

GIMME A BREAK – HOW TO AVOID THE PITFALLS ASSOCIATED WITH OPTIONS TO DETERMINE LEASES

by

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PART 1 BY JANET BIGNELL

As we all well know, whether advising a landlord or a tenant, questions of break clause construction can be amongst the most complex we are called upon to consider. Given the market at present, I propose to concentrate upon tenant's break clauses today.

My basic message is that identification of the issues; advance planning; thorough preparation and the management of the client's expectations, are all important in attempting to avoid the pitfalls to operating a break clause successfully.

What are the pitfalls?

I would like to start my 20 minutes with a quick round up of those issues that one always needs to have well in mind when first instructed by a tenant in a break clause case. I then propose to look at the issue of material compliance in a little more detail.

My top 5 issues all depend upon the precise wording of the particular lease held by the tenant. Each issue has given rise to numerous reported cases. The answer to each will often turn upon a relatively fine point of contractual interpretation.

Consequential upon issues 1 to 5, my 6th issue in any break clause case will almost always be the potential for a claim to be made against the advisers in professional negligence.

(1) Check who may exercise the break clause

If a break clause is expressed to be personal to the original tenant, then it is the original tenant alone who can exercise it. Once the lease has been assigned, the benefit of such a break-clause will be lost, even if the lease is subsequently reassigned to the first tenant: Max Factor v. Wesleyan Assurance Society [1992] 2 E.G.L.R. 210; Equinox Industrial (GP2) Ltd and Anor v Sketchley Ltd [2003] EWHC 2 (Ch).

An option to determine may only be exercised by the person in whom the term is vested at law. Beneficial entitlement is generally insufficient: Brown & Root Technology Ltd v Sun Alliance & London Assurance Co Ltd [2001] Ch 733.

If the present tenant company is a group company, ensure that any personal break clause was capable of assignment to another company within that group Harbour Estates Ltd v HSBC Bank Plc [2005] 1 EGLR 107. If it was not, the benefit of the break clause will have been lost: 3M United Kingdom Plc & Another v Linklaters & Paines (a firm) [2006] PNLR 30 (CA).

If the notice is to be given by the tenant, it should be given by the tenant itself or it should be given by an authorized agent on behalf of the actual tenant. It should not be given in the name of a group company even if that company physically occupies the premises and actually pays the rent. Whilst all may not be lost if this happens, and there are a number of cases where agency has been established, an unchecked assumption as to the identity of the tenant will normally result in a court case: Lemmerbell Ltd v Britannia LAS Direct Ltd [1998] 3 EGLR 67; Havant International Holdings Ltd v Lionsgate (H) Investment Ltd [2000] L&TR 297.

(2) Check when the break clause can be exercised

A break-clause is a species of option properly so called. Accordingly, any prescribed time-limits must be strictly complied with unless there is express provision to the contrary.

Depending upon the construction of the clause, the fall-back may be to rely upon the decision of the House of Lords in Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1997] AC 749. Mannai was itself a break clause case.

Remember, if the tenant's ability to exercise a right to break is tied to the dates for rent review under the lease and the landlord alone has the power to trigger a rent review, the right to break will not become exercisable unless and until the landlord triggers the rent review: Johnsons of London Limited v Protec Trust Management (2000) EGCS 114.

(3) Check how the break clause is to be exercised

A break clause is usually exercisable by notice in writing, and the tenant needs to give such notice as satisfies the terms of the lease: see, for example, Orchard (Developments) Holdings Ltd v Reuters Ltd [2009] 1 EGLR 13. If the notice is to be served by recorded delivery at the landlord's head office then that is how and where the notice should be sent. If the notice is to be given in a particular form, then that form should be deployed.

Remember that where a lease contains a tenant's break-clause, and the tenancy is protected by the Landlord and Tenant Act 1954, the tenant cannot serve a section 26 request to take effect on the break date: Garston v. Scottish Widows Fund and Life Assurance Society [1998] 1 W.L.R. 1583. A tenant cannot use a break clause to bring its lease to an end and at the same time preserve its rights under the 1954 Act to apply for a new tenancy at a lower rent or on different terms.

From an adviser's point of view, it is very important to remind clients that once the tenant has served a break-notice, it loses the right to make a request for a new tenancy: Landlord and Tenant Act 1954, s. 26(4).

(4) Check whether the break clause is unconditional once notice is served, or whether it remains conditional upon the performance of the tenant's covenants

If the clause is unconditional the lease will determine on the break date. If the clause is conditional, check:

- (a) whether the break is conditional upon the tenant's compliance with all its covenants or certain only of its covenants;
- (b) the substance of the material covenants – what is required;
- (c) at what date *or dates* compliance is required; and
- (d) whether the requirement of compliance is absolute or qualified.

Sometimes, it is the covenant to pay rent that is singled out to ensure that there are no arrears at the break date. This may mean the basic rent, or it may mean all sums reserved as rent depending upon the true construction of the clause. If the

break date is a quarter day, consider whether or not a quarter's rent falls to be paid on that date in any event. It is important not to cancel any standing order too early.

Remember that the Apportionment Act 1870 does not apply where rent is payable in advance: see Ellis v Rowbotham [1900] 1 QB 740. Accordingly, if the rent is payable in advance on the usual quarter days and the break is exercisable between quarter days, there will be no scope for apportionment *unless* the lease contains an express apportionment provision. In the absence of such a provision, the tenant must pay the entire quarter's rent.

