

Give me a break

Glenn Dunn reviews established principles for a tenant seeking a valid termination of its lease, and offers tips on how to avoid common problems



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'In *Baker Tilly Management Ltd v Computer Associates UK Ltd* the High Court held that the actual words used in the lease were not determinative. The crucial issue was what those words would mean to the recipient of the notice in the context of the particular transaction.'

As we enter another uncertain economic year, tenant break clauses in leases continue to attract unwelcome scrutiny. Although there is still no industry-standard break clause, the main components are typically:

- the requirement for prior notice (commonly not less than six months);
- service on the landlord in accordance with the notice provisions in the lease; and
- compliance with specified pre-conditions, for example the payment of all rents, vacant possession, and performance of all lease covenants.

A failure to comply with one or more of these components is likely to lead to challenge and create uncertainty for a tenant already anxious to dispose of surplus premises.

Defective notices

All too often, notices served by or on behalf of tenants contain errors. These can include:

- reference to the wrong party as tenant, or a failure to refer to all tenants;
- reference to the wrong landlord; and
- reference to the wrong break date.

Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1997] concerned a notice to determine in which the break date had been incorrectly calculated. The House of Lords held that a minor

defect in a contractual notice will not necessarily invalidate the notice, provided that the reasonable recipient, with a knowledge of the factual and contextual background, would not be perplexed by the error. Here, the tenant's intention to determine the lease had been clearly communicated to the landlord, which was able to establish the correct break date for itself.

Subsequent cases have used the *Mannai* principle to rescue defective notices, provided that the tenant has otherwise complied with the requirements for service as laid down by the lease. However, the principle only applies in certain circumstances and will rarely assist where an incorrect party has been named, or where there is mandatory wording relating to the mode and/or method of service. For example, the court in *Mannai* said that if the lease requires a notice to be served using blue paper, then a notice using pink paper will be invalid.

Pre-conditions

The British Property Federation's 2007 lease code suggests that the conditions attached to the exercise of a tenant's break should be limited to requirements that the principal rent is paid up to the break date and occupation of the premises is delivered to the landlord, leaving behind no continuing subleases. This reflects concern over the effect of a number of cases that make clear that compliance will also be construed strictly, according to the particular requirements of the lease in question.

Compliance with covenants

Pre-conditions can be absolute or qualified, and the courts have made a clear distinction between them. It was

established as long ago as *Bairstow Eves (Securities) Ltd v Ripley* [1992] that there is no discretion to vary an absolute requirement. The lease required the premises to be painted in the last year of the term, and the fact that they were in good decorative repair at the break date, having been painted in the penultimate year of the term, was not sufficient to satisfy the condition.

The position may be less onerous in the case of the qualified covenant, but this itself creates greater potential for uncertainty. In *Reed Personnel Services plc v American Express Ltd* [1997] the break was conditional on the tenant 'reasonably performing and observing the covenants of the [lease]'. The lease

included express obligations to repair the interior and to redecorate during the last six months of the term. The tenant accepted that it had made no attempt to carry out certain decoration and carpet replacement works, but argued the cost of these was only £21,000 and, accordingly, there had been reasonable performance. The court disagreed and held that the economic value of non-performance was irrelevant to the question of whether reasonable performance had occurred.

However, in *Fitzroy House Epworth Street (no 1) Ltd v The Financial Times Ltd* [2006] the Court of Appeal found that the tenant had 'materially complied with all its obligations under [this] lease down

to the [termination] date'. After serving the break notice the tenant made efforts to agree a specification of works with the landlord, but, receiving no co-operation, proceeded to carry out substantial repair and renovation works costing more than £900,000. The court said that the test of material compliance was an objective one and had to be assessed by reference to the landlord's ability to re-let or sell the property without delay or additional expenditure. It emphasised the principle set out in *Bairstow Eves* that had the covenant been absolute, any breach would have invalidated the break notice.

