

EXERCISING A TENANT'S BREAK IN THE RECESSION

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Rash of break clause cases thrown up by the recession

1. It is part of the natural economic cycle that a recession will result in an increase in the numbers of tenants seeking to break leases in an attempt to extract themselves from over rentalised leases or merely reduce their exposure. Sir Kim Lewison, interviewed last year in the Estates Gazette on the subject of the effect of the recession on property litigation is quoted as saying "*there will no doubt be the usual rash of break clause cases*"¹. That prediction has turned out to be correct, with several cases reaching the courts in the past year concerning the validity of the exercise of a tenant's break.
2. Since the 1980s there has been a shift away from the trend of long leases and a reduction in and increasing diversity of lease lengths. At the same time there has been a significant increase in the number of tenant's break options now included in commercial leases. There was some evidence that in the improving market of the late 1990s there was some decline in their use but lease data relating to property held by the institutions show that there had been a return to former levels by 2003 (break clauses present in about 35% of offices leases and 25% of industrial leases in 1993)². Whilst I am not a transactional lawyer, my own experience of dealing with recent lease renewals indicates that in the current market retail tenants seem to be invariably seeking either a very short term or the inclusion of tenant's break options.
3. Break options come in different shapes and forms and depend on the drafting of the lease in question. However they invariably require the service of a notice by the tenant notifying the

¹ Article by Tina Desai, Estates Gazette (31.01.09)

² Data taken from Sandi Murdoch, "Commercial Leases: Future Directions" in Bright, Landlord and Tenant Law Past Present and Future" (Hart Publishing)

landlord that it seeks to exercise the break in accordance with the lease terms. The exercise of the break is frequently made conditional upon other matters, such as payment of outstanding rent, the giving up of vacant possession and in some cases (although rarer now) compliance by the tenant with other covenants in the lease, including compliance with its repairing obligations.

4. The Code for Leasing Business Premises in England and Wales 2007 (“the Business Lease Code”) seeks to promote fairness by ensuring that tenant’s breaks are not made subject to stringent and practically unattainable conditions. The Landlord Code set out therein provides that,

“The only pre-conditions to tenants exercising any break clauses should be that they are up to date with the main rent, give up occupation and leave behind no continuing subleases. Disputes about the state of the premises, or what has been left behind or removed, should be settled later (like with normal lease expiry).”

Key concepts

5. The failure to serve a valid notice in time or to comply with conditions to which the break is made subject, can have drastic consequences for obvious reasons. Breaks are not often rolling and the tenant may lose the opportunity to break the lease for a further 5 or 10 years. The loss involved can quite often be staggering.

6. This is an area of law where technicalities matter. In **Hexstone Holdings Ltd v AHC Westlink Ltd [2010] EWHC 1280 (Ch)** the validity of the notice was challenged by the landlord on the grounds that the notice had not been given by the tenant but rather by an associated group company. The tenant submitted that the landlord’s arguments were “unattractive and opportunistic” but Edward Bartley Jones QC (sitting as a deputy high court judge) rejected that submission in the following passage, which could usefully be cited by a party running a technical point in future:

“[The tenant] was, by clause 7 of the Underlease, given a contractual right which it had to exercise in accordance with the terms of that contractual right and certain basic principles of law where agency was involved. There is nothing “unattractive and opportunistic” in a landlord saying that a contractual right has not been exercised in accordance with its terms (nor in a landlord saying that the requirements of the general

law in respect of the service of notices by agents have not been fulfilled). It may, perhaps be, that the requisite “general agency” could have been established in this case by AHC by different evidence. But there is nothing “unattractive and opportunistic” in [the landlord] saying that [the tenant] has failed to adduce such evidence at trial.”

7. In some cases errors in notices will be saved as a matter of construction on the reasonable recipient test expounded in **Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd** [1997] AC 749, HL.

8. *Mannai* itself concerned the validity of tenant’s break notices which were required (under clause 7(13) of the two leases) to take effect at the expiry of the third year of the term (13 January 1995). The tenant served break notices referring to clause 7(13) of the lease, and which were otherwise valid, save that they gave notice to determine the leases “on January 12, 1995”. The House of Lords held that the notices were valid because the reasonable recipient would have understood that the tenant was intending to break the leases in accordance with clause 7(13), namely on 13 January 1995 and not seeking to do something which he had no right to do (namely terminate the leases on 12 January). The reasonable recipient test was expressed thus by Lord Steyn (at 767D),

“The construction of the notices must be approached objectively. The issue is how a reasonable recipient would have understood the notices. And in considering this question the notices must be construed taking into account the relevant objective contextual scene.”

And at 772G-H,

“The question is not whether 12 January can mean 13 January: it self-evidently cannot. The real question is a different one: does the notice construed against its contextual setting unambiguously inform a reasonable recipient how and when the notice is to operate under the right reserved?”

9. It is important to appreciate that the *Mannai* case itself was one where the break clause in the lease in question did not require that the notice itself specify the correct termination date. As Lord Hoffmann said at 776

“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. But the condition in clause 7(13) related solely to the meaning which the notice had to communicate to the landlord”

10. Of course the lease may contain mandatory requirements of “the blue paper kind”. In such cases the mandatory requirement must be strictly complied with and *Mannai* will be of no assistance in the event of non compliance. For example, in *Claire’s Accessories UK Ltd v Kensington High Street Associates LLC* [2001] PLSCS 112, a landlord’s break notice was ineffective even though it had been served on the tenant’s employees at the premises because the lease required all notices to be served on the tenant at its registered office. This demonstrates the importance of reading the lease as a whole (and not just the break provision in question) before serving a notice. It is crucial to look to see what, if any, are the prescribed requirement of service of notices more generally. In *Orchard (Developments) Holdings Plc v Reuters Ltd* [2009] 16 EG 140, if reliance on a faxed notice was to succeed it was essential that the landlord be shown to have acknowledged receipt in writing at the very latest before the break was to take effect. This had not been the case and so the purported break was ineffective. Similar reasoning applies to cases where the notice is given by or to the wrong party. In these cases, the error is a “blue paper kind” and it matters not what the reasonable recipient would have understood by the notice

Exercising the Right by Notice

Identifying the correct giver and recipient of the notice

11. This falls into two parts: who is required to give the notice and on whom is the notice required to be served? This is perhaps more difficult than one would imagine at first sight. Further, does the relevant contractual provision require that the name of the landlord/ tenant be actually specified in the notice? Even if it does not, it is usually good practice to include such information.
12. Usually the notice has to be given to “the landlord” or “the tenant”. As we all know both reversions and unexpired residues can change hands numerous times during the duration of the term and the original parties to the lease may not have any current interest. It is therefore

important to get it right. Indeed the cases coming before the courts this year demonstrate that the most frequent “clanger” is indeed the failure to ensure that the notice is served on or by the right person.

13. If the lease, as is normal, requires the notice to be given by the tenant to the landlord, and in fact the notice is not so given, it is not permissible to fall back on *Mannai* principles of interpretation. In these cases, it does not matter if the recipient might have thought that the notice was validly given if in fact it was not. This requirement is therefore of the “blue paper” kind identified by Lord Hoffmann in *Mannai*.