Sometimes, the tenant must comply with each of its covenants in order to operate the break. Depending upon the covenant/s in question, the requirements of each clause must be considered carefully to ensure that compliance is possible, and to establish what will be required to ensure that compliance can be achieved.

As regards the date at which "breach" is to be assessed, a "breach" for these purposes *normally* means a subsisting breach. In other words, a breach in respect of which the Landlord has a subsisting cause of action for more than nominal damages. Not a "spent" breach in respect of which the landlord no longer has a cause of action: Bass Holdings Ltd v. Morton Music Ltd [1987] 2 All E.R. 1001.

It is essential to consider whether there may be any potential to argue that any historic breach has been waived.

The date at which compliance is to be assessed is normally the date at which the lease is to terminate and not the date of service of the break notice, or the date of service and the date of termination, although this will depend upon the drafting of the individual lease. If the relevant date is the date at which the lease is to terminate, the tenant will have the opportunity to remedy any breach of covenant between the date of service of the notice and its expiry: Simons v. Associated Furnishers Ltd [1931] 1 Ch. 379.

I discuss the issue of qualified compliance in more depth below.

(5) Check whether there are there any other matters that the tenant must perform at the break date

It is common, for the exercise of the break-clause to be conditional on payment by the tenant of a multiple of the annual rent in order to compensate the landlord for the void which will ensue. If there is a time by which such a payment must be made, the time limit must be strictly complied with: Dun & Bradstreet Software Services (England) v. Provident Mutual Life Assurance Association [1998] 2 E.G.L.R. 175.

(6) Consider the potential for a claim in negligence

The majority of break clause cases that come before the courts will result in a negligence claim if the requirements of the clause have not been clearly met, or the tenant has not been properly warned of the risks inherent in attempting to satisfy a break clause where absolute compliance is required, or where the steps that the tenant has taken fall short of the required standards in a qualified clause.

CONDITIONAL BREAK CLAUSES

Absolute Compliance

In some (notorious) cases, the drafting of a break clause is such that any breach of the conditions, however minor or trivial, will prevent the break from taking effect: see Friar v Grey (1850) 5 Ex 584 and Bass Holdings v Morton Music [1988] Ch 493, for example.

If the clause is of this kind, strict compliance will be necessary: West Country Cleaners (Falmouth) Ltd v. Saly [1966] 3 All E.R. 210. A break clause is a species of option, and options are always strictly construed. This is not only particularly important in respect of time limits but also conditions for exercise of the option.

If a tenant is to seek to comply with an absolute or conditional clause it must:

- (a) give detailed line-by-line consideration to what it is required to do in order to ensure that it has complied with each and every covenant and obligation in the Lease. That exercise will range from compliance with the covenant to pay rent to the covenant to deliver up vacant possession;

- (b) in the event of any doubt, take a conservative line and avoid scope for any argument as to non-compliance;
- (c) draw up a generous timetable setting a date for completion of each of the matters that it must comfortably put in place before the break date;
- (d) appoint a firm of surveyors with experience of break clause compliance, and the issues that this will raise, to inspect the premises by reference to all the documents available and as soon as possible;
- (e) obtain a copy of the planning file and the building regulations files from the local authority, if necessary;
- (f) attempt to engage the landlord in a dialogue regarding reinstatement and a terminal schedule of dilapidations. The aim is to try and reach agreement as to what work the tenant is required to carry out, and to secure the provision of any documentation that the tenant may not have;
- (g) if the premises are to be decorated in colours of the landlord's choosing, the landlord must be asked to provide its decision;
- (h) ensure that everyone working on the project understands the importance of the task at hand and the standard to be achieved by the break date;
- (i) in the case of a qualified covenant, where material or substantial compliance is required, take early advice from a commercial lettings expert by reference to the Fitzroy House case, discussed below.

Qualified Compliance

Fortunately, in many modern leases, tenants' advisers have very sensibly resisted the exercise of the break clause being conditional on absolute compliance with the tenant's covenants. The relevant words of qualification are often to the effect that the lease will not determine if the tenant is:

“in **material breach** of any of its covenants contained in this Lease (including those contained in this sub-clause) at the [Relevant Date]”.

Common alternatives are:

- that the tenant should have committed no “substantial” breach of covenant which is subsisting on the termination date;
- that the tenant should have “reasonably” performed his covenants; or

- that the tenant should have undertaken to pay the cost of remedying any breach found to exist on the termination date.

Fitzroy House

The Court of Appeal considered the interpretation of the “material breach” type of wording in Fitzroy House Epworth Street (No 1) Ltd v The Financial Times Ltd [2006] 2 All E.R. 776, and set out the test that is to be applied by the Court. The facts are instructive in placing that test in context.

In Fitzroy, the Court had to decide whether the tenant had successfully broken its lease of an office block on the fringes of the City, known as Castle House. Castle House was let for a sixteen year term from 1 April 1994 subject to a tenant’s break clause on 1st April 2004. The passing rent was £595,000 per annum. The right to break was subject to compliance with certain pre-conditions, including a requirement that the tenant must have “materially complied” with all its obligations under the lease until the date for which notice of termination had been given. By 1 April, the tenant had completed an extensive, and expensive, programme of repairs and redecoration and had vacated. The rent and all other sums due had been paid.

