



A point of interest on lease breaks

The recently reported case of *Avocet Industrial Estates LLP v Merol Limited* [2011] EWHC 3422(Ch) provides a very harsh reminder to tenants seeking to exercise lease break rights that any pre-conditions that must be satisfied for the lease to break have to be complied with in full without fail. The tenant's failure to pay interest of only £130 resulted in the lease not breaking on the break date, and the tenant continuing to be liable under the lease for the remainder of the term.

The background facts of the case (the tenant seeking to exercise a lease break right) are extremely common in the existing economic climate, where tenants' rationalisation strategies are leading to substantial numbers of break rights in leases being exercised.

Very often (as in the Avocet case) the right to break a lease on notice is contingent upon all sums due under the lease being paid by the break date.

The two particular questions that arose in Avocet were:

1. Was a payment of a particular sum by cheque (as opposed to cleared funds) on the break date sufficient to count as the required payment by the break date?
2. Was the tenant's failure to pay interest on previous late payments of rent a failure to pay the required "all sums due under the lease", even though the landlord had not demanded that interest be paid?

Cheque/cleared funds

In his judgment, the judge reiterated the old common law rule that, if a debt is to be paid by a particular date, it must be paid in cleared funds and not by way of cheque. However, this rule can be found not to apply either following a specific agreement between the parties, or where a course of dealing between them shows that the rule is not to apply.

The tenant in Avocet had originally paid its rent by cheques which the landlord had accepted. For various reasons, the tenant then reverted to paying by BACS. In these circumstances, the judge was able to find that, because the landlord had originally accepted rent cheques, this meant that there was an implied agreement between the parties that cheque payments were acceptable to discharge sums due under the lease, even though the method of rent payment had subsequently changed to BACS.

The fact that the lease required the tenant to pay by standing order if the landlord so wished was not relevant, as the landlord had never specifically told the tenant that it should pay by standing order.

As a result, the court was able to find that the cheque payment on the break date was a sufficient discharge of the sum then due. The decision might have been different however if the tenant had always made payments by BACS, but on this one occasion had chosen to pay by cheque. In that scenario, the court might well have found that there was no implied agreement that cheque payments would be sufficient, so that the common law rule that cheque payments are not sufficient would still apply.

Interest on late rent payments

The lease in the case required the tenant to pay interest where any payment under the lease due to have been paid had not been paid. There was no reference to the landlord needing to quantify or demand interest before it became due. The tenant had been late with rent payments on a number of occasions in the past, but the landlord had not asked for an interest payment in the run-up to the lease break date.

Although the tenant argued that it might be difficult for it to calculate precisely what sum by way of interest was payable (because the precise date of payment of rent sums might be difficult to calculate depending on how the rent sums had been paid) the court was unsympathetic. The tenant was aware of the relevant interest rate (4% above base) and could, the court felt, have calculated what interest sums were due as a result of rent having been paid late. There was no need for the landlord to make a demand first for the interest to be due and payable.

The annual rent for the premises was £67,500, and the amount of interest on late payments of rent was only around £130. Nonetheless, the court was able to find that because this £130 had not been paid by the break date (and had not even been demanded by the landlord), the lease break did not take effect and the lease (and the tenant's liability under it) continued until its expiry.

The landlord's state of mind

The tenant almost saved the day by an argument based on the landlord's state of mind concerning the interest. The tenant specifically wrote to the landlord on the break date saying that it believed it had paid all sums due under the lease. The tenant submitted that, if the landlord knew on receiving that letter that interest was still due, the landlord should have pointed out this error to the tenant immediately (so it could be corrected) and not waited until after the break date.

The court was minded to conclude that if the landlord had known, on the lease break date, that interest was still outstanding, and that thus in effect the tenant was falling into a trap, the landlord might have been bound to point this out to the tenant to give it a chance for the relevant payment to be made before it was too late. However, on the facts of the case, the court found that there was no evidence to suggest anything other than the failure to pay interest and its consequential effect on the lease break only occurred to the landlord after the break date, when it took legal advice. As a result, the court's decision that the lease did not break because of non-payment of interest stood.

Conclusion

Any tenant faced with a lease break which is conditional upon all sums due under the lease being paid before the break date must ensure that:

1. All payments due should be paid by cleared funds by the break date, unless there is a specific agreement with the landlord that sums can be paid by cheque. A previous course of dealing by the parties whereby cheque payments were accepted might give justification for a further cheque payment, but without specific confirmation from the landlord that such would be acceptable, this may be risky.
2. A careful check is made as to whether interest on late payments of rent and other sums (eg service charge) is likely to be payable if rent or other sums have been paid late in the past. The tenant should not assume that it must have a demand from the landlord before having to pay such interest, so should do its own calculations and pay a sum considerably in excess of those calculations to be on the safe side.

On the landlord's side, the case might be seen as giving an opportunity for landlords to resist tenant's break notices. However, the case did seem to indicate that the option was not open to a landlord deliberately to set a trap by failing to demand sums that might be due, or by remaining silent where a tenant stipulates that it believes it has paid all sums due, when the landlord knows otherwise.

The landlord will not be able to set this trap in advance, but after the event might be able to argue that a trap was, unknown to both parties, set which the tenant has fallen into. In other words, the forward thinking, but Machiavellian landlord will not be assisted by this decision, but the landlord who wakes up to a tenant's default after the event in good faith might be.

If there is an overall lesson for tenants in the case, it is that, when negotiating break rights before the lease has even been signed, break pre-conditions requiring payment of all sums due under the lease are dangerous and are capable of giving rise to harsh (from the tenant's point of view) results. Far better for the tenant to negotiate a break right unencumbered with pre-conditions as to payment of sums due under the lease, or at the least stipulate that the only payments that need to be made are the rent itself (and not subsidiary payments eg of interest).

Key Contacts



Mark Barley
Partner
T: 0845 415 8153
E: Mark.Barley@
bondpearce.com



Patrick Wetherall
Partner
T: 0845 415 6794
E: Patrick.Wetherall@
bondpearce.com



James Rees
Partner
T: 0845 415 6790
E: James.Rees@
bondpearce.com

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