Commercial property update

Magnus Hassett considers current trends in lease renewals, a recent case on nuisance covenants, the most recent revision to the energy efficiency scheme, and when the court will re-draft a document

There are likely to be a large number of 25 year leases, granted at the end of the 1980s, which are due to expire soon. Practitioners may therefore start to notice an increase in lease renewal work over the coming months. In the current letting market, it is likely that differences of opinion will arise between landlord and tenant on renewals as to the appropriate length of any new lease term. Flexible – in other words short – terms are likely to be sought by tenants but may be resisted by landlords. Unfortunately, from a landlord's point of view, the Landlord and Tenant Act 1954 imposes no restriction on the shortest term that can be ordered by the court. The 1954 Act provides that the court may order what is 'reasonable in all the circumstances'. Relevant factors when determining what is reasonable can include:

- the length of the old tenancy;
- the length of time during which the tenant has held over after the end of the last tenancy;
- the tenant's business needs (including retirement plans);
- any hardship that would be caused to either party; and
- the need to protect the tenant's right to security of tenure.

Landlords often cite diminution in value of the reversion as evidence of "hardship". In *CBS United Kingdom v London Scottish Properties* [1985] 275 EG 718 the court found against the landlord and ordered a 12-month term – it noted that the landlord would have 11 months to find a new tenant and that the prospect of a void was small. Similarly, in *Rumbelows Ltd v Tameside Metropolitan Borough Council* (1994), finding for the tenant, the judge noted that the landlord's property accounted for only 7.5 per cent of its entire property portfolio.

Although there are cases where the courts have imposed longer terms upon tenants, these have generally been tempered by the inclusion of a tenant's break clause.

In such a challenging market for landlords, even if landlords can show a real detrimental effect of shorter terms, it is doubtful that the courts will generally take their side. To secure longer term deals, will we start to see any landlords who feel they have no choice but to show more flexibility on some other longstanding features of commercial leases such as the upwards only rent review?

A nuisance for developers

When reviewing title for a proposed development site, it is not uncommon to find that the land in question is subject to a covenant not to cause a nuisance to adjoining owners.

It can be tempting to see such a covenant as fairly innocuous, particularly if it has been imposed by an old conveyance. However, a recent case has highlighted the risk of taking this approach.

In *Coventry School Foundation v Whitehouse* [2012] EWHC 2351, land intended for the construction of a school building was subject to a covenant imposed by a 1931 conveyance not to use the land for any purpose which may be (or grow to be) a nuisance or annoyance.

While the courts have in some cases interpreted nuisance covenants so as to restrict building works (for example in *Shephard v Turner* [2006] EWCA Civ 8), in this instance the court found that the wording of the covenant related only to the use of the land rather than to any building works being carried out on it.

However, although the court decided that a breach of covenant would not arise on the grounds of noise alone, it was held that the traffic issues caused by the opening of the school (such as noise, congestion and difficulty parking) were substantial enough that the development of the school would be in breach of the nuisance covenant. This was despite the fact that planning permission had previously been granted for the new school buildings.

It is not the end of the story – the Foundation has appealed, with the case scheduled to be heard by the Court of Appeal in March. However with a number of local residents who benefit from the covenant campaigning against it, the proposed development's prospects do not look nearly as promising as they once did.

The decisions in cases of this type will depend on their specific facts – but this case is a clear reminder that nuisance covenants should not be disregarded by developers or those advising them, since they have the potential to be relied upon by those seeking to object to a new development.

Here to stay

In December 2012 the Department of Energy and Climate Change (DECC) published its response to the public consultation on proposed changes to the CRC Energy Efficiency Scheme (CRC) and confirmed that, despite significant criticisms, a modified CRC is here to stay.

The CRC is a mandatory UK-wide emissions trading scheme which applies to organisations which meet the qualification criteria based on electricity consumption.

After considering the responses received to the consultation, the DECC has announced the changes set out below. The changes are intended to reduce the scheme's complexity and the administrative burden (and associated cost) for participants.

From 1 June 2013:

- The Performance League Table, which 'names and shames' energy-inefficient participants, will be scrapped.
- The number of fuels covered will reduce from 29 to two: electricity and – when used for heating – gas.
- The deadline for the surrender of CRC allowances, which participants use to cover their energy emissions, will be extended from July to the end of October.