The landlords sought a declaration that the tenant had failed to materially comply with its repairing covenants. They relied primarily on a schedule of dilapidations prepared by their surveyor that costed the works required to comply with the repairing and other covenants at £211,000. Following advice from its building surveyor, the tenant admitted a number of minor breaches amounting to £14,500. It denied that any of those breaches (whether individually or taken together) were “material”.

At first instance, the trial judge, HHJ Thornton Q.C., reviewed each item of alleged disrepair in the landlord’s Schedule, and held that the maximum value of the defects that amounted to breaches of the repairing covenants did not exceed £20,000, including supervision fees. He decided that those breaches were not “material”, and that the lease had been terminated on 1 April 2004.

The judge adopted the principles set out by HHJ Rich Q.C. in Commercial Union Life Assurance Co Ltd v Label Ink Ltd [2001] L&TR 29, namely that the insertion of the word “material” mitigated the requirement for absolute compliance to the extent that it was reasonably fair to both landlord and tenant. In Label Ink HHJ Rich Q.C. had held that a breach would only be material if “but only if” having regard to all the circumstances, and to the proper efforts of the tenant to comply with the covenants, as well as the adverse effect on the landlord of any failure to do so, it will be fair and reasonable to refuse the tenant the privilege which the lease otherwise grants. He held that the extent of any breach, the practicality of quantifying any damage arising out of it, the efforts made by the tenant to avoid it, and the genuine interest which a landlord had in strict compliance were all material factors in determining materiality.

Applying this test, HHJ Thornton Q.C. criticised the landlords for refusing to get involved in the tenant’s attempts to agree a programme of remedial works prior to the break date and gave credit to the tenant for endeavouring to ensure compliance, which included following professional advice and carrying out extensive works.

The landlords appealed and the Court of Appeal had to decide whether the judge had misdirected himself as to the test of material compliance to be applied. To that end, the Chancellor, who gave the leading judgment, began by reviewing the decision of HHJ Rich Q.C. in Label Ink. His Lordship agreed with HHJ Rich Q.C. that the insertion of the word “material” must have been intended to mitigate the requirement for absolute compliance with all covenants, which, at that time, was usually found in conventional break clauses, and that the word “material” was not intended to permit only breaches which are trivial or trifling. However, His Lordship did not agree that it had been the parties’ intention to modify the strict rule to the extent that it was fair to both landlord and tenant and held that the test adopted by HHJ Rich Q.C. was not, therefore, warranted by the wording in the lease. Rather, it ignored:

- (a) the recognition in Finch v Underwood (1876) LR 2 Ch. D 310, that such provisions have to be strictly complied with because equity has no power to relieve a party in breach;
- (b) the warning in Simons v Associated Furnishers Ltd [1931] 1 Ch 379 of the need for consistency; and

(c) the insistence in Bairstow Eves (Securities) Ltd v Ripley [1992] 32 E.G.L.R. 52 that the Court should not rewrite the parties' contract.

The Court therefore held that the judgment could not stand because, in adopting the principle in Label Ink the Judge had applied the wrong test. Instead, the Court of Appeal held that "material compliance" must be determined as a matter of fact on an objective basis, and that subjective considerations were irrelevant. This meant that those matters of "conduct" for which the trial judge had given the tenant credit were irrelevant. Instead the Court was required to assess the question of materiality by reference to:

- (a) the number, value and nature of the outstanding defects;
- (b) that each individual breach was either minor or trivial, and when considered as a whole the breaches were still minor or trivial;
- (c) that the outstanding defects had no effect on the landlord's ability to obtain a new tenant nor on the terms that it could reasonably be expected to negotiate;
- (d) that the limited nature of the breaches meant that the overall damage to the reversion was negligible or nil and that there were no recoverable damages, or only trivial damages.

The Court focussed upon the ability of the landlord to relet or sell the property without delay or additional expenditure. In this regard, the Court considered the evidence of the parties' respective commercial lettings experts as to how works valued at £20,000 would affect any rent-free period on a re-letting by the landlord. The tenant's expert had described a defects liability of £25,000 as being "trivial" given the size of Castle House. The landlords' expert had said that an incoming tenant would seek an increase in the rent-free period equivalent to 75% of the cost of the outstanding remedial works. The parties' lettings experts agreed that the rent-free period likely to have been agreed with an incoming tenant in April 2004, had Castle House been in full repair and condition, would be measured in years, and not weeks or months. When compared to the rent of £595,000, the additional rent-free period attributable to the works, valued at £15,000, was only nine days.

By applying the objective test to the facts as found by the Judge, the Chancellor concluded that the tenant had complied with its obligations on 1 April 2004. The lease had therefore been broken.

A number of principles can be drawn from the judgments:

- (a) in cases where the absolute requirement for compliance with the tenant's covenants is qualified by the word "material" or "substantial" (the court found no real difference in the meaning of those terms), the materiality must be assessed by reference to the ability of the landlord to relet or sell the property without delay or additional expenditure.
- (b) if the word used is "reasonable" a different test will apply. Where a break-clause is conditional on reasonable performance by the tenant of his obligations, the requirement of reasonableness may well be stricter: see Reed Personnel Services v. American Express [1997] 1 E.G.L.R. 229.
- (c) the evidence of building surveyors will be crucial in assessing the degree of each alleged breach of the covenants to repair.
- (d) the evidence of lettings experts as to the likely effect that any such breaches will have on the landlord's ability to relet is likely to determine the case.
- (e) the parties' conduct and motivations in a commercial context are irrelevant when assessing whether there has been material compliance.

