Falcon Chambers

RENEWING THE 1954 ACT –
ROOT AND BRANCH OR JUST A TRIM?

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The Law Commission Proposals (So Far)

1. The audience will of course be aware of the fact that, on 28th March 2023, the Law Commission announced that it will be looking at the Landlord and Tenant Act 1954. The title of the project is "Business Tenancies – The Right to Renew".

2. In its press release, the Law Commission explained that:

   "It is now nearly 20 years since the legislation was last reviewed. Those who rely on the Act report that it is inflexible, bureaucratic and out of date, causing extra cost and delay for both landlords and tenants – as well as preventing space in high streets and other commercial centres from being occupied quickly and efficiently."

3. We are in the pre-consultation phase, with a Consultation Paper slated for December of this year.

4. So far, the points that emerge from the project description are:

   a. Whether and to what extent security of tenure, at any rate in its present form, is potentially out of date.
   b. Changes in the commercial leasing market wrought by (a) online retail and (b) COVID-19;
   c. ESG issues: Net Zero and Levelling Up
   d. Fostering "productive relationships between landlord and tenant".

Notices

5. One issue that one encounters in many landlord and tenant contexts, as well as more generally in the law of property, is our dependence on notices to trigger legal

consequences. We are addicted to notices. The niceties of the rules of compliance to produce a valid, and validly served and "given" (if different) notice are beyond the average busy layperson, who is obviously not going to be able to sit down and read Woodfall. There is something wrong with our law when Lord Hoffmann, or the Court of Appeal, have to tell us whether a notice under a commercial contract, or a statute dealing with commonplace commercial arrangements like leases, is valid. There has to be a better way of ensuring the parties can signal to one another, in a relatively formal way, that one party intends to invoke important rights, or to terminate them.

6. One question for reform may well be whether we need to be cured of our addiction to notices as a means for landlords and tenants to communicate with each other in relation to lease termination and lease renewal. At any rate, it may be time to re-think whether it is right that so much depends on the formal correctness of the notices. Some notices require strict compliance as a matter of contract or statute, with form and content prescribed. Others can however be in "substantially the same form" (whatever that means) as the statutory form, though it is a brave lawyer who deliberately sets out to test the limits of that.

7. Might a modern piece of legislation governing business tenancies dispense with notices altogether, and replace them with something else that is more in tune with modern times? Might there be scope for, for example, an online portal that allows the parties to communicate with one another, with prompts for each to act, to eliminate the risk of technical non-compliance?

8. What about our dependence on specific dates? Usually notices are tied to them. Often, those are quarter days, denoting the first date of each quarter of the year, starting with 25th March, Lady Day, which was New Year's Day. This was the position in England between 1155 and 1752. In 1752, the Gregorian calendar restored 1st January as the first day of the year.[1]

[1] We landlord and tenant lawyers to this day are seemingly still reluctant to adopt this innovation.

9. Is it time for us to re-think that? As long as a tenant has a requisite minimum notice period, does it really matter when that notice period expires? It appears not to matter when the business tenancy in question is an expired fixed term that is being continued. It matters a great deal when the business tenancy is a periodic tenancy. In my view, this distinction makes little or no sense. If there is a minimum notice period, and a provision under statute for the repayment of rent that has been paid in advance for the period beyond the expiry of the tenancy following its termination by a statutory procedure, what is the harm? It again ensures that landlords or tenants who wish to bring an end to their relationship are not "snookered" by missing a particular term date. In that context, it will be noted that tenants continue to enjoy rights under section 27 of the 1954 Act to bring their continuation tenancies to an end. Why should landlords also not enjoy a similar flexibility?

10. Let me unpack that.

11. It is, famously, impossible to withdraw[2] or amend a section 25 notice: *Hutchinson v Lambeth* [1984] 1 E.G.L.R. 75. So, if a valid section 25 notice is given by a landlord specifying a particular ground or grounds of termination, that is what it is stuck with. If the planning landscape changes so that a ground (f) becomes available during the currency of the notice, then tough. So in that respect, the notices are of key importance.

