SHOPPING FOR OLD CLOTHES? IMPLICATION AND APPORTIONMENT AFTER MARKS & SPENCER

by

David Holland QC
Landmark Chambers

David Holland was called to the Bar in 1986 and took silk in 2011.

The core of David's practice is all forms of property litigation but he also practices in the areas of professional negligence and costs.

David has immense experience of litigating at all levels of court.

His recent cases include: The Gulf Agencies v Ahmed [2016] EWCA Civ 44; Ghising v Secretary of State [2015] EWHC 370; Magnic v Ul-Hussain [2015] EWCA Civ 224, MWP v Sinclair [2015] EWCA Civ 774, Denton v White [2014] EWCA Civ 906 (in which he represented both the Bar Council and the Law Society), Cohen v Teseo Properties [2014] EWHC 2442 (Ch); Assaubayev v Michael Wilson & Partners [2014] EWCA Civ 1491; The Port of London Authority v Tower Bridge Yacht and Boat Club Limited [2013] EWHC 3084; Flatman v Germany [2013] EWCA Civ 278; Relicpride Building Co Ltd v Cordara [2013] EWCA Civ 158; Tweedie v Souglides [2012] EWCA Civ 1548. He was also counsel for the successful guarantor in Good Harvest v Centaur [2010] Ch 426 and has acted for many of the largest telecoms companies for many years.

The Chambers and Partners 2016 Guide in Real Estate Litigation praises him for the energy and determination he brings to his cases. It says that *"He is very enthusiastic about delivering good advice to clients and is a strong advocate."* He was named as the Real Estate Silk of the Year in the Chambers & Partners Awards for 2013.

David has just been appointed as a Recorder and also sits as a part time Judge of the First-tier Tribunal (Property Chamber) and acts as an arbitrator and expert.

LANDMARK CHAMBERS

180 Fleet Street
London **EC4A 4HG**

Tel: 020 7430 1221
Fax: 020 7421 6060
Email: dholland@landmarkchambers.co.uk

Website: www. landmarkchambers.co.uk

Introduction

1. In two property cases, first ARNOLD V BRITTON [2015] AC 1619 and now MARKS & SPENCER V BNP PARIBAS [2015] 3 WLR 1843, and in the space of just under six months, the Supreme Court has delivered judgments which have ramifications far beyond the property world. In this talk I would like to examine the second of these decisions (to which I shall refer as "M&S") and come to some tentative conclusions about its likely long-term impact.

The facts of M&S

2. The case concerned four sub-underleases of different floors of an office block in Paddington Basin, London, W2. They were, in all material terms, identical. For present purposes it is enough to record that each was granted on 15th January 2010 for "a term of years starting on 25th January 2006 and ending on 2nd February 2018". I shall for ease of reference hereafter refer to "the lease" in the singular.

3. The basic rent was to be:

> *"paid yearly and proportionately for any part of a year by equal quarterly instalments in advance on the [usual] quarter days."*

The initial yearly rent was £919,800 plus VAT per annum. As at 25th December 2011, and following review, the Basic Rent was £1,236,689 plus Vat per annum.

4. Clause 1.2 of the Lease provided that unless the context otherwise required:

> *"(l) references to "last year of the Term" include the last year of the Term if the Term shall determine otherwise than by effluxion of time and references to "expiry of the Term" include such other determination of the Term; "*

5. Most importantly, Clause 8 was a break clause in these terms:

> *"8 Option to Determine*
> *8.1 For so long as the Tenant is Marks and Spencer p.l.c. or a Group Company thereof* ***the Tenant may determine this Lease on the First Break date by serving on the***

> ***Landlord written notice on or prior to the First Break Notice date.***
> *8.2 The Tenant may determine this Lease on the Second Break Date by serving on the Landlord written notice on or prior to the Second Break Notice Date.*
> *8.3* ***This lease shall only determine as a result of notice served by the Tenant under Clauses 8.1 or 8.2 if on the break date there are no arrears of Basic Rent or VAT on Basic Rent; and***
> ***8.4 This Lease shall only determine as a result of notice served by the Tenant under Clause 8.1 if on or prior to the First break Date the tenant pays to the landlord the sum of £919,800 plus VAT.***
> *8.5 On determination the Tenant shall deliver to the Landlord the original of this Lease and all other tenancy documents in its possession relating to the Premises.*
> *8.6 The Landlord may in it absolute discretion waive compliance with all or any or any of the conditions or obligations set out in Clause 8.3.*
> *8.7 If the provisions of this clause are complied with then on the Break Date this Lease shall determine but without prejudice to the rights of either party in respect of any previous breach by the other."* (emphasis added)

The "First Break Date" was 24th January 2012 whilst the "Second Break Date" was 24th January 2016.