Notice not given to the landlord

14. A leading Scottish case illustrates the danger of relying on what managing agents say and or on documents such as rent invoices etc. In **Ben Cleuch Estates Ltd v Scottish Enterprise [2006] CSOH35; [2006] PLSCS 57** the tenant, Scottish Enterprise, was held to have failed to terminate its lease effectively because it had served the break notice on the wrong party. One might therefore readily conclude that the tenant only had itself to blame. However, the facts warrant closer examination.
15. The tenant’s lease contained a break clause that entitled it to terminate on one year’s notice. The clause contained a number of conditions or requirements: in particular, in order to terminate the lease on 2 February 2006, the tenant had to give a written notice *to the claimant landlord* prior to 2 February 2005.
16. The actual landlord was the claimant, Ben Cleuch Estates Ltd, which was a subsidiary company of another company, B, which had been established as part of joint venture to invest funds in commercial properties. The claimant landlord had changed its name but the tenant was not told and invoices were sent in respect of rent by managers stating to be “acting as agents for B”. Perhaps not surprisingly Scottish Enterprise served the notice on B.
17. Even though the notice had come to the attention of Ben Cleuch Estates Ltd, it was held at first instance by the Court of Session (Outer House) that the notice was not validly given because full compliance with the terms of a contractual break clause was necessary to effect the break

and there was no such compliance since no notice had been given to the claimant landlord³. On appeal to the Court of Session Inner House, this part of the reasoning was upheld. It was expressly held that it mattered not how the notice would be construed to the reasonable recipient landlord as the notice had quite simply not been served on the landlord at all. However, on appeal the harshness of the decision was mitigated in that the Inner House held that the actual landlord, Ben Cleuch Estates Ltd, was personally barred in all the circumstances from denying that B was the landlord and therefore from denying the validity of the break notice. This represents a fair result in light of the fact that the rent invoices served on the tenant had specified that B was the landlord and the tenant had relied on that in serving the break notice on B. On the facts one would expect a similar result in the English courts through the operation of ordinary principles of estoppel.

18. This case illustrates the strictness of the principle that where the exercise of an option is made conditional, the conditions will generally be construed as conditions precedent which must be strictly complied if the option is to be validly exercised. It also illustrates how important it is to research the true position before serving any notice. An estoppel argument may not be open to the tenant on the facts, in which case it will be held to have invalidly exercised the break.
19. The *Ben Cleuch* decision was recently followed in the Scottish courts where it was held that indirect receipt of the notice by the actual landlord would not suffice if the notice was actually served by the tenant on another person. In **Batt Cables Plc v Spencer Business Parks Ltd [2010] SLT 860** Lord Hodge held that he was bound by *Ben Cleuch* to treat the question of whether the notice was given to the landlord as a separate and prior question to the understanding of the reasonable recipient as to the meaning of the notice. In that case the break notice was addressed to and served upon the asset management surveyor based at one of the defenders' associated companies and not to the defenders, who were the landlords.

³ There is currently some debate as to whether or not the *Ben Cleuch* decision would go the same way in the English and Welsh courts. My own view is that the harshness of the decision stems from the fact that Ben Cleuch got the notice indirectly because it shared directors and registered office with B. In England the position might be distinguished. In *Townsend's Carriers Ltd v Pfizer Ltd* (1977) 33 P&CR 361 at page 366 Megarry V-C said that "*I do not think that a requirement to "give" notice is one that excludes the indirect giving of notice. The question is whether the notice has been given, not whether it has been given directly. If the note emanates from the giver and reaches the ultimate recipient, I do not think that it matters if it has passed through more hands than one in transit.*" However this reasoning was rejected on appeal by the Court of Session (Inner House) in *Ben Cleuch* [2008] CSIH 1.

Lord Hodge held that “the requirement to give notice to the landlords excludes the indirect giving of notice, contrary to the view of Megarry VC in *Townsend's Carriers Ltd* in relation to the English law of landlord and tenant”. This implicit distinction leaves the point open in this jurisdiction. However, in that case, the surveyor who was served with the notice did in fact have express authority to receive correspondence for the landlord and so the tenant was held to have successfully exercised the break. It did not matter that the notice was addressed to him at another subsidiary company because he was the intended recipient and in fact he did have authority to accept service for the landlords. The fact that there was a misnomer as to the identity of the landlord was held not to have been material.

20. Service on the wrong landlord will also invalidate a break notice in this jurisdiction. In **Standard Life Investments Property Holdings Ltd v W&J Linney Ltd [2010] EWHC 480 (Ch)**, a notice was held to be invalid because it had been served on the wrong party. In that case the original landlord had disposed of its reversion (by way of an overriding lease) to Standard Life before the tenant purported to exercise a break option. The tenant served the notice on the original landlord and not on its current landlord, Standard Life. Under the break option the notice had to be served on “the landlord”.
21. Lewison J rejected an argument that service on the original landlord would suffice merely because the original landlord was defined as “the landlord” in the Lease. The parties to the lease must have contemplated that the reversion would change hands. A former landlord would have no interest in checking whether the conditions applicable to the exercise of the break clause had been complied with and would have no interest in communicating with the current landlord. One such condition was the giving of vacant possession, which could only be given to the current landlord. It could not be contemplated that the tenant would move out of the premises and return the keys to the current landlord without having given any notice of its intention to do so.
22. Further, Lewison J rejected an argument based on the fact that a copy of the notice had been served on a third party whom the tenant claimed was acting as the landlord’s managing agents. There was no evidence that this third party had any decision making power under the terms of the lease such as to entitle the giver of the notice to rely on certain provisions in the lease regarding service on persons with such power. Further the notice was not addressed to the landlord and it was not reasonable for the third party to have realised that this was a mistake.

The reasonable recipient of the letter and the notice would not have understood that it was meant to be addressed to the current landlord.

Notice not given by the tenant

23. Similar considerations apply where the notice is given by the wrong party. There is a distinction here between those cases where the notice has simply not been given by the tenant or a person authorised by the tenant at all. In these cases, *Mannai* will never come to the rescue. In other cases the notice might have been given by an agent with the authority of the tenant. The issue then arises as to whether misnomer regarding the identity of the tenant (or the failure to make the agency clear in the case of an undisclosed agent) passes the *Mannai* test.
24. In **Prudential Assurance Co Ltd v Exel UK Ltd and another [2009] EWHC 1350 (Ch); [2009] PLSCS 200** the landlord granted the two defendant companies, which were part of the same group, the tenancy of a warehouse commencing in April 2002 and expiring in April 2012. The second defendant was a dormant company and a wholly-owned subsidiary of the first defendant. By clause 7.2 of the lease, the defendants were entitled to determine it in March 2007 by giving the claimant not less than nine months' written notice and provided that: (i) they had paid the rents reserved up to the date of the expiry of the notice; and (ii) on such expiry, they delivered up the premises with vacant possession. Once the notice expired, the term would end but without affecting the rights of either party against the other in respect of any previous breach of covenant.
25. In June 2006, a solicitor purporting to act under the break clause on behalf of the defendants sent the claimant a break notice that referred only to the first defendant. The claimant therefore took the view that the notice was invalid since it had been served without the authority of both defendants, as tenants. The court had to decide a number of issues. This paper deals only with the issue whether the notice was effective under the break clause.
26. The notice was held to be ineffective. In order to be effective, a break notice served by or on behalf of a tenant had to communicate clearly and unambiguously to the landlord that the party entitled to exercise the break provision was determining the lease on the permitted date. If a party other than the tenant gave the notice without stating that it acted as an agent, the notice

would be valid provided that the giver of such notice was authorised to do so, and the landlord could act on the notice safely in the knowledge that it would be binding upon the tenant.

