TENANT BREAK CLAUSES – RECOVERY OF OVERPAYMENTS

Introduction

1. In this paper I want to return to the topic of tenant break clauses, and to look at a recent development in the area of recovery of overpayments.

2. The topic of tenant break clauses has been running hot since the latest economic downturn. It has seen a number of important recent cases. It was also the subject of a paper given to the Chancery Bar Association by Tim Dutton (now of Queen's Counsel) as recently as 2011.

3. Nevertheless, despite that recent paper, a relatively prompt return to the topic is justified by the decision in *Marks and Spencer plc v BNP Paribas Securities Services Trust Company (Jersey) Limited* [2013] EWHC 1279 (Ch), a judgment handed down by Morgan J in May of this year which has generated a considerable number of column inches in the Estates Gazette and elsewhere.

4. The significance of the *Marks and Spencer plc* case is that it marks the first occasion on which an English Court has been asked to consider whether an implied term ought to be read into a lease requiring the return of overpayments when a tenant exercises a break clause.

Some context

5. Before looking at the decision itself, it may be useful to remind ourselves why the issue is of such importance.

6. As is well known, where an option to determine is subject to conditions, those conditions must be strictly complied with. Typically, the option is conditional on payment of the rent and/or performance by the tenant of his covenants. Such a condition is treated as a condition precedent[1]. The date by which there must be compliance is, strictly speaking, a question of construction, and historically, at least in the context of options to renew, there has been debate about whether the relevant date for compliance is the date on which the tenant seeks to exercise the option, the date of determination, or both[2].

7. But modern tenant break clauses are almost always drawn in terms which require compliance up to the date of determination.

8. Separately, as is also well known, at common law rent cannot be apportioned in respect of time. The Apportionment Act 1870 alters the position so far as rent payable in arrears is concerned, but the Act does not apply in respect of rent payable in advance[3].

9. So the problem for the tenant who has covenanted to pay rent in advance and wants to exercise a conditional break option which determines the lease part-way through a rent period is: how much should my final rent payment be, an apportioned amount or the whole instalment? To pay the former runs the risk of non-compliance with the condition precedent; to pay the latter, begs the question whether the overpayment can be recovered.

10. The perils of taking the first option are illustrated by the decision in *PCE Investors Limited v Cancer Research UK* [2012] 2 P&CR 5, in which Peter Smith J rejected the tenant's argument that, as a matter of construction, the

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1 *Greville v Parker* [1910] AC 335.

2 See for example, *Finch v Underwood* (1876) 2 Ch D 310, per Mellish LJ, at 315-6, and *West Country Cleaners (Falmouth) Ltd v Saly* [1966] 1 WLR 1485.

3 *Ellis v Rowbotham* [1900] 1 QB 740. That was a forfeiture case but it is clear from the judgments of A.L. Smith LJ and Romer LJ that the decision did not turn on that fact, and is not

terms of its underlease only required it to pay the apportioned rent[4]. Construction arguments seeking to justify apportionment were also rejected in *Re A Company* [2007] BPIR 1, and *Quirkco Investments Ltd v Aspray Transport Ltd* [2012] L&TR 282 and *Canonical UK Ltd v TST Millbank LLC* [2012] EWHC 3710 (Ch).

11. There is also often a further conundrum facing the tenant in situations where there are other pre-conditions to the exercise of the right to break which remain outstanding at the date when the final rent payment falls due. In those situations, even if apportionment would be justified as a matter of construction if the lease determines, at the date when that rent falls due it cannot be said that the lease will definitely determine on the break date. Logic dictates that in this situation the full period of rent is due (because at that point it cannot be said that it is not) and that it must therefore be paid[5].

12. Perhaps unsurprisingly, therefore, the prudent tenant has tended to take the second option, and pay the full instalment. But attempts to seek repayment after the break clause has taken effect, of that portion of the rent payment which is referable to the period after the break, have met with very limited success. In *Quirko*, HH Judge Keyser (sitting as a Judge of the High Court) struck out a tenant's claim for repayment of rent[6]. Repayment was permitted in the Australian case of *Ocelata Ltd & Ors v Water Administration Ministerial Corporation & Anr* [2000] NSWSC 370, and was said to be justified on either of two grounds, namely a restitutionary claim based on total failure of consideration or an implied term to the same effect. But the facts of that case were somewhat unusual, and in *PCE Investors*, Peter Smith J expressed

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therefore dependent upon the circumstances in which the lease is determined before expiry of the contractual term.

