Capturing the benefits of common ownership: Landlord and tenant law in commercial property portfolios

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MPhil 2013

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Abstract

This thesis examines the extent to which landlords of property portfolios are permitted by law to take account of the interests of other properties in their portfolio when exercising control over individual properties. It also examines what rights individual tenants have in the management of of their landlord's portfolio, and what effect competition law might have on portfolio landlords' control. The courts' approach to the reasonableness of a landlord's withholding of consent is considered in detail, with particular attention paid to how it may affect the ability of portfolio landlords to protect the rest of their properties from harm through the withholding of consent. Attention is also given to the legislative interference in the law of landlord and tenant, and the areas where Parliament considered the impact of law on portfolio landlords, such as fines provisions in the Landlord and Tenant Act 1927, and in the rejection of proposals for mandatory full qualification of user covenants. The need for competition law in the land sector in response to the market power of portfolio landlords is also discussed. Finaly, a number of ways for tenants to have some say in the management of the portfolio are examined. These include contractual provisions intended to empower the tenant, the doctrine of non-derogation from grant, the use of letting schemes, the use of competition law to escape restrictive covenants, cooperation between landlords and tenants and the use of alternative dispute resolution to maintain amicable landlord-tenant relationships.

Preface

I am most grateful for the support and guidance I received from my supervisors, Peter Luxton and Elen Stokes, which was vital in completing my thesis. I would also like to thank everyone in the postgraduate research community at Cardiff Law School, who have provided feedback and constructive criticism, as well as making my time in Cardiff so enjoyable. Sharon Alldred, Helen Calvert and Sarah Kennedy were always available to answer my silly questions, making the process of completing this thesis so much easier than it could have been.

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Naomi, my girlfriend, has been thoroughly understanding and supportive while I wrote this, and spent many hours proof reading and listening to me develop my arguments. I am thankful for everything she has done.

Finally, I have endeavoured to state the law as it existed in England and Wales on the 1st of September 2013.

Alan O'Connor Cardiff University 30th September 2013

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1. Introduction

Many commercial properties in the UK are let from landlords who control not just isolated properties, but broad portfolios. As shopping centres continue to gain in popularity over the high street, the benefits which can be realised through centralised control of property portfolios are apparent.

This thesis first examines these potential benefits, achievable through the common ownership and control of property portfolios. It then sets out the constraints that the law places on landlords, and considers whether the law inhibits the capturing of these potential benefits. This leads to further questions, such as what role the law may have in facilitating portfolio landlords in taking account of their whole estate when managing a property within it; whether there are any potential drawbacks to the centralisation of control in a property portfolio and how the law might address them; and what solutions exist for the problems of co-ordinating ongoing landlord-tenant relationships in the context of a portfolio. These questions are also addressed.

Throughout this thesis, it is sought to relate legal analysis back to commercial practice and, through the lens of law and economics, to analyse the effect that the law has on the incentives facing landlords and tenants. This is intended to provide insight into the workings of the law, and to identify areas for potential reform. It is also used to assess the extent to which judges and regulators take account of commercial practice in shaping the law.

Comparisons are made throughout the thesis between the commercial practice, case law and legislative environment in England and Wales with that in other countries. Such comparisons are not intended to be thorough comparative reviews of the systems in question, but rather as illustrations of particular points of interest. Differences in commercial practice may arise as a result of structural factors or regulation, and may dictate the need for regulatory interventions

specific to a particular jurisdiction. The approach adopted by courts in other common law jurisdictions may provide guidance in novel factual situations, or act as persuasive authority in evolving areas of the law.

Although this thesis concerns property portfolios in general, many of the relevant commercial differences between portfolio and standalone lettings relate to "agglomeration effects" and the interaction between nearby properties. These effects are most noticeable in the retail sector and a significant body of work has examined the issue of tenant mix. Therefore, much of this thesis will examine concerns which are only likely to apply to retail portfolio properties.

Thesis overview

Chapter 2 - Commercial management of real property - examines the commercial factors underlying the relationship of landlord and tenant and the motivations driving each party. Drawing from commercial literature, the importance for landlords, of being able to control certain aspects of leasehold property is explained. Following on from this, the nature of the property portfolio is explored. The significance of multiple properties being managed together in a portfolio is considered, with a particular focus on the interaction of properties employed for different retail uses within a portfolio. The issue of tenant mix is discussed from the perspectives of the commercial property management literature and economic theory. This chapter also lays the groundwork for an analysis of the law from the perspective of law and economics.

Chapter 3 - The law governing the management of commercial lettings - follows on from the discussion in Chapter 2 on the importance to a landlord of being able to control certain aspects of their property, outlining how the law in England and Wales governs the exercise of such control. In particular, the chapter addresses how the law governs the control which a landlord may exercise over dealings by a tenant with their interest in the property; how the

tenant uses the property; and any alterations they may make to the physical structure of the property.

Chapter 4 - *The reasonable landlord and the portfolio* - builds on the description of the law outlined in Chapter 3. Many controls retained by landlords consist of a requirement in a lease for the tenant to seek consent from the landlord; and these are often qualified by a provision that such consent shall not be unreasonably withheld. The interpretation given by the courts to reasonableness will be crucial, as it defines the level of control reserved to landlords by such covenants. This is examined in detail through case law. Finally, reasonableness is examined specifically in the context of portfolio properties, to determine whether any special treatment is given to portfolio landlords, and whether the approach taken by the courts allows portfolio landlords sufficient control over individual tenants to realise the benefits achievable through common ownership.

Chapter 5 - Portfolio landlords and legislative policy - examines how Parliament has taken account of portfolio landlords in how it legislated to change the landlord-tenant relationship, and how legislation might constrain or facilitate the unified management of a property portfolio. Given the potential benefits available to society through the co-ordination of property portfolios by landlords, it is in the public interest to allow portfolio landlords sufficient scope to realise these benefits. The effect of legislation on landlords is analysed from a law and economics perspective, to determine whether Parliament has been successful in facilitating portfolio landlords, or whether too wide a berth has been taken by legislators for fear of obstructing portfolio landlords. Chapter 5 also introduces the concept of competition law. The power exercisable by portfolio landlords may be used to harm the public interest by restricting competition. In 2011, an exemption to competition law for land agreements was

withdrawn. This chapter examines the reasons for this, and the protections under competition law for portfolio landlords exercising control in line with the public interest.

Chapter 6 - *The ongoing relationship of landlord and tenant* - looks at landlords' management of portfolios from a different perspective. Chapters 3, 4, and 5 address how and when a landlord may be entitled to take the interests of his portfolio as a whole into account in making decisions relating to a single property. In contrast, Chapter 6 asks when a landlord will - and when he may be required to - take the interests of a single property into account in his management of the portfolio as a whole, or of individual other properties in the portfolio. It also examines when tenants may be able to enforce rights directly against neighbouring tenants, and when they may be able to rely on competition law to escape the landlord's control. In addition to legal rights tenants may have in the management of a portfolio, this chapter examines how the relationship of the parties works, and how co-operation can be promoted. It also examines the potential for the use of alternative dispute resolution in the context of an ongoing landlord-tenant relationship.

2. Commercial management of real property

In order to understand how the law takes account of a landlord's interests beyond those relating to a property which is the subject of proceedings, it is first necessary to examine the commercial underpinnings of a landlord's actions. In this chapter, the context within which landlords make their decisions and the economic motivations driving them are examined.

This thesis concerns the management of commercial property portfolios. "Portfolio" is used to denote a number of properties let separately, whether they form part of the same building or development, or not, although the focus will be on neighbouring properties. While different types of commercial property will be considered, property in use for retail purposes will be examined in most detail, as the conduct of neighbouring retail tenants can have a very pronounced effect on one another, and there is ample literature examining the management of shopping centres. Nevertheless, many of the principles will apply to non-retail commercial property portfolios.

2.1 The landlord

At this juncture, I should briefly explain what is meant by "landlord". The variety of investment structures through which property is owned and managed is ever growing, and much financial literature is dedicated to identifying the correct structure for a particular investor's needs.¹ These structures often end up separating the management and ownership functions, potentially leading to confusion.

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¹ E.g. Nigel Dubben, *Property Portfolio Management: An Introduction* (London; New York: Routledge, 1991); Su Han Chan, John Erickson & Ko Wang, *Real Estate Investment Trusts: Structure, Performance, and Investment Opportunities* (Oxford University Press, 2003); Gaylon E Greer & Phillip T Kolbe, *Investment Analysis for Real Estate Decisions* (Dearborn Real Estate, 2003).

In a legal sense, "landlord" generally denotes the owner of the reversion to a lease.² Certainly the owner of a reversion enjoys the legal rights associated with the management functions, but often these are in fact delegated. It may even be the case that different elements of the management functions are delegated to different agents.³ The financial literature on the subject places a great emphasis on the owner – the beneficial owner in that it is the person or entity entitled to the profits – whether in terms of setting up and organising a portfolio of investments or appointing management agents.⁴

For the purposes of this thesis, "landlord" will be used to refer to the combined ownership and management functions, whether or not they are in fact vested in the same entity.

2.2 The scope of property management

The task of managing property is often referred to by the term "estate management".⁵ This can often be a confusing term. In its commercial sense, there are a number of understandings of it, reflecting the various interests that different parties have in the process.

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² See, for example Landlord and Tenant Act, 1954, s 44.

³ Michael Pitt & Zairul N Musa, "Towards defining shopping centres and their management systems" (2009) 8:1 J Retail Leisure Property 39 at 47; Malcolm H Kirkup & Mohammed Rafiq, "Marketing shopping centres: challenges in the UK context" (1999) 5:5 Journal of Marketing Practice: Applied Marketing Science 119.

⁴ Tony Feng & David Geltner, "Property-Level Performance Attribution: Investment Management Diagnostics and the Investment Importance of Property Management" (2011) 37:5 Journal of Portfolio Management 110; Jacques Gordon, "The Real Estate Portfolio Manager: DIPs, SIPs and REITs" (1998) 4:2 Journal of Real Estate Portfolio Management 169; Stephen A Pyhrr et al, "Project and Portfolio Management Decisions: A Framework and Body of Knowledge Model for Cycle Research" (2003) 9:1 Journal of Real Estate Portfolio Management 1.

⁵ Banfield notes current market practice is to refer to it as "real estate management": Anthony Banfield, *Stapleton's Real Estate Management Practice* (Taylor & Francis, 2005) at xi., although I retain the older term as it continues to be used in legal settings.

Arnison defines estate management as "all aspects of long-term property ownership and control, including development and investment." A 1974 Royal Institution of Chartered Surveyors (RICS) policy review defined Estate Management (for Chartered Surveyors) as:⁷

All facets of the use, development and management of urban land, including the sale, purchase and letting of residential, commercial and industrial property and the management of urban estates; and advice to clients on planning.

Thorncroft, concerned with the "estate" in its abstract, legal sense, defined the term as:⁸

The direction and supervision of 'an interest' in landed property with the aim of securing the optimum return; this return need not always be financial but may be in terms of social benefit, status, prestige, political power or some other goal or group of goals.

The first two definitions cast a wide net, portraying estate management as both a strategic-level activity and day-to-day concern. It encompasses everything done in the management of property. One aspect of it which is only mentioned expressly by Arnison, but which can be seen throughout the literature on the subject is that it is concerned with long-term performance. This distinguishes it from speculative activities, which distinction may be relevant from a public policy perspective.

Thorncroft's definition is useful for a number of reasons. First, it recognises that there are many different types of interests which may be managed, not merely ownership of a fee simple. Estate management is just as relevant to the management of leasehold interests for example. The important factor is that the interest gives the

⁶ CJ Arnison, "Masters and Tenants: Leasehold Tenure as a Mechanism for Moral Governance" in David Chiddick & Alan Millington, eds, *Land Management: New Directions: An Edited Publication of the Proceedings of the Land Management Research Conference Held at Leicester Polytechnic from 15-17 September 1983* (London: Spon, 1984) 136 at 136.

⁷ Cited in: Banfield, *supra* note 5 at 19.

⁸ Michael Thorncroft, *Principles of estate management* (Estates Gazette, Ltd., 1965).

landlord some degree of control, so that he has some ongoing involvement with the property, beyond mere ownership rights. Secondly, Thorncroft recognises non-financial goals for estate management. The literature as a whole demonstrates a bias towards financial motivations alone for the holding of property, but this definition recognises other possible motivations.⁹

Financial returns can be sought through capital growth (i.e. growth in the value of the reversion), rental income or a mixture of the two.¹⁰ The strategy a landlord chooses will depend on a large number of factors, including the qualities of the property in question, the flexibility of existing leases, his risk profile, and wider market conditions.

2.2.1 Estate management and property management

Some literature in the business sphere seeks to distinguish between estate management (in the sense of the Thorncroft definition) and property management – the commercial management of a property. This terminology reflects a less legalistic (and perhaps more practical) view of real property than classic estate management. This may be accounted for by its focus on the owner-occupier rather than the landlord, the former being less concerned with the intricacies of the legal interests in his premises.

