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# Commercial Property Newsletter - Q3 2021

## Commercial Leases and Opting Out of Security of Tenure – Test Case Ruling

Commercial landlords and tenants may contract out of the security of tenure provisions of the Landlord and Tenant Act 1954, but only if certain conditions are met. One of those conditions came under close analysis by the Court of Appeal in a ruling that will be essential reading for property professionals.

The case concerned six fixed-term leases entered into by a retailer with various linked landlords. In accordance with the Act, warning notices were served on the tenant, giving notice that the leases would not provide security of tenure. The Act required the tenant, in each case, to submit a declaration that it had received the warning and understood its consequences.

The declarations had to be 'in the form, or substantially in the form' required by the Act. They were variously expressed, but none of them stated the precise date on which the leases would commence. Some of them stated that the lease would start on a date to be agreed, others that the commencement date would be that on which the tenancy was granted or access to the premises given.

The tenant argued that the declarations did not conform to the requirements of the Act and that it therefore enjoyed security of tenure in each case. Those arguments failed to persuade a judge, who ruled that the declarations achieved their statutory purpose and were effective to exclude the leases from the protection of the security of tenure provisions.

Dismissing the tenant's appeal against that outcome, the Court noted that it was the tenant's responsibility to complete the declarations.

It was an unattractive argument on the part of the tenant to say that it had done so in a way that invalidated the parties' agreement to contract out of the security of tenure provisions.

The tenant's arguments, if correct, would introduce undue technicality to the process and result in practical problems that Parliament could not have intended. It would, amongst other things, be open to a tenant to deliberately sabotage a declaration by inserting the wrong commencement date, thus rendering it invalid.

The declarations submitted by the tenant fulfilled the statutory purpose in that they identified the relevant leases beyond doubt and stated that, after reading the warnings, the tenant understood and accepted their consequences. The declarations were in the form, or substantially the form, prescribed and were thus effective to contract out of the protection provided by the Act.

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## What Amounts to ‘Actual Occupation’ of Land? Court of Appeal Ruling

A few bits of decaying equipment and a caretaker’s occasional visits were insufficient to establish that an industrial site was actually occupied. The Court of Appeal came to that important conclusion in ruling that the apparently abandoned site reverted to Crown ownership when its corporate registered owner was dissolved.

An Isle of Man company transferred ownership of the site to an English company. The transfer was genuine and properly executed but was not registered at the Land Registry. The Isle of Man company, which thus remained the site’s registered owner, was later dissolved.

On the basis that it had obtained title to the site on the Isle of Man company’s dissolution, the Crown sold it for £5,000 to a purchaser who was subsequently registered as its owner under a new title number. The English company’s claim that it was entitled to be registered as sole proprietor of the site hinged on whether it was in actual occupation of the land at the time of the purchaser’s registration. Following a trial, it lost the argument on that point and a judge granted the purchaser a possession order.

Dismissing the English company’s appeal against that outcome, the Court noted that some physical presence, with a degree of permanence and continuity, is required to establish actual occupation of land. The judge had reached a rational conclusion that neither an unpaid caretaker’s intermittent visits to the site for his own purposes, nor the presence of an immovable digger and two apparently disused shipping containers, were sufficient to establish actual occupation. Anyone inspecting the site would have concluded that it had been abandoned.

The Court found that, in the absence of actual occupation by the English company, the site passed to the Crown by escheat, one of the last relics of feudalism still to be found in English law. Escheat is based on the principle that all land in England is owned by the Crown and that no land can be without an owner. When the Isle of Man company ceased to exist on dissolution, therefore, the site’s freehold was terminated and it reverted to the Crown.

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## High Court Grants Breathing Space to Commercial Tenant Hit by Pandemic

Many commercial tenants experiencing cash-flow crises due to the COVID-19 pandemic have been constrained to stop paying rent and are racing to restructure their debts – but where does that leave their landlords?

There was no dispute that the landlord of a health club, part of a national chain, was owed more than £900,000 in respect of the premises after rent was withheld in four successive quarters at the height of the pandemic. In seeking summary judgment in the amount of the debt against the club’s corporate tenant, the landlord said that, in accordance with government guidance, it had not pressed the tenant too hard and had held back from taking enforcement action for a considerable period.

In arguing the claim should be stayed, the tenant pointed out that proposals to restructure its debts were at an advanced stage and would shortly be submitted for judicial approval under Part 26A of the Companies Act 2006. The scheme would involve shareholder injections of £45,000,000 in fresh funding and a further £22,300,000 in liquidity support.

