Magnus Hassett, Laura Williamson and **Katherine Ekers** consider the implications of the dilapidations protocol, break clauses, business rates relief and the meaning of 'unreasonable withholding of consent' in leases

Commercial property update

Dilapidations protocol

The dilapidations protocol has been formally adopted by the courts with effect from 1 January 2012.

The protocol has been around in various forms since 2002. Its principal aim is to save costs by ensuring that the parties are honest with each other as to the true extent of their losses (landlords) and liabilities (tenants).

As a result of the protocol being adopted by the courts, the endorsements that landlords or their surveyors make in order to support their intentions for the premises at the end of the term are now going to come under greater scrutiny by the court. Tenants' solicitors are likely to focus on trying to establish (through disclosure of documents or otherwise) that the landlord has misrepresented the claim in some way and to then use this to seek to negotiate better terms for settlement (in some cases the protocol may result in additional legal costs being incurred rather than costs being saved!)

Those acting for landlords should remind their clients of the care that landlords must now take in relation to how they manage dilapidations claims, and, in particular, how they instruct their surveyors and formulate their intentions for the premises on lease expiry. Landlords may tend towards avoiding the preparation of documents or reports which will inhibit what can be claimed or expose them to any liability for exaggerating or misrepresenting their claims, particularly in circumstances where the landlord has either made no decision to carry out repairs or only has a tentative intention to upgrade the property, or make changes or redevelop.

Break clauses: traps for tenants

Yet another recent case, *Avocet Industrial Estate LLP v Merol and another* [2011] EWHC 3422 (Ch), stresses the need for strict compliance by tenants with any conditions attached to break clauses in leases, and, for tenants' solicitors at least, is a rather depressing reminder of the rigid approach that the courts feel obliged to adopt in this area.

In *Avocet* the tenant's break was conditional on payment of all sums due under the lease. The landlord challenged the purported exercise of the break on the basis that £130 of interest was due following late payment of an insurance premium. Although the interest had not been demanded, it was still technically due as the lease provided that interest was payable at a set rate on all sums not paid by their due date. This meant that there were sums due under the lease which were outstanding at the break date. Despite recognising this represented "something of a trap" for the tenant, the judge felt constrained to hold that the conditions attached to the break had not been met.

The landlord in *Avocet* did not realise interest was due without being demanded until taking legal advice after the break date had passed. Interestingly, if they had realised that interest was due, and at the same time were aware that the tenant believed it had paid all sums due, they may have been estopped from taking advantage of the tenant's mistake. Ironically, it seems the tenant might have been better off if the landlord taken legal advice earlier than it did.

In *Avocet*, £130 of late payment interest invalidated the break and meant that the lease rolled on for another five years at £67,500 per annum. The outcome will leave

many lawyers questioning whether the commercial intentions of the parties are being served by the recent cases on break clauses. Tenants' lawyers are once again reminded:

- At lease-drafting stage, to ensure that any break clause is drafted so as to be 'lease code compliant', i.e. conditional only on payment of principal rent, giving up occupation and leaving behind no continuing sub-leases. If a landlord insists on payment of all sums due then at the very least this should only cover sums demanded in writing not less than seven days before the break date.
- That where a tenant is stuck with a break clause like the one in the *Avocet* case, they must rigidly adhere to any conditions attached to their break. Where the condition includes a condition to have paid 'all sums due' tenants should be reminded to forensically examine their payment history and calculate and pay any default interest.

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Landlords, charities and business rates relief

Full business rates are due on empty commercial properties that remain unoccupied after three months. Commercial landlords, faced with empty property and an ever-increasing burden of business rates, have been looking for ways to trim their void costs. It has become common for landlords to grant leases of vacant property to charities at nominal rents but on the usual basis that the tenant is responsible for outgoings.

Charities often do not have to pay rates as they qualify for an 80 per cent discount provided the property is used wholly or mainly for charitable purposes, and local authorities also have the discretion to grant the remaining 20 per cent as a further discount.

In many of these arrangements, the charities do beneficially occupy the property. The arrangements are mutually beneficial and can bring otherwise empty property back into use. The Charity Commission has, however, flagged in a December 2011 circular that it is aware of local authorities' concern about situations where some charities appear to be entering into tenancy agreements, but, in practice, the property is (or appears to be) empty. The commission reminds charity trustees in the circular that that they must be satisfied that they are not participating in business rates avoidance by landlords.

It would be prudent for solicitors acting for both landlords and charities on leases of vacant property to point out the existence of the Charity Commission circular to their clients before dealing with any such arrangements. From landlords' point of view, they need to be aware that any schemes that are transparently designed to reduce business rates liability, or to trigger a further void rates period, are likely to come under increasing scrutiny by local authorities. Charity trustees should also be aware that the Charity Commission is intending to examine whether the trustees have properly discharged their duties when making decisions to occupy property for charitable purposes.

Leases: withholding consent

Commercial leases often include the phrase 'such consent not to be unreasonably withheld or delayed' following every reference to a requirement for the tenant to obtain landlord's consent. This is a simple enough phrase, but there is a significant amount of case law on what constitutes an 'unreasonable withholding of consent' and the factors that a court may take into account when making its judgment.

The case of *Porton Capital Technology Funds & Ors v 3M UK Holdings Ltd & Anor* [2011] EWHC 2895 is further authority that a landlord is entitled to think first about its own relevant interests when considering a tenant's application for consent and does not need to consider those of the tenant (unless there is a manifestly disproportionate outcome).

The case looked at the issues around the giving of consent in the context of a commercial dispute, where one of the matters to be decided was whether the claimants had unreasonably withheld consent to the defendant's proposal to terminate a business. Such consent was required pursuant to the sale and purchase agreement by which the defendants had bought the business in question from the claimants (with the promise of further payments to the claimants based on future sales).

The judge accepted that landlord and tenant case law on this point could be applied in a commercial context. The principles deriving from *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd* [1986] 1 Ch 513 were therefore applied. One of these is that a landlord need usually only consider its own relevant interests in coming to its 'reasonable' decision. The exception to this is where there is a large disparity between the potential benefit to the landlord and the detriment to the tenant, in which case a landlord may still be held to be acting unreasonably.

Citing the above, the claimants put forward the argument that they were entitled to have regard to their own commercial interests when considering the application for consent, and, moreover, that they were not required to balance their own interests with those of the defendants. On the facts of this case there was no disproportionate detriment to the party applying for consent. These arguments were accepted and the judge ruled in favour of the claimants.

The *Portman* case is further authority that a landlord is entitled to think first about its own relevant interests when considering a tenant's application for consent and does not need to consider those of the tenant unless there is a manifestly disproportionate outcome. If a tenant wishes its interests to be taken into account and given equal weight, for the purpose of assessing the reasonableness of such a decision, then it appears that this would have to be specifically dealt with in the lease. In practice, though, it is difficult to see a well-advised landlord accepting such a provision.

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