BRIEFCASE
QUARTERLY REAL ESTATE CASE UPDATE

September 2022

BRYAN CAVE LEIGHTON PAISNER BLP

KEY CASES

RESTRUCTURING LEASE LIABILITIES; WHAT'S THE PLAN FOR GUARANTORS?

A restructuring plan for a tenant company saved it from having to pay rent. What was the plan for the tenant's guarantors?

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CAN LANDLORDS' LITIGATION COSTS BE RECOVERED THROUGH A SERVICE CHARGE?

In a case involving the largest reported service charge bill demanded for an individual flat, the Upper Tribunal considered whether the landlord's costs of litigating against a neighbouring landowner were recoverable through the leaseholders' service charge.

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BAD NEWS FOR TELECOMS SITE PROVIDERS WHO WERE NOT ORIGINAL PARTIES TO TELECOMS CODE AGREEMENTS

The Upper Tribunal has uncovered another lacuna in the Telecoms Code that leaves site providers who hold a concurrent lease of a telecoms site unable to terminate, modify or renew Code rights that have been granted by a superior landlord.

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UPPER TRIBUNAL DISCHARGES OBSOLETE COVENANT TO ALLOW RESIDENTIAL DEVELOPMENT TO PROCEED

The Upper Tribunal (UT) found that a restrictive covenant benefitting a block of flats won't stand in the way of more flats being built next door.

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OPTIONS NARROW FOR TENANTS SEEKING CORONAVIRUS RENT RELIEF

Protections for tenants introduced by the Commercial Rent (Coronavirus) Act 2022 ended on 23 September 2022, and the Court of Appeal closes the door to tenants relying on other novel arguments for relief.

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> *In my view, it is not correct to say that the plan re-writes the lease. It is more correct to say that it releases [the tenant] from future liabilities under the lease by providing that [they] are not payable on its part" [26]*

CASE 1

OCEANFILL LIMITED V NUFFIELD HEALTH WELLBEING LTD AND CANNONS GROUP LTD

Restructuring lease liabilities; what's the plan for guarantors?

AUTHOR: ROGER COHEN

WHAT WAS IT ABOUT?

- Virgin Active was the tenant of gyms including one in Leeds. Virgin Active had acquired the lease by assignment from Nuffield Health, who entered into an authorised guarantee agreement (AGA) upon the assignment. Cannons, who was Nuffield's guarantor prior to the assignment, agreed to guarantee Nuffield's performance under the AGA.
- During the pandemic and using legislation introduced to support businesses undermined by the response to COVID-19, the High Court approved a restructuring plan for the tenant. The plan had been proposed by Virgin Active and other group companies.
- The reason for the plan was that the pandemic forced gyms to close placing the tenant and its group in serious financial difficulties. Its landlords who were owed about £30 million in rent were opposed to the plan. The plan saved the tenant from having to pay rents; hence the opposition. Two quarters' rent went unpaid. So the landlord sued Nuffield Health and Cannons on their guarantees. The issue was whether the plan released the guarantors or whether the plan released the tenant but left the guarantors' liabilities unaffected.

WHAT DID THE COURT SAY?

- Deputy Master Arkush in the Business and Property Courts held that the guarantors were liable to the landlord for the two quarters of rent they guaranteed, notwithstanding that the plan saved the tenant from paying rent.

WHY IS IT IMPORTANT?

- From the point of view of a prospective guarantor, this judgment makes life riskier. A restructuring plan made under the statutory powers used in this case can extinguish the landlord's recourse against its tenant. This can happen despite opposition from all the creditors in a class; for example, all the tenant's landlords. The court now has a power of "cross-claim cram down" to approve an arrangement even if all the creditors in a class object, provided it is satisfied that the objectors (say, all the landlords) would not be worse off under the arrangement.
- In the case of the Virgin Active group, the court was so satisfied and had approved the arrangement notwithstanding the landlords' dissent.
- Faced with a claim by the landlord under a guarantee of a tenant's obligations, a guarantor can seek first to challenge its liability under the guarantee and secondly to seek to recover from the tenant. The second option is not of practical assistance if the tenant cannot pay; for example, because it is in administration.
- This judgment decides the first aspect. It is important because there had been no prior legal authority on how a restructuring plan under this new power impacts third party guarantees.
- The judge examined the technical arguments for the guarantors and concluded that the guarantees were not impacted. They continued to be enforceable by the landlord.
- What about the guarantor's second choice; a claim against the tenant for reimbursement? The judge referred to the possibility of so called "ricochet" claims by Nuffield Health and Cannons against the tenant. However, he expressly declined to give a view as to whether or not such claim could succeed.
- The result is that the guarantors are held to their guarantees but left uncertain as to their position against the tenant.

