4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

Professor Nicholas Hopkins
Law Commission
Commissioner
1st Floor, Tower, Post Point 1.51,
52 Queen Anne's Gate,
London
SW1H 9AG

Email: nicholas.hopkins@lawcommission.gsi.gov.uk

City of London Law Society Land Law Committee response to the Law Commission's consultation on its 13th Programme of Law Reform

Introduction

The City of London Law Society ("CLLS") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees. This response in respect of the Law Commission's Consultation on its 13th Programme of Law Reform ("Consultation") has been prepared by the CLLS Land Law Committee.

Response

The Committee has been provided with the response of the Property Litigation Association ("PLA") to the Consultation (attached with annexures). The Committee strongly endorses the response and believes that the PLA's proposals will greatly help to reduce uncertainties in the law that hinder commercial relationships and potentially adversely impact on the valuation of property.

Landlord and Tenant (Covenants) Act 1995

The Committee agrees that the Landlord and Tenant (Covenants) Act 1995 ("1995 Act") is the piece of legislation most in need of urgent reform, especially in relation to the problems arising from the way in which the 1995 Act's anti-avoidance provisions have been construed in recent cases. The PLA's suggested amendments to the 1995 Act to address the highlighted concerns (and set out in the PLA's separate briefing note attached) are sensible and the Committee supports them.

The Act is an impediment to what should be day-to-day transactions such as a guarantor guaranteeing an assignee of a lease or becoming the assignee. This constraint can interfere with intra-group restructuring or transfers between business partners and can be more detrimental to the tenant and its guarantor than the landlord.

Repeat guarantees are invalidated even where the tenant and its guarantor intend that the guarantee is provided or freely offer it. Defeating freedom of contract in those circumstances seems unreasonable.

The ambiguity of the 1995 Act and the doubt that subsequent court decisions have cast over the legal effectiveness of guarantees entered into, have a potentially detrimental impact on certain property valuations. This is exacerbated by the fact that very often the strength of the covenant offered lies with the guarantor, since tenants often are special purpose vehicles.

One of the biggest concerns relates to the problems for partnerships caused by the 1995 Act. The guarantor cannot provide a repeat guarantee of assignee partners' lease obligations and there is the uncertainty of whether tenants can assign to themselves (with third parties), highlighted in paragraphs 4.13 and 4.14 of the attached briefing note.

The Committee supports the PLA's proposed amendments set out in paragraph 5.2 of the briefing note. This includes confirming that "sub-guarantees" are legally effective and that a tenant can assign to its guarantor.

Residential landlord and tenant legislation

The Committee supports the PLA's comments in the first attachment to this email on the Right of First Refusal in section 2 of the Landlord and Tenant Act 1987. Poor drafting in the legislation leads to uncertainty as to whether the right applies, for example, the lack of a definition of what is a "building" in the context of where the premises are part of an estate comprised of several buildings.

The Committee agrees that consideration should be given to whether there is a need to preserve the right of first refusal in view of tenants' existing rights to enfranchise. If the Law Commission considers that the right should be retained, the Committee would ask that the Law Commission reviews whether a breach of the statutory provisions relating to the right of first refusal should continue to be a criminal offence. In view of the impact of a criminal conviction, the Committee

would ask whether the nature of the breach is so serious as to merit carrying the stigma of a criminal penalty.

The Committee also considers that there should be greater clarity in the legislation that the right of first refusal provisions do not apply to commercial transactions. This is particularly an issue in relation to mixed use properties as highlighted for example in DARTMOUTH COURT BLACKHEATH LIMITED v BERISWORTH LIMITED [2008] EWHC 350 (Ch). The legislation needs to be amended to make it clear that the right of first refusal does not apply in mixed commercial/residential premises to the grant of a lease of the commercial parts. Currently, if a landlord grants a lease of a shop on the ground floor of a mansion block, the grant of the shop lease may technically trigger the right of first refusal.