27. An objective approach was to be taken when construing a break notice. What had to be considered was how a reasonable person, in the light of the facts that could reasonably have been expected to be available to the parties, would have understood the notice. A mistake in the notice, even as to the identity of the party giving it, would not necessarily invalidate it, provided that its meaning was clear, the mistake was obvious and the recipient could safely rely on it.
28. However, in this case the notice was not a valid exercise of the break clause since it would not clearly and unambiguously have been understood by a reasonable recipient to be an effective notice. Its terms would generate doubt as to whether it had been served on behalf of the second defendant because the terms of the notice suggested that, although the second defendant was known to have been a lessee, the notice was not being served on its behalf. Material both in the notice and extraneous to it suggested that the omission of a reference to the second defendant in the notice was not accidental.
29. Likewise the fatal error in **Hexstone Holdings Ltd v AHC Westlink Ltd [2010] EWHC 1280 (Ch)** was the fact that the break notice had not been served by the tenant, but by an employee purporting to act for an associated company of the tenant. In that case the tenant company had been taken over by the Stobart Group. A letter was written to the landlord informing it that the tenant would change its name and be known as Edie Stobart Ltd. However, that name change never happened and Edie Stobart Ltd was in fact a separate company in the same group. A break notice was served in the name of Edie Stobart Ltd by a Mr. Nixon, an employee of that company. This point was picked up immediately by the landlord who claimed that the notice was invalid. The judge in that case held that, unless saved by some principle of the law of agency, the notice must be invalid since it was not given by the tenant under the underlease but by a third party.
30. In that case it was sought to be argued that Mr. Nixon and or Edie Stobart Ltd were agents for the tenant. There was a very complicated corporate structure in that case. The problem was that Mr. Nixon simply gave the notice in the name of Edie Stobart Ltd because he considered that company controlled the tenant. However, he could not point to any authority having been

given expressly by the directors of the tenant and there was no evidence to establish general agency. This case demonstrates the importance, if you act for a tenant in a similar position, of clarifying the basis of the instructions and adducing full evidence as to the chain of authority, particularly in group company situations. In *Hexstone*, it may have in fact been the case that authority had been given, but inadequate evidence was given at trial to satisfy the court that Mr. Nixon had authority to do that which he had purported to do.

31. However, even if an agency relationship had been established in that case, the notice would not have been saved because the notice failed to make any reference to the fact that the giver of the notice was acting as an agent. Therefore the reasonable recipient could not have safely acted on the notice in the knowledge it would be binding. The reasonable recipient would not have known of the agency and so would not have known whether the actual tenant had authorised it. Further, consistent with the Scottish decision in *Batt Cables*, the judge in *Hexstone* held that if a notice is given by the wrong person (which is not saved under principles of agency) it will not be saved by *Mannai*. A notice given by X without the authority of Y cannot be treated as a notice given by Y simply because the reasonable recipient would think that it was given by Y.

32. In Scotland, the courts appear to adopt a rather more lax application of *Mannai* in misnomer cases where the notice has been served in the name of the wrong party where the party wrongly named as the server had a separate identity. In **AWD Chase De Vere Wealth Management Ltd v Melville Street Properties Ltd [2009] CSOH**, Lord Glennie in the Outer House of the Court of Session held that *Mannai* did save a notice which had been served in the name of the wrong company (an associated company which had never been tenant) but with the tenant's authority. The solicitors in that case did have authority of the tenant to serve the notice. The solicitors had said that they acted for the tenant and referred to the lease. However the name of the tenant was incorrectly identified in the covering letter. In deciding whether the notice would have been potentially confusing to the recipient, the judge declined to place great weight on the English authorities in light of the very wide differences between the English and Scots law in the field of landlord and tenant law. In England an unlawful assignment without consent would still be an effective assignment whereas that was not the case in Scotland. Therefore the misnomer would not, in Scotland, have given rise to any real uncertainty as to whether or not there had been an effective assignment. A recipient, well advised, would know that his consent would have been necessary to effect an assignment and therefore he would

assume that the solicitors who gave the notice probably acted for all the companies in the group and that in serving the notice he had simply got the wrong party. Therefore the notice was declared to be valid. It is doubtful that the same conclusion would have been reached in the English courts. The decision was probably unduly favourable to the tenant in that it appears doubtful that the possibility that the named party, wrongly believing itself to be tenant, had given instructions to serve the notice on its own behalf could really be discounted.

33. In one recent misnomer case, a break notice was held to be saved, applying *Mannai*. In **Baker Tilly Management Ltd v Computer Associates UK Ltd** (11 December 2009, unreported). Baker Tilly Management Ltd was the tenant who applied for a declaration that it had validly exercised the break option on its lease. When the lease was granted the claimant tenant's name was "Baker Tilly Services Ltd". By the time the notice was served, the tenant had changed its name to "Baker Tilly Management Ltd" but the notice was erroneously served using the tenant's old name. It was therefore a classic misnomer case. Peter Prescott QC (sitting as a deputy of the High Court) held that the notice was valid. A distinction had to be drawn between the thing and the label attached to it. In that case the tenant had undergone no material change, it had simply changed its name. The landlord recipient had to be taken to know this and accordingly the break notice, despite the disparity in the names used by the tenant, was valid. It would not have been confusing to the reasonable recipient.

Personal break clauses

34. In some cases the break option might be drafted in such a way as to make it personal to the current tenant. It will usually require express words for a break option to be construed as being personal to a particular tenant. A question arises whether it can be exercised following assignment by the assignor or even on re-assignment to the tenant expressed to have the benefit of the break option.
35. This is exactly what happened in **Aviva Life and Pensions UK Ltd v Linpac Mouldings Ltd** [2010] EWCA Civ 395, [2010] L & T R 10.
36. This was a case in which Linpac, in 1986, took an assignment of two long leases of warehouse units (of 99 years at a rack rent). In the licence to assign, Linpac covenanted to comply with the covenants during the term. Linpac also negotiated a break option, personal to it and

exercisable on 1 December 2010. Subsequently it took a lease in 2005 of another unit for a long term. The lease defined the tenant as including successors in title. The lease contained a tenant's break option. The break option was conditional upon the tenant exercising the breaks in the earlier two licences. Subsequently the licences were varied so as to require simultaneous exercise of the breaks in both licences and the lease. In the lease the reference to the "tenant" in the break clause was also expressed to be personal to "Linpac as original tenant or any company forming part of the same group".

37. Linpac then sought consent to assign the leases (which was refused). It assigned anyway and following assignment the assignee and Linpac sought to exercise the break option.
38. The issue for decision was whether Linpac were able to exercise the break at a time when they had assigned the lease and were no longer tenant. Lewison J (at first instance) held not only that consent to assignment had not been unreasonably refused but that Linpac could not exercise the option at any time either after it had assigned the leases but before it re-acquired them or after it reacquired them.
39. The second element of the decision was appealed, namely that Linpac could not exercise the break once it had assigned the lease. The Court of Appeal dismissed the appeal in construing all of the break options as not being exercisable by Linpac once it had assigned the leases.
40. As all of the break options were conditional upon exercise of the other break options, if the new lease did not permit Linpac to exercise the break once it had assigned the 2005 lease, then it would not be able to exercise the breaks in either of the 1986 licences either. This is precisely what the Court of Appeal decided. Further the Court of Appeal went on to hold that in any event on their own terms the 1986 licences did not permit the break to be exercised after assignment of the lease in each case.
41. Etherton LJ gave the main judgment in the Court of Appeal. He outlined several relevant factors. The instruments in question were to be construed so as to give effect to the intention of the parties, to be ascertained in the light of the commercial purpose and context of the documents and the factual setting known to the parties. In the ordinary way, a break option is usually an incident of the leasehold estate, the benefit and burden of which would pass with the term and the reversion. Even if technically possible, a provision for a former tenant to

terminate a lease at a time when the lease is not vested in it would be extraordinary because of the difficulties of obtaining vacant possession for any business tenant entitled to security of tenure under the 1954 Act, the improbability of the landlord or any assignee from the tenant being content to accept such a provision and the availability of a more obvious route to achieve the same practical end by the tenant subletting rather than assigning. There had been no reported case in which the courts had interpreted a break as being exercisable by a person when they were not the tenant or landlord. If that was the intention, property advisers should have taken particular care to make it unambiguously clear. Although the object of interpretation is to identify the intention of the parties to the particular document, it was undesirable to reach radically different interpretations of break clauses in commercial leases based on slight differences in language that are not obviously intended to achieve different objectives. In this respect, the earlier decision of **Max Factor Ltd v Wesleyan Assurance Society (1997) 74 P & CR 8** was material as it contained similar provisions to those contained in the licences and had been construed against the tenant seeking to exercise the break following assignment.

