoid paying rent for the part of the period after the break date.

Friends Life Management Services Ltd v A&A Express Building Ltd

[2014] EWHC 1463 (Ch) (9th May 2014)

Can a landlord retain advance service charges paid on account of future expenditure where the relevant works were only done after the break takes effect, but during the original term?

That was the issue in Friends Life. The lease was for a fixed term ending in March 2013, subject to a tenant's break in March 2010 which was exercised. It paid service charges which included sums on account of anticipated future works. Those works had not been done by March 2010; some were done later, but in the service charge financial year current when the lease ended (year to 31 December 2010) and some in the following year (2011).

It was common ground the tenant was only to pay service charges for the period up to the end of the tenancy (contrast rent – Marks & Spencer). It was also agreed the landlord could not charge for anticipated future expenditure which would be incurred after March 2013 or the last accounting period current then. But the landlord argued that when drawing up accounts to December 2010 (as the lease required, so the court found) it could add the cost of future works which it was anticipated would be done before March 2013, when the original fixed term would have ended.

The Court (Morgan J) unsurprisingly rejected that and held it was not possible to distinguish a case where the lease ended by effluxion of time and one where it ended as a result of the tenant exercising the break clause. In both cases the landlord could

only charge the cost of anticipated works which were actually done in the financial year current when the lease actually ended.

Accounts therefore would be drawn up to December 2010 although the tenant was only liable to pay for the period to March 2010. Some apportionment was necessary. The court held this should be done from day-to-day over the financial year (i.e. for what proportion of it did the tenancy run) rather than by asking what works were done or costs incurred up to March 2010, as the tenant contended.

In that way the tenant's liability to contribute for works done in the last financial year of the term is not dictated by the mere happenstance of whether the works or the break occurs first. The result strikes a fair balance between the parties: the landlord is allowed a degree of reasonable forward planning in relation to works; but conversely the tenant is not made to pay for expenditure incurred some considerable time after its lease ends.

John Sharples

john.sharples@stjohnschambers.co.uk

John is the Head of Property and Real Estate at St John's Chambers, Bristol and the author of "Land Licences" (Jordans Publishing).