CASE 2

DELL AND ANOTHER V 89 HOLLAND PARK (MANAGEMENT) LTD

Can landlords' litigation costs be recovered through a service charge?

AUTHOR: ROBERT HODGSON

WHAT WAS IT ABOUT?

- The landlord of a residential property at 89 Holland Park in Kensington, comprising five flats, had incurred litigation costs of almost £3 million in a long running dispute with a neighbour, objecting to her plans to build an underground mansion.
- The landlord sought to recover these costs from the five long leaseholders under their service charge provisions, relying in particular on service charge provisions that obliged the landlord to:
  - Employ all such surveyors builders architects engineers tradesmen solicitors accountants or other professional persons as may be necessary or desirable for the proper maintenance safety and administration of the Building (clause 4(4)(g)(ii); and
  - Without prejudice to the foregoing to do or cause to be done all such works installations acts matters and things as in the reasonable discretion of the Lessor may be considered necessary or advisable for the proper maintenance safety amenity and administration of the Building (clause 4(4)(l))
- The First Tier Tribunal (FTT) originally found that the costs were recoverable under the relevant clauses because the landlord's claims related to the 'safety' and 'amenity' of the Building, and the leaseholders were ordered to pay £430,411 each towards the landlord's litigation costs. The leaseholders appealed to the Upper Tribunal (UT).

WHAT DID THE UPPER TRIBUNAL SAY?

- Applying the rules of interpretation of leases propounded by the Supreme Court in *Arnold v Britton*, the UT disagreed with the FTT, finding that the purpose of the clauses relied upon by the landlord was to fund the landlord's obligations as landlord, rather than supporting its wider interests as freeholder. The purpose of clause 4(4) itself was to ensure that the landlord maintained the building and employed staff and professionals where necessary. The UT considered that to interpret that as covering the cost of litigation with a third party or of objecting to planning permission was too great a stretch.
- There was also the fact that the leases made specific provision for the payment of litigation costs by the leaseholders in certain circumstances, for example the landlord's costs of enforcing the covenants of the other lessees and of enforcing the lessee's own covenants to decorate and repair the flats, and to pay the landlord's costs in relation to forfeiture proceedings. Had the parties intended the lessees to also have to fund the costs of defending proceedings brought by third parties or of objecting to planning applications, they would have said so.
- Finally, applying 'commercial common sense', the UT considered that an obligation in the lease for the landlord to incur and for the leaseholders to fund litigation costs of this level was "implausible".

WHY IS IT IMPORTANT?

- So called 'sweeper' clauses in service charge provisions (such as clause 4(4)(l) set out above) will not be so widely construed so as to bring expenses of a kind that could not otherwise have been included into a service charge.
- Before incurring any significant expenditure, landlords should carefully consider whether those costs will be in scope of the service charge provisions, particularly when proposing to rely on a sweeper provision. For major projects, it is possible to first seek a FTT determination that certain costs are chargeable through the service charge.

> *What Part 4 cannot do is fill the gap in the legislation which appears to exist and which prevents a site provider which was not a party to the agreement by which code rights were originally conferred, or its successor in title, from taking steps to bring the agreement to an end.*

CASE 3

VODAFONE LIMITED V GENCOMP (NO 7) LTD AND AP WIRELESS II (UK) LTD

Bad news for telecoms site providers who were not original parties to Telecoms Code agreements

AUTHOR: LAUREN KING

WHAT WAS IT ABOUT?