Hines defines property management as:

the art or science of operating, dealing with, or otherwise handling land or the improvements which are held for rent or for the production of income in a manner as to produce for the owners, within the limits of the law and

⁹ See also: Dubben, *supra* note 1 at 9.

¹⁰ *Ibid* at 4.

¹¹ Mark Deakin, *Property Management: Corporate Strategies, Financial Instruments and the Urban Environment* (Aldershot; Burlington, VT: Ashgate, 2004) at 10.

responsibility to the community, a maximum of economic return over the period of management. ¹²

In short, this definition asserts that property management is an exercise in profit maximisation. To accomplish this, Hines sets out the following functions of property managers in the context of a shopping centre:¹³

merchandising the space to obtain a maximum gross income;

reducing operating and maintenance costs to attain maximum net income;

reducing the finance costs to the owner; and

adapting the center to environmental and market changes over time.

This understanding of property management is perhaps more focused on the day-to-day operation of a property than the longer-term view expressed by the estate management definitions above, but is certainly addressing the same areas of concern. For example, in a legal context, the management of tenant mix in a shopping centre has been held to be good estate management, ¹⁴ although it would likely also fall within the definition of property management.

As such, there is no meaningful distinction between estate and property management for the purposes of this thesis, and no distinction will be made between the two.

2.2.2 Corporate real estate management

Put simply, corporate real estate management (CREM), is the management of property as a factor of production.¹⁵ The term was first used by Zeckhauser and Silverman, to draw attention to the fact that for many companies not in the real estate

¹² Mary Alice Hines, *Shopping Center Development and Investment*, 2nd ed ed, Real estate for professional practitioners (New York; Chichester: Wiley, 1988) at 171.

¹³ *Ibid* at 172..

¹⁴ Moss Bros Group plc v CSC Properties Ltd, [1999] EGCS 47.

¹⁵ Banfield, *supra* note 5 at 297.

business, a significant portion of their balance sheets is taken up by property.¹⁶ The cost (or opportunity cost¹⁷) of the capital tied up in that property should be taken account of for a business to operate as efficiently as possible.

As organisations have tried to streamline their operations, much underperforming legacy property has been disposed of, but in some cases it is necessary for a company to retain property which it is not occupying itself, perhaps to permit flexibility, or to retain control over property interlinked with the property that is occupied.

One of the main points to note about property managed in this fashion is that it is sought to be managed in the best interests of the company's primary business, and in accordance with its broader business strategies.¹⁸ This has been a factor in much case law¹⁹ and may be relevant in assessing a landlord's interests.

2.2.3 Estate management and facilities management

Facilities management refers to the management of a property from the perspective of the "end user" or occupier.²⁰ This involves optimising the property for the use to which it is put. Zeckhauser and Silverman have criticised this discipline for failing to have regard to the property itself, and the opportunity costs involved with its occupation,²¹ although it in more recent times it has embraced the financial control aspects of managing property.²² It combines many of the other specialities discussed

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¹⁶ S Zeckhauser & R Silverman, "Corporate real estate asset management in the United States" (1981) Harvard Real Estate, Inc [I have not been able to see this paper, have only read papers referring to it]; Sally Zeckhauser & Robert Silverman, "Rediscover your company's real estate" (1983) 61:1 Harvard Business Review 111.

¹⁷ Opportunity cost is the cost of opportunities forgone in order to pursue a particular course of action.

¹⁸ Ranko Bon, "Ten Principles of Corporate Real Estate Management" (1994) 12:5 Facilities 9.

¹⁹ E.g. Stakelum v Ryan, [1980] 114 ILTR 42; Sportoffer Ltd v Erewash BC, [1999] L & TR 433; Sargeant v Macepark (Whittlebury) Ltd, [2004] 4 All ER 662; Whiteminster Estates v Hodges Menswear, (1974) 232 EG 715 (Ch).

²⁰ Dubben, *supra* note 1 at 26.

²¹ Zeckhauser & Silverman, *supra* note 16 at 115.

²² Brian Atkin & Adrian Brooks, *Total Facilities Management*, 3rd ed (Chichester: Wiley-Blackwell, 2009) at 4.

above, ²³ and has taken on a number of functions traditionally associated with estate or property management.²⁴

Although it is primarily conducted by the occupier (and so not so much a concern for the landlord) it may become important insofar as the landlord seeks to manage a let property as part of its facilities management strategy for property it occupies itself, or where a landlord seeks to actively manage his portfolio in order to maximise rental income. It may also play a part in explaining tenants' attitudes towards maintenance and alterations of their properties.

2.2.4 Legal term of art

Despite the shifting commercial terminology surrounding the management of real property, in legal contexts, the phrase "good estate management" has come to denote a motive for action by a landlord based on best practices.²⁵ This has been applied with respect to a wide range of property management functions. It has been widely used as a legal term of art, featuring in textbooks, ²⁶ legislation, ²⁷ and drafting practice.²⁸

Woodfall, in a passage which has attracted some negative comment from the iudiciary, ²⁹ describes good estate management as relating to the landlord's property interests beyond the property in question.³⁰

²³ ibid.

²⁴ ibid, 31-34.

²⁵ See 6.2.1, below.

²⁶ William Woodfall, Woodfall landlord and tenant (Sweet & Maxwell); Susan Bright, Landlord and tenant law in context (Oxford: Hart, 2007).

²⁷ Landlord and Tenant (Amendment) Act, 1980, ss.17, 33 (Ireland).

²⁸ eg Bright, *supra* note 25 at 306. See also 6.2.1, below.

²⁹ Bromley Park Garden Estates Ltd v Moss, [1982] 1 WLR 1019 at 1023. – the most recent edition has been modified to reflect the criticisms made of it in *Bromley Park*.

³⁰ Woodfall, *supra* note 25, para 11.150.

Bright considered that "estate management" relates to the landlord's core responsibilities towards a single property, and has used the term "leasehold estate management" to describe the additional functions entailed in looking after a larger development.³¹

2.3 Approaches to management

There are a number of different ways in which landlords may go about managing their properties. In reality, a landlord's strategy will not fit neatly into any one category and different elements of his management might be considered to reflect different approaches. I shall examine a number of axes of comparison of different management styles. The two most common are the distinctions between active and passive management, and between hands-on and hands-off management.

Howard contrasts property- and business- (or consumer-) led approaches to property management.³² Property-led approaches see property as a financial asset to be managed for best return, and to maximise value. This may centre on ensuring occupancy by a tenant of good financial standing and avoiding liability for expenses such as maintenance. Business-led approaches seek to maximise profitability through the success of the businesses occupying the landlord's property. This distinction is less specific than the approaches discussed below but is useful in characterising the broad style of management adopted by a landlord.

2.3.1 Active and passive management

One of the key differences between property and other types of investment is the degree of management required to maintain it. Active and passive management styles

³¹ Bright, *supra* note 25 at 299.

³² Elizabeth Howard, "The management of shopping centres: conflict or collaboration?" (1997) 7:3 The International Review of Retail, Distribution and Consumer Research 263.

represent two alternative approaches to dealing with this need. Prendergast et al suggest that the best landlords from a tenant's perspective are "more than simply landlords." 33

Active management involves proactively seeking out ways to maximise the performance of both individual properties and whole portfolios. This requires the formulation of strategic plans to guide the management of the property, as well as periodic review of property and portfolio performance, which should feed back into the update of the plan. On a portfolio-wide scale, active management may involve selling off under-performing properties.³⁴

There is a strong emphasis on strategic planning in the area: "Pro-active management means not only being ready for the present day but also looking to the future and informing owners of where they stand, what should be done, and what the income and expense ramifications are if things don't get done"³⁵ Active management is also important in the short run. Howard notes that the importance in management beyond merely maintaining and protecting property has grown in response to competition, and in search of improved short-run performance.³⁶

Refurbishments might be made to adapt to the changing marketplace, in order to maximise rental potential and potential rental income. This entrepreneurial strategy

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³³ Gerard Prendergast, Norman Marr & Brent Jarratt, "An exploratory study of tenant-manager relationships in New Zealand's managed shopping centres" (1996) 24:9 International Journal of Retail & Distribution Management 19 at 21.

³⁴ Gordon, *supra* note 4.

³⁵ Ray Perkins, quoted in Jan Yager, "It's about time" (2002) 67:5 Journal of Property Management 36. ³⁶ Howard, *supra* note 31 at 266.

entails relatively high expenditure for the landlord's part, increasing risk, but promises high returns.³⁷

Hutcheson identified a number of tasks that a building manager must undertake to ensure that the property under his charge obtains the maximum attainable returns.³⁸ These fall broadly into the categories of tenant relations, building maintenance and repair, and development. Howard cited "innovation, competition, organization internal space planning, growth [and] profit" as the focus of ongoing shopping centre management.³⁹

There is an increasing focus on the collection and analysis of property data to inform management. Analysis on a property-by-property basis can identify opportunities and causes for concern very early on, giving managers a powerful tool to make and justify decisions. Bon et al have emphasised the importance of a short feedback loop between changes in market conditions and management decisions, which can be facilitated by computerised data analysis. Howard notes the value of information sharing between landlord and tenant in helping to maximise the performance of both. Howard notes the value of information of the both.

Greer and Kolbe point to the responsibility to make decisions regarding "selecting onsite managerial personnel, negotiating maintenance contracts, making rental rate decisions, approving leases, and so forth" as denoting "active investment".⁴³ There is

³⁷ Marc E Rosendorf & Jill Reynolds Seidman, "Restrictive Covenants - The Life Cycle of a Shopping Center" (1998) 12 Prob & Prop 33.

³⁸ John M Hutcheson, "The Life Cycle Economics of Buildings" (1994) 12:5 Facilities 11.

³⁹ Howard, *supra* note 31 at 265.

⁴⁰ This may be important in a legal setting given the requirements to evidence business plans used to base management decisions discussed in *Moss Bros Group plc v CSC Properties Ltd*, *supra* note 14.

⁴¹ Ranko Bon, Jay F McMahan & Paul Carder, "Property Performance Measurement: From Theory to Management Practice" (1994) 12:12 Facilities 18.

⁴² Howard, *supra* note 31.

⁴³ Greer & Kolbe, *supra* note 1 at 4.

evidence to suggest that active approaches to property management are increasing in popularity.⁴⁴

By contrast, from the perspective of the passive manager, a property shares many characteristics with a long-term bond, in line with Howard's description of property-led management. Managed passively, property offers a stable long-term income supply with some opportunities for capital growth and relatively low operating costs. Greer and Kolbe note that passive investment can be identified by the disconnect between the manager and operations. 46

Passive strategies aim to minimise risk for the landlord by devolving responsibilities in respect of a property to the tenant. This style of management may be attractive to institutional investors due to the reduced risk, but will reduce the potential yield of the property, as the tenant will require a discount in order to assume the additional risk. This style of management may also risk depreciating both capital value and future rental income, as the tenant will not prioritise those factors in managing the property, as a landlord-manager would. This management style is typified by a preference for long leases to tenants with good covenant strength, on a full repairing and insuring (FRI) basis, with an upward only rent review clause. These arrangements, which are known as institutional leases, were popularised in the 1980s, and allow for commoditisation of property interests, securities deriving from which could be traded.

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⁴⁴ C M Lizieri, "Occupier Requirements in Commercial Real Estate Markets" (2003) 40:5-6 Urban Stud 1151.

⁴⁵ Howard, *supra* note 31.

⁴⁶ Greer & Kolbe, *supra* note 1.

⁴⁷ John Burton, *Retail rents: fair and free market?* (London: Adam Smith Research Trust, 1992).

2.3.2 Hands-on/-off Management

The hands-on/ hands-off distinction relates to the amount of day-to-day involvement the landlord has with a property. While it may initially appear to be strongly related to the active/passive distinction, it does not line up cleanly with those categories. A landlord who actively manages the tenant mix of a property may not take any responsibility for security or maintenance. Likewise, a landlord who remains very involved in the day-to-day running of a property may not actively look out for development opportunities.

What matters is the duties under the lease – whether it is the landlord or his direct employees, or a service provider contracted by the landlord who actually carries out the activities, so long as the landlord is responsible for having them carried out, it is "hands-on" management.

As with the active/passive distinction, that between hands-on and hands-off management is a matter of degree. Prendergast et al have linked the quality of a relationship and degree of information passing between landlords and tenants to the level of contact between them, ⁴⁸ so hands-on management may be more successful for a landlord adopting a business-led approach.

2.4 The tenant

Another basic management function is tenant selection; both at the start of a lease and in deciding whether or not to consent to a disposition during the continuance of the lease. Banfield points out that in truth it is the tenant of a property – rather than the property itself – that is the source of the landlord's income.⁴⁹ It doesn't matter how

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⁴⁸ Prendergast, Marr & Jarratt, *supra* note 32.

⁴⁹ Banfield, *supra* note 5 at 32.

well a property is managed otherwise, ultimately the income is dependent on the tenant paying his rent.

The covenant strength of the tenant is therefore of paramount importance to the landlord, both in terms of the ability of the tenant to pay rent and the ability to meet other obligations – such as repairing obligations. The covenant strength of a tenant will be reflected strongly in the value of the reversion. Because of the tenant's central importance to a landlord's operations, tenant selection is key to the success of property management. This is relevant both at the time of initial letting and when deciding on whether to consent to a disposition by a sitting tenant. Thus a landlord will want to maximise his control over the process.