6. There was also a provision that, if the tenant did not exercise the break clause on the First Break Date, then the landlord would pay to it £150,000 (by crediting its rent account in that amount).

7. As the court specifically noted, the leases were lengthy and detailed documents each running to 70 pages including 15 pages of tenant's covenants and 9 pages of landlords covenants.

8. On 7th July 2011 (and prior to the First Break Notice Date) the tenant gave notice pursuant to clause 8.1 to exercise its option to end the term on the First Break Date, 24th January 2012. Shortly before 25th December 2011, the tenant paid to the landlord the entire quarters rent for the quarter from 25th December 2011 until 24th March 2012 (a sum of £309,172.25 plus VAT). On 18th January 2012 the tenant paid the additional

sum of £919,800 plus VAT as required by clause 8.4. As a result, the term in the lease ended on the First Break Date.

9. On 20th April 2012, the tenant issued proceedings claiming repayment of, inter alia, the apportioned Basic Rent for the period from 25th January 2012 to 24th March 2012.
10. Before Morgan J at first instance, the tenant put its case in three ways. It said that it was entitled to repayment:
    a. Pursuant to the express terms of the lease; and/or
    b. Pursuant to an implied term in the lease; and/or
    c. In restitution because there was a total failure of consideration.
11. In relation to the first of these points, the tenant relied on the words "and proportionately for any part of a year". The Judge referred to various cases, including QUIRKO INVETSMENTS V ASPRAY [2012] L&TR 19, PCE INVESTORS V CANCER RESEARCH [2012] 2 P&CR 5 and CANONICAL V TST [2012] EWHC 3710 (Ch) and rejected the tenants submissions on the first ground. He held that, on the true interpretation of the lease, as the break clause was conditional on the payment of the £919,800 plus VAT and, as at 25th December 2011, that sum had not been paid and may not have been paid, then it was not certain that the lease would have terminated on 24th January 2012. Thus the full quarter's rent was payable on 25th December 2011. I will return to consider this point briefly at the end of this talk.
12. Then Judge rejected the third ground advanced by the tenant essentially because there was only "partial" failure of consideration. The quarters rent was an entire payment for the whole of the quarter to 24th March 2012. It was not possible to divide it up into separate days. Therefore, as the tenant had been entitled to enjoy the premises for part of the quarter, there had not been a total failure of consideration in that regard.

13. However the Judge held that the rent for the period from 25th January until 24th March 2012 was repayable by reason of there being an implied term requiring the lessor to repay to the lessee, on or after 24th January 2012, an apportioned part of the quarters rent paid on 25th December 2011 in relation to the period after 24th January 2012.
14. The Court of Appeal allowed the landlord's appeal, rejecting the notion that there was an implied term as the judge had found.
15. The case then came to the Supreme Court of the implied term ground alone. At the suggestion of the court, the tenant also argued that the Apportionment Act 1870 applied to rent payable in advance as well as rent payable in arrear and thus that the Court of Appeal case of ELLIS V ROWBOTHAM [1900] 1 QB 740 has been wrongly decided.
16. As we know the Supreme Court dismissed the tenant's appeal on both grounds. In doing so, the Judges had some important things to say about the implication of contractual terms generally.
17. Lord Neuberger (with whom Lords Sumption and Hodge specifically agreed) gave the leading speech whilst Lords Carnwath and Clarke gave concurring but separate speeches.

Implied terms in contracts

18. Lord Neuberger started off by pointing out that it was accepted that there was no express term in the lease which provided for the repayment of the apportioned rent, thus any such term had to be implied.
19. He further pointed out that there were two types of implied term: (i) those implied into a particular contract in the light of the express terms, commercial common sense and the facts known to the parties at the time the contract was made; (ii) those arising because the law (whether statute or the common law) effectively imposes such a term

into certain classes of contractual relationships. This case obviously concerned the first type.

