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COMMERCIAL LEASES UPDATE

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ABOUT RICHARD SNAPE

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Learning Outcome: To give an increased knowledge of the subject matter. To update on current issues, case law and statutory provisions and to be able to apply the knowledge gained in the better provision of service to the client.

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THE LEVELLING-UP AND REGENERATION BILL 2022-23

This was announced in the Queen's Speech and introduced into the House of Commons on 11 May 2022. Part 8 allows local authorities to designate high streets or town centre streets or areas as being important to the local economy because of a concentration of high street users. This will include shops, offices, restaurants, pubs, meeting places, community halls and light industrial units, but not warehouses.

If premises are vacant for at least one year or 366 days or more in the last two years, but are suitable for high street use the local authority can notify the landlord that they intend to put the premises up for high street rental auction. The local authority must consider that occupation would be beneficial to the local economy, society or environment. Occupation involves regular presence of people at the premises but there is no clear definition of what this means, for instance, what about use as storage? Premises includes the whole or part of the building or any that with reasonable adaptation can be used as such.

The first stage is for the local authority to serve an initial notice which may last up to 10 weeks. During this period the owner cannot rent out the premises without the consent of the local authority unless a contract is already in place. The local authority must consent to letting if the tenancy is for at least one year and the local authority is satisfied that the lease will result in occupation by the regular presence of people.

If the premises have not been let within 8 weeks the local authority may serve a final letting notice expiring a maximum of 14 weeks later. During the period the landlord cannot let out the premises or carry out works without local authority's consent.

The local authority can then conduct a rental auction for a lease of between one and five years' duration. The lease will be excluded from the **Landlord and Tenant Act 1954**. The local authority acts in its own name but with an indication that it is binding on the landlord. The local authority will give the landlord a signed copy of the tenancy agreement as soon as is reasonably possible. The terms of the tenancy will be down to regulations but it can include a requirement for the landlord to carry out works or allowing the tenant to do works. The local authority must have regard to any representations by the landlord.

The landlord can counter-notice on the final letting notice being served. The counter-notice may include the fact that the landlord intends to carry out substantial works of construction, demolition or reconstruction affecting the premises, or they intend to occupy for their own business or residential purpose.

COMMERCIAL RENT (CORONAVIRUS) ACT 2022: THE LATEST

On 9 November 2021 the Government produced a new **Code of Practice on Commercial Property Relations** following the Covid-19 pandemic. This came into force with immediate effect.

A new Code of Practice replaced this on 7 April 2022. Part 1 is non-statutory and applies to commercial rent arrears generally. Part 2 applies to protected rent debt in the hospitality, leisure and retail sector (see below) and is legally binding. The **Commercial Rent (Coronavirus) Act 2022** applies to businesses that have been adversely affected by Covid-19, ie. the hospitality, leisure and retail sectors. They must also come within the definition of a business tenancy within **S.23** of the **Landlord and Tenant Act 1954** (including excluded leases). The tenant must occupy under a lease as opposed to a licence, at least partly for business purposes. If there is a sublease, the subtenant is almost certainly the person in occupation: see ***Graysim Holdings v P&O Holdings [1996] AC 329.***

On the same day the **Commercial Rent (Coronavirus) Bill 2021 – 2022** received its first reading in the House of Commons. The Welsh Government also adopted the legislation which received the Royal Assent on 24 March 2022 and came into force on that day. Protected rent debt will be ring-fenced. This includes rent, service charge, interest, VAT and insurance rent where arrears fell due during a period when legislation required the tenant to close the premises or cease trading whether in whole or in part. This will include, for instance, shops which were open for click and collection or pubs and restaurants with limited or at seat service or which able to remain open as takeaways. It will also include theatres and cinemas which are limited as to number of attendees. It will include times when premises could temporarily reopen between lockdowns. The commencement date was 21 March 2020 and the very end day 18 July 2021 in England and 7 August 2021 in Wales. Annex A of the Code of Practice has a table as to the relevant dates for various types of business. There is provision whereby this may be extended if there are any future statutory closures. If, for example, a whole quarter's rent is not paid but statutory restrictions ended during the quarter, the protected rent will be apportioned on a daily basis as will interest.