The covenant strength may not be not the only relevant consideration for a landlord. If a landlord owns nearby property, the issue of tenant mix will become very important. This is discussed below at 2.6.2.

2.4.1 Ongoing landlord-tenant relations

As a result of this renewed interest in the importance of the tenant, much has been written about the need for landlord-tenant relations to remain cordial.⁵² If a landlord has a management role, it will be crucial for both parties that they work together. In such a case, not only is the success of a landlord dependant on the success of his tenants, but the reverse is also true. In order to realise the benefits of working

⁵⁰ John Armatys, *Principles of Valuation* (London: Estates Gazette, 2009) at 20.

Especially in light of the changes made by the *Landlord and Tenant (Covenants) Act, 1995* to ongoing liabilities of original tenants under leases granted after the 1st of January 1996. (See 3.1.6, below).

⁵² E.g. Kathleen McKenna-Harmon & Laurence Harmon, "Winning at Retention" (2003) 68:3 Journal of Property Management 26.

together, it is important that the parties share information and engage constructively rather than adversarially.⁵³

2.5 The property

2.5.1 Repairs and maintenance

Repairs and maintenance are of crucial importance to a tenant, as it is the tenant who will ultimately have to live with any defects in the property. Similarly, a landlord will have a strong interest in ensuring they are carried out to maintain rental value of the property and prevent premature obsolescence. However, for a number of reasons their interests may not align perfectly. First, a landlord and tenant will have different timescales in mind when determining their interests: while a landlord will want to maximise rental income (and capital value) in the long term, a tenant will only be concerned with the duration of his lease, which may be relatively short. Second, a tenant will only be concerned with defects which are likely to adversely affect his business, whereas a landlord will want to prevent or fix defects which could make the property less useful to other potential occupiers, thereby damaging the rental and capital values. Additionally, landlords will be very mindful of the impact of the state of one property on the performance of neighbouring premises within his portfolio.

Normally, the responsibility for repairs and maintenance will be apportioned by the lease. This responsibility may fall on the landlord or the tenant. In either case, the tenant will want to minimise the cost to him, while ensuring that the premises are kept

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⁵³ Howard, *supra* note 31; Gary Warnaby & Kit Man Yip, "Promotional planning in UK regional shopping centres: an exploratory study" (2005) 23:1 Marketing Intelligence & Planning 43; Jane Roberts et al, "Building retail tenant trust: neighbourhood versus regional shopping centres" (2010) 38:8 International Journal of Retail & Distribution Management 597.

in adequate repair for his business, while the landlord will have the more long-term interests of his reversion in mind.

2.5.2 Service charges

It has become standard practice for landlords with responsibility for repairs and maintenance to recoup the costs of maintaining the property by way of a service charge, provided for in the lease.⁵⁴ A good service charge clause will set out unambiguously what services the charge is to pay for and how the tenant's liability is to be calculated. Some future expenses will be difficult to predict, so it is prudent to allow for the scope of allowable service charges to change over time. This may, of course, be done by agreement at a later date but this could be complicated where maintenance and repair costs are split between a large number of tenants, each of which might have different concerns and different priorities. It may also be difficult to determine how increases in service charges should be split between tenants of varying sizes. For these reasons, open-ended clauses, which set out such details, are often used.

Some methods for calculating service charges are described by Adamshick, who notes the differing degrees of year-to-year uncertainty for both landlord and tenant depending on the method used.⁵⁵ Banfield also lists a number of different bases for apportionment of service charges.⁵⁶

2.5.3 Refurbishment and renewals

The lifecycle of a commercial property goes through a number of phases, from new build to obsolescence. Obsolescence will hurt the rental value of property as well as

⁵⁴ Banfield, *supra* note 5.

⁵⁵ Laurie TS Adamshick, "Understanding operating cost escalations from a tenant's perspective" (1995) 13:4 Facilities 14.

⁵⁶ Banfield, *supra* note 5 at 153–4. (5)

its capital value.⁵⁷ In order to maintain the rental and capital values of a property in the long run, a landlord will have to carry out periodic refurbishments and renewals. These will be informed by the nature of the market⁵⁸ and by the evolving strategic management plan of the landlord.

2.5.4 Development

Property development goes beyond mere refurbishments or renewals. It may become necessary where the property concerned has become functionally obsolete and cannot be adapted to meet another purpose, where market changes have reduced or eliminated the demand for a that kind of property in the property's location, or where a premises has become structurally obsolete.

The concept of "marriage value" – that some properties are more valuable when managed together – may be another reason for property development.⁵⁹ Often, it is the case that a particular development cannot take place at all unless it can be in a particular place, of a minimum size, have access to particular amenities, or a combination of those prerequisites. Otherwise, it may be the case that there is an opportunity for economies of scale, making a particular property much more valuable within a development than it would be outside it.

2.6 The activities on a property

2.6.1 User

The ability of a property to generate returns for the landlord will be closely related to the use to which it is put by the tenant (or more correctly, the use to which it would be

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⁵⁷ Deakin, *supra* note 11 at 98.

⁵⁸ And indeed movements between different markets – see generally Marcus Warren, *Economic analysis for property and business* (Oxford; Boston: Butterworth-Heinemann, 2000).

⁵⁹ Banfield, *supra* note 5 at 264–6.

put by a hypothetical replacement tenant). ⁶⁰ The more options a tenant has in relation to his occupation of a property, the higher the rent will be. Landlords will be mindful, however, that some uses may disrupt the landlord's other properties, lowering the rent achievable from those. Therefore, landlords who manage a number of nearby properties often place relatively strict restrictions on the use to which a tenant may put a property. This will have the potential to depress rental values (at least at rent review) but may benefit the landlord overall.⁶¹

In addition to restricting what is done in a property generally, a user clause may place temporal restrictions on certain activities. Thus, deliveries may not be permitted during normal office hours or an anchor tenant may be required to keep open for a minimum amount of hours.

2.6.2 Tenant Mix

The occupier of one property can have both positive and negative effects on the occupiers of nearby properties.⁶² In shopping centres especially, this has led landlords to consider very carefully the issue of tenant mix.

"Tenant mix" is the "combination of business establishments occupying space in a shopping centre to form an assemblage that produces optimum sales, rents, service to the community and financiability of the shopping centre venture"⁶³ It is a key factor

⁶⁰ Greer & Kolbe, *supra* note 1, chap 3.

⁶¹ Banfield, *supra* note 5 at 162; Mary Lou Downie, Peter Fisher & Cheryl Williamson, *Managing* tenant mix in shopping centres in the United Kingdom, RICS Foundation Research Paper Series (RICS, 2002); Steven R Grenadier, "Flexibility and Tenant Mix in Real Estate Projects" (1995) 38:3 Journal of Urban Economics 357; R Abratt, J L C Fourie & L F Pitt, "Tenant mix: the key to a successful shopping centre" (1985) 10:3 Quarterly Review of Marketing 19; Johan de W Bruwer, "Solving the ideal tenant mix puzzle for a proposed shopping centre: a practical research methodology" (1997) 15:3 Property Management 160.

⁶² See 2.7.1, below.

⁶³ SO Kaylin, "In depth analysis necessary for shopping centre game" (1973) Shopping Centre World 46, cited in Downie, Fisher & Williamson, *supra* note 60.

in the success or failure of any shopping centre.⁶⁴ The principles are, of course of broader application, and will be helpful in analysing any group of properties in close proximity under the same management.

An "ideal tenant mix" may include a broad mix of users, creating a specific image for the centre and allowing it to generate maximal customer flow and sales; it will create synergies between tenants and create a pleasant destination for shoppers while maximising the return on the landlord's investment. Because the rent achievable by a landlord for a property will depend on the benefit a tenant derives from it, it will often be the case that a landlord will be incentivised to maximise tenant profitability (this is, of course, tied in with the simple fact that a tenant who is not profitable will not be paying rent to the landlord for very long). If the incentives of landlords and tenants were perfectly aligned, a landlord would be incentivised to maximise *total* profitability across his portfolio, even if this means incurring an opportunity cost in relation to some parts of the portfolio which could be let at a higher rent but only at an overall disadvantage to the portfolio performance.

There are a number of different types of tenant mix strategies, which may be tailored to fit the demographics of a particular shopping centre's location and commercial environment. Some categories which are often used to describe shops are "comparison" shops, "destination" shops and "convenience" shops.

The theory behind comparison shops is that when buying certain types of things (e.g. clothing) customers prefer to compare many different products before making a

⁶⁴ Peter J McGoldrick, *Retail Marketing*, 2nd ed ed (London: McGraw-Hill, 2002).

⁶⁵ Abratt, Fourie & Pitt, *supra* note 60.

⁶⁶ As has been done in at least one shopping centre: Phillip Buxton, "Bluewater Experience" (1999) 22:2 Marketing Week 34; See also: Howard, *supra* note 31.

purchasing decision.⁶⁷ Thus, where a number of comparison shops are located together, it can lead to higher sales for all.

Destination shops are destinations in their own right and so draw in large volumes of customers. They may be referred to as "anchor" tenants, and are crucial to the success of many shopping centres. They often pay a much lower rent per unit area than other tenants because of the benefits they bring to other tenants (and, thereby, to the landlord). 68 The character of the anchor tenant may have a significant impact on the performance of the centre, as the type of customer attracted to the tenant will dictate which types of stores benefit most from the externalities.⁶⁹

Convenience shops are unlikely to draw any customers to a centre but may provide services to them while they are there, prolonging their stay. Some new categories have emerged recently. A shopping centre may grant a lease at very low rent to a tenant who will improve the performance of the centre, by keeping shoppers present longer, possibly targeting demographics likely to become bored and bring other shoppers away with them as well.⁷⁰

It is important to note that due to changes in the broader market, the ideal tenant mix for a particular retail agglomeration will change over time.⁷¹ The uses to which tenants may wish to put their property may also evolve over time.⁷² The landlord should keep the tenant mix policy under constant review in order to ensure that it is

⁶⁷ Downie, Fisher & Williamson, *supra* note 60 at 3.

⁶⁸ B Peter Pashigian & Eric D Gould, "Internalizing Externalities: The Pricing of Space in Shopping Malls" (1998) 41:1 Journal of Law and Economics 115.

⁶⁹ Ciaran Carvalho & Emma Slessenger, "Getting the mix right" 21 August 1999 Estates Gazette 74.

⁷⁰ Francesca de Châtel & Robin Hunt, Retailisation: the here, there and everywhere of retail (Routledge, 2004).

Grenadier, *supra* note 61: Rosendorf & Seidman, *supra* note 36: Hutcheson, *supra* note 37.

⁷² Geoffrey Silman, "To shop and change" (2005) 508 Estates Gazette 186; See: Williams and another v Kiley (trading as CK Supermarkets Ltd), [2002] All ER (D) 301 (Nov).

suited to present market conditions.⁷³ The ability for a landlord to control tenant mix in response to such changes will be vital to ensuring the long term prosperity of a portfolio, and of the tenants within the portfolio. The landlord may steer the tenant mix on an ongoing basis through the exercise of legal controls,⁷⁴ subsequent negotiations to buy back leases and the letting of units which become vacant.

2.7 Managing a portfolio

Although the bulk of the literature on portfolio management is more concerned with financial instruments, performance ratios and profit margins in the abstract, properties are not abstract financial instruments and ultimately it is the ground-level management which will determine their profitability. This thesis will not address the gains achievable to landlords through the management of property assets in a financial portfolio. Rather, it focuses on the practical management of portfolios of property.

As noted by Bon in the context of CREM,⁷⁵ "[j]ust as a fleet of ships requires overall strategy and co-ordination among individual vessels, so too does a 'fleet' of buildings. Although each vessel in a fleet may have a separate mission, the fleet as a whole is informed by a mission common to all."⁷⁶ In the context of closely located properties, or a network of properties, in order to obtain the greatest overall performance, it may sometimes be necessary to follow a strategy for one part of an estate which would be sub-optimal – or even loss-making – for that part on its own.⁷⁷

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⁷³ Mary Lou Downie, Cheryl Williamson & Peter Fisher, *An analysis of landlord's perceptions of retail tenant mix and its management in shopping centres*, The Cutting Edge 2000 (London: RICS Research Foundation, 2000).

⁷⁴ See Chapter 3 for a description of the legal controls available.

⁷⁵ Corporate real estate management, see 2.2.2, above.

⁷⁶ Bon, *supra* note 18.

⁷⁷ Châtel & Hunt, *supra* note 69; Buxton, *supra* note 65.

2.7.1 Agglomeration effects

The point of creating a shopping centre must be to create more overall value than the individual businesses within it could create for themselves. The whole must be greater than the sum of the parts.⁷⁸

"Agglomeration effects" describe a range of factors which lead to synergies between co-located retailers. Teller and Schnedlitz have identified four broad sources of such effects: location-related; tenant-related; marketing-related; and management-related.⁷⁹ Location-related factors are mostly linked to the accessibility of the agglomeration via transport infrastructure. Tenant-related factors are related to tenant mix, as retail agglomerations allow consumers to carry out different tasks in one trip. Marketing-related factors refer to the improved ability of retailers to market their stores when acting together. Management-related factors refer to the gains made possible through the common management of a group of retailers as if they were one.

