

## **Disputes arising out of the exercise of break options in commercial leases |**

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### Note

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## **Introduction**

1. When boom turns to bust, when consumer confidence wanes and demand slumps, many businesses engage in retrenchment, seeking to reduce costs and to concentrate on their more profitable outlets. In such a climate, they will be alert to the opportunity afforded by the presence of break options in their leases to slew off onerous but unrewarding contractual commitments. At the same time, landlords, conscious of the problem of finding suitable replacement tenants in a difficult letting environment, may be more ready to go to Court to dispute the validity of the exercise of such break options than they would be in less challenging economic times. So the stage is set for a high risk litigation in which there can only be one winner, because the break option will either be held to have been validly exercised, or not. In this talk, I consider some of the issues which typically arise in such disputes, and comment on the recent case law

## **Background**

2. Landlords of institutional quality commercial property want a reliable income stream, with the minimum of void periods, and so the ideal from their perspective is to have in place a tenant with a strong covenant, bound to perform the tenant's obligations under the lease for its whole 15 or 25 or however many year term to its contractually stipulated ish. The commercial tenant may have different priorities. A tenant who is expanding into new territory may wish to make an early exit if trade from the leased premises is less profitable than anticipated, and the inclusion in the lease of a break option, enabling him to do so without penalty a number of years into the lease term, is the resulting trade off between the conflicting interests of the parties. Although one tends nowadays to think of break options in favour of the tenant, there is no reason why a break should not be in favour of the landlord, or in favour of both.

In **Hunter's A Treatise on the Law of Landlord and Tenant (4<sup>th</sup> Ed. by William Guthrie; 1877)**

**(Vol. 1) at page 385** it is explained that where there is a "mutual privilege to renounce", this is technically called "a breach or break" clause, the tenor of which is:

"that the lessee shall have liberty to quit or renounce the lease and possession after the lapse of a specified number of years, and upon giving premonition of a stipulated length of time to the lessor; and that the lessor shall upon the same terms be entitled to remove the lessee."

The object of such a clause is to give either party, or both, the power to bring the lease to an end, but according to **Rankine**, when the privilege belongs to the tenant alone, it is a power to **renounce**, and when it is vested in the landlord, it is properly a power to **resume**: **A Treatise on the Law of Leases in Scotland (3<sup>rd</sup> Ed.; 1916) at page 527**. In words which neatly anticipate the two main elements of this talk, **Hunter** observes **at pages 114 – 115** that:

"The tenor of the clause is, that notwithstanding the duration specified, the lessee shall have power, on the expiration of a certain number of years, to quit and renounce the lease and the possession of the subject, upon giving intimation of his intention to the lessor **according to a form prescribed** [my emphasis], at a certain time preceding the term at which he wishes to remove . . . It has been recommended that express provision should be made for the state in which the lessee is to leave the [farm], compliance with which should form the condition under which he can renounce."

The battleground between landlords and tenants in relation to break options tends to be either (i) as to whether the tenants, in purporting to exercise the break option, have observed the prescribed formalities for so doing, or (ii) where the power to break has been made conditional on compliance by the tenants with their lease obligations, whether the tenants have indeed satisfied that condition, on which the entitlement to exercise the option depends. Writing in 1967, **Paton & Cameron** in **The Law of Landlord and Tenant in Scotland** commented, **at page 243**, that "As the power to break depends entirely on express provision in the lease itself, problems seldom arise", which from today's perspective sounds like the authentic voice of an altogether more innocent era.

3. Where the effect of the exercise of an option is to bring to an end a lease which otherwise would endure, it is not unreasonable to require strict compliance with the prescribed formalities, and the general principle is that where the parties contract for strict compliance with formal steps in the giving of notices, the Court will enforce such compliance: **Scrabster Harbour Trust v. Mowlem plc 2006 SC 469 per Temporary Judge Sir David Edward QC at paragraph [469]** (a case concerning a notice requiring arbitration). That entails, for instance, that where provision is made for the tenants to give the landlords a specified period of notice, any failure to allow for such period will render the notice ineffective on the ground of failure to comply with the procedural stipulations of the lease as to service, and so great care must be taken in the computation of the period of notice: **Esson Properties Ltd. v. Dresser UK Ltd. 1997 SC 304.** In **Capital Land Holdings Ltd. v. Secretary of State for Scotland 1997 SC 109**, an Extra Division of the Inner House of the Court of Session was dealing with a break option in a 20 year lease, Clause 2 of which conferred on the tenant the power to terminate the lease by 12 months written notice to the landlord after 10 or 15 years. Clause 7 specified that any notice to the landlord was to be sent to its registered office, if an incorporated body, or to his last known address, if a person. In the event, the notice was served on the landlord's agents. Such service was not in conformity with the provisions of the lease, and so the Extra Division held that the break option had not been validly exercised. In delivering the Opinion of the Court, **Lord Sutherland** commented, **at page 114**, that if Clause 2, which referred only to written notice, had stood alone, there might have been arguments about what constituted proper service on the landlord, but as the parties had made specific provision for service of notices on the landlord in Clause 7, service on agents was invalid.