20. Lord Neuberger then examined cases dealing with the law on the implication of terms which pre-dated the Privy Council case of AG BELIZE V BELIZE TELECOM [2009] 1 WLR 1988. In particular he quoted the following passage from the well-known judgment of Lord Simon in the Privy Council case of BP V SHIRE OF HASTINGS (1977) where he set out five tests:

> *"for a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract."*

He then quoted a passage from the judgment of Sir Thomas Bingham in GRAND PUBLIC SA V BRITISH SKY BROADCASTING [1995] EMLR 472 where the latter said:

> *"the court comes to the task of implication with the benefit of hindsight, and it is tempting for the court then to fashion a term which will reflect the merits of the situation as they then appear. Tempting, but wrong…it is not enough to show that had the parties foreseen the eventuality which in fact occurred they would have wished to make provision for it, unless it can also be shown either that there was only one contractual solution or that one of several possible solutions would without doubt have been preferred …"*

21. Lord Neuberger then summarised these authorities in the following way:

> *"In my judgment, the judicial observations so far considered represent a clear, consistent and principled approach"*

22. He then added six comments as follows:

    a. The implication of a term is not critically dependent on proof of an actual intention of the parties when negotiating the contract. One is thus not strictly concerned with the hypothetical answer of the actual parties to the question

"what would you have agreed?", but with that of notional reasonable people in the position of the parties at the time at which they were contracting.

b. A term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary but not sufficient grounds for including a term.

c. It is questionable whether Lord Simon's first requirement, reasonableness and equitableness, will usually, if ever, add anything: if a term satisfies the other requirements, it is hard to think that it would not be reasonable and equitable.

d. Although Lord Simon's five requirements are otherwise cumulative, business necessity and obviousness, the second and third requirements, can be alternatives in the sense that only one of them needs to be satisfied.

e. If one approaches the issue by reference to the officious bystander, it is vital to formulate the question to be posed by him with the utmost care.

f. A more helpful way of putting Lord Simon's second requirement is that a term can only be implied if, without the term, the contract would lack commercial or practical coherence.

23. Lord Neuberger then dealt with Lord Hoffmann's speech in the Belize case. Lord Hoffmann had there suggested that the process of implication was part of the exercise of the construction or interpretation of the contract. He said (at paragraph 21):

> *"It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean…There is*

only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"

24. Lord Neuberger and the majority of the Supreme Court effectively disagreed. They held that the exercise of implying a term was different in principle from that of interpreting the contract as written.

25. Lord Neuberger said this:

> *"When one is implying a term or a phrase, one is not construing words, as the words to be implied are ex hypothesi not there to be construed; and to speak of construing the contract as a whole, including the implied terms, is not helpful, not least because it begs the question as to what construction actually means in this context. In most, possibly all, disputes about whether a term should be implied into a contract, it is only after the process of construing the express words is complete that the issue of an implied term falls to be considered. Until one has decided what the parties have expressly agreed, it is difficult to see how one can set about deciding whether a term should be implied and if so what term….it would seem logically to follow that, until the express terms of a contract have been construed, it is, at least normally, not sensibly possible to decide whether a further term should be implied."*

26. Thus the process of contractual interpretation is different from that of the implication of terms and this was emphasized by a passage from the judgment of Sir Thomas Bingham in the British Sky case where he said:

> *"The courts' usual role in contractual interpretation is, by resolving ambiguities or reconciling apparent inconsistencies, to attribute the true meaning to the language in which the parties themselves have expressed their contract. The implication of contract terms involves* ***a different and altogether more ambitious undertaking****: the interpolation of terms to deal with matters for which, ex hypothesi, the parties themselves have made no provision. It is because the implication of terms is so potentially intrusive that the law imposes strict constraints on the exercise of* ***this extraordinary power.****"* (emphasis added)

27. The speech of Lord Hoffmann in the Belize case was and is no longer to be regarded as good law. It was "characteristically inspired discussion rather than authoritative guidance".