12. On the other hand, I don't believe any of us have probably ever had a case in which the landlord and the tenant ended up claiming the rent specified in either of their notices. Often, the rent in the claim form doesn't just not correspond with that in the notice, but may also not be the rent contended for at trial, when the parties' respective valuers have opined.

13. Indeed, things continue to be fluid in terms of lease terms, and therefore rent (which falls to be determined after the terms are settled) into trial. It is for this reason that the ordinary principles of late amendments do not apply: see *Davies Attbrook (Chemists) Ltd v Benchmark Group plc* [2006] 1 W.L.R. 2493. In that case, a landlord made a late application to amend its acknowledgment of service to claim a break clause. The tenant

[2] Subject to the limited grounds in Schedule 6.

objected on the grounds of lateness and prejudice. The recorder agreed. However, on appeal, Lewison J (as he then was) stated (at [15]:

"[…] the statutory requirement on the court under sections 33 and 35 of the Landlord and Tenant Act 1954 is to have regard to all the circumstances of the case. Unlike most cases which are concerned with investigating events that have happened in the past, an application under the 1954 Act is concerned with the parties' relationship in the future, and that is one of the reasons why the court will consider evidence of what has happened between the issue of proceedings and trial and indeed the reason why appeal courts will often consider evidence of what has happened since the date of the first instance decision. The fact, therefore, that things change during the course of an application for the grant of a new tenancy is something which is by no means out of the ordinary and should not represent any reason for refusing to allow an amendment."

14. Not only is that fluidity simply a feature of the forward looking 1954 Act renewal. It is also the case that a landlord *can* in fact quite substantially (though of course not exactly) replicate the effect of ground (f), for example, if it has neglected to invoke the same – it can seek a short-term redevelopment break clause: as to this see *B&M Retail Limited v HSBC Bank Pension Trust (UK) Limited* (County Court, unreported, 3rd March 2023).[3] In that case, because of a mail-room mix up during Covid, and landlord didn't spot a section 26 request from the tenant which had come with the ordinary post. The County Court was sympathetic to the argument that this might have been in accordance with the rules, but not in accordance with the spirit, of the legislation and of litigation during Covid times, and that therefore a short-term break was in order.

15. All of this points to the fact that the notices that trigger rights of termination and renewal do not inject quite the level of certainty that everyone might think they do. A 1954 Act renewal is, until the judgment drops, a moveable feast. If the reforms are aimed at fostering greater cooperation between landlord and tenant, it may therefore be a good idea to ensure that ransom positions that can be invoked on technical grounds are removed.

16. It may be, therefore, that there should be:

[3] https://www.falcon-chambers.com/images/uploads/documents/B_M_Retail_Ltd_v_HSBC_Bank_Pension_Trust_%28UK%29_Ltd_2023.pdf

a. a provision allowing the amendment of grounds of opposition under a landlord's section 25 notice or a counter-notice to a section 26 request.
b. a statutory power to correct notices, to take adventitious technical points out of the hands of either party and encourage a more collaborative and less adversarial approach; and/or
c. a supervisory discretion of a Court or Tribunal to amend notices.

17. It appears to me that there is a decent case to be made, on fairness but also public resource, grounds, for ensuring that accidental, and frequently practically trivial, technical failings in notices cannot be adventitiously exploited by one or other party. It seems to me that those sorts of arguments are what drive 1954 Act cases to Court when otherwise they might lead to settlement (as they so often do when those points are not in play).

18. That may obviously have knock on effects – on statutory compensation entitlements, for example. But as matters stand, our addiction to notices appears to serve more to give technical "gotcha" arguments than to safeguard certainty between the parties and facilitate their commercial aims.