Vacant possession

The question of what constitutes vacant possession was considered in *Legal and General Assurance Society v Expeditors International UK Ltd* [2007]. In addition to the tenant 'substantially' performing the lease covenants, the break clause required the tenant to deliver up vacant possession. Prior to the break date the parties agreed a settlement in relation to dilapidations at the property, but on that date the property was still being cleaned and the tenant had not returned the keys. The court found that the effect of the settlement agreement amounted to a waiver of the pre-conditions attached to the break, and the lease was therefore validly determined. It did, however, say that if the issue of compliance had been considered then it would have found that the tenant had failed to give vacant possession, since the landlord could not have gone into occupation on the break date.

Recent cases

Getting the name right

In *Baker Tilly Management Ltd v Computer Associates UK Ltd* [2009] the tenant sought a declaration that it had validly served notice to quit under its lease of commercial premises. The lease had been granted to *Baker Tilly Services Ltd*, but by the time of the notice to quit the tenant had changed its name to Baker Tilly Management Ltd. The specific requirements of the break clause had been satisfied, but the notice was served in the tenant's old name. The landlord sought to avoid termination of the lease by claiming that the notice was invalid because it should have specified the tenant's current name.

The High Court held that the actual words used on their own were not

Practical considerations

The cases described in the main text give a brief insight into some of the pitfalls that surround break clauses. When acting for a tenant you should:

- Check who is required to serve the notice. Is there more than one tenant, or is the break personal to the original tenant?
- Check the identity of the current landlord by examining official copies of the landlord's title and the most recent rent demand. Do Companies House records reveal any name changes since the date of the official copies?
- Check the break date and whether notice is required. Does the lease make any specific requirements in relation to the method of service?
- Consider whether there are specific pre-conditions that must be complied with. If there are, advise the client early on of the need to pay rent up to date and recommend that they seek professional advice about the extent and timing of any required repair works. If vacant possession is also required, any sub-tenants should be advised of the consequences of failing to vacate the premises before the expiry of the sublease.

If acting for a landlord recipient of a notice, do not acknowledge receipt to the tenant before you have considered:

- Was the notice served in time and in the correct manner?
- Are the correct parties named in the notice?
- Are there any other apparent defects in the notice?

Even if the notice has been validly served and there are pre-conditions to be satisfied before the break date, remember that:

- Absolute requirements mean just that and will be construed strictly against the tenant.
- There is no duty for a landlord to co-operate with a tenant's request for confirmation that pre-conditions have been satisfied.
- Unless the lease provides otherwise, a requirement that all rent is paid up to date requires payment of the whole quarter's rent even if the break date falls on the quarter day itself.
- In the current market, the ability to defeat a break notice is very much in the landlord's interests, to minimise void costs and avoid the time and expense of having to find a new tenant.

determinative. The crucial issue was what those words would mean to the recipient of the notice in the context of the particular transaction. Would a reasonable landlord understand what was intended by the notice? A distinction had to be drawn between the tenant as an entity and the label that was attached to that entity. The tenant entity had not changed: it was merely its name that was now different. So when the notice was served it was still the same legal person. Accordingly, the reasonable landlord had to be considered to understand the effect of the notice, notwithstanding the discrepancy in the name used.

Make sure you refer to all current tenants

In *The Prudential Assurance Co Ltd v Exel UK Ltd & anor* [2009] the High Court had to decide whether a break notice intended to be served by joint tenants, but referring only to one of the tenants in the notice, was valid. A warehouse was let to two group companies. By the time of the notice one was trading and the other was dormant. There had been previous correspondence between the parties' solicitors that was unrelated to the break, but was material in the context of what the reasonable landlord would have clearly and unambiguously understood from the contents of the break notice.

The judge found that the notice was invalid because it was not clear and unambiguous. The break clause had to be exercised by both tenants together, and the failure to refer to the dormant tenant meant that the landlord could not tell from the notice whether, for example, there had been an unauthorised assignment or if the trading company was seeking, improperly, to exercise the break for its own benefit. Although the judge was satisfied that the solicitors were authorised by both tenants to serve the notice, this was not made clear in the notice to enable the landlord to safely rely on it to bring the lease to an end.