[4] The Court also rejected an alternative argument that the landlord was estopped by its conduct from asserting the true position. See also *Ibred Estates BV v NYK Logistics (UK) Ltd* [2011] EWCA Civ 683, where arguments that the landlord's conduct amounted to a waiver of a different pre-condition in a tenant's break clause (delivery up of vacant possession) failed.

[5] See the reasoning of Vos J in *Canonical*, at para. [28], which is taken as being correct in *Marks & Spencer plc*, at para. [16].

disagreement[7] with the restutionary analysis in *Ocelota*. Importantly, however, he expressed no view on whether the alternative reasoning in that case - based on the implication of term to like effect - might be sound[8], thus leaving that issue entirely open.

Marks and Spencer plc – the facts

13. It is against that jurisprudential background that the Court in *Marks & Spencer plc* was asked to consider whether a tenant could recover a number of sums paid to its landlord in respect of rent, licence fees, insurance premiums and service charges.

14. The facts of the case were quite straightforward. Marks & Spencer held four floors of an office building known as "The Point", in Paddington, from BNP Paribas under four separate underleases. Two underleases were dated 25th January 2006, the other two were dated 29th April 2006. They had all been varied on 15th January 2010.

15. The underleases were for a term commencing on 25th January 2006 and ending on 2nd February 2018, and were all contracted out of the 1954 Act.

16. The underleases were in materially identical terms and the Court therefore concentrated on the terms of only one of them. Under that underlease, the tenant was obliged to pay:

    16.1. A basic rent of £919,800 plus VAT per annum, by equal quarterly instalments on the usual quarter days[9];

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6 The Court rejected both a restitutionary argument (based on a total failure of consideration) and a construction argument: see paras. [63]-[64].

7 At para. [49].

8 *PCE Investors* was not a repayment case, and it was therefore unnecessary for him to do so.

9 There was an initial 18 month rent-free period and also rent review provisions, which are immaterial.

16.2. A Car Park Licence fee of £6,000 per annum, which was also reserved as rent and again payable by equal quarterly instalments on the usual quarter days;

16.3. The insurance premium paid by the landlord, which was payable on demand; and,

16.4. A service charge, which was payable by on-account payments on the usual quarter days, with a further balancing charge.

17. By clause 8, the Tenant had the option to break on two separate dates. The first break date, which is the material one, was 24th January 2012. For our purposes, the material pre-conditions to the exercise of that option were that:

"8.3 …. on the break date there are no arrears of Basic Rent or VAT on Basic Rent; and

8.4 …. on or prior to the First Break Date the tenant pays the Landlord the sum of £919,800 plus VAT."

18. The tenant served a break notice on 7th July 2011 which was expressed to determine the underlease on 24th January 2012.

19. On 19th July 2011 the landlord invoiced the tenant in respect of the insurance contribution which related to the period 1st July 2011 to 30th June 2012.

20. On 8th December 2012 the landlord invoiced the tenant for the Basic Rent, Car Park Fee and service charge said to fall due on 25th December 2011, but – perhaps ironically in view of the position which it subsequently adopted – not for the full quarter, but only for sums calculated on the basis that the tenant's liability was limited to 24th January 2012.

21. Notwithstanding the sums invoiced, on 25th December 2012 the tenant paid the Basic Rent, Car Park Fee and service charge contribution for the full quarter beginning on 25th December 2011.

22. On or about 18th January 2012, the tenant also paid the sum of £919,800 plus VAT specified in clause 8.4, and as a result, the underlease came to an end on 24th January 2012.

23. Then the inevitable happened. The tenant wrote pointing out that it had paid more than the sums demanded in the 8th December 2011 invoices (without apparently explaining why it had done so) and asking for repayment of the excess. The landlord refused, saying that the amounts invoiced were a mistake (again, without apparently explaining how the mistake was made) and that invoices in respect of the balance would be issued. And thus, the battle lines were drawn.

Marks & Spencer plc – the decision

24. The tenant ran three arguments in support of its claim for repayment of the alleged excess, namely that: (1) the lease contained an express term entitling it to repayment; alternatively, (2) there was an implied term to that effect; alternatively, (3) it was entitled to restitution on the grounds of a total failure of consideration.