Security of Tenure

19. Security of tenure is a feature with which we are all familiar.

20. In the residential context, we have gone from the high levels of protectionism of the Rent Act 1977, through to the liberalisation of the market under the Housing Act 1988, and then back, by stealth, to a more constricted right to terminate residential tenancies, hedged about with myriad rules to tackle "landlordism" and the modern bogeyman, the "evil landlord". This has now crystallised into the abolition of section 21 altogether, under the Renters' (Reform) Bill 2023 (if enacted). So the pendulum has swung in favour of tenants in the residential sector. The reasons for that are clear – in many urban centres, the supply of properties for short term lettings is far outstripped by demand, with escalating rents as a result of landlord's abilities to terminate and re-let residential property.

21. In the agricultural setting, the post-Second World War concerns for national food security that led to the various Agricultural Holdings Acts gave way to the more flexible Farm Business Tenancy. There is little or no appetite for reinstating old forms of security of tenure, and, indeed, with the move towards a rural green economy, it seems that for the time being we are arguably not that concerned, at a national level, with the promotion of agriculture as a means of food production at all. The pendulum rests firmly with the landlord.

22. What of business tenants? Security of tenure was introduced in the early iterations of the protection of business tenancies (unless exempted) for one main reason – to protect the precious goodwill that a tenant had accumulated during the lifetime of the lease. The shop that had always been there attracted loyal customers, and the loss of that loyalty, was hard to compensate. Under the Landlord and Tenant Act 1927, a tenant would only be able to obtain a new tenancy (a once-only) if there was "adherent goodwill" that could not be expressed in the form of a compensation payment. If that "adherent goodwill" could be bought out, that was the end of the tenant's rights to remain beyond the contractual term.

23. The tenant's position was of course strengthened by the 1954 Act, which gave a tenant a repeated right to a new tenancy (provided the qualifying conditions were met), and allowed a landlord to resist that only in limited circumstances, with some of those grounds attracting a compensation payment for the tenant. Security of tenure for reasons of business continuity was therefore highly prized by tenants.

24. However, as the Law Commission notes, that may not be the case now. Lease terms are getting shorter. Savills analysis is that lease terms *shorter* than two years increased threefold between 2018 – 2020. Whilst some retailers still seek ten year terms, the average is said to lie at about 5.5 years. With the advent of chain retailers, concepts of goodwill, invoking the image of the small family shop with a hard-won and loyal customer base, are verging on the irrelevant. It is a rare 1954 Act renewal in which the expert valuation report considers goodwill in any way, and, indeed, the comparative method of valuation, and the use of the zoning method (ITZA) really eliminate that element form consideration. Loyalty to a particular shop has not gone altogether, or

course, but in our fluid (and dying) High Street it is probably more important for a shop to be in the right location, with the right sorts of commercial neighbours.

25. It may still be premature to dismiss the value of security of tenure altogether. This is because, whilst the COVID pandemic might have decimated many a town centre so that business tenant might often be looking to move on rather than stay, (i) that might not of course always be the case, and (ii) a lot of retail and food/drink businesses have instead set up nearer to the homes from where many of us are working. This goes hand-in-hand with a growing retail trend for either (i) experiential shopping, with attractions offered to shoppers in addition to the shopping experience that require expensive fit-outs that only make sense if the retail tenant is able to stay in one location for longer, and (ii) increasing consumer demand for authentic, non-chain shopping experiences that might mean that goodwill might make a comeback after all.

26. It appears that there are three options for the Law Commission. One, abolish security of tenure and leave it all to contract. I doubt that that will be the outcome, as it will result in a number of commercial tenants without the bargaining clout of a large chain being under-protected. Two, an opt-in scheme. Again, if that depends on agreement, one suspects that there is an unacceptably large class of tenants who are not protected adequately, or three, a simpler opt-out scheme.

27. The present scheme, introduced in 2003, appears to be over-engineered, and as *TFS Stores Ltd v The Designer Retail Outlet Centres (Mansfield) General Partner Ltd & Ors* [2021] EWCA Civ 688 shows, capable of throwing up intractable problems that take many months for the Courts to resolve. The need for health warnings, statutory declarations and so on is arguably simply another set of traps for the unwary. Often these documents are just as lost by the time they become relevant to us in litigation as the court orders contracting the tenancies out before 2003 were. This itself raises all sorts of questions about whether contracting out was valid.