If the rent debt is protected then the parties should negotiate how much payment should be made. If there is no agreement either side can apply for arbitration within six months of the legislation being passed. If the tenant's business is not viable and would not be viable if relief was granted then the claim cannot be heard. If it would be viable, arbitration can write off the debt, give further time to repay including in instalments (for no more than two years), or reduce interest potentially to zero. If the tenant is able to find the arrears then they should pay immediately.

If there is an approved Company Voluntary Arrangement or Individual Voluntary Arrangement or compromise or arrangement then there cannot be arbitration.

The Arbitration Process

Either side can apply for arbitration but there must have been engagement or an attempt to engage with the other side beforehand. The Code recommends a written letter to the other side who then has 14 days to respond. If they do so and agreement cannot be reached, either side can apply for arbitration after 14 days. If they do not respond, then application can be made after 28 days. These time periods may be extended by agreement or by the arbitrator. The arbitrator cannot make a decision if the tenant's business cannot become viable. A non-exhaustive list of factors to take into account include management accounts, gross and net profit margins, bank account information and liquidity ratio. The Guidance suggests that a major factor in determining viability would be whether the tenant has been able to pay their debts after the restrictions have been lifted. The Guidance also states that full bank account details would be preferable as would an audit.

Arbitration will be through an open hearing unless the parties both agree otherwise. The person applying for arbitration will usually pay the costs but at the end of arbitration they will be split equally subject to reasonable behaviour of the parties.

The starting point for arbitration is that it should be intended to preserve or preserve and restore the tenant's business but should also have regard to the landlord's solvency. The tenant would not be expected to go into debt to pay the rent. Guidance suggests that if there are multiple debts owed by the tenant to the landlord then they all should be joined together. It is not clear whether viability is based on the tenant's whole property portfolio or not.

The parties should submit their proposals. In Annex B of the Code of Practice there is a non exhaustive list of factors to take into account.

On 11 April 2022 statutory guidance replaced the previous non-statutory guidance 28 February 2022.

On 14 July 2022 the first arbitration decision was published in the case of ***Signet Trading Limited v Fprop Offices Nominee 4 Limited (2022).*** Signet are tenants of 450 premises throughout the country where they sell jewellery. On 23 March 2020 their shops were mandated to shut down. They kept a skeleton staff at their main offices, but most employees were furloughed and they did not pay rent in relation to the office premises. It was held that as the premises were able to remain open they had not been adversely affected by Covid and therefore there was no ability to make a decision in relation to rent arrears of the office premises.

The Moratorium Period

The moratorium period will last for six months. If arbitration has commenced prior to the end of the six months on 24 September 2022 the application will continue to be heard. During the arbitration period the landlord will not be able to sue in debt, will not be able to enforce a prior judgment debt, enforce Commercial Rent Arrears Recovery, serve a statutory demand or winding-up or bankruptcy order, nor will they be able to draw down or require top up of rent deposits. If an application is made in relation to debt the court must stay proceedings between 10 November 2021 and the date the Act is passed. Current proceedings will continue, but the tenant may apply for relief within six months of the Act being passed and the debt will not be able to be enforced.

THE FIRE SAFETY ACT 2021

The Act finally received the Royal Assent on 29 April 2021. It will not come into force until detailed guidance has been provided. The Act clarifies the Regulatory Reform (Fire Safety) Order 2005 and makes clear that a fire safety risk assessment where there are at least two dwellings in a building must include the exterior, structure, external doors and windows, internal doors which open into the common parts, balconies and other external fixtures. Non-compliance may result in prosecution of the responsible person, ie. the landlord, and buildings insurance may be vitiated. The House of Commons successfully rejected a House of Lords amendment whereby the cost of the assessment and any works would not be added to service charge.

The Act came into force in Wales on 1 October 2021 and in England 16 May 2022. On 22 November 2021, the LPE 1 forms changed, partly to reflect this.