In conclusion

Ultimately, the tenant in Fitzroy was successful because it went to great lengths to ensure strict compliance with the break conditions. That included spending around £1m on repairs to Castle House. The works ensured that only a very few minor items of disrepair remained by the break date, those few items being valued by the trial judge at no more than £20,000. In the context of a large office building on the City fringe with a rent passing of £595,000, they were immaterial to the landlord's ability to relet.

The Court's approach in Fitzroy also demonstrates that the analysis of any alleged breach is necessarily fact specific at each level. At one end of the spectrum, it is clear that a trivial breach will not invalidate the tenant's right to break if the break

clause is qualified in this way. At the other, it is probably equally clear that a total failure to comply with an important obligation in a lease, such as a covenant to keep in good decorative condition, would not amount to “material” compliance with covenants. There are going to be many shades of grey between those two sets of circumstances.

I would also add that even though a landlord is free to ignore attempts by the tenant to engage in dialogue as to the extent of the works required in order to comply with the conditions attached to the break this must be the safest approach for a tenant to adopt if it is attempting to comply with its covenants. If a tenant engages the landlord in discussions about the works, potential issues of estoppel and/or misrepresentation may later arise, should the break be challenged.

The real lesson is, of course, to attempt avoid the issue altogether if possible. In any case where the tenant wishes to place the determination of the lease beyond doubt, the best course for a tenant to take must be to open negotiations with its landlord to attempt to secure the right to break on payment of a premium, and not by reference to performance of its covenants and obligations under the lease.

Indeed in the present market, a landlord may also be particularly receptive to such an approach if it is prepared to offer the tenant more favourable terms to remain, rather than run the risk that the tenant will successfully exercise its right to break and leave the landlord with empty premises.

Janet Bignell

23 October 2009

PART 2 BY ANTHONY TANNEY

Janet has identified at the beginning of her talk a list of top 5 banana-skins associated with tenant's break options.

Like Janet I intend to stick with tenant's break options, again for market related reasons. But while Janet has looked at pitfalls for tenants, I am going to start, at least, by looking at what might be considered traps when viewed from a landlord's perspective. In particular, I want to look at circumstances in which a landlord might be held either to have waived its right to require compliance with one or more conditions of a tenant's break option, or to have estopped itself from disputing the effectiveness of the exercise of a break option, whether on the ground of non-compliance with a condition or otherwise.

When I have done that, I shall return again to look at things from the tenant's perspective, with particular regard to one commonly-encountered break condition – namely the delivery of vacant possession on the break date. My object will be to see in a little more detail what such a condition requires, if the tenant is to avoid being locked into a lease which it does not want, and which it may be unable to dispose of in a falling market.

Landlord's pitfalls

Waiver by agreement

A landlord will seldom deliberately waive a break condition, without payment of some sort. But, strange as it may seem, circumstances may arise in which a landlord is found to have agreed to waive a break condition, quite inadvertently.

Let me start with a very common scenario. A lease of premises contains a break clause conditional upon two things: first, material performance of the tenant's covenants at the break date; second, the delivery up on that date of vacant possession of the premises. In the run up to the break date, the landlord and tenant agree that, instead of being

required to comply with its *repairing* covenants, the tenant can pay a sum of money to the landlord instead.

As I have said – a very common scenario. And very clearly the agreement about the repairing covenant could not operate to waive the other covenants and conditions of the break clause?

So you might think. But you'd be wrong.

In Legal & General Assurance Society v. Expeditors International (UK) Ltd [2007] L&TR 229, the tenant held a warehouse unit and yard at Heathrow airport, under two identical leases. Each lease included a tenant's break clause, conditional on two things: (a) performance of the tenant's covenants and (b) the delivery up of vacant possession of the premises on the break date.

The break date was 30 December 2004. On 21 October 2004, the parties executed a deed which they called a "Settlement Agreement", the relevant parts of which were clauses 2 and 4.

Clause 2 stated:

"In consideration of the sum of £172,000...the Landlord releases the Tenant absolutely from its liabilities covenants and obligations past and present under the Lease so far as the same relate to the state and condition of the premises".

Clause 4 was in these terms:

"The Tenant covenants with the Landlord that it will keep the premises in no worse a state and condition than they were in as at 24 August 2004 as evidenced by the schedule of condition attached to this Deed".

The Schedule referred to in clause 4 began with a recital that it was in full and final settlement of the "Dilapidations Claim and Lease Breaks".

The sum of £172, 000 referred to in clause 2 of the Settlement Agreement was calculated and paid on the basis that it included not only the cost of repairs, but also the cost of reinstatement of alterations, which would be liabilities of the tenant only at the termination of the lease. The sum also included an amount reflecting the usual rental void incurred whilst repairs were undertaken to the premises – which again would arise only after termination of the lease. I ought to tell you that at the date of the Settlement Agreement, and subject to the break clause, there were a further 7 years of the term still to go.

Having identified the important elements of the Settlement Agreement, we can now fast forward to the break date.

At the break date the tenant failed to remove all of its effects from the premises. Instead, the tenant left an employee on site, to deal with removals. The tenant also retained the keys to the premises, thereby excluding the landlord (which rather surprisingly did not have a set of keys of its own). All in all, therefore, the tenant retained a presence at the premises after the break date.

The result was, I am bound to say, inevitable. The landlord asserted that the tenant had failed to comply with the condition of the break as to the delivery up of vacant possession, and sued the tenant when it refused to pay ongoing rent.