4. The moral of that story is that it is important, before serving notice of intention to exercise a break option, to consider the interplay between the terms of the break clause itself and any more general provision in the lease about service of notices. In relation to the contents of the latter, a distinction falls to be drawn between provisions which lay down mandatory rules which **must** be complied with for service validly to be effected, and provisions which deem notice to have been sufficiently served if a specified method (frequently sending by First Class Recorded Delivery post to the appropriate address) has been employed, so that the party serving notice, in order to put the effectiveness of service beyond doubt, need only prove that he employed that specified method (as in this example by producing the Post Office certificate or receipt of posting), thereby obviating the need for further proof of its sending or receipt by its proper recipient: **EAE (RT) Ltd. v. EAE Property Ltd. 1994 SLT 627**; **Blythwood Investments (Scotland) Ltd. v. Clydesdale Electrical Stores Ltd. (in receivership) 1995 SLT 150**; **Prudential Assurance Co. Ltd. v. Smiths Foods 1995 SLT 369**; *cf.* **Chaplin v. Caledonian Land Properties Ltd. 1997 SLT 384**.

5. In **Ben Cleuch Estates Ltd. v. Scottish Enterprise 2008 SC 252**, the tenants exercised a break option by serving notice on Bonnytoun Estates Ltd. ("Bonnytoun"). Unfortunately, Bonnytoun were not the landlords of the leased premises; Ben Cleuch Estates Ltd., a subsidiary of Bonnytoun controlled by the same man, a Mr. Cairns, and with the same registered office (at the offices of McGrigors) and managing agents, were. There was no dispute that Mr. Cairns had ultimately received the break notice, in his capacity as director of Bonnytoun, but that he happened also to be director of Ben Cleuch, and thus acquired knowledge of the notice, and was able to react to it, in that capacity, did not, in the Opinion of an Extra Division chaired by the late **Lord Macfadyen**, convert a notice given to Bonnytoun into a notice given to Ben Cleuch. The notice was invalid, because it was not given to the landlord but to a third party, and Mr. Cairns's candid admission that he was not misled by its terms did not

avail the tenants because where the notice had been given to the wrong party, the [second] stage of considering how that notice would be understood by the recipient was not reached.

6. That was not the end of the story, however. The tenants had been formally notified by the previous landlords a couple of years before the break option was exercised that the leased premises had been acquired by a company called Pacific Shelf 1145 Limited, and a week later they had started receiving rent invoices issued in respect of the leased premises ostensibly on behalf of Bonnytoun. Pacific Shelf 1145 Limited was obviously the name of a shelf company, and so when invoices started arriving in that form, it might reasonably have been inferred that Bonnytoun were the new landlords. In fact, Pacific Shelf 1145 Limited had changed its name to Ben Cleuch, but this change of name was never notified to the tenants, which was the source of their confusion about the landlords' identity. In these circumstances, the tenants, it was held, were justified in believing the representation that Bonnytoun were the landlords, and having induced that justified belief, Ben Cleuch were held personally barred from maintaining that the facts were otherwise, and thus from disputing the validity of the break notice. The facts which enabled the Extra Division to so hold were quite singular and perhaps unlikely to be repeated. It would, in my view, be unwise for tenants to assume that where landlords who, on previous occasions, have not taken exception, when they might have done, to notices served on them in a form or manner other than that prescribed in the lease, do found on such failure, that past history of lack of objection will, by itself and without the presence of other special factors, rescue the notice. While the Second Division in **Minevco Ltd. v. Barratt Southern Ltd. 2000 SLT 790** may have affirmed that a clause of a written contract could be varied or altered if there were facts and circumstances explicable **only** on the basis that there had been an express or an implied agreement to alter the contract, the authorities confirm that this is not an easy test to satisfy. The presence of a "no waiver" clause in the contract of lease

