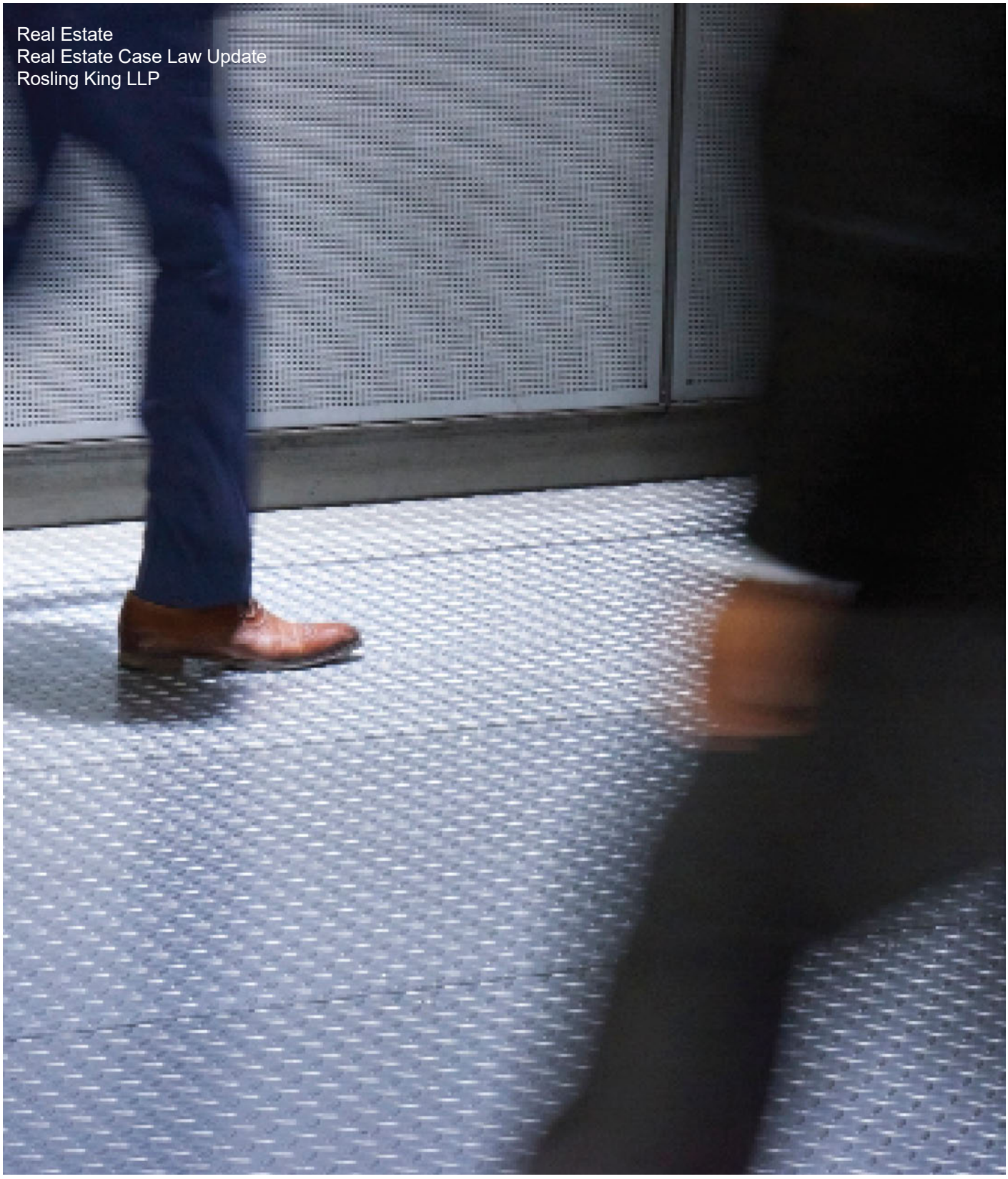
Real Estate
Real Estate Case Law Update
Rosling King LLP

Background

On 5 August 2011, the EMA and Canary Wharf entered into an agreement for lease and a separate construction management agreement in relation to the property. Canary Wharf would complete the development of the property under an agreed shell and core specification with two levels of fit out; one to the developer's standard finish and the other to the EMA's specifications. The EMA's requirements included the building of a conference centre and meeting rooms providing for a "UN-style" seating environment for delegates as well as an unusually large restaurant/kitchen facilities.

On 21 October 2014, pursuant to the agreement for lease, the lease of the property was entered into. It is for a 25 year term, commencing on 1 July 2014 and expiring on 30 June 2039, the rent a reported £13 million per year, and whilst there are alienation clauses (for sub-letting and assignment), crucially, there is no break clause.

In August 2017 (following the UK government's notice of its intention to withdraw from the EU in March 2017), the EMA wrote to Canary Wharf to say that it would be treating Brexit as an event of frustration of the lease. The EU subsequently passed legislation to move the EMA's headquarters to Amsterdam. Canary Wharf sought a determination of the issue and the hearing was expedited so that the judgment could be issued before the (current) 29 March Brexit deadline.