The first issue for the court was whether the tenant had indeed failed to deliver vacant possession, in breach of the conditions of the break clause. As we shall see later, the judge found for the landlord on that issue. Nonetheless, the tenant still contended that it had validly broken the lease. Rather ingeniously, the tenant pointed to the October Settlement Agreement. The tenant asserted that although that Agreement was expressly addressed to dilapidations liabilities, it was nonetheless an implied term of the Agreement that the landlord waived its rights not only with regard to compliance with the repairing covenants of the lease, but also with regard both to the remaining lease covenants *and also* the other conditions of the break option, including the requirement to give vacant possession.

This was a very clever argument, and the Judge and a majority of the CA agreed with it. Sedley LJ said (at para 49)

“The self-evident purpose of the Settlement Agreement was to draw a line under the parties’ mutual rights and obligations at 30 December 2004 when the break notices were to take effect. To this end the Agreement, *anticipating the break*, crystallised the tenant’s outstanding liabilities and the landlord’s entitlements. Its intrinsic assumption was that the right of possession was *irrevocably set to expire* on 30 December, so that any consequences of a failure to yield possession on that date would sound in damages for trespass but could not, as they otherwise would, constitute a breach of the [break conditions]. This seems to me to have been the manifest intention of the parties – manifest in the sense that without it the principal purpose of the Agreement would not have been achieved. In the events which have happened, the lessor’s construction serves its interests; but on the same construction, the Agreement would have left it open to the lessee, for instance in a sharply rising market, to change its mind and simply stay put, rendering the break notices ineffective and frustrating any new letting the lessor might have agreed upon. Both sides in my judgment recognised and intended that the leases would come to an end on 30 December and were settling their intervening rights and liabilities. That the compromise may have overlooked one party’s material interests – for example if the premises were vandalised – is one of many illustrations of the fallibility of prediction, without which contract lawyers would have very little work”.

Amen to that last bit, especially!

Sir Anthony Clarke MR said (at para 68)

“[The Agreement] entitled the landlord to receive money to which it would not have been entitled for some years if the lease did not come to an end in December 2004. The landlord made its claim [to the money] on the express basis that the lease would in fact come to an end because it included the notional rent [for the period taken to complete the repair works].In these circumstances, in order to give business efficacy to the Agreement it is

necessary to imply a term to the effect that the lease *would come to an end whether or not the tenant succeeded in giving vacant possession on or before 30 December...* Equally if, for any reason, the premises were in a worse state when handed over than they had been on 24 August 2004, the landlord could not rely on the [break condition] to defeat the break clause, but would be entitled to appropriate compensation for breach of the covenant in clause 4 of the Agreement”.

So here we have a case which confounds at least our initial expectations: an agreement apparently limited to issues concerning repairing liabilities ends up having a much wider effect, making a conditional break clause more or less unconditional.

Now you may say that the outcome in Expeditors turned simply on the particular wording of the Settlement Agreement in that case. I would sympathise with that view. But I still think there is a wider lesson to be learned. In particular there appears to be no reason why the Settlement Agreement in Expeditors could not have made clear, by use of appropriate wording, that the *remaining* break conditions, ie those not related to the state of repair of the premises, continued to apply, notwithstanding the Agreement. And if that is so, then the lesson has to be this: in agreeing a limited waiver of a break condition, landlords and their advisers must take exaggerated care. They must, if you like, try to inhabit the mind of an ingenious tenant, seeking to exploit any argument, however apparently unpromising, in order to ensure that it has broken the lease. If that means making explicit the limited nature of the waiver, then that is what the landlord must do.

Estoppel

I do not intend here to solemnly set out the ingredients of the various estoppels which a tenant might seek to rely on against a landlord. But the message again is that a landlord can guard against the risk of an estoppel (of whatever hue) by keeping its guard up at all times.

By way of example, let us again take the case of negotiations surrounding dilapidations liabilities. A tenant who fails to repair the premises by the break date will sometimes assert that by negotiating, or more specifically, by something said in the course of

negotiations, a landlord has estopped himself from insisting on compliance with a break condition relating to repairs. One way in which a landlord can guard against such claims is, of course, simply refuse to enter into such negotiations. In that case, there is no risk of an estoppel arising. But often, a landlord actually wants the money more than he wants compliance with the condition. To remain aloof from negotiations represents, in such a case, a squandered chance to earn some lucre.

Where a landlord negotiates for a sum of money in lieu of compliance with a repairing condition, there is probably not much risk of an estoppel arising whilst the tenant still has time to complete the necessary works itself, should the negotiations come to nothing. But the position can change radically as the break date approaches and time begins to run out. Of course in one obvious sense the landlord is in a much better bargaining position at this point. But equally, tenants and their advisers may devote considerable efforts to redressing the balance. Like a spin bowler tempting a batsman into a rash stroke, tenants will use all manner of artifice to attempt to catch their landlord off-guard, and to get him to say something about compliance with a condition which, in the time-honoured phrase, is later relied on in court.

Alertness as to the wiles of tenants in negotiations of this kind will ensure that the tenant does not acquire the ammunition it hopes for. Landlords should always preface any significant communication regarding the break conditions with the warning that it is without prejudice to the landlord's strict rights under the lease, or words to that effect.

I am most reluctant to dilute that message.

