July 2021

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KEY CASES

PANDEMIC CLAUSE INCLUDED IN BUSINESS LEASE RENEWAL

A shopping centre lease renewal decision contains useful guidance on how the court will assess lease renewal terms in a post-COVID world.

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RENT PAYABLE DURING COVID CLOSURES, COURT SAYS

Court sides with landlords saying rent is still due, even where businesses can't trade from the premises and landlords have pandemic insurance.

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COMPANY RESTRUCTURES SANCTIONED DESPITE LANDLORD OBJECTIONS

As tenants increasingly look to insolvency and restructuring options to stay afloat, landlords are paying a heavy price.

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The Supreme Court held the Council had an arguable case that the rates were payable. Continued uncertainty about whether rates mitigation schemes work makes the case for reform even stronger.

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The court implied terms about when a break notice could be served, even where this was not required to make the contract workable.

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Tenant acquires a 1954 Act protected tenancy during lease renewal negotiations.

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CASE 1

PANDEMIC CLAUSES INCLUDED IN BUSINESS LEASE RENEWAL

WH SMITH RETAIL HOLDINGS LIMITED V COMMERZ REAL INVESTMENTGESELLSCHAFT MBH (25 MARCH 2021)

WHAT WAS IT ABOUT?

- The case concerned the 1954 Act lease renewal of WH Smith's retail unit in Westfield Shopping Centre, Shepherd's Bush. Its 10 year lease expired in September 2018, and continued at a passing rent of £953,000. WH Smith served a section 26 notice requesting a new lease from 1 October 2018.
- At the trial in November 2020, mid-pandemic, the court had to consider the rent, service charge provisions and the trigger for a pandemic rent suspension clause under the renewal lease, and also the interim rent payable between expiry of the old lease and commencement of the new lease.

WHAT DID THE COURT SAY?

- **Covid discount:** The parties agreed that pre-pandemic comparables should be discounted by 20% to account for the impact of Covid on the retail market.
- **Pandemic clause:** Pandemic clauses in new retail leases were considered to be the new retail "market norm" and the parties agreed that one should be included, providing for a future rental discount of 50% in this case. The court decided that the appropriate trigger was forced closure of non-essential retail. There was no basis to apply an uplift in the rent for a lease that included a pandemic clause, since this had already been "priced in" to the market.
- **Rent-free fit out inducement:** Section 34 of the 1954 Act requires the tenant's occupation of the premises to be disregarded when valuing the new rent. This means that the premises must be assumed to be vacant and in need of fit out, and the tenant should therefore receive a fit-out period discount (a rent free period, amortised over the term of the new lease).
- **Interim rent:** The valuation date in this case fell on 1 October 2018 - prior to the pandemic, when the retail market was much firmer - and the rent would be significantly higher than the new rent. Accordingly, the interim rent was the higher rent of £758,785 pa (market rent at October 2018), rather than the new lease rent of £404,666 pa (market rent at date of trial – November 2020).
- **Service charge:** The court disallowed the introduction of energy efficiency provisions in the service charge. It was not persuaded that the costs were covered by the existing service charge provisions, and if they were 'new' provisions being introduced, the uncertain mantra of 'good estate management' did not mean that their inclusion in the new lease was fair and reasonable in all the circumstances.

WHY IS IT IMPORTANT?

- This is a useful decision on how the court will approach post-pandemic renewals. It highlights the stark changes in the new retail landscape: rent down from £953k to £405k.
- A pandemic rent suspension clause was agreed, not imposed, showing it is the new normal for certain shopping centre leases. Closure of non-essential retail was held to be an appropriate rent suspension trigger, even though WH Smith could remain open as an essential retailer. The position may be different for retailers in other locations/markets.
- Interim rent claims are likely to be more prevalent and there will be tactical timing issues to consider. Here, interim rent was at a pre-pandemic rate. The decision on assuming a rent-free fit-out period is consistent with other County Court decisions, although a High Court decision would provide welcomed clarity on this point.

- Landlords looking to introduce energy efficiency costs in a service charge will need to explain the precise costs anticipated to persuade the court that this is a reasonable modernisation.

CASE 2

RENT PAYABLE DURING COVID CLOSURES, COURT SAYS

BANK OF NEW YORK MELLON (INTERNATIONAL) LTD AND OTHERS V CINE-UK LTD AND OTHERS [2021] EWHC 1013 (QB)

COMMERZ REAL INVESTMENTGESELLSCHAFT MBH V TFS STORES LTD. [2021] EWHC 863 (CH)

WHAT WAS IT ABOUT?

The landlords were claiming rent from March 2020 against various tenants who had been unable to trade, to varying degrees, during lockdowns. The landlords had pandemic insurance, which included loss of rent cover irrespective of damage to their buildings.

