September 2009

Review

Property @ction

Welcome to the second edition of the review prepared by Hammonds' Property @ction team.

In this issue we look at the following:

(i) *"A total break failure"* – the need for accuracy in notices, and in particular in break notices.

(ii) Vacant Possession: Just how vacant does it need to be?

(iii) *"A Victory, but at What Cost?"* – the position taken by the Courts in a case where the costs far exceeded the value of the claim.

(iv) *"The Case of the Guarantor's Obligations and the bust assignee"* – do guarantor's obligations come to an end following disclaimer of a lease?

As always, all feedback and comments are appreciated. Should there be any topics that you would like covered in future editions then please contact a member of the team.

A total break failure …

Tenants, when their businesses are struggling, will look to ways of cutting overheads. This may include redundancies but it also may include the examination of whether to continue occupying particular premises. In situations where break clauses exist, tenants may seek to use these as a way out of leases. However, care is needed with the service of break notices as the case of *Prudential Assurance Company v Exel UK and Another illustrates*[1].

The facts

In 2002, premises in North London were let to two companies, Tibbett & Britten Limited and Tibbett & Britten Consumer Group Limited. The lease was for ten years at a commencing rent of £1 million per year. The tenants had the benefit of a break clause. The break could be exercised on 24 March 2007 on giving nine months' notice.

In 2004, the Exel Group acquired Tibbett & Britten Limited and it changed its name to Exel UK Limited. The second tenant was, and always had been, a dormant company and remained Tibbett & Britten Consumer Group Limited.

On 13 June 2006, the tenants' solicitors served a break notice but only the name of the first tenant, Exel, was cited on the notice. There was no mention of the second tenant. The letter read as follows:

> *We act for Exel UK Limited, the company formally [sic] known as Tibbett & Britten Limited. As the solicitors and authorised agents of Exel UK Limited we HEREBY GIVE YOU NOTICE pursuant to clause 7.2 of the Lease to determine the term granted by the Lease on 24 March 2007.*

By the time the error had been noticed, the opportunity to break had been lost.

The Arguments

The tenants argued that the notice was valid as their solicitors had been instructed by, and were authorised to act on behalf of, both companies. The landlord was aware that the solicitors were instructed by both companies as a result of other matters.

1 *Prudential Assurance Company Limited v Exel UK Limited & Another [2009] EWHC 1350*

The landlord, however, relied on the fact that the law requires any notice to be clear and to unambiguously communicate what is meant by it.

It is established that break notices are to be construed objectively. What has to be considered is how a reasonable person, in the light of the background which could reasonably have been expected to be available to the parties, would have understood the notice. A mistake in a notice, even in the identity of the person giving it, will not necessarily invalidate it, provided that in all the circumstances its meaning is clear, the mistake is obvious, and the recipient can safely rely on it.

Decision and Comment

The Court ruled that the notice would not unambiguously have been understood by a reasonable recipient to be an effective notice. Its terms would generate "*real doubt*", in the words of the judge, as to whether it was served on behalf of the second tenant, Tibbett & Britten Consumer Group Limited. The result is that the lease, instead of coming to an end, will continue until 2012 although it is understood that the tenants have been given permission to appeal.

Break notices can be problematic, particularly if the lease lays down pre-conditions which must be satisfied before the break date. Attention can often be taken up with looking at these conditions. However, particular care must be paid to the notice itself to ensure that it is valid. There may be a particular way a notice needs to be served, or it may need to be served on a particular person and/or address.

Confusion can arise when the tenant is part of a group of companies, particularly if the lease has been assigned intra-group or if one of the companies in the group has changed its name. The deeds for the property should always be examined in full to check the identity of the current tenant. Appropriate searches, at the Land Registry and Companies House, should be made. The time spent carrying out such checks pays dividends bearing in mind that if the notice is incorrect, a tenant may be exposed to a further five years' liability under the lease.

Tenants must be aware that, more than ever, landlords will be scrutinising the terms of notices served by their tenants. Mistakes do not always invalidate a notice but if the notice would leave a "reasonable recipient" in doubt as to its true meaning then problems will follow.

