

Under pressure? New business tenancies

Rupert Reed QC puts the security of the landlord's rights under the spotlight



IN BRIEF

► In an age of increasing uncertainty for businesses, we can expect greater numbers of tenants to seek new tenancies of shorter terms and with early breaks.

► The court must determine whether the tenant's claim is fair and reasonable and will do so by comparing the hardship to each of the parties.

It is usually assumed that the tenant wants a longer lease than the landlord wishes to grant. The courts then seek a fair and reasonable solution by balancing two rival considerations.

- First, there is a statutory policy of giving a tenant who has established itself in business in particular premises security of tenure.
- Second, there is a countervailing concern that such security should not be at the expense of stifling redevelopment.

Recent economic insecurity has, however, stood that assumption on its head. There are now business tenants who, while they want a new tenancy, seek a much shorter term, and one terminable with early and frequent break dates through that term.

Conventional policy considerations are therefore less relevant. The courts will need to find solutions that are fair and reasonable in applying a new public policy ensuring that landlords enjoy reasonable security of their own. They will need in particular to consider

the real hardship to landlords arising from shorter and more flexible lease terms.

Statutory framework

Part II of the Landlord and Tenant Act 1954 promises by its title security of tenure for business tenants. Where the landlord has given notice under s 25 or the tenant has made a request under s 26, and there is no grounded opposition to the grant of a new tenancy, then the parties must agree, or the court will determine, the terms of the new tenancy. The duration determined under s 33 is to be 'reasonable in all the circumstances' (not exceeding 15 years). 'Other terms' are determined under s 35, having regard to the terms of the current tenancy and to all relevant circumstances.

Break clauses are technically 'other terms': *O'May v City of London Real Property Co* [1983] 2 AC 726 at p 747. However, because break clauses have such a direct impact on the 'term clear' under any lease, the court is likely to consider such clauses together with the length of the term by reference to what is reasonable in all the circumstances.

Security of tenure

The burden has always been on the party seeking change in the other terms of the new lease to show 'a good reason based ... on essential fairness' for such a change: *O'May*. Any change, including the novel inclusion of a break clause, must be shown to be 'fair and reasonable' in the interests of both parties, taking into consideration

the statutory purpose of giving business tenants security of tenure: pp 740-741. It has also been emphasised, however, that the statutory purpose is not to prevent redevelopment or to protect tenants from market forces: *O'May* at p 747. The court has sought to give a 'reasonable degree' of security of tenure by striking a balance: *JH Edwards & Sons v Central London Commercial Estates Ltd* [1984] 2 EGLR 103; *Becker v Hill Street Properties* [1990] 2 EGLR 78.

In the early cases, the balancing of hardship was often struck by requiring the landlord to show a fixed and present intention to develop the property: *McCombie v Grand Junction* [1962] 1 WLR 581. In later cases, however, it was sufficient for a landlord to show the real possibility of development within the term of the new tenancy. Noting the requirement that a landlord's notice under a redevelopment break clause be served in good faith and the availability of statutory compensation for the tenant, the court found there would be greater hardship to the landlord if no break clause were included in the new lease: *Adams v Green* [1978] 2 EGLR 46, (1978) 247 EG 49.

As Lewison J observed in *Davy's of London (Wine Merchants) v City of London Corporation* [2004] EWHC 2224 (Ch); [2004] 3 EGLR 39 at [25], the balancing of interests was often achieved by requiring the landlord to wait for some time before being able to regain possession. In *Amika Motors Ltd v Colebrook Holdings Ltd* [1981] 2 EGLR 62, where the landlord sought to limit the term to only one year, the Court of Appeal determined that there would be 'reasonable protection' for both parties in upholding an order for a five-year lease, but with an option to break on six months' notice after three years.

Landlords' arguments

Landlords have often sought to justify a change in the terms of a lease by reference to a purported policy of raising the prestige or 'tone' of its estate. The courts insisted that such a policy, while reasonable, could not be pursued at the expense of the tenant's existing business: *O'May* at p. 744; *Gold v Brighton Corporation* [1956] 1 WLR 1291, [1956] 3 All ER 442; *In re No. 1 Albermarle Street* [1959] 1 Ch 531. The existence of such a policy could, however, shift the burden to the tenant to show the unfairness of change.

Similarly, landlords argued that the terms they proposed were in line with market practice. For example, in *O'May* the landlord sought a 'clear lease', with the tenant bearing all repair costs, because such terms were of the sort 'now granted' in the market. That proposition was rejected where its effect would be to impose on the tenant a fresh bargain to its significant detriment, even if it was financially compensated: pp 747-749. The

court still had to strike a balance between the parties' reasonable interests.

New uncertainties

Old assumptions have, however, given way to new uncertainties. After the financial crisis and Brexit, there are real concerns for tenants, including the subsidiaries of international groups unsure of their continued presence in the UK. Some look to consolidate their operations in a smaller number of premises. Average lease lengths are falling, and negative economic expectations mean that leases with shorter terms command higher rentals.

It is increasingly the *tenant* which seeks a shorter lease in referring to the need to maintain flexibility in volatile market conditions: *Iceland Foods Ltd v Castlebrook Holdings Ltd* [2014] PLSCS 95, reported by Allyson Colby in EG, 26 April 2014 at p 116.