will present a further obstacle to a tenant who seeks to argue that the landlord is personally barred by his past conduct from insisting now on strict compliance with particular contract terms. Recently, in **Heis and Others, Joint Building Society Special Administrators of Dunfermline Building Society v. FM Front Door Ltd.** [2011] CSOH 175; 21 October 2011; **Lord Hodge** rejected a defence to an application for an administration order that the creditor under a loan agreement previously had acquiesced in late payment of interest by the debtor and thus was personally barred from founding on a subsequent late payment as a ground of default. **Lord Hodge** explained that personal bar seeks to prevent unfairness caused by inconsistent behaviour. But here, the debtor must be taken to be aware of the “no waiver” clause in the loan agreement and thus to have known that a failure by the creditor to exercise a right or remedy did not amount to abandonment of that right on a later non-performance. In these circumstances, he could see no unfairness in the creditors’ assertion of its contractual rights.

7. The two stage approach to assessing the validity of a break notice adopted by the Extra Division in **Ben Cleuch** was applied in **Batt Cables plc v. Spencer Business Parks Ltd.** 2010 SLT 860, in which **Lord Hodge** helpfully summarised the correct approach, as set out in the authorities, in four propositions:

1. Where a contract confers on a party a right, such as an option, by notice unilaterally to alter the rights of the parties and imposes conditions or requirements as to its exercise, the party seeking to exercise that right must comply strictly with those agreed conditions or requirements. The reason for the rule is to enable the parties to be certain whether the event which alters the parties’ rights or legal relationship has or has not occurred.
2. That first proposition is not inconsistent with the approach set out by the House of Lords in **Mannai Investment Co. Ltd. v. Eagle Star Life Assurance Co.**

**Ltd. [1997] AC 749** [the much discussed House of Lords case, which concerned the effectiveness of a break notice in a commercial lease, in which **Lord Hoffmann** first developed his now eponymous “Hoffman approach” to contractual interpretation, which has been received by members of the Scottish judiciary with notably varying degrees of enthusiasm] that the courts should interpret and apply commercial instruments in a common sense “commercial or business” way, eschewing linguistic and legalistic niceties. Effect will be given to the parties’ agreement.

3. Before the court construes the meaning of the notice by use of the device of the reasonable person in the position of the contractually specified recipient, it must first test the validity of the notice against the terms of the power under which it was served. If the notice fails that test because one or more of the contractual requirements for the exercise of the power have not been fulfilled, the court does not go on to apply the reasonable recipient test to construe the notice. That is because the notice is invalid.
4. The fact that a notice finds its way into the hands of the contractually specified recipient and a reasonable person in his shoes would readily appreciate that the sender of the notice intended to exercise the relevant contractual power is *nihil ad rem* if the notice itself is invalid.

8. In **Batt Cables**, the lease required written notice to be given to the landlords, but the notice itself had been addressed not to the landlords but to a surveyor at one of the defenders’ associated companies. **Lord Hodge** held that the tenants had not given the written notice to the landlords, but it was a matter of agreement between Counsel that the break notice would be valid if it had been served on an agent of the landlords who was authorised to receive it and on the facts, the surveyor had the necessary authority for service of the notice on him to amount to service on the landlords. He had

been authorised in the first instance to handle all correspondence relating to the landlords, and the tenants had been told as much. For a case in which the tenants misdescribed themselves in the break notice, but got away with it, see **AWD Chase de Vere Wealth Management Ltd. v. Melville Street Properties Ltd.** [2009] CSOH 150 (12 November 2009), in which **Lord Glennie** observed, when dealing with a submission in which there had been copious citation of English cases involving break notices where the tenant had been incorrectly named, that he did not consider that it would be safe to place too great a weight on the English cases **even as guidance on the facts**, standing “the very wide differences between English and Scots law in the field of landlord and tenant. . . . Given these differences, it would be wrong to assume that the result on similar facts will necessarily be the same in Scotland as it might be in England [at paragraph 11].” In so doing, he was echoing earlier comments by **Temporary Judge Sir David Edward QC** delivering the Opinion of the First Division in the **Scrabster Harbour Trust** case.