Landlord and Tenant Act 1954

The PLA has not provided any comments on the Landlord and Tenant Act 1954 ("1954 Act"), but the Committee has some observations set out below.

Changes in relation to contracting out of sections 24 - 28 of the Landlord and Tenant Act 1954

There are a number of concerns arising from changes made to the 1954 Act by the Regulatory Reform (Business Tenancies) (England and Wales) Order 2003. The Committee would be grateful if the Law Commission can consider these concerns and whether changes are required to the 1954 Act to address them. These concerns lead to inconsistent practices among professionals and potential delay, disruption and increased costs for commercial property transactions. The Government has in the past acknowledged concerns with the changes made by the 2003 Order and suggested possible changes to the legislation to deal with the concerns. The Committee considers that it would be sensible for the Law Commission to consider the Government's papers addressing such concerns and move forward the implementation of changes. Set out below are a number of concerns that the Committee has.

The Committee's primary observation is that the system of warning notices and tenant's declarations under the 1954 Act that was supposed to streamline the contracting out process (as compared to the previous Court order process) has failed. There are legal uncertainties and differences of practice that the Committee highlights in its comments below, which can lead to delays on transactions and the incurring of extra, irrecoverable costs. The Committee, therefore, proposes that the contracting out warning notice and declaration mechanism under the 1954 Act be abolished and replaced by a requirement for a contracted out lease to have a clear warning at the top of the lease as to the statutory rights that the tenant loses. This would greatly reduce the administration and associated costs, yet at the same time warn the tenant that he is giving up statutory rights in entering into the lease. There are many potential traps for professionals and their clients with the current procedures as highlighted below and this simple solution would appear to overcome many of those problems.

If, however, the Law Commission is minded not to recommend such a solution, the Committee would ask the Law Commission to consider the more detailed points on the operation of the 1954 Act set out below.

Must the warning notice be served on the tenant direct?

There is sufficient doubt as to whether service on the tenant's solicitor will constitute good service that many law firms' practice is to serve on the tenant direct with a copy to his solicitor acting on the grant of the lease/agreement for surrender. This is inefficient.

Simple and statutory declarations

The Central London County Court in Patel v Chiltern Railway Co Ltd [23 May 2007] considered that there is no problem in using a statutory declaration when a simple declaration would have been sufficient. The Court of Appeal has subsequently confirmed the decision and the reasoning of the judge would appear to apply to the warning notice/statutory/simple declarations for agreements to surrender protected tenancies (falling within sections 24-28 of the 1954 Act). It would be good for the 1954 Act to make this clear.

Must the exchange of warning notice and declaration be repeated if the tenant's interest is assigned?

Yes, if the change of intended tenant occurs before the agreement for lease or lease (if no agreement for lease) is entered into. No, if the assignment occurs after the lease has been completed. However, the position is unclear, if the assignment occurs between the agreement for lease and grant of the lease. The solution is to prohibit assignment of the benefit of the agreement for lease either absolutely or without the landlord's prior consent. If the latter, the agreement for lease can make non-compliance with the new procedures a "circumstance" in which such consent can be absolutely withheld (for the purposes of section 19(1) (A) of the Landlord and Tenant Act 1927). Again, the position can be clarified by legislative change. There is a similar lack of clarity as to whether the exchange of warning notice and declaration must be repeated if the landlord's interest is transferred between the agreement for lease and grant of the lease.

How early can the landlord's warning notice be served?

A concern arises about whether the landlord's warning notice needs to be re-served if the form of lease is changed after service of the notice but before the lease is completed (or the agreement for lease is exchanged if earlier). In the past, the Office of the Deputy Prime Minister (ODPM) confirmed that the "spirit of the law" is that the tenant should only be able to validly give up his security of tenure rights if he knows what he is giving up. If the terms of the lease change

materially after the tenant signs his declaration, the ODPM suggested that this would cast doubt on the informed nature of the tenant's consent (through the declaration). Therefore, by implication a new notice and declaration would need to be exchanged for the lease to be validly contracted out. The ODPM believed that the “Palacegate” principles (relevant to the former Court Orders for contracting out) still applied. Clarification here would be welcomed.

