

What's the refunds policy for rent?

Summary

The Court of Appeal has set the law straight on the debate over whether a term can be implied in a lease to enable a tenant to get back that part of the advance payment of rent (“the overpaid rent”) which relates to a period (“the broken period”) after the break date, by when the lease will have terminated.

In an unanimous decision, the Court of Appeal has held that there is no precedent for implying a term for repayment of the overpaid rent for the broken period and that a reasonable person would conclude that if the parties had really intended there to be an implied term for repayment they would have made express provision for it.

What was the issue?

The appeal concerned a break clause in a lease. Tenants often negotiate such clauses, recognising that the landlord may well demand compensation, often in the form of a “break premium”, payment of which is made a pre-condition under the break clause. In this case, the parties negotiated a break premium but said nothing about apportionment of rent for the broken period, which the lease required the tenant to pay in advance on the usual quarter days.

The issue for decision was whether a term could be implied into the lease that, if the lease is terminated by the tenant exercising his right to terminate it under the break clause, and the tenant has paid the rent due on the last quarter day in full, the tenant could claim back the overpaid rent which related to the broken period.

What is the test for a term being implied?

The applicable test for a term being implied is set out in the speech of Lord Hoffman in the Privy Council case of *A.G. of Belize v Belize Telecom Ltd*¹ namely:

“21 It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean.....the question can be reformulated in various ways which a court may find helpful in providing an answer – the implied term must “go without saying”, it must be “necessary to give business efficacy to the contract” and so on.....There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?”.

What did the judge at first instance decide?

At first instance, the tenant argued that, as it was paying a substantial break penalty to the landlord to break the lease, the overpaid rent for the broken period should be returned. The tenant put its claim on several bases including: (i) the express terms of the lease, (ii) restitution; (iii) total failure of consideration; and (iv) implied term. Although he found against the tenant on all but one point, Mr Justice Morgan in the High Court agreed with the tenant and held that there was an implied term in the lease that the overpaid rent should be repaid, following the operation of the break. The core reasoning of the judge was that:

- a reasonable person would consider that such a term was to be implied because the tenant should be in the same position as a tenant who paid the break premium on the last quarter day (“the same position conclusion”); and
- the break premium amounted to a year’s rent (before any rent review) and so the parties could be taken to have agreed that this was the full amount of compensation for the landlord if the tenant exercised his right to determine the lease under the break clause and in those circumstances they were unlikely to have considered that the landlord should retain the rent for the broken period as well (“the full compensation conclusion”).

¹ [2009] 1 WLR 1988

The judge reinforced his principal reasons by a number of further reasons as follows:

- the implications of the case law (rejecting an implied term) may have been less obvious at the time the lease was drafted than they were at the date of the judgment.
- in view of the fact that rent is reserved “proportionately for any part of a year” and that the quarterly payments were “instalments”, it may have been fairly obvious what the parties thought should happen in such a case.
- a clause entitling the tenant to repayment could be easily and clearly drafted and was not inconsistent with other provisions in the lease.
- previous cases which rejected claims for repayment of rent for a broken period following the exercise of a break clause or forfeiture had not considered whether there might be an implied term for repayment.
- as a cross check, the judge asked whether it was necessary to imply the term. He held that the implied term was necessary to give business efficacy to the lease.

Why did the Court of Appeal reach a different conclusion?

The Court of Appeal held that although Mr Justice Morgan had applied the correct test for an implied term, the way in which it had been applied in this case was wrong. It concluded that when all the circumstances were considered, the correct inference to draw was that the parties proceeded on the basis that the loss from overpaid rent for the broken period should lie where it fell. Thus no term for repayment could be implied.

The core reasoning for the decision was as follows:

- it would have been obvious to the parties before they signed up to the lease that it was possible that rent would have to be paid on the last quarter day in full for a period which went beyond the break date. They would therefore have made some provision for that case.
- the parties must have had some discussions about what was to happen on termination by operation of the break clause because certain clauses in the lease dealt with the consequences of termination.

- case law gave no support for the implication of a term of the kind argued by the tenant and such case law formed part of the admissible background against which the lease was to be construed.
- a reasonable person would conclude that if the parties had really intended there to be an implied term for repayment they would have made express provision for it.
- there is no general principle that a tenant should only pay under a lease for what he actually received. And the words “proportionately for any part of a year” do not apply in a case when on the last quarter day, there is no certainty as to whether termination will take place on the break date.
- rent is not simply a payment to the landlord for the use and occupation of the premises: it is also used as a yardstick for compensating a party for some loss incurred by entering into a lease or by operation of one of the rights conferred by it.

The Court also suggested in obiter that the tenant could make a proportionate payment of rent on the last quarter day if he had by then also paid the break premium but it did not rule on this point as it was not fully argued by the tenant.

What are the implications of this decision for landlords and tenants?

The decision shifts the balance of power back into the hands of landlords, especially as it follows hot on the heels of another Court of Appeal decision in *Friends Life Ltd v Siemens Hearing Instruments Ltd*² which held that a notice to exercise a break right was ineffective as it did not comply with all the requirements clearly stated in the lease and a recent Court of Session decision in *Arlington Business Parks GP Ltd v Scottish & Newcastle Ltd*³ which held that a break notice to exercise a break right was also ineffective because the tenant had failed to comply with its repair and maintenance obligations under the lease at the date of service of the notice as required by the break clause. These cases are a reminder that the conditions attached to a break clause could be more onerous than they appear at first glance and that there is no room for the notion of substantial compliance so far as break options are concerned.

² [2014] EWCA Civ 382

³ Court of Session (Lord Malcolm) 29 April 2014

The decision is however welcomed as it creates more certainty for landlords and tenants by affirming accepted practice that where a break clause is conditional upon the tenant being up-to-date with payments under the lease, the tenant must pay the full quarter's rent (even though the lease would terminate midway through a quarter). In practice, for tenants this means that going forward it will be much harder to find legal arguments for the repayment of overpaid rent and so any well-advised tenant will continue to pay the full rent due where a break date falls between rent payment dates with no expectation that they will be reimbursed after the event. For any tenants currently negotiating the insertion of a break clause in a new lease, they should consider whether they wish to provide for the break date to be the day before a rent payment date and secondly seek an express term providing for the reimbursement of any overpaid sums relating to the period after the break date.

Marks and Spencer PLC v BNP Paribas Securities Services Trust Company (Jersey) Limited and other [2014] EWCA Civ 603

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