



# ASSET



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## PROPERTY LAW UPDATE AND LOOK AHEAD

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ACES Spring Conference  
London, May 2011

ACES Paper No 11.05/2 by

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## Introduction

This paper will cover the following:

- Landlord's remedies on tenant's insolvency; insolvencies are on the rise and the last two recessions have shown that they have tended to increase towards the end of the recession rather than during the earlier phases.
- Tenant's Breaks; at FFW we are currently managing over 20 tenant breaks, which are very topical for reasons which will be discussed.
- The 1954 Act; this is always topical; the tactics just change when the economy changes.
- Green leases; these were very much the 'darling' of three or four years ago, but have not completely gone away.
- Competition Law; if you do not know much about competition law and property you are about to find out much more over the next year or two.

## Landlord's remedies on tenant's insolvency

I intend to deal with commercial tenancies rather than residential, and will focus on administrations and liquidations.

**Administrations.** Once the tenant has gone into administration, you cannot take any action against it through the courts or recover possession through peaceable re-entry to recover possession or levy distress for rent. However, you can recover rent as an expense of the administration if the company remains in occupation after the administration. In those circumstances, the rent recoverable is only for the period that the company is in occupation.

So the first thing to do is to see if the tenant is still there and if the answer is yes, start demanding rent from the administrator. If they are not, and that is the most likely situation, you are not likely to get the rent, for the time being anyway, from your current tenant. One point to note, the administrator cannot disclaim the lease.

Local authorities are becoming much more aware, when granting leases, of the importance of ensuring that there are other covenants (such as guarantors) when granting lease to tenants (particularly if the tenant covenant is not strong). At a later stage, once rent is being pursued, there may be other covenants as well, such as previous tenants (subject to Covenants Act restrictions). Subtenants must also not be forgotten, as they can be pursued for rent if the tenant is not paying by serving notice on them requiring them to pay all future sub-rents to you (as the superior tenant). This can be a useful source of income if sub-rent is similar to the head rent.

Rent deposits must also not be forgotten – but once they are used up, they are unlikely to be topped up if the tenant is in administration.

**Liquidations.** The rules are similar for (compulsory) liquidations. Moratoriums on forfeiture, court proceedings and distress. In terms of other remedies (e.g. guarantors, previous tenants and sub-tenants), the rules are similar to those in relation to administrations.

One of the main differences between liquidations and administrations is disclaimers. Many liquidators will disclaim leases as an onerous contract. If they do not then the landlord might want to persuade them to do so or serve notice requiring the liquidator to either pay the rent or to disclaim the lease. The effect of a disclaimer is that the future liabilities of the two parties, the landlord and the tenant, are brought to an end. However, if there are other parties involved then the lease does not end; for example guarantors and former tenants or not released by a disclaimer. The same rule applies to the guarantors of former tenants. Sub tenants are slightly different. If the sub tenant does not perform the covenants in the head lease, not the sublease, then the landlord can forfeit that lease. This means that if the sub tenant wants to stay put, it has to perform the obligations in the head lease (and that means paying the head lease rent and not the sub-lease rent). I won't touch on vesting orders as that is a topic in itself.

## Tenant's Breaks

FFW are currently managing huge numbers of these because, in a falling market, many tenants are finding themselves in over-rented properties. Therefore, operating a break option (if there is one in the lease) means that to the tenant can either move out to other premises that are cheaper or renegotiate a deal on their current premises.

This is of importance to Local Authorities both as tenant and where the authority is the landlord. There are many pitfalls in achieving a break, which you can either use to your advantage as a landlord, or be very careful with if you are the tenant.

The terms of break clauses are construed very strictly and if you do not comply strictly with the provisions, then you do not break. Therefore first thing to do is serve notice. So the tenant must establish when and where you need to serve the notice. In terms of when, this may be 6 months, or it could be longer. Remember, if the notice period is 6 months and you give 5 months and 27 days notice, the break is ineffective (and it could be another 5 years, or longer, before you can break again)

Importantly once a break notice is served it cannot be withdrawn. As a tenant, it is therefore important to be sure you do want to break before you serve notice.

There are 3 categories of break notice

- 'Unconditional'
- 'Semi conditional' and
- 'Fully Conditional'

An 'unconditional' break still requires the service of a proper notice.

'Semi conditional' breaks are where there are some conditions to be fulfilled e.g. vacant possession and, often, payment of rent. Remember that the rent has to cover the whole period (i.e. the quarter) during which the break is effected unless there is an express apportionment provision in the lease. As with all other conditions, they must be complied with strictly if the break is to be effective.

'Fully conditional' breaks are the most problematic for the tenant. They either require 'material' compliance or 'full' compliance with all covenants in the lease. Full compliance means all covenants have to be complied with full – e.g. repair, decoration, re-instatement, rent, service charges, etc; everything. With full compliance, every single item needs to be dealt with. If not, then you do not break. Material compliance allows you some leeway if you do not do the job perfectly (but such can be almost as problematic to deal with).

**Practical points.** If you are tenant, plan in advance. We advise tenants to look at it well in advance as the break might, for example, have a 12-month notice period; and it might take 8 or 9 months to do the necessary work needed for full compliance. Also a tenant should try to work with the landlord. The landlord is under no obligation to talk to you, and often the landlord, initially, can be friendly and cooperative. However, this may be mislead – they could be lulling you into a false sense of security and, when it is too late to do the work, the landlord may require strict compliance. and I have seen this time and time again and then the tenant is stuck in the lease.