9. In deciding these cases relating to break clauses, the Scottish Courts have derived assistance from authorities concerning notices of determination of other species of contract, to which the same principles apply. In **Muir Construction Ltd. v. Hambly Ltd.** 1990 SLT 830, the contract in question was the **JCT Standard Form of Building Contract** (1980 edition), Clause 28 of which empowered the contractor to determine the contract in specified circumstances, one of which was failure by the employer to pay the amount properly due to the contractor on a certificate within a stipulated timescale, on giving notice by registered post or recorded delivery. The employer having failed timeously to pay on a certificate, the contractors purported to give notice of determination of the contract by way of hand delivery. The employers subsequently argued that the notice of determination had not been validly served. **Lord Prosser**, sitting in the Outer House, upheld that argument, rejecting the suggestion made on

behalf of the contractors that there was anything contrary to common sense, or inconsistent with a business approach, "in concluding that precise words in a carefully structured provision are intended by the parties to have a precise effect in a carefully structured procedure [at page 833 J-K]." As he pointed out, there is a whole range of possible provisions in a matter of this kind,

"and it was open to the parties to decide whether they wanted to use the words 'by notice', or to add a requirement of writing, or to add provisions as to postage or delivery. In a sense, these are all mechanisms or modes or means towards the overall end. That does not appear to me to mean that their inclusion, and the adoption of a specific mode, is not something which the parties have stipulated for as a necessary part of the procedure [at page 834 A-B]".

Just recently, in **Port of Leith Housing Association v. Akram and Another [2011] CSOH 176 (19 October 2011), Lord Hodge** on a motion for summary decree by the would-be Purchasers of a property at Great Junction Street, Leith rejected the Sellers' argument that a notice of purification of suspensive conditions in missives of sale had not been validly exercised because the purification condition required the Purchasers to give written notice to the Sellers to that effect, and the notice instead had been given to the Sellers' solicitors. **Lord Hodge** pointed out that it was necessary in each case for the court to have regard to the terms of the particular contract. This was a straightforward contract in which there were no precise requirements relating to the service of notices or detailed and precise provisions as to the method of service, and no indication that the parties intended that service of the purification letter on the Sellers' solicitors, who were authorised to receive correspondence from the purchaser's solicitors and to progress the conveyancing of the subjects, would not be valid. The other provisions of the contract did not suggest that the parties intended to draw a clear distinction between themselves and their agents so that where the contract provided that one party was to perform a juristic act in relation to the other, one party's agent could not perform that act in relation to the other party's agent. That was not immediately the end of the matter, however, because **Lord Hodge** considered that proof

was required on whether the Sellers' solicitors had actual or apparent authority to receive the purification notice.

### **Conditional break options**

10. I turn now to the second issue with which this talk is concerned, namely that of where the break clause makes exercise of the break option by the tenants expressly conditional upon the tenants having duly complied with their obligations under the lease. Given that, as the extract from **Hunter** previously quoted indicates, clauses in such terms have been around in Scotland since back into the 19<sup>th</sup> century, it is perhaps surprising that there is so little Scottish case law bearing directly on this issue, the one reported case in point being **Trygort (No. 2) Ltd v. UK Home Finance Ltd. 2009 SC 100**, but there is a long-standing line of English authority, which **Bingham LJ** in the Court of Appeal in the leading case of **Bass Holdings Ltd. v. Morton Music Ltd. [1988] 1 Ch. 493** considered to be so well established as to constitute a rule of law. The First Division in **Trygort**, while denying that any such rule of law might be said to have been established in Scotland, in the event was prepared to follow that line of authority, on the stated basis that the commercial considerations which justified the approach of the Courts in England to similar clauses were just as relevant to the consideration of a commercial lease in this jurisdiction.

11. In the words of **Nicholls LJ** in **Bass Holdings at page 528 A-B**,

“Leases frequently contain a clause entitling the tenant at his option to determine the lease prematurely or, conversely, to extend his interest in the demised property by obtaining a further lease. Such “break” or “renewal” clauses often, although by no means always, include a provision to the effect that the exercise by the tenant of his option is conditional upon his having paid his rent and performed and observed his covenants and agreements under the lease up to a specified date. Typically the specified date is either the date upon which the tenant gives notice of his intention to exercise his option or the date from which the notice would take effect: for example, in the case of a break clause, the date on which, if the option is exercised, the lease will determine.”