28. The emphasis of Lord Carnwath was different but the outcome was the same. His view was that Lord Hoffmann's speech in the Belize case was still good law but,

properly understood, it "should not be read as involving any watering down of the traditional tests". Lord Hoffmann's judgment, he said:

> *"is not to be read a involving any relaxation of the traditional* ***highly restrictive approach to implication of terms"****.* (emphasis added)

29. Lord Clarke was also of the view that in the Belize case, the Privy Council:

> *"was not watering down the traditional test of necessity."*

Outcome

30. Having stated these general principles, The Supreme Court rejected the tenants case that there was an implied term as found by the Judge. Lord Neuberger accepted that there was "considerable force" in the tenant's case and that the suggested implied term would be reasonable and equitable. However he declined to imply such a term for a number of reasons:

    a. The lease was a lengthy and carefully drafted document entered into between two experienced and legally advised parties. There was no express term requiring reimbursement and such a term should not be implied.

    b. The suggested implied term lay uneasily with the requirements to pay a substantial premium to exercise the break option on the First Break Date and to pay the rent up to date. It was difficult to suppose that the parties envisaged the payment of a large sum followed by the subsequent repayment of a lesser sum.

    c. This was strengthened by the provision by which the landlord would be required to pay to the tenant £150,000 if it did **not** exercise the break option.

The impact of the decision generally

31. As I have already pointed out, some six months before Marks & Spencer, the Supreme Court, again lead by Lord Neuberger, had decided Arnold v Britton. As no

doubt you will recall, in his judgment in that case, Lord Neuberger had re-emphasized the importance, in cases involving contractual construction, of giving effect to the express words used by the parties in the contract. He said:

> *"…the reliance placed in some cases on commercial common sense and surrounding circumstances…should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focusing on the issue covered by the provision when agreeing the wording of that provision."*

In my view the Supreme Court in that case is clearly signaling that there will, in future, be much less scope for Judges to override or "bend" the meaning of the express words of a contractual document to fit what the tribunal might regard as "commercial common sense".

32. Similarly in Marks & Spencer I think that the Supreme Court is sending out a clear signal that courts should, in the future, be much less ready to imply terms into contracts particularly where those contracts are lengthy and carefully drafted documents. I have highlighted the emphasis placed by Lord Neuberger on the speech of Sir Thomas Bingham in the British Sky case in which the latter describes the implication of terms in a contract as "an extraordinary power". Lord Neuberger himself expressed a view that a term should be implied only if "the contract would lack commercial or practical coherence" without it.

33. The general principles of contractual interpretation as set out in the cases culminating in RAINY SKY SA V KOOKMIN BANK [2011] 1 WLR 2900 have not, of course, changed. However there is no doubt that these two cases signal a conscious move away from the more "liberal" principles of contractual interpretation based on

"commercial common sense" championed by Lord Hoffmann. Whilst it is very difficult to assess how this might play out in individual cases, I am sure that the Supreme Court has signaled a return to a more "conservative" "literalist" or restrained approach:

a. There will be less room for Judges to override the express words of a contract by an appeal to "commercial common sense";

b. Courts will be less ready to imply terms into contracts, particularly those which are lengthy and carefully drafted.

Apportionment

34. As I indicated, at the express invitation of the Supreme Court, the tenant argued that the Apportionment Act 1870 applied to rent payable in advance as well as rent payable in arrears.

35. At common law rent, whether payable in advance or in arrear, is not apportionable in time. The common law position was altered by section 2 of the 1870 Act which reads:

> *"All rents, annuities, dividends, and other periodical payments in the nature of income (whether reserved or made payable under an instrument in writing or otherwise) shall, like interest on money lent, be considered as accruing from day to day, and shall be apportionable in respect of time accordingly."*

36. In ELLIS V ROWBOTHAM in 1900 the Court of Appeal had confirmed earlier authorities and held that this section applied only to rent payable in arrear and did not apply to rent payable in advance.

37. To cut a long story short, the Supreme Court rejected the tenant's arguments and held that ELLIS V ROWBOTHAM had been rightly decided. Thus rent payable in advance is not apportionable on a time basis either at common law or under statute.

The 1870 act is thus of no application to the vast majority of modern leases (such as the lease in Marks & Spencer) in which rent is specifically made payable in advance.