Shopping centres and town centre management provide good examples of where property managers should be on the lookout for such opportunities.

Agglomeration effects and Externalities

Externalities are consequences of actions not felt directly by the actor, or the "spillover" costs (or benefits, as the case may be) of an action.⁸⁰ These can be positive or negative. A shop that draws in customers who go on to visit neighbouring shops can be said to be creating positive externalities for those other shops. On the other hand, a shop which causes a nuisance and puts shoppers off visiting neighbouring shops creates negative externalities.⁸¹ These spillover costs and benefits mean that the benefit or nuisance creating behaviour will be produced sub optimally

⁷⁸ Howard, *supra* note 31 at 266.

⁷⁹ Christoph Teller & Peter Schnedlitz, "Drivers of agglomeration effects in retailing: The shopping mall tenant's perspective" (2012) 28:9-10 Journal of Marketing Management 1043 at 1046–7.

⁸⁰ See generally: Warren, *supra* note 57 at 124–136.

⁸¹ For an example in case law, see *Chartered Trust plc v Davies*, [1997] 2 EGLR 83 (CA).

by the creator of the externalities, meaning that resources are allocated inefficiently. If the creator of the externalities were to experience the negative spillover of his actions, he would reduce the nuisance-causing activity. Conversely, if he experienced the benefits of positive externalities, he would devote more resources to activities which create those benefits.

Because these effects tend to under-produce benefits and over-produce nuisances, their existence within a property portfolio can lead to reduced overall profitability, which may have a negative effect on the rent achievable by the landlord. Landlords will be keen, therefore, to prevent this from happening (or to stop it from continuing), and will seek to prevent tenants from causing negative externalities within a portfolio

2.7.2 Realising the potential of agglomeration effects

Yuo et al have suggested that the question "is how to internalise or manage these inter-store externalities." "Internalising" an externality involves causing it to be "priced into" decisions, meaning that the interests of a decision maker are aligned with those who experience the effects of their actions and efficiency is promoted. The three methods of achieving this are through property rights (the Coase Theorem), the use of a Pigouvian tax or subsidy, and regulation. 83

The Coase theorem

Efficiency is generally defined by reference to the Pareto condition: Set of affairs A is more efficient than set of affairs B if at least one person is better off under A than B, and no one is worse off under A than under B.⁸⁴ Where enforceable property rights are present, the Coase theorem asserts that in the absence of transaction costs, market

⁸² T S-T Yuo et al, *The management of positive inter-store externalities in shopping centres: some empirical evidence*, Report (University of Reading, 2003) at 2.

⁸³ Ibid.

⁸⁴ Or see in a policy context: Otto A Davis & Andrew B Whinston, "The Economics of Urban Renewal" (1961) 26:1 Law and Contemporary Problems 105.

participants will arrive at a Pareto efficient allocation of resources through voluntary transactions, regardless of the original allocation.⁸⁵ Thus, tenants would be able to negotiate between themselves for an optimal mix of uses.⁸⁶

Transaction costs are the costs entailed in using the price mechanism in the market.⁸⁷ These costs will increase the more parties are involved in negotiations and the more complex the negotiations. Baum has identified difficulties in assessing the correct price for flexible leases,⁸⁸ while Murdoch suggests that the valuation of unusual terms can be based on "intuition" rather than on any objective basis.⁸⁹ The work of Brueckner in relation to determining the ideal initial mix of tenants in a shopping centre⁹⁰ and of Grenadier in determining how the mix should be managed dynamically as external market factors change⁹¹ demonstrates the degree of complexity involved in arriving at an efficient mix. Empirically, it has been found that centrally controlled shopping centres perform better than organically evolved retail agglomerations⁹² and that central management is key to the differential performance of the two types of agglomeration.⁹³ It appears, therefore that due to

⁸⁵ R H Coase, "The Problem of Social Cost" (1960) 3 JL & Econ 1.

⁸⁶ Peters argues that organising tenant mix should be the responsibility of retailers first and foremost: John Peters, "Managing shopping centre retailer mix: Some considerations for retailers" (1990) 18:1 International Journal of Retail & Distribution Management 5.

⁸⁷ Ronald H Coase, "The nature of the firm" (1937) 4:16 economica 386.

⁸⁸ Andrew Baum, *Pricing the options inherent in leased commercial property: a UK case study*, Report 09/03 (Reading: University of Reading, 2003).

⁸⁹ Sandi Murdoch, "Commercial leases: Future directions" in Susan Bright, ed, *Landlord and Tenant Law: Past, Present and Future* (Hart Pub. 2006) 83 at 87.

Law: Past, Present and Future (Hart Pub, 2006) 83 at 87.

⁹⁰ Jan K Brueckner, "Inter-store externalities and space allocation in shopping centers" (1993) 7:1 J Real Estate Finan Econ 5.

⁹¹ Grenadier, *supra* note 61.

⁹² Christoph Teller, "Shopping streets versus shopping malls – determinants of agglomeration format attractiveness from the consumers' point of view" (2008) 18:4 The International Review of Retail, Distribution and Consumer Research 381.

⁹³ Gary Warnaby, David Bennison & Barry J Davies, "Retailing and the Marketing of Urban Places: A UK Perspective" (2005) 15:2 The International Review of Retail, Distribution and Consumer Research 191; Gary Warnaby et al, "Marketing UK Towns and Cities as Shopping Destinations" (2002) 18:9-10 Journal of Marketing Management 877.

transaction costs, tenants will not generally be able to internalise externalities by voluntary agreement.

Where significant transaction costs are present, market participants organise their operations through means other than the pricing mechanism. ⁹⁴ This may involve the imposing of Pigouvian taxes or subsidies or more direct control through the imposition of regulations.

Pigouvian taxes and subsidies

Pigouvian taxes and subsidies internalise externalities by levying a charge on or subsidising activities which generate externalities, calculated to cause the creators of externalities to factor the effects of the externalities on other parties into their decisions. The use of Pigouvian taxes or subsidies is not as precise as voluntary transactions, as the tax or subsidy may not accurately reflect the actual benefit or disbenefit experienced by the other party, but are less costly than a market system to implement.

Empirical evidence suggests that anchor tenants and other tenants capable of producing positive externalities receive a substantial rent reduction in shopping centres. Thus, the tenants benefitting from the extra footfall brought in are subsidising the tenants that create these benefits. This incentivises the creation of positive externalities within centrally managed centres. In the absence of central management, such subsidies may not be possible, as the benefits arising could not be withheld from retailers who refused to pay towards a subsidy. This may be described as a "freerider" problem.

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⁹⁴ Coase, *supra* note 85.

⁹⁵ A C Pigou, (1920) *The economics of welfare*, 4th ed ed (New York: AMS Press, 1978).

⁹⁶ Pashigian & Gould, *supra* note 68; Yuo et al, *supra* note 82.

Regulation

If Pigouvian taxes are not appropriate, regulation may be the only way to ensure that an agglomeration runs efficiently. Portfolio landlords commonly retain rule making powers over common areas and the uses to which property is put. This permits a portfolio landlord to prevent tenants from using their premises for purposes which might harm the interests of neighbouring tenants or the landlord. This central rule making authority replaces the pricing mechanism as the means of control in respect of some areas of business.⁹⁷ In the presence of transaction costs, it may be the only way of effectively achieving the benefits of retail agglomeration.⁹⁸

2.7.3 Aligning the interests of landlord and tenant

If the landlord is to retain significant powers to control his portfolio, tenants may wish to ensure that their interests are aligned with his, so that the property is managed for their benefit. Miceli and Sirmans have found that the key to maximising the benefits achievable as a result of agglomeration is to design leases that allow stores to internalise externalities existing between them, and to ensure that the landlord provides an appropriate level of marketing for all stores.⁹⁹

Wheaton has argued that percentage rents are used in order to align the interests of landlord and tenant, so that the landlord is not incentivised to profit in the short run by

⁹⁷ Coase, *supra* note 85; Richard A Epstein, "Holdouts, Externalities, and the Single Owner: One More Salute to Ronald Coase" (1993) 36:1 Journal of Law and Economics 553.

⁹⁸ Sergio Currarini & Francesco Feri, "Delegation versus centralization: The role of externalities"

^{(2006) 60:2} Research in Economics 112.

99 Thomas J Miceli & C F Sirmans, "Contracting with spatial externalities and agency problems The case of retail leases" (1995) 25:3 Regional Science and Urban Economics 355; John D Benjamin, Glenn W Boyle & CF Sirmans, "Price discrimination in shopping center leases" (1992) 32:3 Journal of Urban Economics 299; Thomas Miceli, C Sirmans & Denise Stake, "Optimal Competition and Allocation of Space in Shopping Centers" (1998) 16:1 Journal of Real Estate Research 113; C F Sirmans & Krisandra A Guidry, "The Determinants of Shopping Center Rents" (1993) 8:1 Journal of Real Estate Research 107.

doing something which might be detrimental to sitting tenants.¹⁰⁰ Such percentage leases have not, however, been favoured traditionally in the UK.¹⁰¹ The fixed rent, with an upward only review provision, which was for a long time the norm in the UK,¹⁰² provides little incentive for landlords to work to improve their tenants' businesses, as rent review clauses are typically not intended to reflect the productivity of the tenant's business, but rather the market value.¹⁰³

2.8 Conclusion

It is clear that portfolio landlords have the potential to create value through prudent management of a portfolio, not only in a financial sense as the management of a group of assets, but by managing the properties as a business, to promote the success of all the tenants in a portfolio. The workings of the ongoing relationship of portfolio landlord and commercial tenant are discussed in Chapter 6. If the incentives exist for a landlord to realise this potential, it will benefit not only the landlord, but his tenants' businesses, and broader society through the efficient allocation of resources. The extent to which Parliament has taken account of the role of portfolio landlords in creating such benefits for society is discussed in Chapter 5.

A portfolio landlord whose interests are aligned with those of his tenants is ideally positioned to overcome the problems of coordinating the activities of an agglomeration of properties, which can be a very complicated task, but such coordination requires not only the alignment of interests, but centralisation of control. In particular, landlords will need the ability to manage the portfolio flexibly in

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¹⁰⁰ William C Wheaton, "Percentage Rent in Retail Leasing: The Alignment of Landlord–Tenant Interests" (2000) 28:2 Real Estate Economics 185.

¹⁰¹ Patric H Hendershott, "A comparison of upward-only and turnover leases" (2002) 20:6 Journal of Property Investment & Finance 513.

Burton, *supra* note 46.

¹⁰³ Howard, supra note 31 at 273.

response to changes in market conditions in order for a portfolio to be successful in the long run. In Chapter 3, the ability of a landlord to reserve control over dispositions, user and alterations is examined, and the Courts' approach to the reasonableness of the control exercised by landlords over these aspects of his portfolio is reviewed in Chapter 4.

3. The law governing the management of commercial lettings

In the previous chapter, three broad areas of concern for the landlord of a commercial property were identified: Who uses the property; what they use it for; and the physical state of the property. By the inclusion of restrictions in individual leases, the landlord may exercise some control over properties in certain respects; namely dealings by a tenant with his interest, changes in the use to which leasehold property is put (user), and alterations and improvements to the premises by a tenant. This chapter lays out the law governing the powers landlords commonly have to exercise such control over tenants.

In most leases in the UK, landlords do not have the power to eject a tenant who is not in breach of their lease. Therefore, a landlord wishing to exercise legal control over the tenant mix in a portfolio must rely on the control retained over changes to user or assignment initiated by a tenant. Of course a landlord may also negotiate the purchase of a surrender of a sitting tenant's lease, and may choose new tenants for any vacant properties, however they become vacant.¹

3.1 Dealings involving leasehold interests

Broadly speaking, leasehold interests may be dealt with by a tenant in three ways: they may be assigned, sublet or used as security (referred to generally as "dealings"). Each of these dealings involves a transfer of some interest in the property and each has the potential to affect the landlord's interests to some degree. The law in all three areas is similar and is addressed together, differentiating between different types of dealing where the law treats them differently.

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¹ See 2.6.2, above.

3.1.1 The Common Law Position

At common law, the default position is that a proprietary interest in land is freely alienable, and this principle extends to leasehold interests.² Such alienation may be effected by assignment, sublease or charge. This position is of benefit to a lessee, as it allows him absolute freedom to deal with the property as his needs change.³ It is, however, subject to modification by covenant and there are several reasons why other stakeholders might wish to restrict this right. The lessor would not want to have foisted upon him a tenant who is seen to pose a risk of not complying with one or more of the leasehold covenants;⁴ or who might not draw as many customers (or the right kind of customers) into a shopping area.⁵ Furthermore, tenants of neighbouring properties may not want the property to be occupied by their competitors,⁶ or by a business which might change the character of the area.⁷ In a residential setting, a landlord might be keen to dictate what types of tenant live in a development – a "no student" policy, for example.⁸

For these reasons, some landlords have for a long time⁹ insisted upon the inclusion in leases of covenants restricting the tenant's ability to deal with the lease and this has become common commercial practice.¹⁰ These covenants take a number of forms,

² Somervell LJ in *Cook v Shoesmith*, [1951] 1 KB 752 at 754, referring to another case, contrasts "the tenant's *prima facie* right to assign or sublet" with restrictions imposed by a covenant. Lord Eldon LC in *Church v Brown*, (1808) 15 Ves Jun 258, stated (at 263) that "the right to assign, unless restrained, [is] incident to [a lessee's] estate."