42. The definition of the person entitled to exercise the break in the 2005 lease was conclusive, because it referred to the person entitled to exercise the break as being “Linpac as original tenant”. These words were held not to simply incorporate a term of art but rather to make it clear that Linpac could only exercise the break whilst it was the original tenant. On that basis alone, therefore Linpac’s appeal was unsuccessful.
43. Further, although the breaks in the 1986 licences did not contain the words “as original tenant” as in the 2005 lease, the position was the same, based on the factors outlined above and the decision of *Max Factor* which was based on very similar wording. It made no difference that the break options were contained in the licences rather than in the leases themselves. The licences were capable of being read with the usual approach and reflected more naturally an intention to limit rather than to expand what would otherwise have been the conventional position that a tenant’s break is exercisable only by the tenant for the time being and, on assignment, passes to the assignee.
44. This last point regarding the interpretation of the 1986 licences was strictly obiter and the judgement of Sedley LJ could be construed as a dissent on this point. He appears to have been attracted by the arguments based on the unique nature of these leases (99 years at rack rental), the fact that Linpac would remain liable on the covenants and thus would have reason

to want to preserve the break even after it had assigned as well as the fact that whilst it might have been difficult for Linpac to give vacant possession, it might not have been impossible. Where he departed from Linpac's counsel was on the construction of the 2005 lease. The words "as original tenant" made it clear that the right was to vest in Linpac so long as it remains the tenant.

45. It therefore remains the case that a personal break provision will rarely be construed as being exercisable once the person with the benefit of it has assigned the lease. It is not impossible to draft leases that have this result, but it would require very clear words in order for the court to so construe it. Of course, such wording is likely to be unfavourable to a landlord or any assignee of the tenant.

Making sure you get the identity of the landlord and tenant right

46. Where title is registered, the position is quite straightforward. The simplest way is to obtain up to date official copy entries from HM Land Registry to identify the relevant "landlord" or "tenant". Be careful not to rely on historic office copy entries on the client's file. The position might have changed since your client took an assignment of the term and or reversion, even if only a few months before. Get up to date entries that cover you in respect of the time when the notice is served.
47. Even then, complications can arise in respect of the period in between assignment and completion by registration. This is best illustrated by the case of **Brown & Root Technology Ltd v Sun Alliance Assurance Co Ltd [2001] 1 Ch. 733** which concerned the validity of a break notice served by the assignor of the term after assignment but before completion by registration. The point in that case was that the right to break was non assignable and therefore the question was whether the transfer (albeit not completed by registration) rendered the break option redundant. The Court of Appeal held that as the transfer had not been completed by registration, the legal estate remained with the subsidiary who was entitled to exercise the break. This is a direct consequence of the deeming provisions in s.22(1) of the LRA 1925 (and now LRA 2002, s.11(3) and 12(3)) whereby the registered proprietor is deemed owner.

48. In **Mount Cook Land Ltd v The Media Centre (Properties) Ltd (No. 2) [2006] PLSCS 89** (County Court, HH Judge Hazel Marshall QC), Mount Cook transferred its interest in the property to its associated company, Mount Eden. The assignment had not been completed by registration when Mount Cook issued forfeiture proceedings. However the registration had been completed when Mount Cook served those proceedings. It was held that at the time of service Mount Cook had no right to elect to forfeit by serving proceedings because it was no longer the landlord. It would follow from this decision that Mount Cook was entitled to issue. Therefore, the appropriate person to serve a section 146 notice is the registered proprietor at the time of service even if there has been an assignment not yet registered.
49. However, certain dicta in **Scribes West Ltd v Relsa Anstalt (No. 3) [2005] 1 WLR 1847**, might render the only safe course of action to serve on (or perhaps more accurately on behalf of) both the assignee and the assignor in the post assignment / pre registration period. In that case there had been a transfer of the freehold reversion between two entities, from Relsa Anstalt to Relsa Barkers, of which notice had been given to Scribes, the tenant, but the transfer had not been registered. Relsa Barkers re-entered the premises on the grounds of non payment of rent, notwithstanding that it was not registered proprietor. It was held that Relsa Barkers was entitled to re-enter when it did, on the basis that section 141(2) of the LPA 1925 governed the position (for old leases) with respect to the transfer of the right to collect rent under a lease on the assignment of the reversion. That section provides that the right to take advantage etc of such a covenant is vested in “*the person from time to time entitled . . . to the income of the whole or any part of the leased land.*” Carnwath LJ held the word “entitled” does not, of itself, import a distinction between legal and equitable interests. It connotes simply an enforceable right to the relevant income and, as equitable assignee, Relsa Barkers had a right to receive rent as an enforceable right as against the assignor. Therefore both Relsa Barkers and Relsa Anstalt had the right to the income. The result is a bit of an oddity. On that analysis, the safest course would be to serve notices on (or on behalf of) **both** the assignor and or assignee of the term/ reversion as appropriate.
50. Unregistered title is more difficult and there is, unfortunately, no real substitute to getting the relevant title documentation and going through it, tracing the conveyancing history and looking for any notices of assignment etc. If notice of assignment has been given, then the tenant cannot rely on s.23(2) of the LTA 1927 which deems service on the original landlord good service if no notice of assignment has been given.

51. It is also good practice to do a company search at Companies House against the company number since the name of a company and or its registered office might have changed. The one constant will be the company registration number. Watch out for sneaky changes of name. It is not unheard of for companies in a group to swap names which can be very misleading. Check the name against the number and in doubt the number prevails.
52. If there are joint tenants, the notice should be addressed and served on or by all of them. For example, section 25 notices addressed to one of two joint tenants have been held to be invalid⁴. Similarly joint landlords should join together in giving a notice⁵ and should be jointly served.

When can or does the notice have to be given?

53. Again issues of timings of notices are very important, especially if the right to serve a notice is not “rolling” but rather can only be exercised at one point in time or before a certain date.
54. As a general rule one should get in the habit of diarising key dates in leases such as those in break clauses and option provisions so as to allow plenty of preparation time. As before, the question of when a notice must be served is a matter governed by the contractual provisions themselves.
55. It you are required to give at least 6 months’ notice before the expiry of the (say) 3rd year of the term, make sure that the notice is served in plenty of time. Likewise if the notice must be given between certain dates, make sure it is not served prematurely. There may be interesting points as to the construction of a break clause which requires, “**Six calendar months’ notice in writing immediately prior to the expiration of the term hereby granted.** Does that mean “not less than 6 months” or “6 months, not a day more or less”? It should be noted that the authors of *Barnsley’s Land Options* say this at 9-032,

⁴ Booth Investments Ltd v Reynolds (1974) New LJ 119

⁵ Pearson v Alyo [1990] 1 EGLR 114, CA

“A notice given before the appointed time may be ineffective. Care must be taken where an option requires notice to be given “six months before the expiration of the term”. It may not permit the tenant to serve his notice at any earlier time.”

56. If possible it would be sensible, when faced with such a provision, to make sure that service is effected on the day in question. However, my own view is that the court is unlikely to construe such a provision as requiring service on a particular day although it might need to imply a term to ensure that notice is not given very prematurely.
57. In **Biondi v Kirklington and Piccadilly Estates Ltd [1947] 2 All ER 59**, the written request for a renewal was to be made “6 calendar months before the expiration of the term”. The term of the lease was 35 years. The lessee purported to rely on a notice which had been served by his predecessor a mere 10 days after the commencement of the lease and sought specific performance. Roxburgh J said, at p. 60

“The phrase: “On the written request of the lessees made 6 calendar months before the expiration of the term hereby granted”- i.e., Feb.8, 1946 – is capable of at least four different meanings: (i) made on Aug. 8, 1945; (ii) made at any time before Aug.8, 1945; (iii) made on or a reasonable time before Aug. 8, 1945; and (iv) given so as to take effect on Aug. 8, 1945.”