From 1 April 2014:

- CRC compliance transfers to tenants of 'building leases', i.e. where the tenant constructs the building and the term is for 30 years or more.
- The 'landlord and tenant rule' otherwise remains the same, so that landlords remain liable for CRC compliance where they supply energy directly to tenants.
- Capped auctioning of allowances will be replaced with two fixed price sales in each reporting year – a cheaper forecast sale at the start, and a second more expensive 'buy to comply' sale after the end of each year.
- Removal of the '90 per cent rule', requiring participants to demonstrate that at least 90 per cent of their emissions are covered by the EU Emissions Trading Scheme, climate change agreements, or the CRC. Instead there will be a 2 per cent de minimis threshold for gas used for heating.
- Trusts with a majority beneficial owner will group their energy emissions with that beneficial owner for CRC qualification and participation. All other trusts will group their emissions with the trustee, or operator where one is engaged to conduct regulated activity, for qualification purposes. They may then disaggregate for CRC participation.
- CRC will no longer apply to state funded schools in England.

Resist the temptation

In the recent case of *Campbell v Daejan Properties Limited* [2012] EWCA Civ 1503, the Court of Appeal has considered how obvious an error has to be in a lease for the courts to be able to correct it by construing the lease in a different way.

Mrs Campbell is the tenant under a long lease of a maisonette on the top two floors of a five storey house at Upper Wimpole Street, London, W.1. The lease was originally granted in 1958 for 65 years but a new lease was entered into in 1999 to extend the term to 164 years.

The lease was originally drafted in an odd way when it came to the tenant contributing to costs and outgoings and no changes were made in 1999 when the new longer lease was entered into. The dispute only arose after the landlord, Daejan, carried out major works of repair in 2005/6.

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Under the lease, the tenant is liable to contribute to various costs and expenses in different proportions. The maisonette comprises 29.2 per cent of the total floor area of the house and 26 per cent of its rateable value but the lease provides for the tenant to pay 40 per cent of the insurance and 42.1 per cent of the central heating costs and 31.25 per cent of the rates. Most critically, the tenant is liable to pay 40 per cent of the costs of external repairs.

The case turned on whether the contribution of 40 per cent to external repairs related to those to the whole house or just to the main roof above the maisonette and its outer walls. As drafted, the lease provided for the tenant to only pay 40 per cent of the costs incurred by the landlord in repairing the exterior of the premises, not the whole house. Daejan argued this was illogical and a clear mistake and, at first instance, the judge agreed with them. He held that Mrs Campbell was liable for 40 per cent of the costs of all external works to the house and this included the walls to the lower floors as well as the roofs to the various extensions.

However, the Court of Appeal took a different view. It held that the governing principle is that parties mean what they say and the courts should resist the temptation to re-draft or improve upon the terms agreed. It is only if there is an obvious error that the courts can construe a lease contrary to its express meaning. This was not a rectification case where the court could look at background documents to seek to establish what was intended.

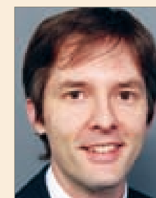
Although the court agreed that the lease was badly drafted, it held there was no obvious pattern in the various service charge provisions which made it clear that the tenant was to pay 40 per cent of all external costs to the whole house. In fact, 40 per cent would be excessive based on its size and rateable value. It accepted the tenant was liable under the lease to pay 40 per cent of the total insurance but noted the landlord had reduced this to 33.3 per cent.

The court, while accepting it was unusual, did not think it absurd that the tenant would only pay for costs to the part of the exterior directly relating to the maisonette or that this would leave the landlord unable to recover 100 per cent of repairs to the whole of the house. In fact, the court made clear there was no presumption that a lease should enable the landlord to recover 100% of its expenditure.

Importantly, the court noted that, firstly when works had previously been undertaken in 1992, Mrs Campbell had only paid 40 per cent of the costs relating directly to her premises and, secondly, the landlord had not sought any changes when the new lease was entered into in 1999.

Although the wording of the lease was clearly capable of improvement, and the different contributions somewhat inexplicable, the court did not find it so commercially absurd that it needed to correct the document.

The case is a reminder to practitioners that the courts will not rewrite badly drafted documents where it is not obvious that a mistake has been made.



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