EMA's case

The EMA argued two types of frustration would occur due to Brexit: (1) frustration for 'supervening illegality' and (2) for 'common purpose'. The EMA put forward five reasons why it believed the lease was frustrated due to 'supervening illegality':

1. Brexit would cause it to lose certain privileges and immunities, necessary for its proper functioning and independence;
2. As a matter of EU law, neither it nor any other EU entity could legally use the premises after Brexit;
3. Brexit would prevent the EMA, as a matter of law to exercise the rights conferred on it by the lease i.e. it would be unable to assign or sublet the premises;
4. It would be *ultra vires* (outside its authority) for it to meet its obligations under the lease, including the obligation to pay rent; and
5. EMA's future effectiveness would be impaired by having to pay rent both in London and Amsterdam.

In summary, the EMA alleged the withdrawal of the UK from the EU would cause the lease to be frustrated because the UK's withdrawal would trigger a number of legal changes relating to EMA's legal capacity to continue with the lease.

In respect of frustration for 'common purpose', the argument hinges on whether the supervening event (in this case Brexit) renders the parties' performance of the lease into something radically different. There is a relevant body of caselaw in this area known as the "coronation" cases, where rooms and boats had been reserved to view the coronation of King

Edward VII but the event was subsequently postponed due to the illness of the King. In one of those cases, *Krell v Henry*, the contract for a 'room with a view' was deemed discharged due to frustration because the facilities to be provided by the owners were no longer of any use for that contractually contemplated purpose.

The Decision

In considering the issues, Mr Justice Smith undertook an in-depth review of the law of frustration to resolve whether the lease was frustrated by 'supervening illegality' or by reason of frustration of 'common purpose'.

1. Frustration by 'supervening illegality'

   It was held by the judge that the *European Union (Withdrawal) Act 2018* incorporated European Union law that previously applied to the United Kingdom by virtue of its status as Member State into the United Kingdom even though the United Kingdom would be a non-EU country post-Brexit. As such, the EMA would not lose its privileges and immunities because of Brexit. Whilst it was admitted those protections would be substantially degraded they would not necessarily vanish altogether.

   Furthermore, the EMA had the power to acquire or dispose of property in a non-EU country. The EMA had the capacity to enter into a lease for 25 years which envisaged EMA leaving the premises altogether mid-term, by way of assignment or sub-let, therefore it has the capacity to deal with premises properly acquired when it became surplus to its requirements. Additionally, there was no rule of law or legal obligation that prevented an EU entity from being located in a non-EU country, even though there were good reasons – both political and practical – for not doing so.

   Even if the EMA did not have the requisite capacity to continue to use and/or dispose of the premises or to pay rent, the lease could still not be frustrated by supervening illegality. The English law of frustration applies to the transaction and discounts (except in limited circumstances which did not apply here) any foreign law which relates to the incorporation of a party. So the English law of frustration governed the performance of the lease, not EMA's capacity to enter into the lease which was governed by EU law. Even if a supervening illegality existed under EU law (being the EMA's jurisdiction of incorporation), the English law of frustration could not be so extended to take into account that supervening illegality occurring under foreign law. There was nothing in English law that prevented the continuance of the lease.

   Moreover, even if EMA would have lost its capacity because of Brexit, the lease would still not have been frustrated because it could be argued that the frustration was self-induced. This was because the EU could have legislated for the winding down of the EMA in the UK rather than (as the judge put it) "simply baldly ordering the relocation of the EMA".

2. Frustration for 'common purpose'

In considering this ground of frustration, the Court had to consider the foreseeability of the supervening event to determine what the parties were contemplating at the time of entering into the agreement. The judge looked back at the period when the agreement for lease was entered into (August 2011) and heard from the parties' experts about what were the discussions and prospects of Brexit at that time (the judge was keen not to be influenced by the deluge of material that currently exists on the topic which may be skewed with the benefit of hindsight). He held that Brexit was not foreseeable when the agreement was entered into. However, he reasoned that, whilst the "seismic event" of Brexit was not in the parties' (or many other's) contemplation, the involuntary departure of the EMA due to something outside of its control was something that was provided for in the lease because it contained certain alienation provisions. The risk of EMA's departure for any reason (including an unforeseen Brexit) is not one that the parties shared a common expectation or view; in fact the parties' positions were divergent (as would be expected under a commercial lease). Canary Wharf were keen to secure the circa £500 million rental income from the EMA and the EMA sought to secure bespoke premises at the best rate. Accordingly, there was no 'common purpose' (like in the coronation cases) to be frustrated. Ultimately, it seems the EMA chose to enter into a long-term lease with long-term obligations. As the judge held, it could have opted for different premises, with a shorter lease; it could have negotiated a break clause and paid a far higher price foregoing the inducements it received.

Commentary

There will undoubtably be more Brexit-related cases to come and in fact the EMA have been granted leave to appeal, which is not surprising given the significance of this case. The prospect of a reversal of the decision on appeal will likely have property market and others on tender hooks but the EMA's chances of success appear limited. The overall sense of the High Court judgment is that frustration should not be used by the EMA to get out of what was in hindsight a bad bargain. It seems unlikely the Court of Appeal will deviate from High Court's reasoning but we will have to wait and see.

For further information, please contact Alex Pelopidas or the Partner with whom you usually deal.