³ See 2.2.2 - 2.2.3, above.

⁴ This may have been exacerbated by the enactment of the Landlord and Tenant (Covenants) Act, 1995, which made assignees of a lease liable directly to the landlord, and removed the liability of the original tenant (subject to any Authorised Guarantee Agreement entered into as part of the assignment) *see* 3.1.6 below.

⁵ See 2.6.2; 2.7.1, above. For examples in the case law, see: *Crown Estates Commissioners v Signet*, [1996] 2 EGLR 200; *Moss Bros Group plc v CSC Properties Ltd*, [1999] EGCS 47.

⁶ Chelsfield MH Investments Ltd v British Gas Plc, (1995) 70 P & CR D31.

⁷ Eg: Chartered Trust plc v Davies, [1997] 2 EGLR 83 (CA); Petra Investments Limited v Jeffrey Rogers plc, [2000] 3 EGLR 120.

⁸ Rayburn v Wolf, (1985) P & CR 463.

⁹ At least as far back as *Dumpor's Case*, (1602) 4 Co Rep 119, 76 ER 1110.

¹⁰ Marie Smith & Murray J Ross, Ross: Commercial Leases (London: Sweet & Maxwell), sec H [1].

namely "absolute" covenants; (merely) "qualified" covenants; and "fully qualified" covenants.

Absolute covenants, as their name suggests, limit the ability of a tenant to deal with his interest in the property, without any procedure in place to allow for dealings with the property. The landlord may, at his sole discretion, permit a particular transaction, but is not bound to come to this decision reasonably. 11

"Qualified" covenants bar the tenant from dealing with the land in a specified way, without the consent of the landlord. In the case of covenants that are merely qualified, the landlord was traditionally allowed to be as unreasonable as he wanted in refusing to grant permission to assign, or otherwise deal with, the property. 12 It has been noted that merely qualified covenants may mislead tenants in giving the impression that a landlord will consent to a reasonable request for permission to deal with the property, when in fact the landlord has no such intention.¹³ For this reason such covenants have been the subject of statutory intervention in a number of jurisdictions. ¹⁴ In England and Wales, merely qualified disposition covenants are treated as fully qualified by operation of s19(1)(a) of the Landlord and Tenant Act 1927.

"Fully qualified" covenants prohibit the tenant from dealing with the property in a particular way, except with the consent of the landlord, but are qualified by a statement to the effect that the consent shall not be unreasonably withheld. This provides a level of reassurance to the tenant at the time of entering into the lease,

¹¹ FW Woolworth and Co Ltd v Lambert, [1937] Ch 37.

¹² Subject to the Equality Act, 2010. See Brian Doyle, Equality and discrimination: the new law, New law series (Bristol: Jordans, 2010), chap 5.

¹³ Letitia Crabb, "Restrictions on Assignment of Commercial Leases: A Comparative Perspective" (2006) 35:2 CLWR 93.

¹⁴ ibid.

protecting him from the landlord's future whims. Such covenants do not, however, create a positive duty on the landlord not to unreasonably withhold consent unless stated specifically in the lease. 15 Rather, they release a tenant who is unreasonably refused consent from his obligations under the covenant, allowing him to proceed with the transaction in the absence of consent and to fall back on the landlord's unreasonable withholding of consent as a defence to any future action brought by the landlord in respect of the transaction. 16 A tenant in this position does not normally have a remedy in damages against the landlord at common law, however he could bring proceedings seeking declaratory relief (that the landlord should have consented to the transaction and that the tenant would not be in breach of covenant in dealing with the property in the manner proposed). Although this is not strictly necessary some parties may be reluctant to take on a property interest from a tenant in the absence of consent.¹⁷ Additionally, since the coming into force of the Land Registration (Amendment) (No 2) Rules 2005, an assignment of a registered lease with a disposition covenant may not be registered, and so cannot take effect in law, unless the necessary consent has been received by the Land Registry, and so the transaction could not proceed without an application to court. 18

It is primarily the final category, that of fully qualified covenants, which is relevant to this thesis.

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¹⁵ Rendall v Roberts and Stavey, (1959) 175 EG 265. Such a duty does now exist at law by virtue of the Landlord and Tenant Act, 1988, but this is not a contractual duty (see 3.1.5 above).

¹⁶ Romer LJ gave an accurate statement of the law as it then was in FW Woolworth and Co Ltd v Lambert, supra note 11 at 53.

¹⁷ The Law Commission, Codification of the law of landlord and tenant: Covenants restricting dispositions, alterations and change of user, 141 (The Law Commission, 1985) at 83.

¹⁸ Land Registration (Amendment) (No 2) Rules 2005/1982.

3.1.2 The Law of Property Act 1925

The Law of Property Act 1925 (the 1925 Act) makes slight changes to the law relating to consents for mortgages. A landlord may not unreasonably refuse consent to a subdemise by way of mortgage where it is required, ¹⁹ nor to an assignment by the mortgagee upon a power of sale arising. ²⁰ Presumably, by analogy with provisions in the Landlord and Tenant Act 1927 relating to consent to alterations, the section only affects the operation of merely qualified covenants restricting the creation of mortgages, and not absolute prohibitions. ²¹

The 1925 Act also prohibits the levying of a fine for consent to assignment.²² It does not, however, prohibit landlords from requiring their tenants to pay legal costs associated with the granting of consent nor any premium provided for in the lease.²³

3.1.3 The Landlord and Tenant Act 1927

The Landlord and Tenant Act 1927 (the 1927 Act) made a number of changes to the common law position on dealings by tenants with leasehold interests. Most significantly, section 19 sets out as follows:

- (1) In all leases whether made before or after the commencement of this Act containing a covenant condition or agreement against assigning, underletting, charging or parting with the possession of demised premises or any part thereof without licence or consent, such covenant condition or agreement shall, notwithstanding any express provision to the contrary, be deemed to be subject—
- (a) to a proviso to the effect that such licence or consent is not to be unreasonably withheld, but this proviso does not preclude the right of the landlord to require payment of a reasonable sum in respect of any legal or other expenses incurred in connection with such licence or consent; [...]

¹⁹ *Law of Property Act 1925*, s 86(1).

²⁰ *Ibid*, s 89(1).

²¹ Landlord and Tenant Act 1927, s 19(3); See: FW Woolworth and Co Ltd v Lambert, supra note 11.; 2.1.4 above.

²² Law of Property Act 1925, supra note 19, s 144.

²³ See Letitia Crabb, "A fine point: premiums as covenanted rights" (1993) May/June Conv 215.

This has the effect of limiting the types of alienation covenant to absolute and fully qualified ones, with all merely qualified covenants becoming fully qualified by operation of the Act. In *FW Woolworth and Co Ltd v Lambert*,²⁴ a case concerned with an improvements covenant, it was argued that section 19(2), which is very similar to the above provision, should apply to an absolute covenant prohibiting alterations on grounds that that such covenants in fact allow for an alteration to be made with the consent or licence of the landlord. Romer LJ dismissed this argument, referring to absolute covenants against assignment, and pointing out that there has been a historic difference between absolute and merely qualified covenants and that if there was not a practical difference, the words in the 1927 Act relating to consent would be "otiose and useless" if the section were intended to apply to both qualified and absolute alienation covenants.²⁵

3.1.4 The Landlord and Tenant Act 1954

The Landlord and Tenant Act 1954 (the 1954 Act) does not make any changes to the substantive law in this area but there is one procedural provision which should be noted. Under section 53 of the Act, the County Court has jurisdiction to determine whether consent has been unreasonably withheld by the landlord.

3.1.5 The Landlord and Tenant Act 1988²⁶

Although the changes made by the Landlord and Tenant Act 1988 (the 1988 Act) are largely procedural in nature, they amount to a significant transformation in both the

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²⁴ FW Woolworth and Co Ltd v Lambert, supra note 11.

²⁵ *Ibid* at 58–9.; *Cf Landlord and Tenant (Amendment) Act* 1980 (Ireland), s 66, which uses two subsections: one to change absolute covenants to merely qualified covenants, the other to change merely qualified covenants (including covenants that are interpreted as being merely qualified under that act) into fully qualified ones. The Law Reform Commission's 2007 proposals use one subsection to achieve the same effect: *Draft Landlord and Tenant Bill*, Law Reform Commission, 2007.

 $^{^{26}}$ See generally: Mark Warwick, "Landlord and Tenant Act 1988 - written consents and requests for information" [2003] L & T Review 6.

duties of landlord and tenant in giving and seeking consent respectively, and in the consequences for a landlord who unreasonably withholds consent to a dealing.

A number of new duties were imposed on landlords by this Act: to give consent unless it would be reasonable not to;²⁷ to notify the tenant of the decision within a reasonable time period, 28 setting out any conditions attaching to the consent and giving reasons for any refusal of consent.²⁹ It is also for the landlord to prove that all the procedural steps were complied with, and that any refusal of consent or any conditions imposed as part of the consent were reasonable.³⁰

By necessary implication of these duties, a landlord can no longer rely on reasons for withholding consent that were not communicated to the tenant.³¹

Where a landlord fails in his duties under any of the above headings, the tenant will, in addition to any action that may lie at common law, have a claim in tort for breach of a statutory duty.³² It should be noted that as the landlord's wrong is a tortious one, and not contractual, a tenant will not be entitled to repudiate the lease, no matter how unreasonable the landlord's conduct, although exemplary damages may be awarded where the landlord's conduct has been particularly egregious.³³

There had been some debate on the question of whether section 1(6) of the 1988 Act had as its effect the reversal of the common law burden of proof on the question of

²⁷ Section 1(3)(a) - This may be contrasted with the previously existing position, where the Tenant's covenant not to deal with the lease without first obtaining consent from the landlord was conditional upon such consent not being unreasonably withheld, but no corresponding duty was imposed on the landlord.

²⁸ Section 1(3)(b)

²⁹ Section 1(3)(b)

³⁰ Section 1(6); See Footwear Corp Ltd v Amplight Properties Ltd, [1999] 1 WLR 551 at 557–8.

³¹ Norwich Union Life Insurance Society v Shopmoor, [1998] 3 All ER 32; Cf Bromley Park Garden Estates Ltd v Moss, [1982] 1 WLR 1019.

³² Section 4

³³ Design Progression Ltd v Thurloe Properties, [2005] 1 WLR 1.

contractual reasonableness - as opposed merely to reasonableness in the context of the statutory duty.³⁴ It was argued that as a matter of construction, had the legislature intended to alter the common law burden of proof they would have done so explicitly.³⁵ The curious result of this situation would be that it would be for the landlord to prove that any refusal of consent was reasonable to avoid having to pay damages for breach of statutory duty, but for the tenant to prove that the refusal was unreasonable in order to proceed with the assignment. Following on from this position, it is difficult to see how a tenant who had established statutory unreasonableness but not unreasonableness under the lease could show the necessary causation for the award of statutory damages, as the tenant would not be able to proceed with the transaction in any event.³⁶ Taken to its logical conclusion, such an analysis would therefore frustrate the purpose of the legislation. This question appears to have been authoritatively settled in the case of Footwear Corp v Amplight *Properties.* ³⁷ The burden of proof is on the landlord not only in regard to the statutory duty, but also in relation to the substantive question of the reasonableness of a refusal under the lease.

3.1.6 The Landlord and Tenant (Covenants) Act 1995

The Landlord and Tenants (Covenants) Act 1995 (the 1995 Act) makes a number of important changes to the law in this area, for leases made on or after the 1st of

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³⁴ James Andrew Sandham, "Alienation covenants and the Landlord and Tenant Act 1988: it ain't over until the landlord consents!" [2004] Conv 453.

³⁵ The subsection reads: "(6) It is for the person who owed any duty under subsection (3) above— (a) if he gave consent and the question arises whether he gave it within a reasonable time, to show that he did, (b) if he gave consent subject to any condition and the question arises whether the condition was a reasonable condition, to show that it was, (c) if he did not give consent and the question arises whether it was reasonable for him not to do so, to show that it was reasonable, and, if the question arises whether he served notice under that subsection within a reasonable time, to show that he did."

³⁶ See *Clinton Cards (Essex) Ltd v Sun Alliance and London Assurance Company Ltd*, [2003] L & TR 2 for a discussion of the causation required for the award of damages under the 1988 Act.

³⁷ Footwear Corp Ltd v Amplight Properties Ltd, supra note 29 at 557–8; approved by the Court of Appeal in Go West v Spigarolo, [2003] QB 1140.