28. If bargaining positions are re-balancing, and see-sawing slightly around a point of bargaining equality, with landlords anxious to avoid rental voids and tenants keen to keep their options open, then maybe the right answer is that the tenancy agreement simply includes a standard term as to whether or not the lease is intended to be within

the 1954 Act or not, or to have a much simpler mechanism stating whether security is excluded.[4] There may even be a case for *extending* security of tenure by allowing periodic tenants a renewal right as well.

Rent Valuations

29. Section 34 states that, on renewal:

> *(1) The rent payable under a tenancy granted by order of the court under this Part of this Act shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court to be that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor, there being disregarded—*
>
> *(a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding,*
>
> *(b) any goodwill attached to the holding by reason of the carrying on thereat of the business of the tenant (whether by him or by a predecessor of his in that business),*
>
> *(c) any effect on rent of an improvement to which this paragraph applies,*
>
> *(d) in the case of a holding comprising licensed premises, any addition to its value attributable to the licence, if it appears to the court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the licence belongs to the tenant.*

30. In practice, the comparable method of valuation which dominates section 34 means that in many cases, the valuation assumptions are referred to but often not relevant to more than the legal background against which the valuations are taking place. There may be the odd case about disregards of improvements,[5] but goodwill and prior occupation do not in my experience make a great difference to the valuation, one way or the other. These days, in most cases a shop is just a shop, and it doesn't matter who was there before or what they did.

31. Apart from therefore being a bit old-fashioned, section 34 is inoffensive, except in two respects.

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[4] That will also save a lot of time and trouble in those cases where the parties feel the need to have the argument about security of tenure in the guise of an argument about the lease/licence distinction. If the agreement is a licence, then it is outside the 1954 Act. It is at least arguable that in commercial cases, the Courts take documents at their face value. If the parties have opted to call something a licence, that is what it is – which in effect allows the parties to decide that the 1954 Act does not apply on a contractual basis in a number of cases where the arrangement could be a lease or a licence.

[5] And when there are, they can be massive: *Humber Oil Terminals Trustee Ltd (HOTT) v Associated British Ports (ABP)* [2012] EWHC 1336 (Ch)

32. Turnover rents – the Law Commission could usefully clarify that the rent that can be imposed under section 34 is not limited to a periodic payment, but may be in a different form. The most recent form that has been contended for is a turnover rent, or a rent comprising a base payment with a variable uplift linked to the turnover of the premises in the preceding year. This device is more in evidence in the market, as it is a way of "sharing the pain" after COVID and other economic shocks, and, hopefully, sharing the gain from better times to come.

33. In *W (No.3) GP (Nominee A) Limited v JD Sports Fashion plc* (unreported decision of HHJ Fine dated 22nd October 2021),[6] the Court declined to impose a turnover rent for a retail unit, such a rent being inconsistent with the disregards under section 34. It accepted however that it could be appropriate to award a turnover rent but only exceptionally, and where it was common practice in the relevant industry under consideration.[7] The Court held that a turnover rent was "rent" within section 34, and not "another term" under section 35.

34. It concluded at paragraph [74]:

> *"[…] where the parties do not agree that the lease renewal rent shall be a turnover rent, the court must evaluate the identified concerns to ensure that the purpose of the Act, to protect both landlords and tenants and to arrive at an open market rental valuation, is met. In some cases, such as where the nature of the business is clear, the likely turnover is discernible and the statutory disregards of little or no relevance, for example, a car park, a turnover rent may be appropriate. However, in other cases, the court needs to assess on the facts of the individual case whether a turnover rent accords with the purpose and provisions of the Act."*

35. The point is likely to become more prevalent as, even without COVID, the precarity of businesses, particularly those engaged in the food and drink trade, is such that turnover-based payments appear to produce a more equitable outcome. A walk through any major city will show, no doubt, a reduction in trade for businesses depending on office workers for evening drinks and business lunches generally. The availability of turnover rents beyond the traditional and limited industries in which they are presently found in likely

[6] http://www.falcon-chambers.com/images/uploads/news/E00DE178_transcript_W_v_JD_Sports_Fashion_PLC_%2822.10_.21%29%28Jud%29_.pdf

[7] See her thorough review of the authorities between paragraphs [49] – [60].

to be appealing to many – even if, as *JD Sports* shows – it may simply not be appropriate for ordinary retail.