The question of general importance which arose in **Bass Holdings** was whether in those clauses such a condition required for its fulfillment that **throughout** the whole term of the lease up to the specified date there shall have been **no breach** of any of the tenant's obligations, or whether the condition was fulfilled if at the specified date there was **no subsisting breach** of any of those obligations, by which was meant "that in respect of the rent, covenants and agreements there is at the specified date no outstanding cause of action." **Nicholls LJ** referred to these respectively as the "**never any breach**" and the "**no subsisting breach**" constructions. In similar vein, **Kerr LJ** observed at pages **517 F – 518 A** that:

" . . . there is clearly a long standing conveyancing practice . . . whereby tenants' options in leases are made subject to provisos dealing with the observance of the tenants' covenants, . . . whether the option be for a new lease as here, or for premature termination of an existing lease (a "break" option) . . . In all such cases the provisos link the required observance of the covenants to a point in time in the nature of a *terminus ad quem*. This may be either the date of the exercise of the option as here, or the date of the expiry of the option, or – in cases of options for renewals . . . – the date of the expiry of the lease. For present purposes the particular date referred to in the proviso ("the operative date") does not matter. What matters is whether the breach (or breaches) of covenant on which the plaintiffs rely as precluding the exercise of the option has only occurred in the past, so that its effect is spent by the operative date in question, or whether there is still a breach – or at any rate a cause of action based upon a breach, whether for forfeiture or damages or both – which subsists on the operative date."

He referred to the breaches of covenant in these two situations respectively as "spent breaches" and "subsisting breaches." In the circumstances of the instant case, the operative date did not matter because it was common ground between the parties that "if the defendants were in breach of repairing and decorating covenants at the time when they purported to exercise the option, then it must necessarily follow that it could not have been exercised validly": **per Kerr LJ at page 516 D-E**. The parties were at odds as to whether, as a matter of fact, there had been compliance with those covenants as at that date, but in order to avoid possibly needless proceedings to decide that issue of disputed fact, had agreed to go to trial on, *inter alia*, the more fundamental question

of whether any past breach, whether spent or not, would preclude exercise by the tenant of the option (which in this case actually was to extend rather than to determine the lease). After a review of the authorities, the Court of Appeal upheld the “no subsisting breach” construction, confirming that such conditions apply only to subsisting breaches and not to spent breaches. The reasoning which underpinned that conclusion was that:

“it must be accepted that absolute and precise compliance by the tenant with every single covenant throughout the period of the lease prior to the operative date is virtually impossible of attainment. If this were required as a condition precedent, then the option would in practice be worthless or merely at the mercy of the landlord. Therefore the parties cannot have intended that the absence of spent breaches should be a condition precedent. Secondly, however, it is natural and sensible that the landlord should require the tenant not to be in breach of any covenant on the operative date and that all outstanding claims for breach of covenant should have been previously satisfied, so that the lease is then effectively clear. The proviso is therefore to be construed as intended to apply to subsisting breaches, with the result that the relevant condition precedent is the absence of any subsisting breach: ***per Kerr LJ at page 518 D-F.***”

12. In **Trygort**, the landlords too argued for a “never any breach” construction of the break option. That course was forced upon them by the facts of the case, because it was accepted in submission before the Court that as at the date when the break notice was issued, there were no subsisting breaches of contract by the tenants, any prior breaches which had existed having been remedied. The landlords argued that it was enough for them to prove that the tenants had been in breach of contract at some stage prior to the issue of the break notice. They boldly contended that the plain ordinary meaning of the relevant part of the clause (which provided that “The Tenant shall not be entitled to issue any notice determining These Presents in terms of this Clause 2 if the Tenant **has been in breach** of its obligations to the Landlord in terms of These Presents”) applied to breaches occurring at any time during the currency of the lease. The tenants, equally boldly, argued that the plain ordinary meaning of the words used favoured their position, but as a fallback maintained that if the language of the clause was considered ambiguous, then their construction was the one which made commercial

sense, and should be preferred. On the wording of the clause in question, **Lord Kingarth**, in delivering the Opinion of the Court, perhaps inevitably rejected the primary contention of both sides that, looking at the language of the relevant clause, the words used were, in context, reasonably capable, as a matter of ordinary language, of only one meaning, namely that for which they had respectively each contended. Rather, the Court considered that:

“it can reasonably be said that having regard to the words used, in the context in which they appear, there does exist a degree of uncertainty as to whether the words fall to be read as meaning, on the one hand, ‘has at any time been in breach’ (despite the absence of the underlined words) or ‘has been and remains in breach’ (again, despite the absence of the underlined words). In our view it can reasonably be said that both meanings are possible without doing any violence to the language used [**at paragraph 9**].”