25. The Court rejected the restitution argument. It also concluded that the lease could not be construed as containing an express term entitling the tenant to repayment of the excess. It did, however, find an implied term to that effect, and ordered repayment of excess Basic Rent, Car Park fee, and insurance premium, in each case apportioning on a daily basis[10].

[10] That method of apportionment is plainly uncontroversial as regards the Basic Rent and Car Park fee, but there may be room for argument as regards the insurance premium: see paras. [51]-[52]. The landlord conceded the service charge claim during the hearing.

26. The decision in relation to the restitution argument is unsurprising, since it is entirely consistent with *Quirko* and *PCE Investors*.

27. The decision as regards the express term argument was expressed as follows[11]

> *The short answer is that the lease does not contain an express provision which confers on the tenant a right to recover part of the quarter's rent nor imposes on the landlord an obligation to repay a part of a quarter's rent. The Claimant points to the words "proportionately for any part of the year" but those words do not allow the tenant to pay only a part of a quarter's rent on 25th December 2011 still less do they provide for the tenant to be entitled at a later date to claim to recover a part of a quarter's rent from the landlord.[emphasis added]*

28. The words highlighted reflected a conclusion which the Court had earlier reached, the basis for which needs to looked at in more detail because it also underpins the Court's reasoning in relation to the implied term argument.

29. The conclusion that the lease did not permit the tenant to pay only part of the quarter's rent was based on the following propositions:

(1) As a matter of construction, the amount of Basic Rent payable on the last quarter of the term before expiry by effluxion of time, i.e. the 25th December 2017 quarter, would only be a proportionate part for the period from that date to 2nd February 2018[12]. Interestingly, although the Court considered that the words "*proportionately for any part of a year*" in the reservation of rent made the position clear, it made the point that it would have reached this conclusion, as a matter of common sense, even in the absence of such words;

(2) If, on 25th December 2011, it had been certain that the term would end on the 24th January 2012 break date, then the tenant would have been in the same position as it would have been as at 25th December

[11] At para. [29].

2017, and only be obliged to pay an apportioned part of the quarter's rent[13];

(3) But, because one of the conditions remained to be fulfilled at that date (namely the payment of the £919,800 plus VAT compensation) the position was not certain. The choice was between construing the obligation as being (a) to pay the whole quarter; or, (b) simply to pay the apportioned part on the quarter day (with the balance to be paid at an unspecified date in the future if the break did not take effect). Consistently with the decisions in *PCE Investors* and *Canonical UK*, the Court preferred the former interpretation[14].

30. The Court's analysis of the implied term issue appears at paras. [30]-[40] and repays reading in full. After quoting from Lord Hoffmann's opinion in the Privy Council case of *A-G of Belize v Belize Telecom Ltd* [2009] 1WLR 1988, the learned Judge when on to say[15]:

> *Accordingly, I have to ask whether the implied term contended for by the Claimant would spell out what the instrument, read against the relevant background, would be reasonably understood to mean. I have already held that the lease expressly provides that, in a case where the break clause is not operated, the rent is payable for the term to 2nd February 2018 and not for any period after that date. Further, I have held that if on the last quarter day before a break date it was certain that the terms would end on the break date then the provisions as to the payment of rent by instalments do not require the lessee to pay a full quarter's rent but only an apportioned part of a quarter's rent. That leads a reasonable person reading the clause to expect that where the break clause is operated to take effect on 24th January 2012, the rent is payable for the term to 24th January 2012 but not for any period after that date.*

31. The Court then identified a number of factors which supported that conclusion:

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12 At para. [27].
13 Para. [28].
14 Para. [28].
15 Para. [35].

(1) The payment of a sum by way of compensation equivalent to one year's rent showed that the parties had turned their minds to the question of compensation and made it unlikely that the lessor could retain the full quarter's rent in addition;

(2) The reference to payment by "instalments" suggested an obligation to pay the full amount due but no more;

(3) The reference in the lease to the rent being reserved "*proportionately for any part of the year*" also supported the conclusion that it was "fairly obvious" what the parties thought should happen in this case.

32. Lastly, insofar as the state of the law may be relevant to the question of whether a term should be implied, the Court pointed out that while it might appear obvious now, in light of *Quirkco* and *PCE Investments*, that the lessor was entitled to retain the whole quarter's rent, it was less obvious in 2006 when these leases were entered into[16].