## The 1954 Act

I will deal now with security of tenure and a couple of topical tactics arising from the 1954 Act. The first one relates to Notices and the second relates to Interim Rent. These are the background rules.

A landlord may serve a Section 25 notice to bring a lease protected by the Act to an end. The notice must give between 6 and 12 months notice of termination of the lease, but cannot terminate the lease before the contractual expiry date. The landlord can oppose the granting of a new tenancy under one of the grounds prescribed by Section 30 subsection 1 of the Act.

Either party can apply to Court for the determination of any ground of opposition or in respect of the terms of the new lease.

A tenant can serve a Section 26 request requesting a new lease. Similar rules apply on timing - between 6 and 12 months notice must be given and such a date must not be before the contractual expiry date of the current lease. If the landlord wishes to oppose the granting of a new tenancy, it has 2 months to serve a counter notice (and, if it does so, it must specify one of the Section 30 grounds).

Either party can apply to court once a Section 26 notice and a counter notice has been served.

Crucially if a Section 25 notice has been served, a Section 26 notice cannot be served, and if a Section 26 notice has been served then a Section 25 cannot be.

**Some Tactics; Scenario 1.** The property is an outdated retail building, the term expired just under a year ago, the landlord is keen to re-develop and the tenant is keen to stay put. This is not unusual in a retail location that delivers a good trade. What should the landlord do?

The landlord needs to get on and serve a Section 25 notice with six months to terminate the tenancy and specify Ground (f) (redevelopment) as the ground for opposing the grant of a new tenancy. If the landlord is in a hurry, it can issue proceedings and put the tenant under pressure to provide the evidence and so on. Then the landlord has a 'sporting chance' of getting the tenant out in the 6 month period.

The position of a tenant is more complicated. If the tenant wants to stay in the property as long as possible and if it thinks the landlord is just about to serve a Section 25, it should get on and serve a Section 26 because you can then put a date 12 months in the future and buy yourself more time. Alternatively if you think the landlord is being dilatory and is not going to do anything, then you may just want to sit tight and see what happens.

**Some Tactics; Scenario 2.** This scenario deals with interim rent – this is the rent payable for a period after a notice/request is served until a new lease starts/the tenant vacates. The crucial thing about interim rent is that the trigger for paying interim rent is the service of a notice. Interim rent can be higher or lower than the lease rent and either a landlord or a tenant can apply for a determination by the court. An interim rent runs from 6 months after service of the notice/request. Therefore, if no notice/request is made, no interim rent is payable (and the tenant continues to pay the passing rent),,

The property is office premises in Central London; the lease ended at Christmas time and it is now June no notices have been served. The passing rent is higher than the market rent. What do you do as the landlord? As the landlord you do absolutely nothing as you are benefiting from the fact that the interim rent has not been triggered. As the tenant, get on and serve your notice as quickly as possible as you have already lost a few months of interim rent, and as you will not get an interim rent for another six months, the longer you leave it the less you benefit from it. Obviously precisely the opposite tactics apply in a rising market.

## Green Leases

About 3 or 4 years ago, everyone was talking about green leases and making extravagant but worthy claims about what green leases were going to achieve. Local Authorities were at the forefront of the movement, as were some developers who were either doing it because they felt it was important or because they thought it was going to be good for their PR. Then the recession hit and most stopped talking so much about green leases.

A green lease is one that encourages the parties to reduce the environmental impact of the premises. Whilst not a legal definition, it means is that the parties are trying to manage things like energy consumption, water management, waste management, sustainable materials, repairs and so on and operate the property and the business in a sustainable way.

But then, after the recession, the Carbon Reduction Commitment (CRC) gave a little more impetus to green leases. The CRC was a complex and exciting concept where you have a league table, you make payments, you get bonuses

and payments back depending where you are on the energy efficiency league table. This helped to keep the green lease concept going with the debate about how costs would be shared between landlord and tenant. Then along came the Comprehensive Spending Review that effectively turned CRC into a property tax and siphoned off any money coming out of it straight into the Government's coffers. Consequently this again meant that green leases were off the agenda.

However, given the right drafting, I predict that green leases will be back some time in the future.

## Competition Law and Property

**The 1998 Competition Act.** When this Act came into force it expressly excluded land agreements from anticompetitive behaviour, however, the 2004 Order changed all that and from April 2011 the Competition Act now applies to land agreements, with a few exceptions. So the Act does apply to most commercial property contracts - anything that creates or alters an interest in land is caught within the tightly drawn 1998 Act.

What might offend the 1998 Act? For example take the situation where you have a shopping centre that you want to extend whilst protecting the interests of existing tenants by retaining footfall in the older section and not merely transferring it to the new extension. One way to achieve this is to put in place restrictive covenants that restrict the type of shops that can locate in the new section. For example there might be a restriction on a newsagents opening in the new section of the shopping centre, as there is already one in the old part. Those kinds of covenants could offend the Competition Act as they restrict competition in the shopping centre.

**Impacts.** In the short term, where restrictive covenants are breached, it is likely that in their defence there will be a Competition Act point taken and there will be debate in the Court of Appeal and the House of Lords about how the Competition Act applies and whether it does afford a defence to that breach. There is the possibility of Office of Fair Trading (OFT) involvement. Whilst they can investigate private contacts, they OFT may be cautious about doing so given their other priorities. If they do become involved, then the provisions can be invalid and there can be fines levied in respect of any breaches.

At present, there is no jurisprudence as to how competition law will be applied to land agreements – so watch this space!

In the medium to long term, I think the Competition Act could have a very profound effect on the way we do business and indeed how leases and property contracts look in the future.