This creates an obvious difficulty in that the statutory purpose of providing security of tenure is no longer engaged. A tenant may assume that it can have a lease for as short a term, and with as early a break, as it wishes. The editors of *Woodfall* suggest at [22.146.3] that, save where the tenant proposes a term so short as not to give the landlord time to re-let, the court is unlikely to order the grant of a tenancy for a term longer than that sought by the tenant. They specifically identify as relevant factors 'any hardship that would be caused to the *tenant* by the grant of a *short* term' and 'any hardship that will be caused to the *landlord* by the grant of a *long* term': [22.146] (emphasis added). *Reynolds & Clark on Renewal of Business Tenancies*, 5th edn, 2016, notes that the decisions to date, where tenants have sought shorter terms, 'have invariably favoured tenants': [8-28].

However, it is rightly accepted in *Woodfall* at [22.146] that there is no presumption that the tenant may have as short a lease as it wishes. There are two relevant lines of cases.

First, there are cases in which a tenant in the process of moving out was given a short lease or one with an appropriate break. In *Re Sunlight House* (1959) 174 EG 311, where the tenant requested a very short lease of only six months because it was arranging to move premises, the court ordered a lease of over 10 months to give the landlord a reasonable opportunity to re-let its premises. Similarly, in *CBS UK Ltd v London Scottish Properties* [1985] 2 EGLR 125, the court granted the tenant a very short term where the tenant was in the very process of moving and wanted only time to make an orderly departure. In *Charles Follett Ltd v Cabtell Investments Ltd* [1986] 2 EGLR 76, the judge permitted the tenant a break clause exercisable for some months in order just to consider its position.

Second, there are cases from the early 1990s when the UK property market was last in recession where the tenant was seeking a

shorter lease. In *Ganton House Investments v Crossman Investments* [1995] 1 EGLR 239, the court accepted that it was faced, in 1993, with a 'wholly different commercial position' from the normal position. Landlords were struggling to let their premises in a falling market. The judge accepted that he should take that likely hardship to the landlord into consideration in hearing a claim by a tenant for a short one-year term. He further acknowledged the landlord's evidence that a short lease would diminish the capital value of its premises and so reduce their value as a security. On that basis, he ordered a term of 14 years (but with an early break to allow a specific move then contemplated by the tenant).

There is further suggestion in *Ganton House Investments* that the court should consider a different issue of public policy, namely the desirability of a degree of stability in the letting market, as well as the effect on the value of the landlord's reversion of a shorter term. However, the court must still determine whether the tenant's claim is fair and reasonable and will do so by comparing the hardship to each of the parties.

portfolio: *Rumbelows Ltd v Tameside MBC* [1994] 13 EG 102.

The shorter term may also generate a significant accounting loss, although judges have tended to dismiss mere 'paper' losses that may never be realised: *CBS* at 128H; *Iceland Foods*. However, that view needs now to be reconsidered. Where the property is held as part of a portfolio for the purpose of giving a long-term income and stable capital value appreciation, such loss may damage portfolio performance and shake investor confidence.

In considering hardship to the parties, the court may consider the relative sizes of their businesses. In *Upsons Ltd v E Robins Ltd* [1956] 1 QB 131, the tenant was granted a much shorter lease than it claimed because it was a large retail chain and the landlord had only one shop that it had bought intending to take it into occupation. In recessionary times, a longer lease may cause less hardship to a retail chain as tenant than a shorter lease will cause to a small property fund as landlord.

Just as the courts have previously discounted the stated policies of landlords, they should now consider carefully whether to weigh in the balance a policy of a tenant to consolidate its property holdings, for example off the high street and into business parks. The courts have already given little weight

“The courts have already given little weight to a tenant's policy of wanting shorter terms given the unpredictable nature of its business”

Hardship to the landlord

The difficulties for a landlord arising from a shorter lease term are obvious. There are likely to be significant refurbishment, re-letting and legal costs incurred after an early expiry or break: *CBS* at 128. Raising the necessary funds at short notice to pay those costs may be harder where the property has fallen in value.

The courts have made clear that the statutory protection for tenants should not be at the expense of unfairness to landlords, not least by reducing the value of the landlord's property: *Michael Chipperfield v Shell (UK) Ltd* [1980] 1 EGLR 51. Significantly, a very short lease term is of significantly less capital value because it would be valued off a higher yield. The courts may consider that loss of value and marketability arising from a shorter term, as well as the void and re-letting costs, the uncertainty as to whether a tenant would leave, and the limited market for the particular premises: *CBS*; *Iceland Foods*. However, the court may discount such hardship where the value of the property was only a small part of the value of the landlord's

to a tenant's policy of wanting shorter terms given the unpredictable nature of its business: *Rumbelows*. They should be similarly cautious in accepting evidence as to current market practice: *CBS*. The issue remains whether there is strong reason in terms of fairness to depart from the terms of the current tenancy.

Conclusions

In an age of increasing uncertainty for businesses, we can expect greater numbers of tenants to seek new tenancies of shorter terms and with early breaks. We can no longer rely on the old assumption that the court is primarily concerned to balance the need to provide security of tenure with the need to permit development.

The court may need to consider a public policy that is not within the statutory purpose but which remains important, namely that of maintaining stability within the letting market. **NLJ**