Does the warning notice need to be re-served and the declaration re-sworn if the form of lease attached to an agreement for lease is varied materially after exchange of the agreement but before completion of the lease?

This is, probably, not a problem if the "variations" are ones the parties were bound to agree in accordance with the terms of the agreement. Otherwise, problems may arise – perhaps the procedures should be re-done before the landlord is bound to agree the variations to the lease or, alternatively, perhaps the changes should not be made until after the lease has been granted and then the lease can be formally varied, but there may be tax consequences. Consideration should be given to whether the process can better take account of transactional realities.

Where the contracted out lease contains an option to renew on a contracted out basis, what needs to be done to ensure that the renewal lease is validly contracted out?

The warning notice and declaration must be exchanged in relation to the renewal lease (as it is intended to be granted) between the parties who are the intended landlord and tenant to the renewal lease before the tenant is contractually obliged to take up the renewal lease. There are at least two ways of achieving this:

- exchange the warning notice and declaration before the lease containing the option to renew is entered into. Therefore, with a contracted out lease containing an option to renew on a contracted out basis, there will need to be 2 sets of warning notices and declarations before the "original" contracted out lease (or agreement for such lease) is entered into. One set in relation to the original contracted out lease/agreement for such lease and one set for the renewal lease. However, this only works if the form of the renewal lease is frozen (or possibly where any changes are immaterial on the “Palacegate” test).

  Also the tenant may change during the currency of the original lease and, therefore, there will be a need to serve new warning notices on the assignee before it becomes contractually bound to take the renewal lease (to ensure it is validly contracted out). To deal with this, there will need to be an extra "circumstance" in the assignment provisions (for the purposes of section 19(1) (A) of the Landlord and Tenant Act 1927), permitting the landlord to refuse consent to assign unless the warning notice and declaration have been swapped in relation to the renewal lease. Even this would not pick up automatic assignees (by operation of law).

- wait until the tenant has decided to exercise the option before doing the contracting out paperwork. The tenant would need to be obliged in the option mechanism to serve an "advance notice" on the landlord that the tenant is going to exercise the option and it would need to be a precondition to completion of the renewal lease that the new procedures for contracting out have been carried out. The tenant will probably want a landlord's obligation to serve a warning notice within a specified period of receiving the tenant's advance notice. The advance notice will be a separate notice from the one exercising the option that contractually commits the tenant.

This is somewhat convoluted and it would be useful for the Law Commission to consider if this process can be streamlined.

A protected lease contains an offer back clause on tenant's assignment (or subletting) so that the landlord has the right to take the lease back before it passes to a third party. What has to be done to render binding the "agreement to surrender back" to the landlord?

There must be an exchange of the warning notice and declaration before the agreement to surrender becomes contractually binding. However, there is a potential impasse (the “Allnatt” stalemate) with offer back clauses in leases protected by Part II of the 1954 Act that have not specifically been authorised by the warning notice/declaration process. To deal with this, the offer back clause may prescribe that:

- the tenant notifies the landlord of its desire to assign;
- the tenant must obtain the landlord's consent to assign;
- the landlord, if it wishes to take the lease back, can choose to serve a warning notice within a particular time period of the tenant's notice;
- if and when, in response to the warning notice, the tenant signs the declaration (and provides a copy to the landlord), the obligation to surrender will arise but not before;

and the assignment provisions in the lease can prescribe that the landlord can withhold consent to an assignment to a third party unless and until the offer back procedures as above have been fully complied with.