Fire Safety (England) Regulations 2022

These will come into force in England on 23 January 2023. They apply to buildings where there are two or more dwellings and which are 18 metres or more or 7 storeys or more in height. This includes mixed use premises. The responsible person will have to provide electronically details of external wall systems and floor plans to the fire rescue authority. They will also have to provide electronic details of the lifts to be used by fire officers. Such lifts will have to be checked monthly as must essential fire fighting equipment. All entry doors must be checked quarterly and fire doors yearly. Hard copies of floor plans must kept and information provided to leaseholders. Fire safety signage must be provided and be visible in low light.

RECENT COMMERCIAL LEASE CASE LAW

Rent Debt Claims

Bank of New York Mellon (International) Limited v Cine-UK Limited
London Trocadero (2015) LLP v Picturehouse Cinemas Limited [2022] EWCA 1021

The Court of Appeal gave judgment on these cases on 27 July 2022 and confirmed the previous High Court decisions. The first case involved Cine-UK. The second case involved Picturehouse Cinemas and Gallery Cinemas together with their holding company Cineworld who acted as guarantors. No rent had been paid since the beginning of the lockdowns in 2020.

The Court of Appeal held:

1. There was no implied term that rent would not be payable either using the business efficacy test or the obviousness test. Both leases worked without implied terms and allocated to the tenant the risk that the premises could not be used for their intended purpose.

2. If one accepted that Covid restrictions were unprecedented (which was debatable) that was not a good reason to disapply fundamental principles of contract law.

3. Failure of basis could rarely be made out when a valid contract existed and was being performed. The leases contained considered contractual terms setting out circumstances in which the obligation to pay rent would be suspended and pandemic restrictions were not amongst them.

4. The rent suspension clause in the Bank of New York Mellon lease required damage to mean physical damage and did not include financial or non-physical damage caused by Covid restrictions.

The landlords were successful in claiming rent arrears as debt.

Lease or Licence?

Camelot Guardian Management Ltd v Khoo [2018] EWHC 2296 Here K entered into a licence with C to occupy property as a guardian. The property was designed as office space and owned by Westminster City Council. It was stated that K's obligation was to secure the premises against trespassers and to protect the premises from damage. This was held to be a genuine licence.

In ***Ludgate House v Ricketts and Southwark Borough Council [2020] EWCA 1637*** the Court of Appeal held that a guardian scheme gave rise to a licence which did not constitute occupation for business purposes. Ludgate House were still in control of the premises and business rates had to be paid. ***Global 100 Limited v Laleva [2021] EWCA 1835*** here a guardian was held to be the equivalent of a service occupier with a genuine licence and not an assured shorthold tenant.

Global 100 Limited v Jimenez [2022] UKUT 50
S.254 Housing Act 2004 states that to constitute a house in multiple occupation the premises must be used wholly as living accommodation. This was held to apply to guardians as their security aspect was merely a consequence of their occupation. The premises was therefore a house in multiple occupation which required a licence. The occupiers were entitled to rent repayment orders and the

owner was committing a criminal office.

Tenancies at Will and Periodic Tenancies

Under a tenancy at will either side can terminate at any time and a tenancy at will not have the benefit of security of tenure under the **Landlord and Tenant Act 1954**. In the case of ***Javid v Aqil [1991] 1WLR 1007*** the tenant paid three months' rent in advance on entry into the premises whilst negotiating the final lease. They remained and made three further payments of rent. As negotiations were going nowhere, the landlord required the tenant to leave. The tenant claimed that they were a periodic tenant within the 1954 Act. It was held by the Court of Appeal that payment of rent would not give rise to a periodic tenancy but, as the parties were still negotiating, there would be a tenancy at will.

Erimus Housing Limited v Barclays Wealth Trustees (Jersey) Ltd [2014] EWCA Civ 303 In this case, the landlord had granted to the tenant a lease which was contracted out of the protection of the Landlord and Tenant Act 1954. The contracted-out lease came to an end, and although at first there were some attempts to negotiate a new lease, it was eventually accepted that the tenant was holding over on the terms of the expired lease. Heads of Terms for a new contracted-out lease were later agreed, but no new lease was ever completed. Nearly two years after the original lease had expired, the tenant suggested that it should continue to hold over for another six months or so, and the landlord made no objection to this.