January, 1996, or so-called "new tenancies". The most significant change made by the Act was the disapplication of the rule of privity of contract to new tenancies. Thus covenants in new leases are directly enforceable by and against the landlord and his successors in title, by and against the tenant and his successors in title. ³⁹

To prevent the change from having an adverse effect on the property market, section 16 of the 1995 Act allows for the creation of Authorised Guarantee Agreements (AGAs). 40 These agreements are to guarantee the performance of the covenants by the proposed assignee. This guarantee may only last until the term of the original lease lapses or the assignee assigns the lease, so it will not apply to a subsequent lease (or lease extension) entered into between the assignee and the landlord, or if the assignee subsequently assigns it to a third party. 41 The landlord may insist on the existing tenant entering into an AGA where there is a prohibition of assignment (whether absolute or fully qualified), and it is reasonable for the landlord to insist on the AGA as a condition to consenting to the assignment. 42

Section 22 of the 1995 Act inserts new subsections 19 (1A) to (1E) of the 1927 Act, allowing for the inclusion into a lease, or a later agreement of a clause setting out circumstances in which the landlord will be entitled to withhold consent, and conditions which a landlord may attach to any such consent. Where a landlord refuses consent based on one of the reasons set out in a clause made under section 22, or attaches conditions to the assignment which were prescribed by such a clause, his

 $^{^{38}}$ Except those leases entered into after that date under an agreement for a lease made before that date or under a court order made before that date - s1(3)

³⁹ See generally: Martin Boxer, *Landlord and Tenant: The New Regime and Its Pitfalls; a Critical Guide to the Landlord and Tenant (Covenants) Act 1995* (London: Cavendish, 1996) at 25 et seq. ⁴⁰ Timothy Fancourt, "Licences to assign: another turn of the screw?" (2006) (Jan/Feb) Conv 37 at 46–

Landlord and Tenant (Covenants) Act, 1995, s 16(4).

⁴² ibid, s 16(3)

⁴³ Landlord and Tenant Act 1927, s 19(1B)

refusal or attachment of conditions will not be unreasonable.⁴⁴ One condition which is commonly imposed is that any consent to assign will be subject to the tenant entering into an AGA, guaranteeing the proposed assignee's performance of the covenants under the lease. Landlords have to be careful in drafting these covenants to include any reasons they might seek to rely on subsequently, but not to make the assignment process so restrictive as to depress the rent achievable under the lease.⁴⁵

3.1.7 What kinds of dealings are governed by the covenant?

This question is a matter of construction of the lease and is best answered by reference to the relevant covenant in any given case. The limitation may be on assignment, subletting, charging, or otherwise dealing with the property or a part thereof. In some cases, the covenant may prohibit one type of dealing – subletting a part only of the premises for example – but not another – subletting the whole of the premises.

There are numerous examples of different covenants that have been interpreted by the courts, which it is not proposed to examine in detail here.⁴⁶ Arising out of the principle that interests in land should be freely alienable, the courts have interpreted covenants seeking to restrict that right strictly against the landlord.⁴⁷

Involuntary conveyances do not generally come within the scope of such covenants but may in certain circumstances, for example where they are expressly included.⁴⁸ In

⁴⁴ Landlord and Tenant Act 1927, s19(1A)(b); Crabb has suggested that the landlord may still bear the burden proving reasonableness: Letitia Crabb, "Regulating Licences to Assign: the Impact of the Landlord and Tenant (Covenants) Act 1995" (2000) Journal of Business Law 182 at 184.

⁴⁵ See: Report of the ABI Working Party on the Landlord and Tenants (Covenants) Act 1995 (London: Association of British Insurers, 1996).

⁴⁶ See Patrick McLoughlin, *Commercial leases and insolvency*, 4th ed (Haywards Heath: Tottel, 2008) at 258 for a discussion of different wordings and the interpretation given to them by the courts.

⁴⁷ Grove v Portal, [1902] 1 Ch 727; See the comments of Harman LJ in Sweet and Maxwell v Universal News Services, [1964] 2 QB 699 at 727.

⁴⁸ Doe on the demise of Mitchinson v Carter, (1798) 8 Term Rep 57; 101 ER 1264.

Crescent Leaseholds Ltd v Gerard Horn Investments Ltd,⁴⁹ the Court of Queen's Bench for Saskatchewan distinguished a change of ownership arising out of a voluntary company merger which created a new company in which all assets of its predecessor companies would be vested. The alienation covenant in the lease expressly applied to assignment by operation of law, but the trial judge distinguished this from other cases on the ground of voluntariness.

It is worth noting that dealings with unregistered leases in breach of covenant do take effect in law, subject to the landlord's rights in respect of the lease.⁵⁰ Thus the landlord may forfeit the lease and recover damages from the tenant in default, and may in some circumstances be entitled to a mandatory injunction ordering a new subtenant to surrender the lease to the original tenant.⁵¹ This should be noted where a tenant seeks to proceed with a transaction in the absence of consent on grounds that he believes it to have been unreasonably withheld.

3.1.8 Reasonableness

When the court comes to assess the reasonableness of a landlord's withholding of consent, it will consider the reasons from the landlord's perspective⁵² but based upon what a reasonable person might do in his place. It is not a question of whether the landlord made the right decision, but of whether the decision made by the landlord was within the range of permissible decisions in the circumstances.⁵³

⁴⁹ Crescent Leaseholds Ltd v Gerard Horn Investments Ltd, (1982) 141 DLR (3rd) 679

⁵⁰ Old Grovebury Farm v W Seymour Plant Sales and Hire (No 2) Ltd, [1979] 1 WLR 1397.

⁵¹ Crestfort v Tesco, [2005] EWHC 805 (Ch). In that case the landlord was able to establish a cause of action against the sublessee, namely tortuous interference with contractual relations. See generally *Chitty on Contracts* (Sweet and Maxwell), paras [1–172].

⁵² International Drilling Fluids v Louiseville Investments, [1986] 1 Ch 513; Ashworth Frazer Ltd v Gloucester City Council, [2002] 1 All ER 377.

⁵³ Pimms v Tallow Chandlers, [1964] 2 QB 547; Ashworth Frazer Ltd v Gloucester City Council, supra note 51.

The landlord must actually have based its decision on the reasons given in court.⁵⁴ In *Berenyi v Watford Borough Council*, it was clear from the minutes of the Council's meeting that they had not considered the reason later relied on in court.⁵⁵ In *Bromley Park Garden Estates v Moss*, one of the reasons given had not materialised until after consent was rejected.⁵⁶ As a result of the 1988 Act, only reasons given to the tenant within a reasonable time of the application for consent being made may be relied upon in court,⁵⁷ although these may be expanded upon.⁵⁸ Where good reasons are given as well as bad reasons, the court may uphold the landlord's refusal of consent, so long as the good reasons are not corrupted by the bad reasons.⁵⁹

In extreme cases, the landlord may have to take the effect of a refusal of consent upon the tenant into account, ⁶⁰ although this will not normally be the case. ⁶¹

Under the s1(6) of the Landlord and Tenant Act 1988, the burden of showing that a refusal to consent was reasonable rests on the landlord. It was confirmed in *Footwear Corp v Amplight* that this applies equally to the question of reasonableness for the purposes of landlord and tenant law as it does for the purposes of a claim for damages under section 4 of the 1988 Act.⁶²

As discussed at 3.1.6 above, the Landlord and Tenant (Covenants) Act 1995 (the 1995 Act) allows for the incorporation of circumstances into the lease, in which the

⁵⁴ Bromley Park Garden Estates Ltd v Moss, supra note 30.

⁵⁵ Berenyi v Watford Borough Council, [1980] 2 EGLR 38.

⁵⁶ Bromley Park Garden Estates Ltd v Moss, supra note 30.

⁵⁷ Footwear Corp Ltd v Amplight Properties Ltd, supra note 29.

⁵⁸ Ashworth Frazer Ltd v Gloucester City Council, supra note 51.

⁵⁹ British Bakeries v Testler, [1986] 1 EGLR 64; BRS Northern Ltd v Templeheights Ltd, [1998] 2 EGLR 182; Cf: Berenyi v Watford Borough Council, supra note 54, where the Council's reasons were inseperable from its bad faith attempts to block the tenant's plans.

⁶⁰ International Drilling Fluids v Louiseville Investments, supra note 51.

⁶¹ NCR Ltd v Riverland Portfolio No 1 Ltd, [2005] EWCA Civ 312.

⁶² Footwear Corp Ltd v Amplight Properties Ltd, supra note 29.

landlord will be justified in withholding consent. Where a landlord relies on one of these reasons, his refusal of consent will be reasonable.

A landlord cannot insist upon the payment of a fine for his consent, ⁶³ and where such a fine is demanded the tenant may proceed with the transaction without paying it. ⁶⁴ If the tenant should pay the fine however, he will not be able to recover it in court. ⁶⁵ The landlord may charge the tenant for any reasonable costs incurred in giving consent. ⁶⁶

The substantive question of reasonableness is highly dependent on the facts of individual cases, ⁶⁷ and is discussed at length in Chapter 4, below.

3.2 User covenants

As with disposition covenants, landlords often wish to restrict how a tenant may use property. While a change in user may be linked to an assignment or sublease, as discussed in Chapter 2, a portfolio landlord may be most concerned about ensuring that the use to which a property is put does not cause difficulties for other nearby tenants of the landlord.

3.2.1 The common law position

At common law, a tenant is entitled to use the let premises for any purpose, provided that such use is not illegal or prohibited by the lease and would not fall foul of the doctrine of waste.⁶⁸ It has, however, for quite some time been common practice to

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⁶³ Law of Property Act 1925, supra note 19, sec 144. This does not apply to leases where alienation is prohibited absolutely.

⁶⁴ Andrew v Bridgeman, [1908] 1 KB 596.

⁶⁵ihid

⁶⁶ Landlord and Tenant Act 1927, supra note 21, sec 19(1)(a).

⁶⁷ See: Bickel v Duke of Westminster, [1977] QB 517; International Drilling Fluids v Louiseville Investments, supra note 52; Ashworth Frazer Ltd v Gloucester City Council, supra note 52.

⁶⁸ See Charles Harpum, Stuart Bridge & Martin Dixon, *Megarry & Wade: The Law of Real Property*, 8th ed (Sweet & Maxwell, 2012) at 890.

restrict the use to which tenants may put such property.⁶⁹ As with disposition covenants, covenants restricting the user of a property may be absolute, qualified or fully qualified. Unlike disposition covenants, however, there is no statutory modification of merely qualified user covenants, preventing the landlord from refusing consent on unreasonable grounds⁷⁰ (although such statutory intervention was recommended by the Law Commission in 1985).⁷¹ Thus with both absolute user covenants and merely qualified ones, the landlord may consent to a change in user, or may refuse consent for any reason.

It is for the landlord to demonstrate that the use to which the tenant is putting the premises is prohibited by the user covenant.⁷² In cases of doubt, user covenants will be interpreted in favour of the tenant.⁷³

3.2.2 Statutory intervention

The most noteworthy aspect of statutory intervention in relation to user covenants is the lack of it. Merely qualified user covenants do not prevent a landlord from being unreasonable in refusing consent, so a landlord's decision may not be challenged.⁷⁴ Even where a tenant has negotiated the inclusion of a fully qualified user covenant in the lease, there is no statutory duty on landlords to be reasonable when deciding whether or not to give consent or in how long they take to make their decision. Therefore damages will not be available for a landlord's unreasonableness unless the landlord has covenanted specifically not to be unreasonable in considering such

⁶⁹ The Law Commission, *supra* note 16, paras 3.85–3.86.; The balancing exercise between tightly drafted user covenants allowing for greater control by the landlord and negative effects of restrictive user covenants on rental value are discussed at 4.3.1, below.

⁷⁰ Guardian Assurance Co Ltd v Gants Hill Holdings Ltd, [1983] 2 EGLR 36 (Ch).

⁷¹ The Law Commission, *supra* note 17, paras 6.14 – 6.17.

⁷² Basildon Development Corp v Mactro, [1986] 1 EGLR 137.

⁷³ Skillion v Keltec Industrial Research, [1992] 05 EG 162.

⁷⁴ Subject to the Equality Act, 2010.

applications.⁷⁵ Further still, where applications are made simultaneously for an assignment and change of user, statutory damages for unreasonable delay or withholding of consent may not even be available in relation to the assignment, if the breach of statutory duty cannot be said to have caused the loss.⁷⁶

The only statutory modification of covenants restricting user came in the form of section 19(3) of the Landlord and Tenant Act 1927. Where a lease contains a qualified or fully qualified user covenant,⁷⁷ this section prohibits landlords from charging a fine or increasing rent in exchange for consent to a change of user, save that it:

does not preclude the right of the landlord to require payment of a reasonable sum in respect of any damage to or diminution in the value of the premises or any neighbouring premises belonging to him and of any legal or other expenses incurred in connection with such licence or consent.