The restructuring was said to offer a far better outcome for creditors than if the tenant were to fall into administration. Granting the stay sought, the Court noted that more than 75 per cent of the tenant’s secured creditors had already indicated their support for the scheme and that there was, at minimum, a reasonable prospect of it receiving judicial sanction. Firm court dates had been set for the hearing of the tenant’s application. The tenant argued that, were an immediate judgment granted to the landlord, the scheme could be seriously disrupted. The amount of the judgment debt would probably have to be removed from the pot available to creditors and the landlord would be in a position to recover substantially more than others in the same position.

In the interests of equal treatment of all the tenant’s creditors, the Court found that the restructuring process should be allowed to proceed without a judgment being entered in the landlord’s favour. Overall, the interests of the wider class of creditors trumped the landlord’s private interests. The order staying the claim included a recital that the landlord was entitled to judgment.

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## Are you paying Business Rates on empty premises?

What exactly constitutes ‘occupation’ of a commercial property? The High Court has provided a definitive answer to that question in a ruling which will ease the path to obtaining business rates exemptions in respect of unoccupied premises.

The case concerned a public health body which purchased a large office building to serve as its future national headquarters. On advice, the body moved about 30 crates of documents into the building for two periods of six weeks. Its liability or otherwise to more than £2.5 million in non-domestic rates hinged on whether the property could be viewed as having been occupied during those periods.

The local authority for the area argued that the installation of the crates fell short of actual occupation and merely gave a semblance of occupation. The presence of the crates, the contents of which were alleged to be obsolete and ripe for disposal, was said to be too trifling to establish the body’s intention to occupy the premises.

Ruling on the dispute, the Court noted that, under rating rules, it is possible to reduce non-domestic rates liability for a property by occupying it for a period of six weeks, then leaving it empty for three months in a cyclical pattern. The effect of such arrangements is that the property is subject to rates during the six-week periods of occupation and effectively exempt during the three-month periods of vacancy. The total rates liability for such a property is reduced to about one third of what it would be if the property were left empty for the same period.

Resolving the occupation issue in the body’s favour, the Court noted that it was quite open about its rates mitigation motive in shifting the crates in and out of the property. It did not seek to convey an impression that differed from reality and was not intent on creating merely a semblance of occupation. The minor issue concerning the utility of the crates’ contents was immaterial.

The Court noted that there is no requirement that use of property must be substantial in order to constitute occupation. Minimal, eccentric, even whimsical uses, like the storage of empty pizza boxes, may be sufficient to establish occupation.

The storage of the crates was of some value or benefit to the body and served a purpose that went beyond upkeep or development of the property itself.

Only one possible conclusion, the Court ruled, could be drawn from the presence of the crates – that the body was in occupation of the premises during the two six-week periods. In taking the opposite view, the council had erred in law. The council was on that basis ordered to repay to the body £2.5 million in non-domestic rates that it had previously remitted under protest.

The Court observed that, unless a possessor of commercial property misunderstands the law or takes a wrong step, it is in a position to benefit by occupying and vacating the property at times of its choosing. There was nothing surprising or disturbing about that conclusion, which flowed from the established principle that the Court is not an arbiter of morals, but of law.

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## Break Clauses in Commercial Leases – What Does 'Vacant Possession' Mean?

Commercial leases frequently stipulate that premises are to be handed back to the landlord 'with vacant possession' – but what exactly does that mean? The Court of Appeal pondered the issue in a case concerning an office block that was stripped back almost to the walls prior to the tenant's departure.

Before it purported to exercise a break clause in the block's 24-year lease, the tenant removed almost all fixtures and fittings, including ceiling tiles, window sills, pipework and floor finishes. Some of the features stripped out formed part of the original base build of the premises and were either the landlord's property or elements of the building itself.

After the landlord launched proceedings, a judge found that the break clause had not been validly exercised and that the lease therefore continued in force.

The building having been left in a dysfunctional and unlettable state, the premises handed back by the tenant were considerably less than the premises defined in the lease. The stripped-out condition of the building posed a major impediment to the landlord's use of the premises and the tenant could not, therefore, be said to have given up vacant possession.

In upholding the tenant's appeal against that outcome, the Court found that the landlord's interpretation of the break clause had implications that the parties were unlikely to have intended and that ran counter to business common sense. A situation would arise where the tenant would be able to validly terminate the lease if it handed back the premises in a dreadful state of repair, but not if a more than minimal number of ceiling tiles or other original features were missing, regardless of whether the deficiency was the tenant's fault.

The landlord argued that, if the tenant's interpretation were correct, it would have been able to exercise the break clause if it had demolished the building altogether, leaving a bare patch of earth. The Court, however, noted the improbability of such a scenario. The tenant had validly exercised the break clause in that it had, in accordance with the lease, handed the premises back to the landlord free of people, chattels and third-party interests.

After ruling that the lease had terminated on service of the break notice, the Court noted that the landlord was not left without a remedy. If it could establish that the tenant had, by stripping out the premises, breached repair or other covenants in the lease, it would be entitled to compensation.