In fact, the tenant vacated in September 2012, almost three years after the original lease had expired. The tenant argued that it had validly given three months' notice to quit ending on 28 September 2012, but the landlord argued that there was a yearly periodic tenancy, so that the tenant was required to give at least six months' notice, expiring on the anniversary of the term (so that the lease could not be brought to an end before 31 October 2013).

On appeal, the Court of Appeal unanimously allowed the appeal. Although the progress of negotiations had been slow and lacking any urgency, there was no evidence that the negotiations had ever ceased or been abandoned by the parties because of an inability to agree terms.

Valley View Health Centre v NHS Property Services [2022] EWHC 1393 In early 2007 Valley View partners entered premises the immediate landlord of which was a Primary Care Trust. In April 2013 the landlord's interests passed to NHS Property Services. Rent was paid, but no formal agreement was reached. It appears that there was no negotiation as to a lease for the first four years and after that, negotiations were sporadic and for substantial time periods there seemed to be no negotiation at all. Nevertheless, the High Court held that this gave rise to a tenancy at will on the basis of the above cases. The Court also implied service charge liability primarily in relation to maintenance of the boiler system.

St Andrew's Medical Centre v NHS Property Services [2022] EWHC 1393 Here, the medical centre was given a 15-year lease which terminated in 2019. They then remained negotiating a new lease and paying the rent. Negotiations were temporarily suspended due to a dispute over service charge liability. This also gave rise to a tenancy at will.

Heads of Terms

Pretoria Energy Company (Chittering) Limited v Blankney Estates Limited [2022] EWHC 1467 Here, there were negotiations for Pretoria to have an anaerobic digester on the site of a former flax factory. Heads of Terms were produced in November 2013 for a 25-year lease at £150,000 per annum subject to full planning approval. These were signed by both parties. Unlike a previous draft, they included an exclusivity clause not to negotiate with anyone else until 31 July 2014. Subsequently, it was found that the demolishing of the flax factory, which was to be done at

Blankney's expense, would be more expensive than originally thought and Blankney corresponded with Pretoria to foot some of the bill. Pretoria seems largely to have ignored the correspondence and would not agree undertakings as to solicitor's costs or provide details of their solicitors. In November 2014 Blankney announced that they would be granting a lease to someone else. Nothing happened subsequently until September 2020 when Pretoria brought an action claiming that Heads of Terms constituted a contract and Blankney were in breach. The Court held that **S.2 Law of Property (Miscellaneous Provisions) Act 1989** had been complied with as the Heads of Terms were in writing, signed and contained all express terms. However, they were not intended to be legally binding for the following reasons:

- The exclusivity clause meant that after the lockout period Blankney could negotiate with other people
- There were no key specific terms and no detail. It would be too difficult to imply such terms.
- The Heads of Terms required the lease to be contracted out of the **Landlord and Tenant Act 1954**, but no notice had been served. They referred to the "proposed agreement". This suggested no intention to be legally bound and there is no need to use the words "subject to contract."
- There may have been a different outcome but for the lockout agreement and the legal status of the Heads of Terms should be clear.

Break Clauses

In ***Capitol Park Leeds plc v Global Radio Services [2021] EWCA 95*** the High Court held that a condition precedent as to vacant possession had not been complied with when the tenant vacated but removed ceiling tiles, window frames and grids which belonged to the landlord. The Court of Appeal reversed this decision. All that is needed is that the tenant removes fittings and tenant's fixtures, people, and there is no legal interest remaining. If the tenant has removed landlord's fixtures or is in breach in any other way they can be sued in damages.

Wigan Borough Council v Scullindale Global Limited [2021] EWHC 779 Here, the Council had granted S a 199 year lease of Haigh Hall. S intended to convert the premises into a hotel. The Council had the right to serve a break notice if works allowed under a planning permission were not completed by 31 March 2018. The works were not completed but it was 18 months later that the Council service a two-month break notice. The tenant argued that it must be implied that the break would be served within a reasonable time. The court did not accept this argument but stated that the break notice could be served at any time when the breach was subsisting. The landlord won.