Nor does this provision apply to applications for change of use which would require structural alterations to the property. The Law Commission has criticised this provision, as no such fine would be payable if such alterations (which would amount to improvements)⁷⁸ were sought on their own and it seems strange to allow the levying of a fine for two consents sought together, neither of which alone could be charged for.⁷⁹

While section 19(3) cannot be contracted out of, unless the covenant is fully qualified the landlord may use the withholding of consent to pressure the tenant into entering into a new lease on terms kinder to the landlord in order to change the user.

⁷⁵ No evidence was found to suggest that such covenants are in fact used.

⁷⁶ Clinton Cards (Essex) Ltd v Sun Alliance and London Assurance Company Ltd, supra note 36.

⁷⁷ Although it does not apply to absolute user covenants.

⁷⁸ *Balls Bros v Sinclair*, [1931] 2 Ch 325. See 3.3, below.

⁷⁹ The Law Commission, *supra* note 17, para 6.16.

Where the landlord offers consent in exchange for a sum of money, the tenant may bring proceedings challenging the reasonableness of the sum requested. Where the court identifies a sum that would be reasonable, the landlord is required to give his consent upon payment of that sum.

3.2.3 Fully qualified user covenants

As with covenants restricting disposition, a fully qualified covenant against change of user will only bind the tenant insofar as the landlord reasonably refuses consent to a change of use. Once a tenant has applied for consent, he may proceed with the change of use if consent is unreasonably withheld. Because of the relative paucity of cases examining the reasonableness of refusals of consent to a change of use, the courts have looked to decisions on the reasonable refusal of consent to dispositions to guide them in this area.⁸⁰ A detailed analysis of the law in relation to the reasonableness of withholding consent is given in Chapter 4.

A number of points should be noted as resulting from the absence of legislation in this area similar to the Landlord and Tenant Act 1988 for dispositions. Where the tenant is challenging the reasonableness of a refusal of consent, it is for the tenant to show that consent to assignment was unreasonably withheld.⁸¹ The landlord is not bound to follow a reasonable procedure in dealing with requests.⁸²

Unlike the position for disposition covenants prior to the enactment of the 1995 Act, a fully qualified user covenant may provide for circumstances in which it will be reasonable for a landlord to withhold consent. Any such circumstances will be strictly

⁸⁰ Anglia Building Society v Sheffield City Council, [1983] 1 EGLR 57; Tollbench v Plymouth City Council (1988), 56 P & CR 194 (CA) at 198–99; Hillgrove Developments Ltd v Plymouth City Council, [1997] EGCS 115.

81 Luminar Leisure Ltd v Apostole, [2001] 42 EG 140.

⁸² Tollbench v Plymouth City Council, supra note 80.

construed and it will be for the landlord to show that an otherwise unreasonable withholding of consent is permissible under such a provision. 83

As with the reasonableness of refusals of consent to deal with a leasehold interest, section 53 of the Landlord and Tenant Act 1954 gives the County Court jurisdiction to determine the reasonableness of refusals of consent.

3.2.4 Obsolete user covenants - Section 84 of the Law of Property Act 1925

Where more than 25 years have expired on a lease for a term of at least 40 years, the tenant may apply to the Lands Chamber of the Upper Tribunal⁸⁴ to have a user covenant modified or set aside, where it has become obsolete by reason of a change to the character of the property, the area in which it is situated, or any other factor which the Tribunal deems relevant, where the covenant is impeding some reasonable user of the premises.⁸⁵ An order may be granted by consent of the landlord or if the change will not affect his interests. A sum of money may be awarded to compensate anyone who benefits from the covenant for any loss suffered as a result of the discharge or modification of the covenant, or for the difference in consideration that would have been realised had the covenant not been in force.

3.2.5 Keep open covenants

As discussed in Chapter 2, "keep open" covenants may be critical to the success of a development. The question may arise, however, whether these covenants are enforceable. The courts are generally reluctant to compel someone to carry on a

⁸³ Berenyi v Watford Borough Council, supra note 54.

⁸⁴ Formerly the Lands Tribunal, jurisdiction transferred by *Transfer of Tribunal Functions (Lands Tribunal and Miscellaneous Amendments) Order* 2009/1307, art. 2.

⁸⁵ Law of Property Act 1925, supra note 19, s 84, as amended by the Law of Property Act, 1969.

business, either by injunction or by order of specific performance. In *Co-operative Insurance v Argyll Stores*, the Court of Appeal found that the circumstances, where the defendant closed a supermarket, a destination unit in the Plaintiff's shopping centre, at very short notice and without trying to find an assignee, were extreme enough, and in particular that the defendant's conduct was egregious enough, to warrant the granting of specific performance of the keep open covenant. The House of Lords overturned the decision, however, holding that because of the level of judicial oversight that might be required to enforce such an order, and the onerousness of it to a business forced to keep a shop open at a significant ongoing cost, such an order would not be appropriate. While the House of Lords did look to the drafting of the covenant to determine whether it was precise enough to be specifically enforced, it has been suggested that no keep open covenant could be drafted in such a way as to make it specifically enforceable.

3.3 Alterations and improvements

At common law, a tenant may make alterations to let premises, so long as they do not amount to waste, or breach other obligations of the tenant. It is common practice for leases to restrict the tenant from making alterations or improvements to the property. Different types of alterations may be restricted in different ways. Such clauses may be absolute, qualified or fully qualified, but as with disposition covenants, merely qualified covenants against improvements are modified by statute to become fully qualified. This section also applies where the covenant prohibits the making of

⁸⁶ Braddon Towers Ltd v International Stores Ltd, [1987] 1 EGLR 209; FW Woolworth Plc v Charlwood Alliance Properties, [1987] 1 EGLR 53.

⁸⁷ Co-operative Insurance v Argyll Stores (Holdings) Ltd, [1996] Ch 286 (CA).

⁸⁸ Co-operative Insurance v Argyll Stores (Holdings) Ltd, [1998] AC 1 (HL).
⁸⁹ Peter Luxton, "Are you being served? Enforcing keep open covenants in leases" [

⁸⁹ Peter Luxton, "Are you being served? Enforcing keep open covenants in leases" [1998] Conv 396 at 401.

⁹⁰ Landlord and Tenant Act 1927, s 19(2).

alterations without consent and the alterations actually sought to be made amount to improvements.

The Equality Act, 2010, prohibits landlords from unreasonably withholding consent to alterations made to facilitate access to people with disabilities.⁹¹

3.3.1 Defining alterations and improvements

What exactly is prohibited by the covenant will come down to interpretation of the lease, but the courts have stressed that there will be limits to any formulation.⁹² "Alterations" has been held to mean "alterations which would affect the form or structure of the premises."93 In *Bickmore v Dimmer*, the affixing of a clock to the exterior wall of a jeweller's shop was not in breach of the alterations covenant.⁹⁴ Stirling LJ noted that such a covenant did not restrict alterations "absolutely essential to carrying on the business", nor anything "fixed to the premises and convenient for the carrying on the business in a reasonable, ordinary, and proper way."95

"Improvements", for the purposes of the 1927 Act, are improvements from the perspective of the tenant. 96 The landlord may seek compensation for damage to his interests and may set as a condition that the premises be returned to their prior condition before the tenancy comes to an end. 97

⁹¹ Equality Act, 2010 sch 21 para 3(3). See: Doyle, note 12 at 58–59.

⁹² See: Woodfall: Landlord and Tenant, para 11.258 for a discussion of different formulations and their

⁹³ *Bickmore v Dimmer*, [1903] 1 Ch 158 at 167 (Vaughan Williams LJ).

⁹⁴ ibid.

⁹⁵ Bickmore v Dimmer, supra note 92 at 168.

⁹⁶ Balls Bros v Sinclair, supra note 77, approved in FW Woolworth and Co Ltd v Lambert, supra note 10 at 49 (Lord Wright MR)..

⁹⁷ Landlord and Tenant Act 1927, supra note 20, sec 19(2).

3.3.2 Reasonableness

A tenant may apply for a declaration that consent to improvements was unreasonably withheld. The onus of proving that the consent was unreasonably withheld rests on the tenant. As to the question of reasonableness generally, the courts have looked to the cases on alienation, although as s19(2) allows for the landlord to require the payment of compensation where the alteration sought might damage his interests, or to have the property restored if the alterations will not improve the rent achievable by the property, the courts will scrutinise whether the landlord could have protected his interests by such a requirement rather than by withholding consent.

3.4 Property retained by the landlord

The landlord may also retain some property for use as common areas by tenants. While tenants will be granted easements of access over such common areas, and guarantees in respect of opening hours, the landlord generally retains broad powers of control over the common areas. The duties of the landlord in relation to how such control is exercised are discussed in Chapter 6.

3.5 Conclusion

The ability of landlord to exercise control over his portfolio will depend significantly on the types of covenant included in the lease. For absolute covenants (or merely qualified user covenants), the specific wording used in the drafting of restrictions will be the most significant factor, and so should be considered carefully, as any such restrictions will be construed strictly against a landlord.

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⁹⁸ Lambert v FW Woolworth (No 2), [1938] Ch 883 (CA) at 906.

⁹⁹ Lambert v FW Woolworth (No 2), supra note 98.

¹⁰⁰ *Ibid* at 906.

In the case of fully qualified covenants, the courts' interpretation of reasonableness is likely to have a much greater impact on a landlord's ability to control his portfolio in the long run. This is discussed in detail in Chapter 4.

4. The reasonable landlord and the portfolio

As it becomes more and more common for restrictions contained in leases on how and by whom leasehold property may be used to be fully qualified, the importance of how the courts understand the qualification that the landlord may not unreasonably withhold consent will grow in importance. The procedural elements of reasonableness are set out in Chapter 3: The landlord may only rely in court on reasons which actually led to his decision; any bad reasons relied upon must not corrupt the good reasons; and the burden of proof rests on the tenant in respect of changes of user but on the landlord in relation to dispositions. Additionally in respect of assignments, the landlord may only rely on reasons given to the tenant within a reasonable time of the application for consent being made.

Once these procedural elements have been met, it is up to the court to determine whether any refusal of consent was reasonable. Although the nature of reasonableness makes it impossible to avoid uncertainty completely,⁴ concerns have been expressed, that the way the courts have gone about interpreting reasonableness has not helped the situation, making it excessively unpredictable and not providing sufficient certainty for landlords (or indeed tenants) faced with making decisions about whether to consent (or challenge a refusal of consent).⁵ Some have also

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¹ Neil Crosby et al, *Monitoring the 2002 code of practice for commercial leases* (London: Office of the Deputy Prime Minister, 2005).

² See 3.1.8; 3.2.3, above.

³ Footwear Corp Ltd v Amplight Properties Ltd, [1999] 1 WLR 551; see 3.1.8, above.

⁴ Letitia Crabb, "Licences to assign and collateral advantages" (1986) July-August Conv 287.

⁵ James Andrew Sandham, "Alienation covenants and the Landlord and Tenant Act 1988: it ain't over until the landlord consents!" [2004] Conv 453; Gilbert Kodilinye, "Refusal of consent to assign: the unreasonable landlord" (1988) Conv 45.

suggested that the courts' approach to reasonableness has been unduly favourable to tenants.⁶

It is only relatively recently that the courts have tried to put a cogent framework on when it is reasonable for a landlord to refuse consent to a disposition or change of use in the context of a fully qualified covenant. The development of guiding principles which have been identified may be traced through case law. Very often, these principles are discussed with reference to landlords seeking to abuse their power, and so restrictive interpretations of reasonableness have been favoured. However, it must also be borne in mind that the ability of a landlord to exercise some level of control over a portfolio will affect how well that portfolio (and in turn the landlord's tenants) performs in the long run.⁷ In order to encourage investment, care must be taken to avoid excessively curtailing landlords' freedom in questions of management.

This is particularly relevant in the context of property portfolios, where landlords have the capacity to create value through prudent management, to the benefit of all of their tenants. As has been demonstrated in Chapter 2, commercially minded landlords ought to give consideration to a much wider range of factors in managing an individual property forming part of a portfolio than a landlord managing the same property in isolation. Such factors may include the effect of any change on other properties in the portfolio (or on the portfolio as a whole), the precedent that might be set by giving consent to a change, or practical considerations relating to the administration of a portfolio of properties. The extent to which these factors can

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⁶ Jonathan Brock, "Blundell memorial lecture: consent to assign - reasonableness revisited" (1998) 2:6 L & T Review 117; Mark Warwick, "Landlord and Tenant Act 1988 - written consents and requests for information" [2003] L & T Review 6; Timothy Fancourt, "Licences to assign: another turn of the screw?" (2006) Conv 37-53; Cf Letitia Crabb, "Restrictions on Assignment of Commercial Leases: A Comparative Perspective" (2006) 35:2 CLWR 93.

⁷ See 2.6.2.

reasonably be taken into consideration in deciding whether to give consent will have a significant bearing on the willingness of portfolio landlords to accept fully qualified, as opposed to merely qualified or absolute, covenants relating to user and alienation (where they have any choice⁸). The courts' approach to reasonableness will also play a role in informing the ongoing management of such portfolios, and even the legislature's attitude towards mandatory full qualification.⁹

This chapter examines how the additional complexities of property portfolios are dealt with by the courts, and how the case law in the context of portfolio properties might inform an understanding of reasonableness in a broader sense. The portfolio cases hint at a more flexible judicial approach to reasonableness than some accounts would acknowledge; one that takes account of both the economic motivations and commercial realities facing the landlord.