A chink of light for tenants?

38. Rent can however be made apportionable by the express terms of a lease.

39. To remind ourselves the lease contained the following provisions in the reddendum. The basic rent was to be:

> *"paid yearly* ***and proportionately for any part of a year*** *by equal quarterly instalments in advance on the [usual] quarter days."* (emphasis added).

Whilst clause 1.2 contained the following terms:

> *"(l) references to "last year of the Term" include the last year of the Term if the Term shall determine otherwise than by effluxion of time and references to "expiry of the Term" include such other determination of the Term;*"

40. I have personally always thought that words in the reddendum, such as those in the lease highlighted above, should be sufficient to permit the tenant exercising a contractual break clause to apportion the rent if the break date is in the middle of a quarter. However, and although ultimately it is a question of the interpretation of the terms of each individual lease, there are a series of first instance cases which hold that, in line with the position on forfeiture, such words do not entitled a tenant exercising a break clause to pay an apportioned rent. See:

    a. QUIRKO INVETSMENTS V ASPRAY [2012] L&TR 19 (where the words in the reddendum were "and so in proportion for any period less than a year");

    b. PCE INVESTORS V CANCER RESEARCH [2012] 2 P&CR 5 (where the words of the break clause were that the rent had to be paid "up to" the break date);

c. CANONICAL V TST [2012] EWHC 3710 (Ch) (where the words in the reddendum were "and proportionately for any part of a year")

41. The essential reasoning is that, as each of the leases in these cases contained a break clause that was conditional on the fulfilment of certain criteria at the break date, it could not be said with certainty on the last quarter date whether the term would in fact end. Thus the full quarter's rent was payable.

42. In Marks & Spencer, Morgan J considered these cases and held that, as the payment of the £919,800 plus VAT premium had not been paid by 25th December 2011, the rent payable on that date could not be apportioned as it could not be said with certainty that the lease would end. If the tenant had not paid the premium on or before the First Break Date, the lease would have continued.

43. In the Supreme Court, Lord Neuberger acknowledged that the reasoning which prevents a tenant from apportioning rent payable in advance at common law and by statute on a forfeiture in the middle of a quarter applies equally to the exercise of a break clause where the break date is mid-quarter (se paragraph 53). However he did say this (at paragraph 35):

> *"A further point on which the claimant relies arises from the fact that the basic rent is stipulated in the lease to be "paid yearly* and proportionately for any part of a year *by equal quarterly instalments in advance" (emphasis added). It is common ground that the effect of the italicised words is that, if the lease had run its full course to 2 February 2018, the tenant would only have had to pay an apportioned part of the basic rent due on 25 December 2017, because, as at that date, the parties would have known that the lease would expire before the next quarter day, 25 March 2018. In the present case, it is common ground that, because the claimant had not paid the sum of £919,800 plus VAT due under clause 8.4 before 25 December 2011, it would not have been known as at that date whether the lease would come to an end before 25 March 2012, and the tenant therefore had to pay the quarter's rent in full: it only became clear that the lease would determine on 24 January 2012 when the claimant paid the £919,800 plus VAT on 18 January. However,* ***if the claimant had paid the £919,800 plus VAT before 25 December 2011, the claimant argues (rightly in my view) that it would have been clear on 25 December 2011 that the lease would end on 24 January 2012, so that the***

> ***claimant would only have had to pay an appropriate proportion of the basic rent on 25 December 2011***.*"*(emphasis added)

44. Thus, it seems to me that, on the terms of this lease, Lord Neuberger would have been minded to give effect to the words in the reddendum had the premium been paid on or before the quarter date.

45. It may be, therefore, that, always depending on the words of the individual lease, a tenant exercising a break clause may be able to argue that it is only liable to pay an apportioned rent. A lot may depend on whether, on the last quarter day before the break date, it can be seen that the lease is definitely likely to terminate or whether, on that date, there are still conditions which the tenant is still to fulfill and which it might not fulfill.

46. I acknowledge that it will be a brave tenant who takes the point, but this is at least a small chink of light for tenants in an otherwise dark, peculiarly "landlord friendly", legal landscape.

DAVID HOLLAND QC