Rent Review

Monsolar v Woden Park [2021] EWCA 96 The case concerned a 15 acre solar farm. The lease was for 24 years and the rent started at £15,000 pa. The rent increased by RPI every year but on a strict interpretation all the previous years RPIs were also added each year. If RPI remained the same as for the last 20 years this would result in a final year's rent of over £76m pa. The Court of Appeal confirmed the High Court decision that this result would be irrational and was a clear mistake. They rectified the clause so that the final year's rent would be £30,000 pa.

Contrast this with the Supreme Court decision in ***Arnold v Britton [2015] UKSC 36***. Where the ground rent of the 99 year lease started at £90 pa but increased every year at 10% compound interest resulting in a final rent of £554,000 pa. The Supreme Court refused to rectify the lease as the wording was clear and unambiguous.

LANDLORD & TENANT ACT 1954

Renewal Terms

A major talking point of the moment is whether the new lease may include a rent suspension provision in the event of lockdown due to pandemic. The burden would be upon the tenant that this was fair and reasonable and reflected in a change of rent. ***WH Smith v Commerz Real Investmentgesellschaft (2021) April, County Court***. The tenants had a lease of premises in a large shopping centre. They were able to remain open during the various lockdowns as the premises included a post office. On a lease renewal the landlord accepted that the new lease would include a rent suspension provision in the event of pandemic but only if the tenant's premises had to close. The tenant argued that their profits were much reduced due to lack of footfall in the shopping centre and therefore they wanted a rent suspension provision if any of the premises had to close due to pandemic. The county court judge decided for the tenant. This case may be instructive although a county court decision does not set a precedent.

The landlord failed in trying to vary the lease so as to the make the tenant liable for the cost of an energy audit, and EPCs and any energy efficiency work. The previous rent based on a 2013 rent review was £953,000 pa. The new rent was £404,666 pa.

In spite of this, in ***Poundland v Toplain (2021) July 2, County Court***, the court refused to change a rent suspension provision to include a pandemic clause. It also refused to include a provision whereby the right to forfeit for any breach would be suspended for the duration of any future lockdown. Following on from the House of Lords decision in ***O'May v City of London Real Property Company (1983)***, the starting point is that the new lease should be on the same terms as the current lease and the landlord would be unfairly prejudiced by any change. The distinguished WH Smith on the basis that in that case the landlord was prepared to accept a pandemic clause but was disputing its extent.

Clipper Logistics v Scottish Equitable (2022) County Court. On a renewal the landlord wished to ban alterations which would bring the premises below an E rating in relation to energy efficiency. He also wanted to be indemnified for the costs of a new EPC if the tenant made alterations which adversely affected or invalidated the EPC and wanted to oblige the tenant to maintain the current EPC rating and return the premises with the current rating. The landlord lost on most of these and it was decided that the changes to alterations covenant were not needed anyway. The lease was changed in relation to returning the premises with the same rating.

W (No. 3) GP v JD Sports (2022) County Court. Here the court held that the Landlord and Tenant Act 1954 did not envisage the possibility of a turnover rent on a renewal as the new rent had to be a market rent and it would be impossible to ascertain which part was a turnover rent.

Grounds of Opposition

GROUND (f) – intention to demolish and reconstruct

S Franses Ltd v Cavendish Hotel (London) Ltd [2017] EWHC 1670 (QB) [2017] WLR (D) 503 [2018] UKSC 62 Here the court accepted that ground (f) could be used even though the work of reconstruction was specifically planned in order to terminate the lease. However, as the work would not commence for 12 months then the intention was not sufficiently immediate.

The Supreme Court decided the case in December 2018 and reversed the first instance decision. In deciding whether ground (f) may be used the question is whether the landlord would have done the work regardless of any intention to repossess.

The Supreme Court decision is obviously welcome to tenants. However, landlords will have to ensure that they can prove that they would still do the proposed works if the property was vacant. The issue of whether the works need to be done soon after possession is obtained was not addressed by the Supreme Court.