That being so, the Court had little doubt that the commercially sensible construction was that contended for by the tenants, and in that connection, they suggested [**at paragraph 10**] that “much assistance can be gained from consideration of the long-standing line of authority in England which was referred to and followed in” **Bass Holdings**. The Court of Appeal in **Bass Holdings**, whilst acknowledging that questions of construction depend upon the particular language of the particular instrument, had observed that this was a field in which the Court “should be slow to find that small, inexplicit differences in language lead to a clause being construed, contrary to the norm, as imposing a “never any breach” requirement”: *per Nicholls LJ at page 534 E*. In **Trygort**, the First Division of the Court of Session, while accepting that a clause having the meaning contended for by the landlords could conceivably be drafted, emphasised that it would require to be clearly and precisely expressed. It seems to me, with respect, that a break clause which was clearly and precisely expressive to that effect would be one which no properly advised tenant would ever accept at the stage of negotiation of lease terms, because the “never any breach” requirement would render it scarcely conceivable that the break option could ever successfully be exercised.

13. The decision of the First Division of the Court of Session in **Trygort** is instructive insofar as it affirms that there is no distinctively Scottish approach to this issue, and that in consequence (in notable contrast to the approach to English authority adopted by the First Division in **Scrabster Harbour Trust** and by the Commercial Judge in **AWD Chase de Vere**), resort may be had to English authorities for such assistance as they may provide. It might, however, be considered a little disappointing that the Court of Session should so readily have been persuaded simply to import a tract of English authority here when, on the face of it, they might, in what is supposed to be the Scottish tradition, have sought to derive the same answer by resort to principle. The operative legal principle here would seem to me at root to be that of mutuality of obligation: the principle that in mutual contracts, in the words of **Stair**, “neither party should obtain implement of the obligations **to** him, till he fulfill the obligations **by** him [**Institutions, I, 10, 17**]”, so that in the circumstances we are considering here, unless the tenants have duly performed their obligations under the lease, they cannot enforce their right to break the lease: see, generally, **Bank of East Asia Ltd. v. Scottish Enterprise 1997 SLT 1213**; **Inveresk plc v. Tullis Russell Papermakers Ltd. 2010 SC (UKSC) 106**. The question is begged whether the principle of mutuality of obligation might be deployed by landlords to challenge the validity of tenants’ purported exercise of a break option even in cases where the right to exercise the break option is not expressly stated in the same clause to be conditional on the tenants having, at the operative date, duly and fully obtempered their obligations under the lease. I do not attempt to answer that question here, but the point may be worthy of further consideration.

14. An issue which did not require to be addressed in either **Bass Holdings** or **Trygort** was that of what is, in the terminology developed by **Kerr LJ** in the former case, the operative date for the purposes of the condition. In **Bass Holdings**, it was a matter of concession that “if the defendants were in breach of repairing and decorating covenants at the time when they purported to exercise the option, then it must necessarily follow that it could not have been exercised validly.” In other words, the operative date was accepted to be the date on which the tenants exercised their option to extend the term of the lease. On the terms of the relevant clause of the lease, there was no distinction to be drawn between the exercise of the option (or the giving of notice of intention to exercise the option) and its taking effect. In other cases, however, it may be necessary to identify what is the operative date for the purposes of the break clause. Depending on how the break clause is expressed, it could be the date on which the notice of intention to terminate is given, the date on which the notice is to take effect, or even both. If the operative date be the date on which the notice of intention to terminate is given, it would follow that even were the tenants to remedy any subsisting breaches of their obligations between that date and the date on which the notice is to take effect, it would not avail them any and their purported exercise of the break option could be successfully challenged. On the other hand, if the operative date be the date on which the notice is to take effect, the position on the date when the notice of intention to terminate was given is irrelevant, and in the absence of proof of subsisting breach on the date on which the notice is to take effect, the break option would be validly exercised.