36. Rent Free – this has been much debated in the recent cases. Assume that you are at the point of renewal of a lease. Assume that there has been a tenant's fit out that falls to be disregarded in the hypothetical world. That means, it would appear, that in the hypothetical world the willing tenant is bidding for an unimproved shell. A tenant in that position would ask for a rent-free period to fit out the premises in order to put them into a condition that they can be traded from. So, in the hypothetical world, if, say, a rent of £10,000 per annum would be agreed, in the first year that would be reduced to £5,000 to reflect the fit out period, and the £5,000 that is deducted would be spread over the term, depressing the rent. Back in the real world, however, the real tenant won't be fitting anything out. It can trade happily from Day One of the renewal tenancy as it has already done the improvements (and may already have benefited from a rent free period in reality under the tenancy falling to be renewed). Should the real tenant be able to claim a second rent-free to do works it won't be doing, as that is what the market would demand, because of the statutory disregard of improvements?

37. Arguably, the awarding of a further rent free on renewal is to push the hypothetical too far, at the expense of the real. The market value per annum of the premises, when capable of beneficial occupation, is £10,000 per annum, and that is precisely what the renewing tenant is getting. It appears to push the fiction too far to take the opposite view.

38. On the other hand, a rent free period is often as much an incentive as to allow fit-out. It is therefore part and parcel of the financial package on which the premises are let. If the landlord had contracted, on Day One of the lease, to pay the tenant a reverse premium on a one-off basis of £5,000, why should that not be taken into account when setting the rent. One might compare the older cases on reverse premiums, or the cases under the Electronic Communications Code, beginning with *EE Ltd & Anor v Morriss & Ors* [2022] EW Misc 1 (CC), in which incentive payments by incoming tenants were rentalised. Further, why should the sitting tenant pay more rent because it has already

fitted the premises out? Perhaps that is simply contrary to the matters section 34 expressly instructs us to disregard.

39. A middle way is however hard to see practically. Hypothetically one might be able to determine whether the rent free period is incentive, or to allow fit out, or a blend of the two. However, this will may factually difficult to determine, and the apportionment exercise required by the blended approach may be difficult to undertake (though notably it has been done by agreement in *Old Street* (referred to below) at [73].

40. The Courts have not spoken with one voice, though the majority voice is that rent-free periods are not ignored when setting the section 34 rent:

    a. *HPUT Trustee No 1 v Boots UK* (unreported decision of HHJ Dight CBE sitting in the County Court at Central London, 24 May 2021) decided that there should be no reduction in reality for the fact that in the hypothetical world the incoming tenant might wish to have a rent free period.
    b. *Old Street Retail Trustee (Jersey) 1 Ltd v GB Healthcare* (unreported decision of HHJ Richard Roberts of 18th November 2022): the correct approach was to analyse the comparables to assess what rent would have been paid for them if no rent-free period had been allowed, and then to use that to determine the s.34 rent for the subject unit. This follows the approach in earlier cases such as *Iceland Foods Limited v Castle Brook Holdings Limited* (unreported decision or Mr Recorder Clayton of 3 September 2013), *Britel Fund Trustees Limited v B & Q Plc* [2016] (unreported decision of HHJ John Mitchell); *WH Smith Retail Holdings Ltd Commerz Real Investmentgesellschaft MBH* (unreported decision of HHJ Richard Parkes KC or 25 March 2021)

41. The Law Commission may wish to consider whether this outcome, which flows from a strict application of section 34(1), is one that is acceptable as a matter of policy. It may be that the tenant fit-out rent free was more wide-spread after section 34 was introduced, or that taking it into account was an unintended consequence of the disregards.