Nonetheless, if only to offer a balm to landlord's understandable nerves, it is perhaps worth noting that estoppel arguments by tenants have not, on the whole, found favour with the courts – whose attitude has tended to be that tenants must look out for themselves on points of this kind.

I want to refer to two break clause cases which exemplify this. Neither concerned break *conditions* as such, but both are instructive, I think, as to the general approach taken by the courts in this kind of case. One of my two cases – Prudential Assurance Company Ltd v. Exel UK Ltd [2009] EWHC 1350 (Ch) - is the most recent case I have found on

break clauses, and is worth referring to for that reason alone. The other case – which I shall discuss first – is rather older, and is one in which I successfully appeared as junior counsel. So even though many of you will be familiar with it already, my inner narcissist requires me to draw it to your attention, even so.

The case in which I appeared as junior – successfully, in case I did not say - is Dun & Bradstreet Software Services (England) Ltd v. Provident Mutual Life Assurance Association [1998] 2 EGLR 175.

This concerned 3 leases in identical terms of office premises in Bristol, held by D&B. Each lease contained a break clause in these terms:

“The tenant may by not less than 9 months written notice served on the landlord expiring on 24th June 1995 (time being of the essence) determine this demise on 24th June 1995 *upon condition that* the Tenant shall thereupon (or on the earlier vacation of the property) pay to the Landlord.....a sum equal to 6 months rent”.

Notices were duly served, and (to cut a long story short) the issue of their effectiveness boiled down to the requirement to pay the penalty rent. This requirement was a condition precedent to the effectiveness of the break, and was to be complied with, at the latest, on the break date.

It was common ground that the penalty rent had not been tendered until some weeks after the break date. But the tenant contended that the landlord was estopped from disputing on this ground the effectiveness of the break.

The material relied on by D&B arose out of the parties’ mutual desire that D&B should remain in the premises on an interim basis, after the break had taken effect. To that end, the parties had commenced subject to contract negotiations which, by 25 May 1995, had resulted in agreement. The agreement included a postponement of the break date to a date in 1996, and a variation of the amount of the penalty rent.

At this point, lawyers were instructed to draw up the necessary documents: Mr J for D&B and Mr B for the landlords. On 15 June 1995, Mr B wrote to Mr J, subject to contract, proposing to prepare the necessary documentation by way of new short

leases, and concluding that “clearly this documentation needs to be completed no later than the end of next week before the break takes effect”.

Meanwhile Mr J’s belief was that the subject to contract agreement, postponing the break date, and varying the amount of the penalty rent, meant that the condition as to payment of the unvaried penalty, as well as the obligation to give up possession after the break date, were both suspended, pending completion of the agreement. However, Mr J never mentioned this belief to Mr B. On 23 June 1995, one day before the break date, Mr J wrote to Mr B stating that he did not think the documents could be completed before the break date, and expressed the hope that pending completion D&B could rely on the landlord’s co-operation to remain in possession of the premises. In the meantime, D&B itself had obtained an assurance to this effect from the landlord direct. No mention was made at any time of the obligation to pay a penalty rent, and the break date came and went without compliance with that obligation.

In the CA, Counsel for D&B particularly relied on the direct assurance sought and obtained by D&B from the landlord that, pending completion, D&B could remain in occupation. Counsel said that it was necessarily implicit in this assurance that the subject to contract agreement was still on foot, and that D&B therefore did not have to pay the penalty rent. It was, he said, simply inconsistent with the deal being on foot – including as it did a varied penalty rent – to expect D&B to pay the unvaried penalty.

Though I appeared for the landlord – successfully, as I may have said - I think I am allowed to say that this submission carried a lot of persuasive force. But it was rejected by the court. Peter Gibson LJ’s reasoning is in the following passage (at 181E):

“I find myself unable to accept this submission. I can see no clear representation in the [landlord’s] assurance or otherwise in the conduct of the landlord that the penalty rent need not be paid on time. What is noteworthy in the exchanges between the parties is that there was no mention whatever of whether the payment of penalty rent should be made on or before [the break date] or could be postponed, even though both sides were fully aware of the point. There was no indication by [Mr J to Mr B] of [Mr J’s] belief that payment need not be made, though there were ample opportunities to do so..... [Mr J] in his letter of June 23

merely expressed the hope that his clients could rely on the landlord's co-operation to remain in the premises., but never mentioned postponement of the penalty rent. That expression of hope....was consistent only with an awareness on the part of [Mr J] that absent such co-operation the parties would be able to rely on their strict legal rights so that, if [D&B] made payment on June 23 or 24 the leases would come to an end.....It cannot be said that the landlord was under a duty to alert the [tenant] advised as they were by reputable solicitors, to the obligations under the break clause which they themselves had sought to operate.”

I think this stands as an example of what I have called a fairly hard-nosed approach. The only crumb of comfort for tenants generally is to be found in a passage at the end of Peter Gibson LJ's judgment (at 181L)

“In my judgment in this category of case viz promissory estoppel one must still find a clear representation.....I would add that in my view in any event the test of unconscionability is here not satisfied, though the circumstances put this case fairly close to the line. The position might have been otherwise if the tenants had revealed their mistaken thinking and would have been otherwise if the landlord had made clear the representation for which [counsel for the tenant] contended”.

This passage is a crumb of comfort for tenants. Equally, however, it tells landlords exactly what they must not do, if they wish to avoid being estopped.

That concludes our journey into the centre of Tanney's self-regard. On to a more recent case.