- In 2003, the freeholder of the Old Fire Station at Market Street in Bingley, granted a 15 year lease to Vodafone, permitting it to install, keep and operate telecoms apparatus on parts of the roof of the building. Shortly before Vodafone's lease was due to expire, the freeholder also granted a 40 year concurrent lease of the same and other parts of the Old Fire Station to AP Wireless, subject to and with the benefit of Vodafone's lease. In December 2019, Gencomp purchased the freehold of the Old Fire Station.
- When Vodafone sought to renew its Code agreement, it served notices on both AP Wireless (concurrent leaseholder) and Gencomp (freeholder), inviting them to enter into a new Code agreement conferring Code rights, and/or be bound by the new agreement.
- Neither APW nor Gencomp objected to the renewal of Vodafone's Code rights, however all the parties disagreed about how that renewal could be achieved under the Code. Vodafone considered that it was only the freeholder who could renew its Code rights, whilst AP Wireless argued that it was the only party capable of granting new Code rights to Vodafone.

WHAT DID THE UPPER TRIBUNAL SAY?

- Part 5 of the Code deals with termination, modification and renewal of Code agreements between the original parties to the agreement and their successors in title.
- However, despite the contractual expiry of Vodafone's agreement, Part 5 was not available to any of the parties in this case: Gencomp was no longer in a position to confer code rights as it no longer had a right to occupation or possession of the site (AP Wireless did); and AP Wireless could not renew Vodafone's Code agreement because it was not an original party to Vodafone's Code agreement – a necessary pre-cursor to the use of Part 5 of the Code.
- Part 4 of the Code, on the other hand, concerns the imposition of new Code rights (as opposed to the termination or renewal/modification of existing agreements dealt with under Part 5), and AP Wireless would be the correct party under Part 4 to grant new Code rights to Vodafone (thanks to *Compton Beauchamp*, in which the Supreme Court recently held that Part 4 is not off limits to operators, who are already in occupation of sites, who wish to seek new or additional Code rights).

WHY IS IT IMPORTANT?

- Although the Upper Tribunal found a way for Vodafone to acquire new Code rights over the site under Part 4, this decision exposed an unfortunate lacuna in the Code. Part 4 is about the imposition of new Code agreements, not the termination of existing agreements, and it contains nothing which would assist a site provider barred from using Part 5. The Code therefore breaks down when it encounters a concurrent lease: a concurrent lessee who wishes to redevelop land within their demise over which code rights have been granted by a superior landlord cannot use Part 5 of the Code, so will have no obvious means of terminating those Code rights.
- A party considering taking a concurrent lease of a site should therefore give careful consideration to any pre-existing telecoms agreements, particularly if it has any redevelopment plans.

CASE 4

HAE DEVELOPMENTS LTD V THE CROFT EALING LTD

Upper tribunal discharges obsolete covenant to allow residential development to proceed

AUTHOR: MEGAN DAVIES

WHAT WAS IT ABOUT?