Who can exercise the break?

Norwich Union Life & Pensions Ltd v Linpac Mouldings Ltd [2009] concerned the exercise of a break that was expressed to be personal. Linpac Mouldings Ltd was the assignee under two leases of industrial premises granted in 1986. At the time of the assignment, the landlord gave Linpac a personal right to determine the leases;

subsequently the leases were assigned to a group company, Linpac Automotive Ltd (Automotive). Later, Automotive went into administration and the administrator sought the landlord's consent to reassign the leases to Linpac.

The landlord refused consent to the administrator's application on the ground that the main purpose of the reassignment was to enable Linpac to exercise the break clause. Automotive nevertheless reassigned the leases without consent, and Linpac purported to give the landlord notice to terminate the leases. In reaching its decision, the court had to consider two critical questions. First, was Linpac entitled to exercise the break even though it was no longer the tenant? If the answer to this was no, would a reassignment of the leases to Linpac be effective in restoring the break right?

The court found for the landlord on both issues. It held that the purpose of a break clause is to entitle the tenant in possession to terminate the lease. There could be no commercial sense in allowing a former tenant to exercise the break to the detriment of the tenant in possession. Similarly, there could be no commercial sense in a finding that the parties intended that a right that was personal when granted could be revived by subsequent reacquisition of the lease. This would cause uncertainty both for the landlord and for any prospective purchaser of the reversion. Had Linpac wanted to be able to exercise the break in the future, it could have retained the lease and sublet the premises.

Timing of the notice

The consequences for a tenant leaving service of a notice until the last minute can be catastrophic. In *Orchard (Developments) Holdings plc v Reuters Ltd* [2009] the Court of Appeal had to decide whether a right to break had been validly exercised. The terms of the break clause were favourable to the tenant, requiring only six months' prior notice to be given and for vacant possession of the premises to be provided at termination. There was no issue over the requirement for vacant possession, but the landlord claimed that the provisions for service of notices under the lease had not been met.

The lease provided that any notice would only be valid if given by hand, or sent by registered post or recorded delivery, unless the receiving party or

its agent acknowledged receipt. The last day for service of any notice under the break clause was 30 July 2005. On 29 July 2005 (a Friday), a process server was instructed to serve the notice by hand, but it was posted through the wrong letterbox. Further copies of the notice were sent by fax on both 29 and 30 July 2005, which had to be acknowledged by the landlord or its agent in order to be effective. Both faxes arrived, but only after the landlord's office had closed for the week.

The landlord refused to acknowledge receipt of the faxes until well after the break date had passed, at which point the tenant claimed that the notices had been retrospectively acknowledged. Alternatively, the tenant claimed that the landlord was not entitled to frustrate the notices provision in the lease by refusing to acknowledge receipt. The Court of Appeal disagreed, and held that ineffective notice had been given. The landlord had no duty to acknowledge receipt in view of the more formal methods of service prescribed by the lease. There could also be no retrospective acknowledgment of the notices, and two of the three judges expressed a view that no valid acknowledgment could be given after the deadline for serving notice had passed. ■

Bairstow Eves (Securities) Ltd v Ripley [1992] 2 EGLR 47

Baker Tilly Management Ltd v Computer Associates UK Ltd (Unreported, Chancery Division, Peter Prescott QC, 11 December 2009)

Fitzroy House Epworth Street (no 1) Ltd v The Financial Times Ltd [2006] EWCA Civ 329

Legal and General Assurance Society v Expeditors International UK Ltd [2007] EWCA Civ 7

Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd [1997] AC 749

Norwich Union Life & Pensions Ltd v Linpac Mouldings Ltd [2009] EWCH 1602 (Ch)

Orchard (Developments) Holdings plc v Reuters Ltd [2009] EWCA Civ 6

Reed Personnel Services plc v American Express Ltd [1997] 1 EGLR 229

The Prudential Assurance Co Ltd v Exel UK Ltd & anor [2009] EWHC 1350 (Ch)