In Prudential Assurance Company Limited v. Exel UK Limited [2009] EWHC 1350 (Ch) three issues arose: (i) was a break notice served by one joint tenant in fact served with the authority of the other; (ii) was the notice invalid because it was expressed to be served by only one of the joint tenants; (iii) was the landlord estopped from denying the validity of the notice?

The tenants were a trading company called Exel UK Ltd and a dormant company called Consumer. Both companies were in the same group, and shared a registered office and a company secretary. The lease was not shown anywhere in Consumer's accounts. The two companies were the original tenants: there had never been any assignment of the lease.

The lease included a break option, exercisable on notice by the tenant. On 13 June 2006, a firm of solicitors, Messrs K, served a notice on the Prudential, purporting to exercise the break option. The heading of the notice correctly described the lease as being between the Prudential and the two joint tenants, Exel and Consumer. The notice stated that Messrs K acted for Exel, and that as agents for Exel, they were giving notice under the break option.

After the last date for serving the notice, in September 2006, solicitors for the landlord, Messrs C, asserted that the notice was invalid, because it had been given by Exel alone. Exel and Consumer disputed this, and said that in any event the landlord was estopped from disputing the validity of the notice on the grounds on which it relied. Litigation was the inevitable result.

The deputy Judge found that Messrs K, the solicitors, did indeed have the authority of both Exel and Consumer, to serve the notice. In passing, I might add that the judgment contains a very useful – if perhaps overlong – analysis of the agency issues arising where a group of companies administers the whole of its portfolio through a group property services department.

However, because the notice was given in the name of Exel alone, the deputy Judge held it to be invalid. He held on authority that a notice so given would be valid only if the landlord could in the circumstances safely assume that it was binding on all parties who comprised the tenant – which was not the case on the facts. As before, the decision contains a useful – if again overlong – review of the relevant cases.

All of which put in play the Tenants' argument that the Landlord was estopped from disputing the validity of the notice on that ground.

The material relied on arose from the fact that a third party called L&B was in possession of part of the demised premises, claiming squatter's rights. The Tenants referred the court to an e-mail from Messrs C dated 13 June 2006. This e-mail responded to a request from Messrs K on behalf of Exel alone seeking confirmation that if L&B did not vacate the disputed part of the premises, the landlord would not take advantage of that point in order to deny the validity of the break notice. Messrs C's e-mail stated that the landlord would take no such point "should your client seek to break its lease".

The deputy Judge rejected the idea that this e-mail amounted to a sufficient representation to sustain a promissory estoppel. He said that it was necessary to show a representation went specifically to the question of whether Exel alone could serve a notice. That was not the purpose of the e-mail, which was instead addressed to the issue of whether the break would have been affected by the presence on the demised premises of L&B. But the deputy Judge also went further – rather helpfully from a landlord's viewpoint. He said that it was intrinsically unlikely that a landlord would ever make a representation of the necessary kind: why, asked the deputy Judge, would the landlord promise to accept a notice from one of two joint tenants, given that the effect of the notice on the other tenant would remain at large?

The tenants also made a claim to a conventional estoppel. This claim rested on correspondence passing between solicitors, again in connection with the L&B issue. This correspondence began with Exel's solicitor, Messrs K, applying the label "our client" to both Exel and "the tenant". In their replies to the correspondence, the landlord's solicitors, Messrs C, had in turn referred to "your client".

The deputy Judge held that this material did not go nearly far enough to establish the common assumption needed to sustain a claim to a conventional estoppel. The expression "your client" used by Messrs C could have referred either to Exel, or to "the tenant" (meaning both Exel and Consumer). So the basis for the alleged common assumption was absent.

That was enough to dispose of both estoppel claims. But for good measure the deputy Judge also drew attention to a point which will often be available to defeat claims to an

estoppel in cases such as this. He held that when drafting the break notice, the solicitors, Messrs K, were relying on a belief which, in error, *they themselves had formed* as to the identity of the tenant. The drafting was not undertaken in reliance upon a representation or promise by the landlord as to who could serve the notice, nor any shared assumption as to who could do so. This was sufficient to defeat both estoppel claims, even had the other elements been established.

The overall message from these cases is, I think, that a tenant will have an uphill task in showing an estoppel.

My own message, however, is that the success of a claim to an estoppel will always depend on the precise facts. And for that reason, constant alertness is needed. Careless talk may no longer cost lives. But it may yet cost leases.

Vacant possession

Back to pitfalls for tenants.

The issues which arise in connection with a vacant possession condition are again best examined by looking at actual decided cases, of which there are two fairly recent, principal examples. I am afraid I appeared in neither of them, and therefore must justify citing them on the rather thin grounds that they are both relevant and illuminating.

The first case is John Laing Construction Ltd v. Amber Pass Ltd [2004] 2 EGLR 128.

This case concerned an office block and adjacent land in Hemel Hempstead, of which Laing was tenant. The lease contained a tenant's break option, exercisable by notice, whose effect was conditional on (among other things) the tenant "yielding up the entirety of the demised premises" on the break date. The break date was 16 October 2003 and the issue was whether or not the condition had been fulfilled on that date.

Laings had in fact vacated the premises some two years before the break date, and the premises had (with weary inevitability) become a magnet for vandals. Laings had therefore installed a 24 hour security presence at the premises, as well as fencing and concrete barriers, to keep out travellers.