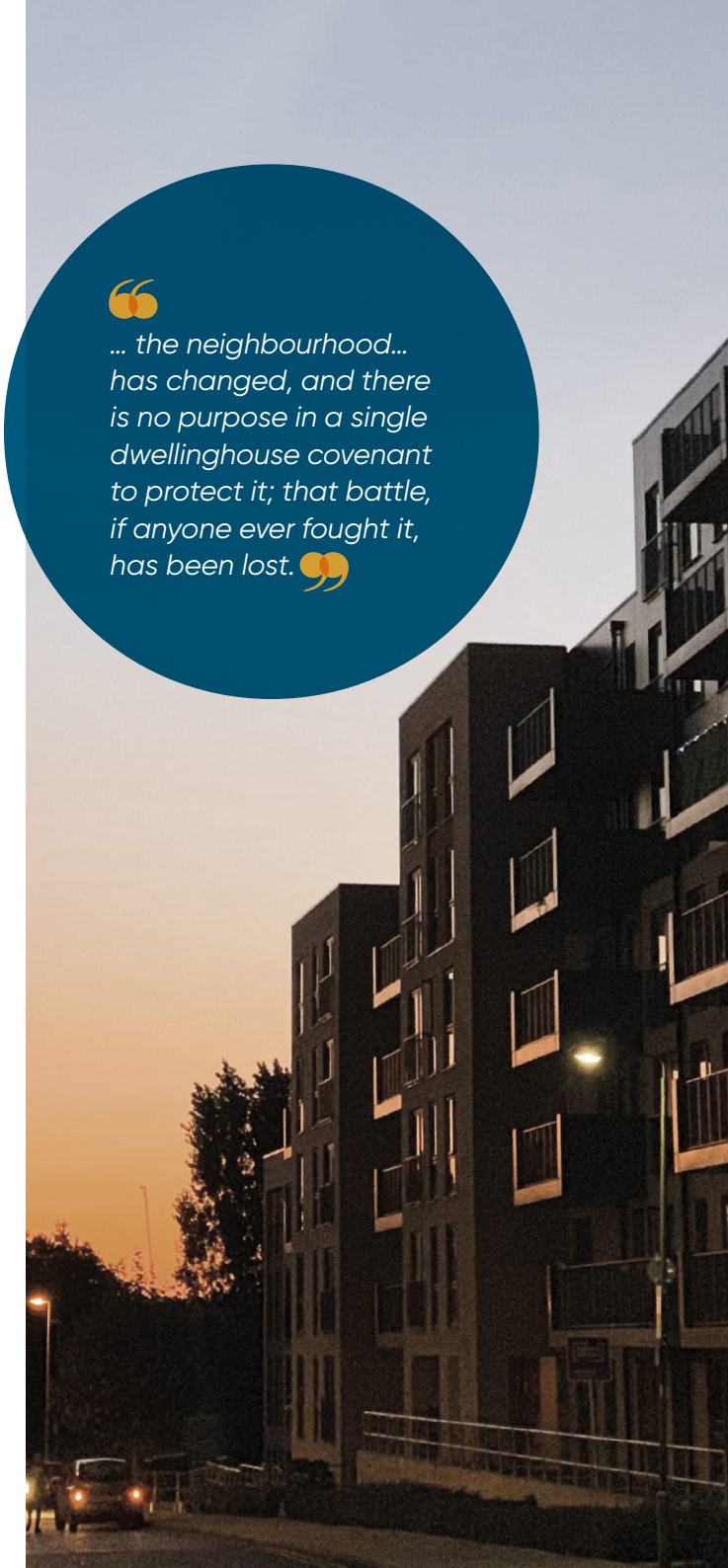
- HAE Developments Limited owned a large residential property in Ealing, and obtained planning permission to demolish the single detached house on the property and to construct eight flats.
- The proposed development would, however, breach a number of restrictive covenants, including a "single dwelling house" restrictive covenant, that were imposed in 1955 when the property was created by a sale of part of an adjoining Victorian residence, "The Croft", which stood in substantial grounds.
- The Croft had itself been developed in the 1960s to provide 11 flats and 22 maisonettes, within four three-storey blocks, together with 33 associated garages.
- HAE applied to the UT to discharge or modify the restrictive covenants that burdened its title (that would prevent the proposed conversion to flats) on the basis that (1) they were obsolete, (2) discharging them would not injure the objectors (the owners of flats in The Croft), and (3) the covenants prevented a reasonable development of the land.

WHY IS IT IMPORTANT?

- Restrictive covenants might not always be a hindrance to development if it can be shown that the neighbourhood has moved on and there is no longer any practical benefit to the owners of the benefitting land.
- The costs of UT applications to discharge or modify restrictive covenants can be significant, particularly where extensive expert evidence is required, and the usual litigation rule that the loser pays the winner's costs will often not apply to successful applicants.

WHAT DID THE UPPER TRIBUNAL SAY?