58. The judge went on to say that only construction (ii) would have availed the plaintiff so the ratio of his decision is purely confined to the rejection of that construction on the basis that no long interval of time was contemplated between the making of the request and the granting of the further lease and also on the basis that under the terms of that agreement, breaches were only to be taken into account as at the date of request. The construction contended for by the lessee would have allowed it to renew based on a notice served 10 days after the lease commenced regardless of breaches at the end of the lease some 35 years later.
59. Roxburgh J did not go on to state which of the other three constructions he preferred but he did say this, at p. 61,
- “I admit that the other three constructions also involve difficulties. It would not be easy to hold that the notice had to be given on one particular day and no other, and the remaining two constructions cannot be readily extracted from the language used.

But, in my judgment, any one of these three is to be preferred to that for which the plaintiff contends as doing less violence to the good sense and language.”

60. Some comfort can be derived from the indication that it would not be easy to hold that the notice had to be given on one particular day. The difficulty is that the lessees’ approach requires the insertion of an implied term (that notice would be served a reasonable time prior to the term date). This is why Roxburgh J stated that construction (iii) could not be readily extracted from the language used.
61. The *Biondi* case was again referred to in a subsequent decision, **Multon v Cordell [1986] 1 EGLR 44**. In that case the leases provided for the options to be exercised by the “written request of the tenant made three months before the expiration of the term hereby created”. The leases were for a term of 35 years. The parties seem to have assumed that notice was not required to be given precisely 6 months before the expiration. In that case notices had been given some 3 years before the expiration of the leases and the question put to the judge by the parties was as to whether that period was “reasonable” in light of the *Biondi* case. HHJ Thomas (sitting as a High Court judge) found that a notice was not valid because it had been given too far in advance.
62. An issue of timing arose recently in **Hexstone Holdings Ltd v AHC Westlink Ltd [2010] EWHC 1280 (Ch)**. In *Hexstone* the court rejected a submission that a break notice had to be served on (or to take effect on) a particular day. The relevant break option in that case provided as follows:
- “7.1 Subject to the pre-conditions (as hereinafter defined) being satisfied the Tenant may determine the Term on 31 October 2009 (time being of the essence for such date) by giving to the Landlord six months’ prior written notice (time being of the essence for such notice) ...”
63. Counsel for the landlord submitted that as time was expressly stated to be of the essence, the notice had to be given on, or at least so as to take effect from, 30 April 2009 and that date only. The deputy judge rejected this submission (although the point is obiter because the landlord won on its primary case which was the notice had not been served on the landlord at all). He said that on any objective analysis of the words used, it would be a commercial absurdity to suggest that the parties intended that the break notice had to be given on 30 April 2009 and

only on that date (or if given earlier it must be expressed only to take effect on 30 April 2009). The words in parenthesis were, albeit surplusage, merely emphasising that the notice had to be given at least six months in advance of the termination date. Even though this construction involved the words being surplusage, the clause as a whole was not happily drafted in other respects. This case demonstrates the considerable reluctance of the courts to construe a break notice as requiring service on a particular day. In the *Hexstone* case, the difficulties implicit in the giving of an extremely premature notice would not have arisen as the relevant underlease was only entered into on 7 January 2008 in any event. Had those considerations applied, the court might have been more willing to construe the clause as requiring service on a particular day, in light of the express words making time of the essence.

How is the notice to be given?

64. At common law, actual physical receipt of a notice is required. Therefore, merely putting a letter in the post is insufficient⁶. Or leaving a notice at the recipient's house is insufficient unless it can be proved that the notice came into the hands of the tenant or his properly authorised servant. In *Holwell Securities Ltd v Hughes*⁷ a notice to exercise an option was sent to the D's solicitors. The solicitors told him that they had been served with the notice. It was held that there was no proper service. Russell LJ said⁸ that: "*A person does not give notice in writing to another person by sitting down and writing in out and then telephoning to that other saying "Listen to what I have just written."* The date of service at common law will be the date when the notice is received.
65. In addition, there are important statutory provisions which provide for additional methods of service. The most important point about these provisions is that they *deem service* to have been effected and so the risk of non receipt is placed on the intended recipient of the notice as opposed to the giver (as is the position at common law). They are "intended to assist the person who is obliged to serve the notice, by offering him choices of mode of service which will

⁶ *Beanby Estates Ltd v Egg Stores (Stamford Hill) Ltd* [2003] EWCH 1252. [2003] 1 WLR 2064, per Neuberger J at page 2075.

⁷ [1974] 1 WLR 155.

⁸ At page 159.

be deemed to be valid service, even if in the event the intended recipient does not in fact receive it⁹.

66. The most important statutory provisions relating to the service of contractual notices are contained in section 196(3) and (4) of the Law of Property Act 1925:

“(3) Any notice required or authorised by this Act to be served shall be sufficiently served if it is left at the last-known place of abode or business in the United Kingdom of the lessee, lessor, mortgagor, or other person to be served, or, in the case of a notice required or authorised to be served on a lessee or mortgagor, is affixed or left for him on the land or any house or building comprised in the lease or mortgage, or, in the case of a mining lease, is left for the lessee at the office or counting-house of the mine.

(4) Any notice required or authorized by this Act to be served shall also be sufficiently served, if it is sent by post in a registered letter addressed to the lessee, lessor, mortgagor, or other person to be served, by name, at the aforesaid place of abode or business, office, or counting-house, and if that letter is not returned by the postal operator (within the meaning of the Postal Services Act 2000) concerned undelivered; and that service shall be deemed to be made at the time at which the registered letter would in the ordinary course be delivered.

(5) The provisions of this section shall extend to notices required to be served by any instrument affecting property executed or coming into operation after the commencement of this Act unless a contrary intention appears.

(6) This section does not apply to notices served in proceedings in the court.”

67. Under the general law of landlord and tenant, it is possible for good service of a landlord's notice to be effected by serving it on the duly authorised agent of the tenant (and vice versa)¹⁰. However, great care should be taken to ensure that an agent is duly authorised (whether

⁹ *Galinski v McHugh* (1988) 57 P&CR 359, per Slade LJ at page 365 (in relation to section 23(1) of the *Landlord and Tenant Act 1927*).

¹⁰ *Galinski v McHugh* [1989] 1 EGLR 109, per Slade at p.111, and *Yenula Properties Ltd v Naidu* [2003] L&TR 9, per Robert Walker LJ at pages 116-117.

expressly or by implied and or ostensible authority) to accept the notice in question. This particularly applies to solicitors. As Walton J in *Re Munro*¹¹ warned:

“It is, of course, a common fallacy to think that solicitors have an implied authority on behalf of their clients to receive notices. They may have express authority so to receive them, but in general a solicitor does not have any authority to accept a notice on behalf of his client.”

68. If you are proposing to serve on an agent (in particular solicitors and or managing agents), it is good practice to get written confirmation to make sure that he or she has authority to accept service so that you do not later get in dispute as to whether that person had the requisite authority, as the cases cited above demonstrate.
69. Of course, if you slip up, there may be arguments to be made as to whether the agent, by reason of his general retainer had implied and or ostensible authority to accept the notice in any event (which is usually a question of fact and degree). Also, the principal will usually be bound if he asserts that the agent has authority even when he does not. However, it is better not to “go there” in the first place.
70. Before serving any notice, it is important to check the Lease to see whether it contains free standing provisions regarding service. Some contractual provisions can restrict and or extend the permitted methods of service. It is important to ensure that a notice has been served by a method permitted by the Lease.
71. It would take clear words for a Lease to be taken as restricting a method of service permitted at common law. For example in a recent case, **Truegold International Ltd v Questrock Ltd [2010] EWHC 966 (Ch)**, an issue arose as to whether an option notice had been validly served or not. Provisions in the lease providing for service on solicitors were held to be simply permissive such that service on the client directly at its registered office in the BVI was effected service. In any event, on the facts, the solicitors had also been served in time. The judge pointed out that the relevant party may, at the time for service, have no solicitors acting for it. For another example where the service provisions in the lease were construed so as to allow

¹¹ [1981] WLR 1358.

other permitted methods of service see Warwick Ltd v GPS (Great Britain) Ltd [2006] PLSCS 210.