15. The English case law on what is the operative date unsurprisingly affords little by way of guidance beyond that the answer to the question will turn on the particular wording of the clause under review. In **Finch v. Underwood (1876) 2 Ch. D. 310 (C.A.)**, which concerned an option to renew at the expiry of the original term,

conditional upon the tenants' obligations having been "duly observed and performed", there was a subsisting breach of the covenants to repair when the notice of intention to take a fresh lease was given, which breach was still subsisting at the expiry of the original term. **Mellish LJ** observed, *obiter*, at pages 315 – 316, that:

"Under the terms of the covenant in the present case the lease is to be granted only in case the covenants and agreements on the part of the tenants shall have been duly observed and performed. What does that mean? I think it does not mean that the tenants must have strictly observed and performed the covenants all through the term, for the expression is 'shall have been duly observed and performed'; and I think that this is satisfied if they have been so observed and performed that there is no existing right of action under them **at the time when the lease is applied for** [my emphasis]."

Those remarks were approved by **Nicholls LJ** in **Bass Holdings**. It was pointed out in **West Country Cleaners (Falmouth) Ltd. v. Saly [1966] 1 WLR 1485 (C.A.) per Dankwaerts LJ at page 1490 E-F**, that the notice that had to be given in **Finch v. Underwood** was only a twenty-one day notice, "and consequently there was very little difference in this respect between the date of the notice and the date when the leasehold term had come to an end." On the wording of the clause in the case before him, which also concerned an option to renew at the expiry of the original term, conditional upon the tenants' obligations having been "duly observed and performed," **Dankwaerts LJ** held that it was the date of expiry of the lease and not the date when the notice purporting to exercise the option was given that was the material one (*i.e.* that was the operative date). The landlord succeeded in justifying her refusal to grant a renewal in proceedings brought against her by the tenants because it was established that the covenant to paint the interior of the premises in the last year of the lease had not been duly observed and performed. In **Bastin v. Bidwell (1881) 18 Ch. D. 238**, the tenants who wished to exercise an option to renew were in breach of covenants to paint both when the six months notice of renewal was given and when it expired, and so it was immaterial whether, on a proper construction, the clause then before **Kay J.** meant that there should be no breach at the time the notice was given, or no breach at the

time that the notice expired. In **Robinson v. Thames Mead Park Estate Ltd. [1947] 1 Ch. 334** it was held sufficient for the purposes of the clause that the tenant, when she came to give her notice calling on the landlord to grant a new lease, had then ended any previous breaches of covenants, or failures to perform covenants. In the more recent case of **Fitzroy House (No. 1) Ltd. v. Financial Times Ltd. [2006] 1 WLR 2207**, the decision of the Court of Appeal turned on the meaning and effect of the proviso, contained in a break option in a lease, that the tenant had **materially** complied with all its obligations under the lease at the date of termination. The Court accepted 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 options, but it rejected the argument that it must have been the intention to modify the rule to the extent that it was reasonably fair to both landlord and tenant, because (i) such provisions required to be strictly complied with; (ii) the need for consistency; and (iii) the insistence in previous case law that the Court should not rewrite the parties’ contract: see, especially, in this context, **Bairstow Eves (Securities) Ltd. v. Ripley [1992] EGLR 47**; and *cf.* also **Bassett v. Whiteley (1983) 45 P. 7 C.R. 87** (clause providing that tenants shall be entitled to a renewal of the lease where they “shall have **reasonably** performed and observed” lease obligations). Where exercise of the break clause has not been made expressly conditional on the absence of any **material** breach by the tenants of their obligations to the landlords under the lease, the English case law suggests that it will not avail tenants to argue in support of the validity of their purported exercise of a break option that any subsisting breach by them at the operative date was not material. In both **Finch v. Underwood** and **West Country Cleaners (Falmouth) Ltd. v. Saly**, non-compliance by the tenant with the repairing covenant was held to render the exercise of the option unenforceable even though the repairs were of small value.

16. None of the cases so far discussed address the situation where there was a subsisting breach when notice of intention to exercise the break option was given, but such breach was spent by the date on which the notice was to take effect, because in the intervening period the tenant had remedied all outstanding breaches and there were no remaining causes of actions in respect of such breaches. That was, however, the situation which prevailed in **Simons v. Associated Furnishers Ltd. [1931] 1 Ch. 379.**

The lease in that case provided for a break option in the terms that if the tenant:

“shall desire to determine the present demise at the expiration of the first five or ten years of the said term and shall give to the lessor six calendar months previous notice in writing of such their desire and shall up to the time of the determination pay the rent and perform and observe the covenants and conditions on their part hereinbefore contained then immediately on the expiration of such five or ten years as the case may be the present demise and everything therein contained shall cease and be void, but without prejudice to the remedies of either party against the other in respect of any antecedent claim or breach of covenant.”