With that arrangement, there may be a typical “Allnatt” stalemate in that if the tenant does not co-operate in signing the declaration, he cannot assign to the third party and yet the landlord cannot enforce the agreement to surrender. Commercially, however, the tenant is likely to sign the declaration to try to achieve his objective of assigning. In practice, many landlords and tenants who have entered into Allnatt-style offer back clauses simply follow the contractually agreed procedures and do not take the 1954 Act compliance point and of course once the surrender itself is completed the compliance issue goes away. However, the Law Commission should consider if

there is any statutory solution to the “Allnatt” stalemate, which remains a potential problem in many commercial property transactions with the adverse impact of delay and extra cost.

The contracted out lease contains a put option whereby the landlord can require the tenant to take another contracted out lease. What needs to be done to ensure the new procedures are complied with in relation to the lease the tenant is required to take up?

The warning notice and declaration must be swapped in relation to the new lease (as it is intended to be granted) between the intended landlord and tenant to the new lease before the tenant is contractually obliged to take up that lease. The landlord can simply serve the warning notice before it exercises the put option. The problem for the landlord is it cannot compel the tenant to sign the declaration and if the declaration is not signed, the new lease will be protected. As a result, put options for contracted out new leases (a rare breed, admittedly) are not likely to be worth the paper they are written on.

More significantly, there remains the issue of put options in guarantor clauses in contracted out leases and whether there is a need to go through the new procedures in relation to a landlord requiring a guarantor to take up a new contracted out lease following a tenant’s disclaimer. There are two schools of thought here. One is that if there is a guarantor and the guarantee contains such a put option, the landlord should serve a warning notice and the guarantor should sign a declaration before the "original” lease containing the guarantee is entered into. The more pragmatic view is that the new procedures should be carried out if and when the landlord requires the guarantor to take a lease following tenant disclaimer. Although there is a risk that the lease has not been properly contracted out, some landlords may take the view that this risk is less of an issue than the confusion that is caused by having to serve a multiplicity of warning notices on guarantors (which of course may include guarantors under licences to assign, underlet, authorised guarantee agreements etc).

It is worth reiterating that such warning notices and declarations do not relate to the contracted out lease that is about to be entered into, but relate instead to a lease that may never be entered into pursuant to the guarantee clause. Differences of practice among law firms cause confusion in the property industry and delay, disruption and extra costs on transactions. The Law Commission should look to clarify the position, perhaps, along the lines previously suggested by the Government that if the original lease is contracted out, the lease pursuant to the guarantee clause is automatically contracted out without needing to serve the notice on the guarantor and have a declaration for that lease. This would have an important beneficial deregulatory impact.

Problems caused by the "Newham decision"

The decision in London Borough of Newham v Thomas-Van Staden [2008] EWCA Civ 1414 has caused some consternation in the property community and the Committee would be grateful if the Law Commission can consider whether legislative change can be made to section 38A(1) of the Landlord and Tenant Act 1954 ("1954 Act") to resolve the problems caused by the decision.

Section 38A (1) states "The persons who will be the landlord and the tenant in relation to a tenancy to be granted **for a term of years certain** which will be a tenancy to which this Part of this Act applies may agree that the provisions of sections 24 to 28 of this Act shall be excluded in relation to that tenancy."

It is the reference in bold to "**for a term of years certain**" that causes the problems.

Particularly prior to the "Newham decision", many leases, apparently contracted out of sections 24-28 of the 1954 Act, define the term of the lease to include "any holding over or continuation period" or words to that effect. The reference to a holding over or continuation period is inappropriate for a contracted out lease, because there is no such period for such a lease under the 1954 Act. Draftsmen sometimes included this reference or similar wording either due to inadvertence or because they thought it would do no harm to retain it since it was simply irrelevant.

However, the "Newham decision" confirmed that including such a reference meant that the lease could not be validly contracted out. This was because section 38A(1) required the contracted out tenancy to be for a term of years certain. The Court of Appeal in Newham decided that because the definition of term referred to holding over etc, this meant that the tenancy was not for a term of years certain and, therefore, was not validly contracted out.

The effect of this is that a landlord who may have redevelopment plans for a property and who assumed he could recover possession is now faced with the prospect of having to go through the 1954 Act procedures to seek to recover possession. All because the term definition included some words that many practitioners previously considered merely irrelevant.