Vacant possession: just how vacant does it need to be?

Many tenants' break clauses require, as a condition before the break is effective, the tenant to give vacant possession of the premises at the break date. It is rare that this obligation is qualified or diluted in any way by reference to reasonableness, substantiality and so on. There can often be arguments as to what the tenant should and should not remove from the premises.

Authorities

In one recent case, *Legal & General Assurance Society Limited v Expeditors International (UK) Limited*[2], the Court of Appeal decided that if the exercise of a break clause is conditional on the giving of vacant possession, and this is not precisely complied with, then the break option is not exercised even if no harm is caused by the failure to comply. Even a day's delay in giving vacant possession is fatal and means that the break has not taken effect.

In *Scotland v Solomon*[3], the High Court repeated the rule, set out in earlier authorities, that "*subject to the rule de minimis a vendor who leaves property of his own on the premises on completion cannot, in our opinion, be said to give vacant possession, since by doing so he is claiming a right to use the premises for his own purposes, namely, as a place of deposit for his own goods inconsistent with the right which the purchaser has on completion to undisturbed enjoyment*".

Sub-tenants remaining in the property at the end of the lease or even trespassers who have broken in, and who are there at the break date, can frustrate the requirement to give vacant possession. The reason for this is that it is an obstacle preventing the owner from taking back the land and it substantially interferes with the owner's enjoyment of the premises.

The basic test, adopted by the Courts, is whether what is left behind impedes the right to physical enjoyment. It must, however, substantially interfere or prevent the enjoyment of the right of possession of a substantial part of the property. Therefore, for example, if a cellar has been left filled with valueless rubbish including sacks of hardened cement and empty drums, which would cost the owner a great deal of money to remove, then vacant possession will not have been provided.

The new *Code for Leasing Business Premises in England and Wales* is the result of a pan-industry discussions between landlords, tenants and the government. Instead of referring to vacant possession, it refers to giving up occupation. This is less onerous, arguably, than vacant possession but the fact remains that if a break option is conditional on vacant possession being given then it must be complied with.

Guidance

Drawing the authorities together, the following main points emerge regarding vacant possession:

(i) If there are trespassers in the premises then the premises are not vacant. The owner is not getting vacant possession if the land is occupied by someone else. Steps must be taken, well before the break date, to ensure that there is no one else in the premises and that they are as secure as possible.

(ii) The retention of keys beyond the break date is probably fatal to the giving of vacant possession. It does not necessarily matter that the landlord has his own keys. If the keys have been lost then a tenant should take the initiative and change the locks and provide the landlord with the new keys. Also, if the tenant has installed an alarm, he must communicate the code to the landlord so that there is no barrier to the landlord entering the premises.

(iii) The leaving of items that substantially prevent or interfere with enjoyment of a substantial part of the property should be removed. The continued presence of employees, the ongoing use of the premises for storage and so on will likely fall foul of vacant possession requirements. If there is any doubt then advice should be obtained. It might also be a good idea to ask the landlord to inspect and obtain the landlord's agreement that what is being left behind does not breach the requirement for vacant possession.

2 *Legal & General Assurance Society Limited v Expeditors International (UK) Limited [2007] EWCA Civ 7*

3 *Barrymore Ignatius Scotland & Another v Winston Christadoss Asir Solomon & Another [2002] EWHC 1886 (Ch)*

"A victory, but at what cost?"

Litigation can be expensive and this is even more so where there are complexities, points of principle or large sums of money involved.

Whilst the basic rule is that the winner will have his costs paid by the losing party, the Courts have a great deal of flexibility in respect of what costs orders to make. Everyone involved in litigation, from the lawyers to property professionals to the parties, must therefore bear in mind that a victory may end up being very hollow. A Court may decide to only award a fraction of costs incurred. Conduct, together with a willingness to settle, will be under the microscope at trial as the case of *Multiplex Constructions (UK) Limited v Cleveland Bridge UK Limited* shows[4].