The landlords applied for summary judgment that the rent was payable. The tenants defended on various grounds:

1. Summary judgment was unsuitable for claims involving complex technical defences
2. Pursuing the claim was contrary to the Government's Code of Practice for commercial leases
3. The rent cesser clause should be construed so that the inability to trade amounted to 'damage or destruction' which triggered the rent suspension
4. Terms to the same effect should be implied
5. The landlords should not be able to sue for the rent where they had pandemic insurance cover
6. The lockdown was a frustrating event, and the leases should be treated as temporarily suspended/terminated

WHAT DID THE COURT SAY?

- The court rejected the tenants' arguments and held that the rent was due in full. The Master took the following factors into account:
- The pandemic was not entirely unforeseeable (e.g. the SARS epidemic). Landlords had insured against such events, and tenants could have taken out their own business interruption insurance against this risk. This meant there was no justification for the implied terms sought.
- The landlords' concern was to insure the 'bricks and mortar' and it was for the tenants to insure what was important to them. Although the landlords' insurance covered loss of rent, irrespective of physical damage, rent was not 'lost' where tenants remained liable under the lease terms. The rent cesser provisions only operated where there was physical damage or destruction to the premises, which was not the case here.
- Considering previous case law, there was no support for arguments regarding frustration/partial frustration, particularly because these were 1954 Act protected leases with at least a year to run, and the reasonably expected closure periods were no longer than 18 months.

WHY IS IT IMPORTANT?

- The court rejected all of the tenants' Covid-related defences and held that rent was payable in full, even during lockdowns and where landlords had pandemic insurance. The Masters in both cases were sympathetic to the tenants but considered it was a matter for Parliament to intervene, not the Courts.
- This line of case law may have influenced the government's decision to extend the forfeiture ban for commercial leases out to March 2022, and may impact further interventions in the new legislation to be passed shortly, which will include binding arbitration where agreement can't be reached in certain circumstances.

CASE

COMPANY RESTRUCTURES SANCTIONED DESPITE LANDLORD OBJECTIONS

VIRGIN ACTIVE HOLDINGS LTD, RE (CHD),1 APRIL 2021

WHAT WAS IT ABOUT?

Virgin Active asked the court to sanction its restructuring plans, proposed under a new restructuring procedure introduced by the Corporate Insolvency and Governance Act 2020.

The plans included:

- Class B Landlords: rent arrears written off with contractual rent being paid going forwards
- Class C Landlords: rent arrears written off with a 50% contractual rent reduction going forwards

WHAT DID THE COURT SAY?

- The Court sanctioned the restructuring plans, despite them having only been approved by a majority of those voting at the class meetings of the secured creditors and Class A Landlords (who were each not financially compromised) and having failed to attain the required approval threshold of the remaining 15 classes of creditors, with some classes having received zero votes in favour.
- The Judge made use of the court's ability to effect the 'cross-class cram down' to sanction the plan, notwithstanding the classes not voting in favour. This required the court to assess:

  (a) whether, if the plans were sanctioned, any members of the dissenting classes would be any worse off than they would be in the event of the relevant alternative (the "no worse off" test);

  (b) whether each plan had been approved by 75% of those voting in any class that would receive a payment or those that have a genuine economic interest in the company in the event of the relevant alternative; and

  (c) in the circumstances, whether the court should exercise its discretion to sanction the plans.
- Unsurprisingly, it was the 'out of the money' creditors that had voted against the restructuring plans, although they did not submit specific evidence to explain why they had voted against them.
- Ultimately, the judge was satisfied that the creditors who opposed would be no worse off under the restructuring plans than they would be in the relevant alternative of an administration and, in all the circumstances, the court should exercise its discretion to sanction the plans.

WHY IS IT IMPORTANT?

- This was a test case for the new restructuring procedure, which allows a company to bind all creditors, even if they vote against the plan, through the use of 'cross-class cram down' provisions. The result shows that the court will readily take advantage of its ability to effect the cross-class clam down.
- In another recent case, *Lazari Properties 2 Ltd v New Look Retailers Ltd (ChD)10 May 2021*, the court also approved New Look's CVA, in spite of landlord challenges, highlighting that landlords would receive far less or nothing in an alternative insolvency process.
- Struggling tenants will be looking at all restructuring options, and we can expect to see more tenants taking advantage of this restructuring procedure and CVAs. Where landlords would be no worse off in an administration, it appears that challenging tenant's proposals will be a difficult feat.