The implications

(i) Some propositions

33. It is always dangerous to seek to extract general propositions from individual cases, still more to do so when the decision turns on questions of the interpretation and implication of terms in a particular lease. Nevertheless, as has been pointed out[17], all but one of the factors which the Court regarded as relevant to its decision are present in almost all modern leases. Thus, the phrase "*proportionately for any part of the year*" is a common phrase, and the description of rent as being payable by instalments is ubiquitous.

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16 Para. [36]. The first reported case in which the principle which has long applied in the case of forfeiture was applied in relation to break notices was *Re A Company* [2007] BPIR 1.

17 See *Overpayment Re-imbursed*, Guy Fetherstonhaugh QC, Estates Gazette 15th June 2013.

34. Accordingly, but with that health-warning firmly in mind, I would tentatively suggest that for a significant number of tenants, the position post *Marks and Spencer plc* is as follows:

(1) The lease is likely to be construed in terms that the tenant is not liable for rent in respect of the period after the date on which a break notice takes effect;

(2) Where the break notice is unconditional at the date when the last quarter's rent preceding the break date becomes due, then the tenant need only pay the apportioned amount on the quarter day;

(3) Where for any reason the break notice remains conditional on that quarter day, then the tenant must pay the whole amount; but,

(4) In that last situation, the tenant is entitled to recover the amount for which it turns out he was not liable.

35. The only factor which was at all unusual in *Marks and Spencer plc*, was the provision for payment of the £919,800 lump sum by way of compensation. But, as the facts of *Canonical* illustrate and experience suggests, that factor may not be as unusual as all that.

36. Moreover, I think there is some doubt as to whether that factor really adds much to the analysis. It was not a factor on which the Court placed any express reliance in construing the terms of the lease[18]. It was only referred to in the passages dealing with the implication of the term regarding repayment[19]. True it is that the existence of such a provision shows that the parties turned their minds to the question of compensation in the event of the break clause being exercised but, of itself, it tells us nothing about what they intended the relationship between the rental obligation and the

[18] See paras. [27]-[28].

[19] At para. [35].

compensation should be. The inference drawn by the Court, namely that this provision made it "*unlikely that the parties intended that, in addition, the lessor would be entitled to retain the full amount of the quarter's rent*", seems to me to be one which depends entirely upon whether the tenant was liable for the rent in the first place, rather than on the existence of the compensation clause.

(ii) A tension between the cases?

37. For the tenant facing the dilemma which I described earlier, the decision in *Marks and Spencer plc* does therefore offer some hope, in two respects. First, those inclined to adopt the cautious approach of paying all sums arguably due so as to ensure that the break notice takes effect, now have some hope that they may be able subsequently to recoup a proportion of those payments. Secondly, those tenants of a braver (not to say foolhardy) disposition, who consider that their break notice is unconditional at the relevant time, now have an argument that they need only make an apportioned payment.

38. But this last point hints at a tension which I think may exist between *Marks and Spencer* and three of the 2012 first instance decisions which I have mentioned (*Quirkco*, *PCE Investors* and *Canonical UK*). The tension arises from the fact that the decision in *Marks and Spencer plc* depends upon drawing a distinction between the tenant's liability for rent (proposition (1) above) and the tenant's obligation to make rental payments (propositions (2) and (3)). By drawing this distinction, the *Marks and Spencer plc* decision is able to steer a rational course through the conundrum which arises where the break notice remains conditional on the last quarter day before the break date by:

(1) Acknowledging the clear terms of the payment obligation; but also,

(2) Deciding that the tenant is not liable for rent in respect of the period after the break clause had taken effect, and thereby providing an appropriate legal context in which to imply a term regarding repayment.

To put it another way, it was essential to decide that the tenant was not liable for rent for the period after the term ended because if it were otherwise there would be no "excess" to be repaid. And, having decided that he was not liable, it was a relatively short step to imply a term that the excess should be repaid.

39. Whether the other three cases, *Quirkco*, *PCE Investors* and *Canonical UK*, make the same distinction between liability for rent and the obligation to make rental payments, or do so to the same degree, is a moot point.