The tenants having given the requisite notice of their desire to determine the lease at the expiration of the first five years of the term, the landlord refused to recognise the validity of the notice on the ground that at the date of the notice there were subsisting breaches of the repairing covenants in the lease which at the date of expiration of the notice remained unremedied. The tenants disputed the latter contention, and the parties went to trial on the issue of the validity of the notice.

17. **Clauson J.** held, on the evidence, that at the date of expiration of the notice, the buildings had been put into such a state of repair as to satisfy the tenants’ covenants in the lease, but that left for determination the question whether the fact that when the notice was given there were unremedied breaches of covenants by the tenants in respect of which there were existing causes of action was sufficient to invalidate the notice. **Clauson J.** held that it did not. He could find nothing in the wording of the clause to make the date when the notice was given the crucial date. Had he to construe the condition as providing that throughout the five years there must be no instance of an

unremedied breach of covenant, then it would seem to follow that the existence of an unremedied breach of covenant at the particular moment the notice was given would have been, just as the unremedied breach of covenant at any other moment of the five years would have been, an answer to the tenants' claim, because the condition would not have been fulfilled, but here he was bound by a very heavy weight of judicial opinion to hold that the true meaning of such a clause, which (or one so closely resembling it as to be practically indistinguishable) had been in common use for more than a century past, was that:

"it will have been complied with, if at the end of the five years, 'there should not exist any cause of action in respect of performance of covenants'; or, I may put it this way, the condition must be understood as 'requiring that the account between the parties must, both as to rent and covenants, be clear; the rent need not have been always paid on the day; but all arrears, if any, must have been paid up; the covenants must have been strictly kept, or, if broken, must have been satisfied' [**at page 386**]."

18. That reasoning seems sound, and the result it produces commercially sensible, and while ultimately it must always come down to the proper construction of the break clause in question, if there is any ambiguity in the clause as to whether the point in time "in the nature of a *terminus ad quem*" to which the "compliance by the tenants of their obligations to the landlords under the lease" is linked is the date of termination of the lease or the date on which the tenants gave written notice of their intention to determine the lease, the case law points to the Court favouring the construction that the operative date is the date of termination of the lease.

19. Where tenants gives notice in accordance with the provisions of a break clause of their intention to exercise a break option some months hence, their landlords are, it seems to me, placed in a rather awkward position. They will not want to flag up too obviously to the tenants that they are thinking of questioning the validity of the purported exercise of the break option, for fear that this will prompt the tenants into

remedying all subsisting breaches before the termination date, thereby cutting the ground out from under any possible challenge, but on the other hand, if they remain silent, and continue to deal with the tenants ostensibly on the basis that the lease will indeed be terminating on the termination date, they may be storing up trouble for the future. For example, were the tenants in the meantime, to the landlords' knowledge, to enter into a lease of alternative premises for the period subsequent to the termination date, and then to incur significant expense transferring their business operation thereto, it readily may be anticipated that any subsequent action by the landlords for declarator that the exercise of the break option was invalid and that the lease endures would be met by pleas that the landlords are, in the circumstances, personally barred from insisting on that position. The answer to such pleas, at least where the operative date is the termination date, may well be that the validity of the purported termination can be tested only by reference to the position as it appears on the termination date, as the tenants themselves, as parties to the lease, must be aware, and indeed, in **Bass Holdings, Kerr LJ** pointed out [**at page 519 F-G**] that because a condition requiring the absence of any subsisting breach on the operative date involves not only that any breach should have ceased, but also that there should be no subsisting cause of action in respect of any breach, then a landlord "may perhaps take advantage of the latter condition, in order to defeat a tenant's option, by postponing any claim for forfeiture or damages in respect of an earlier breach until after the operative date". It is important that tenants' advisers are alert to the possibility that any subsisting breaches of obligation on the operative date may be fatal to exercise by the tenants of the break option, and advise their clients accordingly. When, as now, the incentive for landlords to challenge the exercise of a break option is that much greater than it would be in less straitened economic times, it would be a mistake for tenants minded to take advantage of a break option to leave hostages to fortune in the form of payment arrears or unattended to decoration or maintenance obligations.