CASE 4

COUNCILS CAN SUE FOR RATES WHERE SPV MITIGATION SCHEMES USED

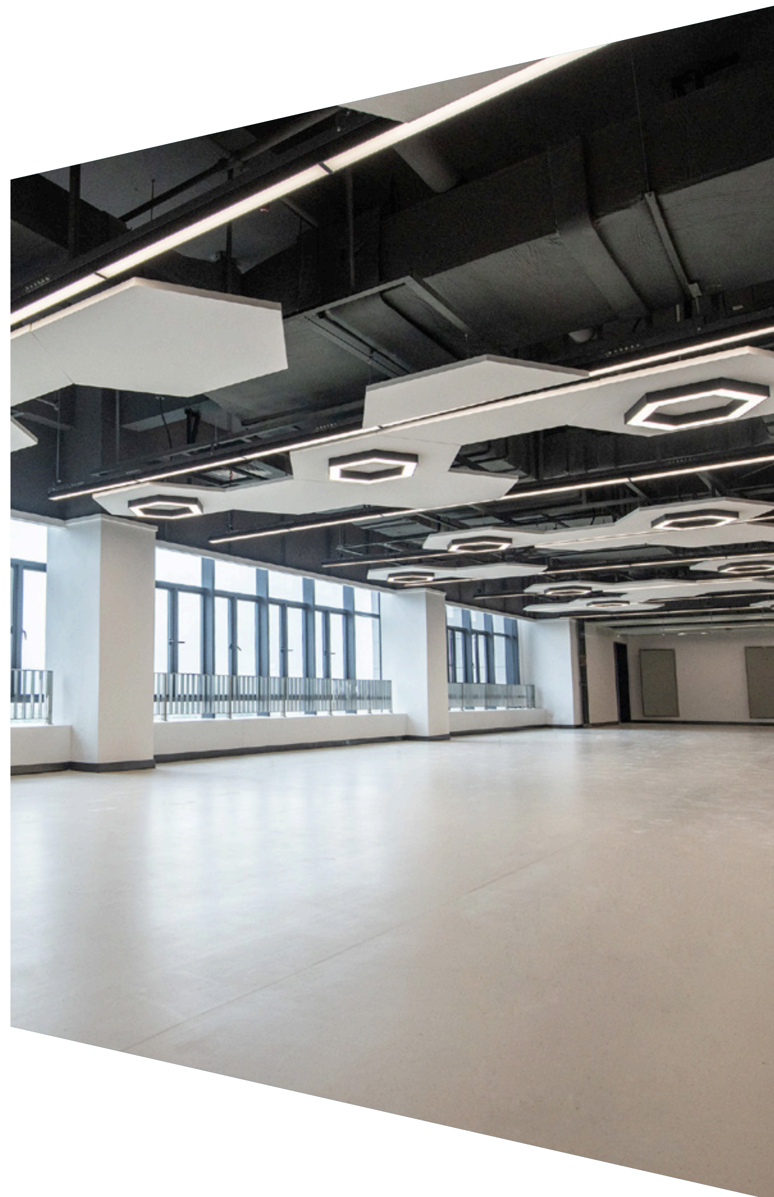
HURSTWOOD PROPERTIES (A) LTD AND OTHERS V ROSSENDALE BOROUGH COUNCIL AND ANOTHER [2021] UKSC 16

WHAT WAS IT ABOUT?

- Developers sought to avoid liability for empty rates through rates mitigation schemes which involved granting a short lease to a special purpose vehicle ('SPV'). The SPV became the 'owner' and liable for rates, but was then dissolved or put into liquidation to escape liability.
- Local councils argued that the developers were still liable for the rates because the SPV arrangements were shams which had no effect in law. They also asked the court to apply a legal principle (the Ramsay principle) which requires the court to adopt a "purposive" approach to statutory interpretation. In this case, this meant that the court had to interpret the purpose of relevant rating legislation in the context of the landlords' tax avoidance scheme that had been put in place.
- The Court of Appeal struck-out the councils' claims and they appealed that strike-out decision to the Supreme Court.

WHAT DID THE COURT SAY?

- The Supreme Court said there was a triable issue regarding the rates liability so the councils' claims should not be struck out and the case should continue to trial.
- Although the leases to the SPVs were not shams in that the SPVs were entitled to possession, the schemes didn't have any business or other 'real world' purpose - their sole purpose was to avoid rates liability. The SPVs had no assets or business, and it was never intended that they would pay the empty rates. The lease included a rent clause, but the rent was not intended to be demanded or paid.
- The Ramsay principle requires to the court to read the statute as a whole in its historical context and interpret it to give effect to Parliament's purpose.
- The legislative purpose of charging rates for empty property was to deter owners from leaving property unoccupied for their own financial advantage and encouraging owners to bring empty property back into use for the benefit of the community.
- Normally, the 'owner' would be 'the person entitled to possession', i.e. the person with the legal right to actual physical possession under property law. However, that would defeat the purpose of the legislation here. So the entitlement to possession remained with the developers as they had the practical ability to decide whether to leave the property unoccupied, and had not passed that real entitlement to the SPVs by the leases.