40. In *Quirkco*, the tenant counterclaimed for the return of overpaid rent. The Judge, after citing dicta of Ralph Gibson LJ in *Capital and City Holdings Ltd v Dean Warburg*[20] to the effect that references to "proportionately" and "proportionate" in that lease did not modify the tenant's obligation to pay a full quarter's rent in the event of forfeiture part-way through a quarter, went on:

> *I consider that the words*[21] *relied on …… do no more than deal with the fact that the commencement and expiry of the term did not coincide with quarter days, so that proportionate payments would be required at either end of the lease. No such proportionate payment would be required in respect of the break clause, because the validity of the exercise of the option under that clause would not be capable of ascertainment at the preceding quarter day and because the lease makes no provision for a proportionate payment or for the pro rata recovery of any monies attributable to the period after the expiry of the notice under the break clause. [emphasis added]*

[20] (1989) 58 P&CR 346, at 251.

[21] Which were "*in proportion for any period of less than a year* ".

41. In *PCE Investors*, the reddendum made no express reference to apportionment[22], and Peter Smith J determined the construction argument in relation to apportionment in the following terms:

> *In my view the position on the construction of the Underlease is quite clear. A full quarter's rent fell due on the September Quarter Day. That was payable in advance and on that day it could not have been certain that the lease would terminate on the Termination Date. There is a commercial and sensible certainty in requiring all obligations to operate until the very date of termination but not be retrospectively changed if an early termination occurs.*[23]

42. Only in *Canonical UK* is the distinction between liability for rent and the obligation to make payments alluded to. Thus, Vos J, while acknowledging a number of cases which restate the general principle that rent is a payment for occupation of land that is only payable in respect of the period of occupation, went on to say:

> *As it seems to me, these cases are not in doubt but the question here is not whether ultimately the tenant must pay more than the rent due for the period of its occupation. That might be an issue if the tenant had overpaid and claimed the overpayment back whether in restitution or otherwise. What is in issue here is the contract between the parties. It could provide for quarterly payment in advance, even after service of a break clause, and it could provide otherwise.*[24]

and then, later:

> *As it seems to me, the words of the reddendum [which was clause 3] are not just about the mechanics of payment. Clause 4.1 provides the tenant's covenant to pay the rent. The words of clause 3 provide what rent is to be paid and when. As I have said, if the lease provides for the rent to be paid <u>beyond what is due</u>, there is a further question, which is beyond the scope of this case, as to the procedure, if any, for recovery of excessive payments made.*

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22 Despite the fact that term did not commence or expire on any quarter day.

23 At para. [54].

24 At para. [16].

That may well engage the principle …. about rent being due only for periods of occupation[25] *[emphasis added]*

43. In the end, however, that distinction did not affect the outcome in *Canonical UK*, since in – in common with *Quirkco* and *PCE Investors* - the question of whether the rent condition in the break notice had been complied with was tested by reference to whether or not the break notice was unconditional on the quarter day.

44. There must, however, be an argument that the date by reference to which the efficacy of a break notice is to be judged is the break date. And it seems to me that if by that date a notice is otherwise unconditional, then whether or not the tenant ought to have paid more on the quarter day, it can reasonably be said that the rent is up-to-date since, on the *Marks and Spencer* analysis, the tenant has paid all the rent for which it is liable. On that basis, it could be argued that, if *Marks and Spencer* is correct, then the results in *PCE Investors* and *Canonical UK* ought to have been different.

(iii) Where does this leave tenants?

45. As Peter Smith J observed in *PCE Investors*[26]

" … the most important matter from a business point of view is certainty. The tenant will want to know precisely what obligations fall on him during the lease and upon its termination …"

46. Whether or not the solution proposed by *Marks & Spencer* to the conundrum faced by tenants with a conditional break clause is correct, it can hardly be said that the law in this area is anywhere near establishing a simple, clear and practical set of principles on which landlords and tenants can safely rely.

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25 At para. [27].

26 At para. [27]. A sentiment echoed by Vos J in *Canonical Uk*, at para. [30].

47. Appeals in both the *PCE Investors* and *Canonical* cases have been compromised, but an appeal in *Marks & Spencer plc* is currently due to be heard by the Court of Appeal in March 2014. Given the current level of uncertainty which surrounds this area of the law, this may therefore be one of those rare occasions when, as onlookers, we need not feel too guilty in hoping that the parties fail to settle their differences.

PATRICK ROLFE

5 Stone Buildings
Lincoln's Inn

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