As the break date approached, the parties fell out on various extraneous issues to do with the break notice, and it eventually became clear that there would inevitably be a dispute about whether the break had been validly exercised or not. In those circumstances, on the break date the tenant did not hand back the keys, and continued to maintain the security presence and security barriers which it had installed 2 years before.

At or before trial, the landlord abandoned its arguments about the extraneous issues, and sought to rely solely on Laing's failure to "yield up" the premises in accordance with the break condition. The landlord said that "yielding up" required some overt, formal act on the part of the tenant, such as yielding up keys, and that had not happened in this

case. Laings had also failed to remove security barriers, and ought to have invited the landlord to take over the security contract.

The most withering thing anyone has ever said in court about an argument of mine was that it was “adventurous”. I am afraid to say that the landlord’s argument in this case was adventurous.

The deputy Judge noted that Laings had merely taken proper precautions against the landlord’s contentions - not abandoned until well after the break date - that the lease would continue. Retention of keys and maintenance of security was to be seen in that light, and not as a desire by Laings to retain an interest in the premises notwithstanding service of the break notice. There was no formal requirement for yielding up. When addressing the issue whether a yielding up had occurred, the task of the court was to

“look objectively at what has occurred and to determine whether a clear intention has been manifested by the person whose acts are said to have brought about a termination to effect such a termination and whether the landlord could if it wanted to occupy the premises without difficulty or objection” (see 131H to J).

The clear intention was manifest. And the security barriers were no hindrance to the landlord taking the premises back, because in practice the landlord would have had to maintain them there himself in any event (see p.132C).

Though the issues in Laing were clearly related to the requirement to deliver up vacant possession, nonetheless the break clause in that case did not in fact explicitly use those words. It was doubtless for that reason that that the court was not referred to authority on the meaning of the expression “vacant possession”.

This omission was made good in the second of my two cases, Legal & General v. Expeditors (above). The issues surrounding delivery of vacant possession did not feature in the appeal in this case, but were discussed and decided upon at first instance ([2006] L&TR 22).

In Expeditors the judge was called on to consider and apply the decision of the CA in Cumberland Consolidated Holdings v. Ireland [1946] 1 KB 264. That was a

vendor/purchaser case, in which it was held that vacant possession had not been delivered on completion of the sale of a warehouse, whose cellar was 2/3 full of bags of hardened cement, and empty chemical drums. The judgment of the CA in Cumberland Holdings appeared to lay down two different tests for determining if VP had been given.

The first test was that:

“subject to the de minimis rule, a vendor who leaves property of his own on the premises on completion cannot in our view be said to give VP since by doing so he is *claiming a right to use the premises for his own purposes, namely as a place of deposit for his own goods, inconsistent with the right the purchaser has on completion to undisturbed enjoyment*”.

The second test focussed on the fact that what a purchaser bargains for upon a sale of land is not merely the legal right to possession, but also what the CA called the “power in fact to exercise that right”. The purchaser would be denied his bargain if there remained on the premises a physical impediment which “substantially prevents or interferes with the *enjoyment* of the right of possession of a substantial part of the property”.

In Expeditors, the demised premises comprised warehouse units and a yard at Heathrow. The premises were let under 2 leases in materially identical terms, each containing a tenant’s break option conditional on delivery of vacant possession on the break date – which was 30 December 2004. In contending that the break had not been validly exercised, the landlord cited the presence on the site on 31 December 2004 of gas containers, debris on grass verges surrounding the yard, together with pallets and some garment rails inside the premises.

The Judge considered the Cumberland Holdings decision, and held that the second test – the test of physical impediment - was not breached. He found that the gas containers were in fact fixtures, and were therefore part of the premises, rather than an impediment to the use of the premises. Moreover the debris-strewn grass verges were not part of the demise at all – the debris amounted to a trespass on these verges, but did not amount to a breach of the obligation to give VP of the premises. Finally, the

pallets and garment rails did not, as a matter of fact and degree, amount to a substantial interference with the use of the premises by the Landlord.

However, the Judge found that the first of the Cumberland Holding tests was breached. I'll explain why in just a moment – but what is immediately clear is that failing *either* of the Cumberland tests will mean that vacant possession has not been given. The reason why the first test was breached was that on the break date, the tenant was still using the premises. It retained keys. Moreover for some days after the break date, the tenant kept a man on site to clear up, and to organise removal lorries to come and remove pallets for use by the tenant elsewhere. And all this time, the landlord could not itself gain access because the premises were locked. All of that, said the judge, amounted to use of the premises inconsistent with the landlord's right to possession.

Of course, none of this mattered, because of the Settlement Agreement which I have already discussed. But it is clear that the Judge's reasoning on vacant possession forms part of the *ratio decidendi* of Expeditors.

What, then, of the John Laing decision? Would it be decided the same way now? Recall that John Laing postulates a test for yielding up which looks at whether the tenant had manifested a clear intention to terminate the lease, and at whether the landlord could, if it wished, occupy the premises without difficulty. It does seem clear enough to me that had the Laing break clause been conditional on giving vacant possession, the result would have been the same. The security barriers left by Laings were, on the facts, easily removable, so would not have been a substantial impediment to use of the premises by the landlord. And the maintenance of the security measures by the tenant was scarcely use of the premises by the tenant for its own purposes, inconsistent with the rights of the landlord.

So we can safely rely on Laing as both a reliable and useful illustration, on its facts, of a case where a tenant gave vacant possession, and thus broke its lease.

Anthony Tanney

2 November 2009