WHY IS IT IMPORTANT?

Landlords using similar rates mitigation schemes will be concerned about their enforceability, and local authorities will be reviewing such schemes carefully.

As quoted by BCLP rates specialist, Rogen Cohen, in Property Week: *"The ruling means that the options for owners of empty buildings to avoid empty rates are reduced. This makes the case for reform of empty rates even stronger."*

CASE 5

COURT IMPLIES TERMS OF DEVELOPMENT LEASE BREAK OPTION FOR STATELY HOME

WIGAN BC V SCULLINDALE GLOBAL LTD AND OTHERS [2021] EWHC 779 (CH)

WHAT WAS IT ABOUT?

- Wigan Borough Council leased Haigh Hall, a grade II listed stately home, to the tenant for a term of 199 years, for a premium of £400,000. The lease required the tenant to convert the premises into a hotel and wedding venue within a specified time frame, in accordance with planning permission, failing which the landlord could terminate the lease and take the premises back upon payment of a premium (by the landlord).
- The tenant spent millions renovating the premises. Nevertheless, the landlord served notice to terminate the lease and re-acquire the premises, due to the tenant's failure to complete the redevelopment works in accordance with the lease.
- The Council argued that the valuation date for assessing the price for it to re-acquire the premises was when vacant possession was obtained (2021) rather than the notice expiry (November 2019). The Council also claimed damages for trespass/mesne profits from November 2019.
- The tenant argued (1) the break option had not arisen or it should be implied that the Council had to serve notice while the breach existed or within a reasonable time, not at any time throughout the lease; (2) the Council had prevented the tenant from doing the works, or alternatively had waived the break option or was estopped from exercising it; and (3) in any event, the Council had not suffered any loss (due to forced Covid closures) so mesne profits should not be payable.

WHAT DID THE COURT SAY?

- Although the court held that the break notice was validly served, it implied a term that the break notice could only be served while the development was incomplete. The question was therefore whether the tenant had failed to complete the development on time, and on the facts the Court found that the tenant had not done so either by the 23 May 2018 deadline specified in the lease or when the break notice was served in September 2019.
- The tenant's arguments on waiver and estoppel failed, as it couldn't point to any clear communications made by the Council. However, the court held that the relevant valuation date for the re-acquisition price payable by the Council was the expiry of the break notice in November 2019. This was £1m more than the value in 2021 when vacant possession was given (the date the Council had argued for).
- No mesne profits were awarded on the basis that the Council had suffered no loss and the tenant had suffered no benefit as a result of its continued occupation after November 2019.

WHY IS IT IMPORTANT?

- This was a rare example where the court implied a term even though it was not necessary for business efficacy- the lease still worked without the implied term. Nevertheless, it was implied on the basis that it was so obvious as to go without saying that the landlord could only terminate the lease while the development was incomplete, not at any time during the remaining 197 years of the lease term.
- It is a reminder that exercising a break option is different to other lease termination rights, such as forfeiture, which can be waived if you treat the contract as continuing and do not elect to terminate promptly. Here, the Council's delay in exercising the break option after the right arose was irrelevant.
- The case highlights the effect of the pandemic on the hospitality industry. Here it resulted in a £1m valuation difference between November 2019 and the 2021 trial, and influenced the judge's decision that no damages/ mesne profits were payable, since the property was forced to remain closed during the pandemic.

RECENT TEAM BLOGS AND ARTICLES

PERIODIC TENANCIES AND PROPRIETORY ESTOPPEL- NOT ALL SMOKE AND MIRRORS

SMOKE CLUB LTD AND OTHERS V NETWORK RAIL INFRASTRUCTURE LIMITED

In *Smoke Club Ltd and others v Network Rail Infrastructure Limited*, the Upper Tribunal found that the tenant had acquired periodic tenancy, protected by the 1954 Act, where negotiations continued after lease expiry but the tenants were clear that they would not accept a tenancy at will.

CLICK HERE FOR FULL ARTICLE

WRONG PAYMENT DATE INVALIDATED SERVICE CHARGE DEMAND

H STAIN LTD V RICHMOND

In *H Stain Ltd v Richmond*, the Upper Tribunal held that a service charge demand issued to a residential leaseholder was invalid where the payment due date was a few days short.

CLICK HERE FOR FULL ARTICLE

GETTING IN TOUCH

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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