72. The recent case of The Hotgroup Plc v The Royal Bank of Scotland Plc (as Trustee of the Schroder Exempt Property Unit Trust) [2010] EWHC 1241 (Ch) demonstrates the danger of failing to read the provisions of the lease regarding service. In that case the break clause itself provided that the tenant's break could be exercised upon giving not less than 9 months' prior notice to the landlord, RBS. A notice was served in time on RBS, who held the reversion on trust for SEPUT. However, the lease also contained an unusual separate clause which provided that a break notice would not be "deemed" to have been served on the landlord unless it was also served on the beneficiary, SEPUT's, property manager, Schroder Property Investment Management Ltd ("SPRIM"). A notice had not been served on SPRIM in time.
73. The tenant ran a technical argument that the reference to "deemed service" in the lease only referred to cases where the service on the landlord relied upon was deemed, rather than actual service. Charles Hollander QC (sitting as a deputy) rejected this argument, holding that "deemed" in this context meant "treated". In other words, unless a copy of the notice were served on SPRIM, the notice would not be treated as having been served on the landlord. In most cases a recipient will not know if the service is actual, deemed, or both actual and deemed. On occasion it may be fortuitous whether actual or deemed service could be relied upon and it should make no difference. The commercial purpose of the clause was to ensure that the notice did not gather dust in the landlord's office but came to the attention of the person with the actual responsibility for the management of the property, namely SPRIM.
74. There has been another fairly recent case in which the Court of Appeal held that the tenant had failed to effectively serve a break notice in accordance with the provisions of the lease. To a large extent it turns on its own facts but it does demonstrate the importance of focussing on the detail of the service provisions. In Orchard (Developments) Holdings Plc v Reuters Ltd [2009] 16 EG 140, the tenant's representatives had faxed and posted (by hand) a notice, that had to be given more than 6 months' before the relevant break date in question. However the posting was ineffective because the notice had been put in the wrong letter box. Therefore the tenant had to rely on the fax. However the lease provided that if such method of service was to be valid, receipt of the notice had to be acknowledged by the landlord. The tenant sought to rely on an acknowledgement in a solicitors' letter that had been written during the course of

proceedings after the break date in question. The tenants' counsel contended that the requirement for receipt was evidential only. However the Court of Appeal disagreed and held that the break notice had not been validly served. Properly construed, the lease did not permit a subsequent "receipt" given after the break date to effectively put an end to the lease retrospectively. Such a result would offend against the requirement of certainty. The lease provided that receipt went to the essential question of validity of the notice and this was not merely evidential. The three Lords Justices in that case appear to have been divided as to whether the "receipt" had to be given before the last date on which the notice had to be served or whether it would have been sufficient if it had been given in the 6 month period between the time for service of notice and the date in the lease on which the break was to operate.

75. Whilst this case does depend on its own interpretation, it is illustrative of the importance of considering the lease terms (including those as to service) very carefully in order to ensure that the notice is given in accordance with them. It also raises interesting questions as to the duties imposed on landlords to acknowledge receipt in such cases on request. In that case Rix LJ (at para. 52) seems to give some indication that he might have held that the landlord owed a duty of care to provide a receipt within a reasonable time of request, if that notice was given prior to the last time for service. This goes against general orthodoxy that the recipient of a notice owes no implied duty to accept receipt or to raise any issue as to invalidity before time for service of a notice has expired. However in this case the notice was faxed at the very last minute and so there was no question of the landlord having failed to give a receipt in time. Further it was common ground between the parties to the appeal that there was no obligation on the landlord to respond. This dicta may be picked up on in future cases to argue that in some cases the lease should be construed so as to impose such a duty on the recipient of the notice to acknowledge receipt on request so as to reflect "*commercial reality and honest dealing*".

Break conditional on compliance with covenants

76. Some break options, particularly in older leases, make the exercise of the break or option conditional upon the tenant complying with the covenants in the lease. These clauses can raise various issues. They are contrary to the Business Lease Code, to the extent that they

seek to make compliance with covenants other than payment of rent and yielding up a precondition. As Sandi Murdoch writes¹²,

“Traditionally, tenant’s breaks were often subject to strict preconditions, and, when breaks become more prevalent, this was a ploy used by landlords to render the break effectively inoperable. It is clear that tenants and their advisers have become wise to this, and it is now rare for tenant’s breaks to be conditional on anything other than the payment of rent”

77. Where the clause is absolute, even minor or trivial breaches will deprive the tenant of the ability to break the term.
78. The classic exposition of the principle is to be found in the judgments of the Court of Appeal in **Finch v Underwood [1876] 2 Ch 310**. In that case the landlord agreed with the tenant on receipt of notice from the latter, to renew the lease if “*the covenants and agreements on the tenant’s part shall have been duly observed and performed*”. Notice was given but the landlord refused to renew the lease because the interior of the property needed repairs at a cost of £13. Vice-Chancellor Malins (at first instance) held that the landlord was obliged to renew the lease because the want of repair was “trifling”. He was overruled by the Court of Appeal which analysed the case as one of compliance with a condition precedent.
79. If the tenant is given a privilege (whether a right to renew or break) which can be exercised in certain circumstances and on certain terms, those conditions must be strictly complied with. It was held that as there was a want of repair which, though not serious, constituted an existing breach of covenant when the lease was applied for, the condition precedent had not been fulfilled and the tenant was not entitled to call upon the landlord to grant him a new lease.
80. In *Finch v Underwood*, James LJ said this at page 315,

“No doubt every property must at times be somewhat out of repair, and a tenant must have a reasonable time allowed to do what is necessary: but where it is required as a condition precedent to the granting of a new lease that the lessee’s

¹² “Commercial Leases: Future Directions”, in Bright, *Landlord and Tenant Law, Past Present and Future* (Hart Publishing 2006) at p. 94.

covenants shall have been performed, the lessee who comes to claim the new lease must shew that at the time the property is in such a state as the covenants require it to be. He can easily send in his builder, get a report of what repairs are necessary, and do them before he applies for the lease. There is no hardship in requiring this of him, and I think he is not entitled to excuse himself by saying that the want of repair is trifling. The answer to that is, "No matter; your bargain was to leave the property in thorough repair." If he has not fulfilled his legal bargain, which is also his bargain in equity, he cannot sustain his claim for a lease."

81. Further in **Bairstow Eves (Securities) Ltd v Ripley [1992] 2 EGLR 47**, the Court of Appeal rejected the submission that where a condition precedent is written in absolute terms¹³, it should be regarded as satisfied unless at the relevant date there were breaches of covenant for which substantial damages would be recoverable. In that case Scott LJ said,

"There is no authority that permits the court to rewrite the condition precedent so as to exclude from account a subsisting breach on the ground that only nominal damages are recoverable."

Later he observed (at p.50C)

"The court is not entitled to rewrite that covenant [to paint the premises in the last year of the term] or to presume to inform [the landlord] that the breach of covenant was only trivial and should be ignored for the purposes of the condition precedent".