The Case

Multiplex, the main contractors in the £760 million Wembley stadium development, and Cleveland Bridge, its former suppliers of the steel used in the construction, including the new stadium's iconic arch, counter-sued each other in a £20 million breach of contract case. Cleveland and Multiplex claimed breach of contract against each other and substantial damages. The relationship was a tense one resulting in Cleveland walking off site.

In 2006, the Court of Appeal found that Cleveland was in breach of contract but rather than trying to reach an agreement, the parties appeared to be devoted to litigation for its own sake. Rather than settling the claim, it was left to the Court to determine how much Multiplex owed Cleveland for work done and the damages owed by Cleveland to Multiplex as a result of the contractual breach.

The outcome of the case was that Multiplex recovered damages of around £6 million from Cleveland. However, to get to that point the parties went through four years of litigation, endured a three month trial, incurred legal and expert fees of £22 million and spent £1 million on photocopying.

The Outcome

Multiplex was ultimately successful. It established its claim and recovered £6 million from Cleveland, albeit that it had initially sought a much higher amount. However, the Court ordered that Cleveland only had to pay 20% of Multiplex's costs. The judge, in reaching that figure, was critical of the conduct of both parties and the unwillingness to settle.

Whilst the judge did accept that emotions were running high, he commented how the parties had *"bicycled over the edge of the precipice and plunged into the abyss. Costs were escalating. Huge amounts of management time were being deployed to no useful purpose. Neither party was going to escape from the abyss with any financial benefit"*.

Guidance and Comment

The following points emerge from the case:

(i) The basic principle, on conclusion of a piece of litigation, is that the winner will get its costs paid by the losing party. However, this is a rebuttable presumption and the Court can impose a different order. In deciding on whether to depart from the basic principle, the Court will look at conduct and what, if any, offers to settle have been made. A winning party should not, therefore, assume that it will recover all of its costs particularly if it has behaved poorly, stubbornly refused to engage in settlement talks and blindly plunged into the abyss.

(ii) An issue based approached will be adopted. If there are a number of issues in the litigation then an overall winner may be hard to find. The judge can make different orders for costs in relation to discrete issues and should consider doing so where a party has been successful on one issue but unsuccessful on another issue and, in that event, may make an order for costs against a party who has been generally successful in the litigation.

(iii) Settlement should be considered at all times, whether by way of without prejudice offer letters or mediation. Any offers made should, of course, be realistic. The making of offers, or suggesting mediation, can provide costs protection as well as giving evidence of reasonable behaviour.

(iv) Whilst parties are obviously determined to do their best in litigation and to maximise the result, this should not be at any cost. As mentioned above, the costs incurred in the Multiplex case were significant. Some 550 files of documents were disclosed and the trial could have taken much longer had the judge not actively managed the case to limit the length of the trial. Reasonableness, proportionality and a willingness to settle must be shown at all times.

4 *Multiplex Constructions (UK) Limited v Cleveland Bridge UK Limited & Another [2008] EWHC 2280 (TCC)*

The Case of the Guarantor's Obligations and the bust assignee

An authorised guarantee agreement (AGA) is a document under which an outgoing tenant guarantees the incoming tenant's performance of various covenants under a lease. It is not uncommon for the AGA, in the event the assignee goes into liquidation and the liquidator disclaims the lease, to require the assignor to take a new lease of the premises. The Court of Appeal, in *Shaw v Doleman*[5], has recently confirmed that a guarantor's liability under an AGA will survive when the tenant goes into liquidation and the lease is subsequently disclaimed.

The Facts

Ms Shaw was the former tenant of a small retail unit consisting of a ground floor lock-up shop and basement. The lease was for ten years from 12 March 2004 at an annual rent of £16,000, subject to review. The covenants covered liability to pay insurance, rent, costs incurred by the landlord in securing payment and interest on any monies outstanding.

On 9 August 2005, Ms Shaw assigned the lease to Ceramic Café Limited and entered into an AGA with the then landlord, Mrs Sarion Rees. She was the mother of the claimant/respondent Mrs Doleman. The terms of the licence to assign granted by Mrs Rees were that Ms Shaw would covenant with her in the form of the AGA set out in the Sixth Schedule to the Lease. The covenant was to be "*throughout the period during which the Assignee is bound by the tenant covenants of the Lease.*" That language is reflected in the terms of the AGA itself.