The landlord and the tenant had agreed in heads of terms that the lease would be contracted out and the rent was agreed on that basis. Yet a tenant can potentially use the technical error highlighted by the "Newham decision" to gain an unfair advantage over the landlord.

For those reasons, the Committee would ask the Law Commission to consider the removal of **for a term of years certain** from section 38A(1).

Rentcharges

The recent case of Roberts v Lawton [2016] UKUT 395 (TCC) is a timely reminder of the danger posed by rentcharges. In that case, the judge observed that if a lease is granted by a rentcharge owner pursuant to section 121 of the Law of Property Act 1925, it will subsist forever, even after any arrears of rentcharge have been paid off (and potentially even after all rentcharges are abolished in 2037).

This is clearly unfair. It appears from the judgment that there are organisations that are being set up specifically to take advantage of this loophole. Although all rentcharges will be disappearing in 2037 (other than estate rentcharges), that is still 21 years away and it would be sensible to take some action now to prevent this sort of high handed behaviour. This could be achieved simply by

providing a means by which the landowner can remove the lease once the arrears have been paid off.

The "registration gap"

The "registration gap" continues to cause problems in practice, particularly in the light of the delays encountered with the processing of applications by Land Registry. It can take months for a registration to be completed, and in the meantime, the new owner (equitable but not yet legal) cannot serve notices in its own name. There may be numerous notices that need serving in respect of an investment property, for example, rent review trigger notices, notices under the Landlord and Tenant Act 1954, break notices etc.

A good example of this problem was the recent case of Stodday Land Ltd v Pye [2016] EWHC 2454 (Ch), where the court held that a new landlord cannot validly serve a notice on a tenant until it has become registered as proprietor of the property at Land Registry. This “registration gap” is a conveyancing trap and efforts need to be made to try to eliminate it.

If a buyer has paid for a property, surely it should have the rights of a landowner, even if the registration formalities have not yet been finalised. This could be addressed by stating in a Law of Property Act that a landowner will have the rights it will have when it becomes the registered proprietor as soon as the purchase money has been received by the registered proprietor.

Jackie Newstead,
Hogan Lovells International LLP
Chair, City of London Land Law Committee

2nd November 2016

© CITY OF LONDON LAW SOCIETY 2016
All rights reserved. This paper has been prepared as part of a consultation process.
Its contents should not be taken as legal advice in relation to a particular situation or transaction.

THE CITY OF LONDON LAW SOCIETY

LAND LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

J Newstead (Hogan Lovells International LLP) (Chair)

J. Barnes (Herbert Smith Freehills LLP)
N. Brent (Druces LLP)
J. Brooks (King & Wood Mallesons LLP)
J. Chapman (Ashurst LLP)
J. Crookes (Pinsent Masons LLP)
B. Dear (Eversheds LLP)
Ms C. DeLaney (Rosenblatt Law LLP)
Ms J. Elkins (Field Fisher LLP)
M.J.H. Elliott (Linklaters LLP)
Alderman Alison Gowman (DLA Piper UK LLP)
Ms A. Hardy (Squire Sanders UK LLP)
D. Hawkins (Norton Rose Fulbright LLP)
L. Heller (Emeritus)
Ms V Hill (Freshfields Bruckhaus Deringer LLP)
N.D.E. Jones (Simmons & Simmons LLP)
A. Judge (Travers Smith LLP)
P. Karia (CMS Cameron McKenna LLP)
D. McKimm (Allen & Overy LLP)
J.Nevin (Slaughter and May)
T. Pedder (Macfarlanes LLP)
J.R. Pike (Reed Smith LLP)
J. Shields (Nabarro LLP)
P. Taylor (Addleshaw Goddard LLP)(Emeritus)
Ms. S. Unadkat (Trowers & Hamlins LLP)
I. Waring (Berwin Leighton Paisner LLP)

W. Gordon (Olswang LLP) (Secretary)