In June 2021 there was a subsequent case in relation to the rent for the new lease. Due to the pandemic, the new rent was set at £102,000 pa whereas the original rent was £220,000 pa.

ENERGY ACT 2011

Minimum Energy Performance of Buildings Standard

Energy Efficiency Regulations 2015 - Minimum Energy Performance of Buildings Standard

S.49 of the **Energy Act 2011** required the Secretary of State to introduce legislation on minimum energy performance standards by 1st April 2018 for rented property at the latest.

Firstly, the minimum standard is an E rated building. (The Government is consulting on reducing this and the proposal is to introduce a minimum B rating by April 2030.) It is estimated that around 20% of buildings of rented property will fail on this. Secondly, the legislation will apply to all new leases (with exceptions below). Thirdly, for existing lettings there will be a backstop of 1st April 2023 when they will come within the legislation.

For residential lettings the Government has stated that as of 1 April 2025 the minimum energy rating will be C for new lettings. This will become retrospective on 1 April 2028.

Exclusions are as follows:

- The regulations will only apply to buildings where there is an EPC. There may be lettings in place before the introduction of EPCs in 2007 which therefore escape the regulations.

- Where EPC regulations exempt landlords from providing an EPC, the minimum efficiency regulations will contain the same exemptions, e.g. a short term letting of a building prior to its demolition.

- Lettings under 6 months subject to a maximum of two such lettings to the same tenant.

- Leases where the length is more than 99 years.

- Lettings where the landlord cannot obtain the necessary consents for the efficiency works. Necessary consents can include:

    a) Planning or buildings regulation approval

    b) Consents from lenders or superior landlords

    c) Consent from a sitting tenant to allow the landlord access to do the works.

- Where the works cause a material net decrease in the property's capital value.

There are still some major issues to be determined, for instance whether any non-compliant leases will be illegal and thus unenforceable. There will also be major issues in relation to post 2018 rent reviews and dilapidations claims. In relation to the latter **S.18 Landlord & Tenant Act 1927** might limit the tenant's liability if the landlord has to bring the building up to minimum energy standards in order to re-let it. The tenant may also possibly find themselves liable, especially for leases terminating post April 2023 and April 2020 for residential properties, due to the statutory compliance provisions within the lease.

The **Energy Efficiency of Buildings (Private Rented Property) (England & Wales) Regulation** will apply to any commercial lease of more than 6 months and less than 99 years duration and to residential assured, assured shorthold and protected tenancies and to any other tenancy designated

by the Secretary of State. Any exemption in relation to detracting from value will have to be confirmed by an independent surveyor and will only last for 5 years. The penalties will be a maximum fine of £5,000 or 5% of rateable value for commercial property where the breach has occurred for less than 3 months and a maximum £2,000 fine for residential property. The fine will be doubled after 3 months.

Note: Guidance suggests that the reduction in capital value referred to above should be at least 5%. Any exemption will only last for 5 years and any reduction must be confirmed by an independent surveyor.

Note: According to the guidance the provisions apply to non-domestic lease renewals.

Note: On 23rd February 2017 the Government produced guidance on minimum energy efficiency standards for non-domestic premises. In particular, an exemption must be specifically applied for and will only last for 5 years. If the landlord cannot obtain necessary consents for the work, they must show that they have taken all reasonable steps to obtain such consent. There will be a register of exempt premises. The landlord may also be able to show that he has taken all steps that can be expected and cannot make the property E rated. There will also be an exemption if the landlord can show that the proposed work would not be paid for by the energy savings within 7 years.

If a property continues to be let after 1st April 2023 with a F or G rated EPC then they may be faced with enforcement action and the leasing out of the premises will be unlawful. It is unclear how this affects the landlord and tenant relationship.

If a listed building exemption is being claimed then the landlord must show that any EPC recommendation report would unacceptably alter the appearance of the building.

Any exemptions are personal and will not benefit a purchaser of the reversion who must apply for a new exemption. If they are an unexpected landlord, e.g. an inheritance or disclaimer, they have 6 months to apply for the exemption.