- The relevant restrictive covenants were discharged for the following reasons:
  - (1) The restrictive covenants were obsolete given the considerable change in the neighbourhood since the covenants were imposed in 1955. This included the fact that a number of neighbouring properties, including The Croft - the property benefiting from the covenants, had since been converted from single family homes to flats. The proposed development would fit into the neighbourhood.
  - (2) Discharging the covenants would cause no injury to the objectors. The Croft was already heavily overlooked by neighbours, and the restrictive covenants did not protect the objectors from this in any event.
  - (3) The proposed development of the land burdened by the restrictive covenants was considered to be a reasonable use of the land.
- There was no basis for compensation being payable to the objectors as no loss was considered to be suffered from the discharge.
- Even though the developer was "successful" with its application, the UT refused to award its costs, its jurisdiction to award costs in these applications being limited to circumstances where the respondent (objector) has acted unreasonably, and the threshold for unreasonableness in this context is high.



CASE 5

COVID-19 RENT ARREARS ROUND-UP

Options narrow for tenants seeking coronavirus rent relief

AUTHOR: PHIL SPENCER

COVID ARBITRATION

- Parties wishing to refer a dispute about the payment of "protected" arrears to the arbitration scheme introduced by the Commercial Rent (Coronavirus) Act 2022 (the "Act") had until 26 August 2022 to notify respondents of their intention to do so. The protections given to tenants by the Act which prevented landlords from taking action to recover "protected" arrears ceased to apply from 23 September 2022.
- Uptake of the arbitration process appears to have been limited, with only seven awards having been published since the implementation of the scheme in March 2022. We report below on two of the most recent awards, both of which ostensibly came down on the side of the landlord more than the tenant.
- In *Horsham District Council and Bills Restaurants Limited*, the arbitrator determined that the protected arrears should be paid in full by the tenant, albeit in monthly instalments for a year. This was consistent with the requirement of the Act that the tenant "meet its obligations as regards the payment of protected rent in full and without delay" whilst taking account of the need to preserve "the viability of the business of the tenant" based on the limited evidence both parties had provided.
- In *KXDNA Limited and 60 SA Limited*, the arbitrator had to consider a number of submissions including (i) planned capital investments by the tenant in future years and (ii) earnings projections that the landlord suggested had been deliberately revised downwards once the matter had been referred to arbitration. £1,805,820.30 was owed in total and the landlord was awarded £1,023,284 (payable over 2 years), which is what it had proposed in its pre-arbitration offers when relying on pre-arbitration financial projections from the tenant.

TENANT DEFENCES IN THE COURT OF APPEAL

- Tenants hoping to rely instead on defences to Covld rent arrears, tested recently in the Court of Appeal, have had those hopes dashed, with the consolidated appeal of *Bank of New York Mellon v CINE UK and Trocadero v Picturehouse Cinemas* being dismissed.
- The Court of Appeal placed heavy emphasis on the fact that the professionally negotiated leases already allocated the risk of the tenant not being able to use the leased premises as a cinema (as was the case during the pandemic) between the tenant and the landlord. There was consequently no "failure of basis" during the pandemic, the rent continued to fall due, and the tenants could not claim unjust enrichment for periods of forced closure sanctioned by Covid regulations. Nor was there any reason to imply a term into the leases (that rent did not accrue during periods when the tenants could not use the premises as a cinema), as this would also interfere with the express terms that already allocated risk between the parties. The tenants also couldn't rely on rent cesser clauses, drafted in terms that suspended rent in the event of damage to the premises caused by an insured risk. Although a pandemic was an insured risk, the court construed damage to mean physical damage or destruction to premises, and the landlord's cover only applied if a tenant was not legally obliged to pay rent, as opposed to choosing not to do so (which was the case here).

WHY IS IT IMPORTANT?

- Tenants who have not already served notices of intent to arbitrate under the Act are now out of time to do so, though recent awards have perhaps been more landlord-friendly than expected in any event.
- All landlords' remedies for tenants' failure to pay rent, including "protected" arrears previously ring-fenced by the Act, have been restored. Tenants will no doubt see this as unfortunate timing, having regard to rising inflation and interest rates, soaring energy costs and a looming recession, all creating the perfect storm for a rise in tenant insolvencies – the very outcome which all the government measures implemented over the past couple of years sought to avoid.

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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