82. Unusually in this field, one point has gone the "tenant's way". In **Bass Holdings Ltd v Morton Music Ltd [1988] 1 Ch. 493** it was held that the standard form of wording requiring absolute compliance only requires compliance as at the date of notice or termination (as appropriate) and does not require compliance throughout the term of the lease. In other words, spent breaches are ignored for these purposes. The rationale behind this is twofold. First, it would be almost impossible for the tenant to attain such a standard of "perfection" such that the right would become in effect meaningless. Secondly, in this context, the landlord has no real interest in ensuring not only compliance at the time of exercise/ termination but also throughout the history of the term. In a Scottish case, **Trygort (Number 2) Ltd v UK Home Finance Ltd**

¹³ In that case the lease conferred on the tenant a right to renew "*if the tenant shall perform and observe all the covenants and obligations herein on the tenant's part contained*"

[2008] CSIH 56 a similar approach to spent breaches was adopted by the Court of Session (Inner House). The clause in that case provided that the tenant would not be entitled to exercise a break option “if it had been in breach of its obligations to the landlords under the lease”. It was held that, adopting a commercial sensible construction, the break notice only applied to breaches subsisting at the time the notice was given.

83. Disputes can arise as to when the compliance is required: is it the time of the giving of notice or the time of termination, or both? Ultimately it is matter of construction of the relevant clause in question¹⁴.
84. In **Legal and General Assurance Society Ltd v Expeditors International (UK) Limited** [2007] L & TR 21, the Court of Appeal held that a Settlement Agreement relating to “dilapidations claims and lease breaks” should be read as being subject to an implied term that the landlord had waived the right to rely on the remaining conditions of the break clause that had not been expressly dealt with. In that case the issue related to the failure of the tenant to give up vacant possession in time. It is therefore always open for the parties to compromise their claims and to waive the conditions, but the point remains that were it not for such express or implied term, the failure to give up vacant possession would be fatal to the purported operation of the break.
85. Given the above decisions it is not surprising that some break clauses are drafted in such a way as to protect the tenant against the possibility of being tripped up by some minor or insubstantial breach. Words of limitation often used include those which require only “substantial”, “reasonable” or “material” compliance with the tenant’s covenants.

Material Compliance

86. The Court of Appeal had to consider the meaning of the word “material” in this context in a case of considerable importance, **Fitzroy House Epworth Street (No. 1) Ltd and another v The Financial Times Ltd** [2006] EWCA Civ. 329; [2006] PLSCS 80.

¹⁴ *Finch v Underwood* (1876) 2 Ch. D 310 (date of notice); *Simons v Associated Furnishers* [1931] 1 Ch. 379 (determination of term); *Robinson v Thames Mead Park Estates* [1947] (date of notice); *West Country Cleaners (Falmouth) v Saly* [1966] 1 WLR 1485 (expiry of lease); *Bassett v Whitely* (1983) 45 P & CR 87 (date of new lease)

87. In *Fitzroy House*, the first instance judge, Thornton J, applied a subjective test as had previously been formulated in *Commercial Union Life Assurance Co. Ltd v Label Ink Ltd* [2001] L & TR 29 ("*Label Ink*"). It is clear that the judge had taken a rather dim view of the attitude adopted by the landlord.
88. In *Fitzroy House*, the market was such that the landlord, Fitzroy House, was keen to frustrate the tenant's efforts to exercise the break in respect of the three storey office block known as Castle House, Paul Street, London, EC2. The Financial Times was entitled to terminate the lease on 1 April 2004 on not less than 13 months notice if it had, *materially complied with all its obligations under the Lease down to the date for which notice of termination has been given*".
89. Having given notice under the lease, the FT undertook an extensive programme of repair (at a cost of about £1 million) in order to comply with its covenants. The FT tried to involve the landlords by offering facilities for inspection at all material times but the landlords did not take them up. They duly vacated on termination of the works.
90. The landlords then claimed that the lease was still subsisting because as at the 1 April 2004 the FT had "*failed to materially comply with*" its repairing obligations. It was common ground that the outstanding repair would cost about £20,000 to carry out.
91. Thornton J found that the outstanding breaches were not "material" and that the Lease had been validly terminated by the FT. The Court of Appeal dismissed the appeal but in so doing they found that the test adopted by Thornton J was wrong. However, on the facts as the judge had found them and the expert evidence before him, the Court of Appeal was satisfied that the breaches were not material.
92. The Court of Appeal rejected the subjective "fair and reasonable test" employed in *Label Ink*. The Vice-Chancellor said this (at paragraph 24):

"It cannot, I think, be seriously disputed that the issue of "material compliance" whatever it involves must be determined on an objective basis".

And at paragraph 16 he said,

"I can agree that the insertion of the word "material" must have been in order to mitigate the requirement for absolute compliance with all covenants at the relevant time then to be found in conventional break clauses. Other variations, now common, are "reasonable" and "substantial". But I cannot agree that it must have been the intention to modify the rule to the extent that it is reasonably fair to both landlord and tenant. The word "material" is susceptible to a number of nuances but what is fair and reasonable between landlord and tenant is not one of them".

93. His Lordship went on (at paragraph 35) to have a stab at pinning down the concept of "materiality" as follows:

"Materiality must be assessed by reference to the ability of the landlord to relet or sell the property without delay or additional expenditure. Where the provision is absolute then any breach will preclude an exercise of the break clause. But I see no justification for attributing to the parties an intention that the insertion of the word "material" was intended to permit only breaches which were trivial or trifling. Those words are of uncertain meaning also and are not the words used by the parties".

94. He added (at paragraph 36),

"Nor, is it, in my view, of any assistance to consider whether the word "material" permits more or different breaches than the commonly used alternatives "substantial" or "reasonable". The words "substantial" and "material", depending on the context, are interchangeable. The word "reasonable" connotes a different test. The issue here is whether, notwithstanding the breaches found by the judge the tenant had, nevertheless, "materially complied" with its obligations. The application of an ordinary English word to a set of primary facts is itself a question of fact, see *Cozens v Brutus* [1973] AC 854, 861."

95. The Court of Appeal rejected the landlord's contention that there would not be material compliance unless the only breaches in existence on the break date were trivial and of the kind that would occur if a screw was missing or loose in a particular location (para, 84). Addressing the question as one of fact, the Court of Appeal held that there had been material compliance.

Therefore, although Thornton J had gone about it in the wrong way, he had nonetheless come to the right result.

96. Whilst not seeking to lay down any set meaning to the phrase “material compliance”, the Court of Appeal has given useful guidance as to the factors which are relevant.
97. The Court of Appeal held that Thornton J had erred in taking into account the following factors in coming to his decision: (1) the fact that the FT had taken all reasonable steps to put and keep the premises into repair, had spent nearly £1 million for that purpose and had followed professional advice as to what was required; (2) the fact that the FT had made all reasonable efforts to secure the agreement of Fitzroy to what was needed to ensure compliance and that it would have incorporated any reasonable requirement of Fitzroy into its remedial programme if asked; (3) the fact that Fitzroy unreasonably declined to involve itself in the FT’s attempts to agree a remedial programme and adopted an attitude of waiting and seeing whether it could catch the FT out on a technicality so as to prevent it from determining the lease because the market was so soft; and (4) the fact that it would be unreasonable to the FT if it was unable to determine the lease and if Fitzroy, given its behaviour, was able to prevent such a determination from occurring.
98. On the other hand it is clear that the Court of Appeal considered that Thornton J had been right to consider: (1) the fact that the number, nature and value of the outstanding defects was insubstantial; and (2) the fact that the outstanding defects had no effect on the ability of Fitzroy to obtain a further tenant nor on any terms that it could reasonably expect to negotiate.
99. The case underlines the importance to both sides of obtaining expert valuation evidence as to the effect, if any, of the outstanding breaches on the value of the landlord’s reversion and his ability to re-let the premises at a market rate. As to the nature of the breaches, it is important to view them in context. Whilst repairs costing £20,000 might not be substantial when viewed against the overall cost of £1million, the position is likely to be very different if the overall cost of the works were £40,000 such that only half the necessary works had been done.
100. *Fitzroy House* was recently applied in **Mourant Property Trust Ltd v Fusion Electric (UK) Limited [2009] EWHC 3659 (Ch)**. In *Mourant*, the effect of *Fitzroy House* was summarised as follows:

“The underlying law is not in dispute. It is well established that the conditions attaching to the exercise of options to determine leases must be strictly complied with. It is also agreed that the leading case on the “materiality” of dilapidations is *Fitzroy House*..., from which it is agreed that the following propositions emerge. First, the word “material” is not intended to modify a rule requiring absolute compliance to the extent that was reasonably fair to both landlord and tenant. Secondly, the test is an objective one and the motive of the tenant in seeking to comply with the covenant is irrelevant. Third, the commercial context in which the provision is to be construed is that the landlord would be very much concerned that at the time of the break the covenants should be fully observed so that the property could be relet or sold without delay or additional expenditure. Accordingly, materiality of any breach is to be assessed by reference to the ability of the landlord to relet or sell the property without delay or additional expenditure.”