Other Terms

42. A further query arises under section 35. Are we to hidebound by the terms of earlier leases on renewal? It is often said that a departure from the terms of the initial lease that is being renewed has to be justified, because that lease is the product of specific open market negotiations and represents (it is asserted) the product of the free negotiation between the parties which should echo strongly into the renewal lease. The burden is said to be on the person seeking the change of terms to justify that change.

43. It should be said at this point that a similar type of clause was found by the Court of Appeal not to have the same effect under the Electronic Communications Code, because the that would not fit with the statutory context of the Code, governing, as it does, a fast moving and constantly evolving industry: *On Tower UK Ltd v JH & FW Green Ltd* [2021] EWCA Civ 1858. Might retail or other sectors not have a similar claim to being fast-moving and have a need to be agile in response to constantly shifting customer demand? Recent years have shown us that business tenants need to be able to respond quickly to radically changing circumstances, and may now require as standard terms clauses about pandemics, undreamt of before recent events took hold. Moreover, this is not confined to rent abatement or pandemic business insurance – tenants may need more relaxed user clauses to allow them to diversify their businesses in times of trouble (subject to planning), for instance.

44. As the law presently stands, section 35 does not work like that. This consequently may be a roadblock for one part of the Law Commission's reforms – promoting levelling up and ESG policies. On the present state of section 35, it is thought unlikely that the Courts will, when a tenancy protected by Part II of the Landlord and Tenant Act 1954 falls due for renewal, insert ESG-type obligations when none were present before. The presumption is that the renewal tenancy's terms will track the terms of the tenancy that preceded it, unless the party seeking to depart from them can give good reasons why this is so**:** *O'May v City of London Real Property Company* [1983] 2 A.C. 726.

45. Typically, the fact that the change makes sense from the landlord's perspective for the sake of estate management is not a good enough reason on its own. Take the recent changes in the Minimum Energy Efficiency Standards. The cast several severe burdens on landlords. In cases where there is no agreement as to how they are to be allocate

between the parties, it is more likely than not landlords who will be seeking to change the existing terms to have the burdens re-balanced by the Court. One can expect that they face an uphill struggle, particularly when the change will cost the tenant: see *Clipper Logistics Plc v Scottish Equitable Plc* (Decision of Mr Recorder McNamara, 7th March 2022).[8] In that case, the landlord sought to migrate the cost of MEES compliance onto the tenant. Ultimately it merely permitted a clause preserving the status quo at the end of the term: this was a covenant by the tenant to "*return the premises to the Landlord with the same EPC rating as it has as the date of this Lease*". The Court thought this was a fair and reasonable change, sufficiently protecting the landlord over a 10 year term albeit it acknowledged that this did nothing to protect the landlord should the premises fall below standard *during* the term (provided that they were back to the original standard at the end).

46. Perhaps, therefore, with one eye on the cases under the Code, the Law Commission will feel that *O'May* has had its day.

Conclusions

47. It is early days for the proposed reforms. Doubtless there are other things that can be looked at. Might ground (f) be looked at again to see whether it is in line with the modern ways properties are developed – for instance, the retention of period features in older buildings might mean the works don't satisfy ground (f), but is that really a sensible policy? Does interim rent really have to be that complicated, and should there not be a statutory clawback mechanism (perhaps with interest?) if the tenant overpaid during the interim period? As floated above, should all periodic tenants have a right to renew, rather than having to choose between (a) leaving or (b) being locked perpetually into terms agreed many years ago, or, worse still, never agreed but implied from the payment of rent? Doubtless there are more matters that could be explored.

48. Hanging over this reform, however, is the question that has hung over every major overhaul of legislation from the Land Registration Act 1925/2002 to the Electronic

[8] https://proconferences.com/wp-content/uploads/Clipper-Logisitics-PLC-v-Scottish-Equitable-Plc-Final-Judgment-7.3.2022_THL_153081226_1.pdf

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Communications Code – if it ain't completely broke, should you fix it? Or, to put it another way, is the cure worse than the disease?

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