By 2007 Ceramic Café Limited was in financial difficulties: it fell into arrears with the rent, had a judgment against it, vacated the premises and eventually went into liquidation on the making of a winding up order on 22 August 2007. The liquidator disclaimed the Lease on 31 October 2007. Mrs Doleman sought to make Ms Shaw liable under the AGA. Ms Shaw contested liability. In brief, her defence was that her guarantee liability under the AGA terminated with the disclaimer, which terminated the Lease.

The Decision and Comment

The Court of Appeal held that whilst the disclaimer terminated the lease and the liabilities of Ceramic Café Limited, it did not affect the liabilities of any other person. Therefore, the guarantor remained liable to the landlord under an AGA even though the landlord had not exercised its right to compel the guarantor, in this case Ms Shaw, to take a new lease on disclaimer. In this case, Ms Shaw therefore had to pay the arrears despite the disclaimer of the lease and despite the fact that she had ceased occupying the property some two years previously.

Where a party wishes or intends its liability to come to an end then express provision must be made. The failure to do so will mean, as it did with Ms Shaw, that obligations continue despite disclaimer.

5 *Gabriella Shaw v Hazel Doleman [2009] EWCA Civ 279*

FURTHER INFORMATION

For further information please contact:

Patrick Walker
Director for Advocacy
T: +44 (0)113 284 7566
E: patrick.walker@hammonds.com

Sally Lodge
Partner
T: +44 (0)113 284 7102
E: sally.lodge@hammonds.com

William Lawrence
Partner
T: +44 (0)20 7655 1551
E: william.lawrence@hammonds.com

Caroline Wort
Senior Associate
T: +44 (0)121 222 3405
E: caroline.wort@hammonds.com

Helen Hoath
Senior Associate
T: +44 (0)161 830 5068
E: helen.hoath@hammonds.com

Hammonds

Berlin

Hammonds LLP
Unter den Linden 14
10117 Berlin Germany
Telephone +49 30 7261 68 000
Fax +49 30 7261 68 001

Birmingham

Hammonds LLP
Rutland House
148 Edmund Street
Birmingham B3 2JR
Telephone +44 (0)121 222 3000
Fax +44 (0)121 222 3001

Brussels

Hammonds LLP
Avenue Louise 250
Box 65
1050 Brussels Belgium
Telephone +32 2 627 7676
Fax +32 2 627 7686

Leeds

Hammonds LLP
2 Park Lane
Leeds LS3 1ES
Telephone +44 (0)113 284 7000
Fax +44 (0)113 284 7001

London

Hammonds LLP
7 Devonshire Square
London EC2M 4YH
Telephone +44 (0)20 7655 1000
Fax +44 (0)20 7655 1001

Madrid

Hammonds LLP
Plaza Marques de Salamanca 3-4
28006 Madrid Spain
Telephone +34 91 426 4840
Fax +34 91 435 9815

Manchester

Hammonds LLP
Trinity Court
16 John Dalton Street
Manchester M60 8HS
Telephone +44 (0)161 830 5000
Fax +44 (0)161 830 5001

Munich

Hammonds LLP
Karl-Scharnagl-Ring 7
80539 Munich Germany
Telephone +49 89 207 02 8300
Fax +49 89 207 02 8301

3234/09/09

Paris•

Hammonds Hausmann
4 Avenue Velasquez
75008 Paris France
Telephone +33 1 53 83 74 00
Fax +33 1 53 83 74 01

Hong Kong•

Hammonds
Suites 3201-05, 3217-20
32nd Floor Jardine House
1 Connaught Place
Central Hong Kong
Telephone +852 2523 1819
Fax +852 2868 0069

Beijing+

Hammonds Beijing
Representative Office Hong Kong
Suite 1419 - 20
South Tower Beijing Kerry Centre
1 Guang Hua Road
Chao Yang District
Beijing 100020 China
Telephone +86 108529 6330
Fax +86 10 85296116

• Affiliated undertakings of Hammonds LLP + Representative Office

WWW.HAMMONDS.COM