101. In *Mourant*, the tenant of two warehouse units was held not to have complied with the pre-conditions set down in the lease for exercise of the break. The break clause required material compliance with the tenant’s covenants as well as the giving up of vacant possession on the termination date. However, because the tenant was keen to do the works itself (at lower cost than the landlord might charge), its contractors and their tools, equipment and materials were still on the premises at the time the break was to take effect and thus vacant possession had not been given. The judge rejected the tenant’s evidence that it had attempted to hand back the keys. He retained a set expressly to allow the contractors to continue to carry out the works. That was enough to dispose of the case because the requirement to give vacant possession is an absolute condition that must be strictly complied with.

102. Secondly, it was held that there were material breaches of the tenant’s repairing obligations as at the termination date. In that case the tenant appears not to have understood the importance of the conditions. The judge accepted the landlord’s expert evidence to the effect that an incoming tenant would expect compensation for the works outstanding at the termination date. The accepted expert evidence was to the effect that the landlord would, due to the outstanding disrepair, be likely to have to offer a rent free period of 3.5 months for one unit and 4 months for the other. The judge therefore held that the breaches were material and the lease had not been effectively determined because there was no material compliance with the repairing covenants.

103. The case is interesting in that it demonstrates the type of expert evidence a landlord might seek to adduce in a bid to contend that breaches of a repairing covenant are “material”. Evidence that goes directly to the issue of the ability of the landlord to relet the premises is of greater value than a mere examination of a schedule of dilapidations.

Reasonable compliance

104. The Vice-Chancellor in the Financial Times case clearly indicated that “reasonable” imports a different concept from “material”. This will impact on the type of evidence which can be adduced.
105. Whilst it was not permissible in the FT case to look at the parties’ respective conduct to assess material compliance, if the break clause is made conditional upon “*reasonable compliance*” with or performance of the tenant’s covenants, it will be relevant to look at the tenant’s conduct in carrying out repairs, including whether it followed expert advice: see **Gardner v Blaxill [1960] 1 W.L.R. 752**, Paull J; **Bassett v Whitely (1982) P & CR 87**.

Vacant Possession

106. It is common for break clauses to be drafted so as to be conditional upon vacant possession being given on the termination date. Failure to provide vacant possession will invalidate a purported break, as the *Mourant* case demonstrates. The key advice is that the tenant should ensure that it takes everything with it (including the rubbish). If items are left on the premises, an expensive dispute can arise as to whether or not vacant possession has in fact been given. If works are being done to ensure compliance with repairing obligations this might lead to contractors being on site until the last minute. However, the giving of vacant possession is a strict requirement and so time should be allowed to ensure that the contractors leave well before midnight on the termination date and take their equipment with them.

Payment of Rent

107. Break provisions often make the exercise of a break conditional on payment of all rent due on or before the termination date even if there is no need to comply with other covenants. It is not

uncommon to find a break provision exercisable immediately after a rent payment day, even if the rent is paid quarterly in advance. There is commercial purpose in such a provision from the landlord's point of view because he might not find another tenant for a few months (and may have to provide a rent free period to such a new tenant for fitting out). Tenants often consider such a provision unfair because they are paying for the premises at a time when they do not have beneficial occupation of it. However, tenants should be very wary of seeking to apportion the rent in any way without the landlord's express consent.

108. This is because where rent is payable in advance (as it usually is), the Apportionment Act 1870 is of no use since it has been held not to apply where rents are payable in advance. Unless the tenant can point to some specific provision in the lease (most specifically the provisions reserving the rent) it is likely to be bound to pay the full rent due. A detailed examination of the lease might assist in arguments to the contrary¹⁵.
109. The only safe course, even if the terms of the lease provide an argument that the lease should be treated as apportionable on a break, is to pay the full rent and seek to argue about it afterwards. Failure to pay up before the termination date is likely to jeopardise the break. However, if the tenant contends that the rent is apportionable or is otherwise not due, payment of rent should be expressly made with a reservation of the tenant's rights.
110. Once the break is exercised, the tenant might seek restitution of sums it says it has overpaid. However, an "unjust factor" will need to be pleaded and this is not so easy to identify. It is difficult to see how mistake can be pleaded if the payment was made voluntarily with the aim of preserving the break and avoiding litigation as to the effectiveness of termination: see **Marine Trade SA v Pioneer Freight Futures Co Ltd BVI [2009] EWHC 2656 (Comm)** where a sum believed not to be due was paid to avoid early termination of the agreement, to protect a reputation. It might even be seen as a compromise of a valid claim if the landlord claims such sums as due to it. "Failure of consideration" to the extent of the overpayment may arguably provide a ground for restitution if the full rent was not in fact payable. The landlord might have a change of position defence if it has changed its position in good faith on receipt of the payment. This makes it all the more important to make payment on a reserved basis,

¹⁵ See article "Ensure you pay up before reaching breaking point" by Guy Fetherstonhaugh QC, Estates Gazette (26 April 2008)

although it should be noted that in a recent article¹⁶, Guy Fetherstonhaugh QC remarks that there may be some tactical advantage to not paying under protest, in order to seek to subsequently argue mistake.

A checklist

111. It will readily be apparent from the above, that a tenant seeking to exercise a break must get his house in order at the earliest opportunity. The following is a useful checklist:

- (1) The break clause should be examined in detail *at the earliest stage* so that the tenant knows what it has to do (detailed advice at the time of the transaction will enable the tenant and its team to diarise key dates);
- (2) The tenant should ask itself, “when must the notice be served and what are its requirements?” This will require the tenant’s representative to read the terms of the lease in full, not just the break provision. In particular the service provisions should be examined. If in doubt as to who to serve, serve everyone. Further, does the tenant need to have complied with other covenants at the time of notice?
- (3) In drafting notices, check and check again. Do full searches of the Land Registry and Companies House on the day of service. Check company numbers as well as names. Do not rely on historic evidence of ownership. If serving on an agent, ensure you have evidence of express authority to accept service. If acting for a tenant, ensure that the person giving the instructions in fact has the correct authority from the tenant, especially he or she is purporting to act for several companies in a group.
- (4) If compliance is required, when is it required and to what objective standard?
- (5) If compliance is required, what are the outstanding breaches (if any)? The tenant should obtain expert advice as to any disrepair and as to the works necessary to ensure compliance to the standard required by the break clause. A record should be

¹⁶ “Outstanding rent could turn into a game of Russian roulette, Estates Gazette (30 January 2010)

kept as to the state of the premises before and after works are done. It would be wise to get the landlord involved but do not expect it to cooperate. Push on regardless.

- (6) It is vital that the tenant allows itself ample time to carry out the works and to hand back the premises with vacant possession in time (allowing for inevitable slippage).
- (7) If required by the clause, the tenant should ensure that it yields up in good time having paid all outstanding arrears.

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