4.1 Dispositions

As will be apparent from the discussion of the case law below, the facts of individual cases play a crucial role in whether a refusal of consent is reasonable, but some general themes emerge, which may be useful in thinking about reasonableness in the abstract. Therefore, before examining the range of cases in the area, it is useful to consider some general principles of the law as identified by the appellate courts and discussed by commentators.

A move towards general principles of reasonableness in relation to landlords' withholding of consent began with Lord Denning MR's dicta in *Bickel v Duke of*

⁸ See 3.1.3 above (Landlord and Tenant Act 1927); 5.4.2 below (where I suggest that full qualification be implied into all covenants restricting user and alienation).

⁹ The Law Commission, Codification of the law of landlord and tenant: Covenants restricting dispositions, alterations and change of user, 141 (The Law Commission, 1985). See chapter 5. Although of course a legislature has greater scope than an individual landlord, being able to alter the general law relating to reasonableness if the judicial attitude to the question is standing in the way of mandating full qualification.

Westminster.¹⁰ Although his speech stands as a key defence of a factual, case-by-case approach to reasonableness, it does point to the emergence of broad principles which might guide practitioners in anticipating when a court might find it reasonable for a landlord to withhold consent. Drawing on the earlier decision of the House of Lords in *Viscount Tredegar v Harwood*,¹¹ he rejected the idea that individual cases would be binding on a subsequent court, suggesting instead that the likely decision of a court in a given case might be determined by reference to the body of case law as a whole:¹²

When [the words of a fully qualified covenant] come to be applied in any particular case, I do not think the court can, or should, determine by strict rules the grounds on which a landlord may, or may not, reasonably refuse his consent. He is not limited by the contract to any particular grounds. Nor should the courts limit him. Not even under the guise of construing the words. The landlord has to exercise his judgement in all sorts of circumstances. It is impossible for him, or for the courts, to envisage them all [...] Seeing that the circumstances are infinitely various, it is impossible to formulate strict rules as to how a landlord should exercise his power of refusal. The utmost that the courts can do is to give guidance to those who have to consider the problem. As one decision follows another, people will get to know the likely result in any given set of circumstances. But no one precedent will be a binding precedent as a strict rule of law. The reasons given by the judges are to be treated as propositions of good sense – in relation to a particular case – rather than propositions of law applicable to all cases.

The position which Lord Denning MR advocated seeks to reconcile the conflicting desires for legal certainty and justice in individual cases by supporting the idea that reasonableness is assessed based on consistent - if difficult to characterise precisely - principles, allowing parties to deduce from previous cases what their likely legal position is, but without preventing future courts from deciding subsequent cases on the basis of their individual merits. The question of reasonableness is to be assessed in the context of all of the facts of the case, including the intention of the parties in drafting the covenant. Conceptually, this strikes an appealing balance, but practical

¹⁰ Bickel v Duke of Westminster, [1977] QB 517.

¹¹ Tredegar (Viscount) v Harwood, [1929] AC 72.

¹² Bickel v Duke of Westminster, supra note 10 at 524.

difficulties associated with maintaining consistency in the absence of firm rules have led courts and commentators to seek to define principles governing the concept of reasonableness.

In, *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd*, the Court of Appeal approved this case-by-case approach in general terms.¹³ Balcombe LJ did, however, lay down the following "propositions of law" – elicited from previous judgments – for determining reasonableness:¹⁴

- (1) The purpose of a covenant against assignment without the consent of the landlord, such consent not to be unreasonably withheld, is to protect the lessor from having his premises used or occupied in an undesirable way, or by an undesirable tenant or assignee. [...]
- (2) As a corollary to the first proposition, a landlord is not entitled to refuse his consent to an assignment on grounds which have nothing whatever to do with the relationship of landlord and tenant in regard to the subject matter of the lease [...]
- (3) The onus of proving that consent has been unreasonably withheld is on the tenant $[...]^{15}$
- (4) It is not necessary for the landlord to prove that the conclusions which led him to refuse consent were justified, if they were conclusions which might be reached by a reasonable man in the circumstances [...]
- (5) It may be reasonable for the landlord to refuse his consent to an assignment on the ground of the purpose for which the proposed assignee intends to use the premises, even though that purpose is not forbidden by the lease [...]
- (6) There is a divergence of authority on the question, in considering whether the landlord's refusal of consent is reasonable, whether it is permissible to have regard to the consequences to the tenant if consent to the proposed assignment is withheld [...] a proper reconciliation of those two streams of authority can be achieved by saying that while a landlord need usually only consider his own relevant interests, there may be cases where there is such a disproportion between the benefit to the landlord and the detriment to the

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¹³ International Drilling Fluids v Louiseville Investments, [1986] 1 Ch 513.

¹⁴ *Ibid* at 519–21.

¹⁵ This been reversed in England and Wales by s1(6) of the Landlord and Tenant Act, 1988: See 3.1.5.

tenant if the landlord withholds his consent to an assignment that it is unreasonable for the landlord to refuse consent.

(7) Subject to the propositions set out above, it is in each case a question of fact, depending upon all the circumstances, whether the landlord's consent to an assignment is being unreasonably withheld.

Balcombe LJ's propositions leave the question of reasonableness to be decided by the courts on the facts in most cases, with only the first and second propositions imposing concrete limits on landlords' conduct.

The House of Lords finally considered the question of reasonableness in the context of landlords' consents in the case of *Ashworth Frazer v Gloucester City Council*.¹⁶ Lord Bingham identified "three overriding principles" for determining the reasonableness of a refusal of consent:¹⁷

The first, as expressed by Balcombe LJ in International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd is that

"a landlord is not entitled to refuse his consent to an assignment on grounds which have nothing whatever to do with the relationship of landlord and tenant in regard to the subject matter of the lease ..."

The same principle was earlier expressed by Sargant LJ in Houlder Bros & Co Ltd v Gibbs [1925] Ch 575, 587:

"in a case of this kind the reason must be something affecting the subject matter of the contract which forms the relationship between the landlord and the tenant, and ... it must not be something wholly extraneous and completely dissociated from the subject matter of the contract."

While difficult borderline questions are bound to arise, the principle to be applied is clear.

Secondly, in any case where the requirements of the first principle are met, the question whether the landlord's conduct was reasonable or unreasonable will be one of fact to be decided by the tribunal of fact. There are many reported cases. In some the landlord's withholding of consent has been held to be

¹⁶ Ashworth Frazer Ltd v Gloucester City Council, [2002] 1 All ER 377.

¹⁷ *Ibid*, paras 3–5.

reasonable (...), in others unreasonable (...). These cases are of illustrative value. But in each the decision rested on the facts of the particular case and care must be taken not to elevate a decision made on the facts of a particular case into a principle of law. The correct approach was very clearly laid down by Lord Denning MR in Bickel v Duke of Westminster.

Thirdly, the landlord's obligation is to show that his conduct was reasonable, not that it was right or justifiable. As Danckwerts LJ held in Pimms Ltd v Tallow Chandlers Company: "it is not necessary for the landlords to prove that the conclusions which led them to refuse consent were justified, if they were conclusions which might be reached by a reasonable man in the circumstances . . ." Subject always to the first principle outlined above, I would respectfully endorse the observation of Viscount Dunedin in Viscount Tredegar v Harwood [1929] AC 72, 78 that one "should read reasonableness in the general sense". There are few expressions more routinely used by British lawyers than "reasonable", and the expression should be given a broad, common sense meaning in this context as in others.

In *Channel Hotels v Tamimi*, Peter Gibson LJ commended these principles, describing them as being "indubitably correct." ¹⁸

4.1.1 The general principles

While the propositions in *International Drilling* and "overriding principles" of *Ashworth Frazer* have been broadly accepted as useful syntheses of the principles determining the reasonableness of a landlord's refusal of consent, there has been some debate as to their precedential value. Some have sought to elevate (at least some of) them to rules of law, while others have seen more flexibility, pointing to the repeated approval by subsequent courts of Lord Denning's factual reasonableness approach in *Bickel*, and describing the propositions in *International Drilling* and other

¹⁸ Channel Hotels & Properties (UK) Ltd v Tamimi, [2004] EWCA Civ 1072, para 48.

¹⁹ Crabb, *supra* note 4; Crabb, *supra* note 6; Letitia Crabb & Jonathan Seitler, *Leases: covenants and consents*, 2nd ed (London: Sweet And Maxwell, 2008).

²⁰ International Drilling Fluids v Louiseville Investments, supra note 13; Ashworth Frazer Ltd v Gloucester City Council, supra note 16.

cases as "guidelines (...) to be taken seriously"²¹ or "no more than guidelines in what is essentially an issue of fact."²²

The largely procedural fourth of Balcombe LJ's seven propositions in *International Drilling*, (repeated in Lord Bingham's third overriding principle) and the broad guidance of propositions five and six have not been very controversial. Legislative change has reversed the position of the third proposition, relating to the burden of proof, following recommendations from the Law Commission.²³ The legal situation is in any event relatively straightforward in respect of each of those principles and is discussed in Chapter 3.²⁴ The key difference in opinion amongst commentators relates to the relationship between the first and second propositions and the last (or between the first and second overriding principles).

Kodilinye suggested that there are in fact three reasonableness standards used by courts: The personality or user test, a contractual approach and a broad approach.²⁵ He suggests that in different cases the courts have used different approaches in assessing the reasonableness of a withholding of consent, or have referred to a mixture of them.

The personality or user test

In interpreting fully qualified covenants, and the meaning of "reasonably", the courts have often sought to ascertain the purpose of the covenant. The answer to this question favoured by Balcombe LJ, and comprising his first proposition is said to be

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²¹ Vivien M King, "How reasonable can a landlord be?" (1999) Property Law Journal 16.

²² Peter Luxton, "Inevitable or merely likely? Anticipated user and consent to assign" (2002) Journal of Business Law 466 at 470.

²³ Landlord and Tenant Act, 1988; The Law Commission, supra note 9.

²⁴ 3.1.8, above.

²⁵ Kodilinye, *supra* note 5.

founded in the judgment of AL Smith LJ in *Bates v Donaldson*, ²⁶ as approved by the Court of Appeal in *Houlder Bros v Gibbs*. ²⁷

The comments of AL Smith LJ in *Bates* should be viewed in context, as an abridged version has the potential to give the impression of a statement of more general significance than was actually the case: ²⁸

[The clause] was in my judgment inserted alio intuitu altogether, and in order to protect the lessor from having his premises used or occupied in an undesirable way or by an undesirable tenant or assignee, and not in order to enable the lessor to, if possible, coerce a tenant to surrender the lease so that the lessor might obtain possession of the premises [...]

This wording is rather more consistent with a finding of fact than a general statement on how this type of covenant ought to be construed. The reference to the purposes for the insertion of the clause are equally non-generalisable. It is difficult to accept that AL Smith LJ intended to suggest that any reason not relating to the personality of the intended assignee or intended user of the premises would be unreasonable.

It appears that Pollock MR in *Houlder Bros* took a similar approach to AL Smith LJ in *Bates* in examining the purpose of the covenant on the facts of that particular case, in the context of the relationship between the parties:²⁹

For my part, I agree with A. L. Smith L.J., and I think that one must look at these words in their relation to the premises, and to the contract made in reference to the premises between the lessor and lessee; in other words, one must have regard to the relation of the lessor and lessee inter se, or, perhaps one may add, to the due and proper management of the property, as in Governors of Bridewell Hospital v. Fawkner.

²⁶ Bates v Donaldson [1896] 2 QB 241.

²⁷ Houlder Bros & Co Ltd v Gibbs, [1925] Ch 575.

²⁸ Bates v Donaldson, supra note 26 at 247.

²⁹ Houlder Bros & Co Ltd v Gibbs, supra note 27 at 583.

This affirmation does not seek to limit the grounds of refusal which a landlord may reasonably rely upon to a defined list, but rather gives the type of consideration which a landlord is entitled to take into account.

Kodilinye has pointed to the common form of covenant used in the early cases upon which this principle is said to have been established: Where consent was not to be withheld "in the case of a respectable or reasonable person." He argues that this principle arises partly out of an interpretation of those words, and so should not be taken as a general rule. 31

Examining this question in the abstract and by reference to Chapter 2, which deals with the commercial underpinnings of the leasehold property market, the purpose suggested by this test appears to be a reasonably sensible explanation for such clauses. Often, two of the most relevant factors for a landlord in assessing the suitability of a proposed assignee will be his financial standing or other personal characteristics, and the use to which he will put the property.

While it is true that many objections may be brought within the scope of the test,³² it is curiously selective. Why not limit the purpose of such covenants to controlling who uses the property? A landlord wishing to control the use to which a property is put has the option of insisting upon a separate user clause, which can be enforced independently.³³ One might also take a broader view: Perhaps a landlord might wish

³⁰ Kodilinye, *supra* note 5.

³¹ This may be especially relevant given that the form of words implied by the 1927 Act do not include a reference to a respectable or reasonable person.

³² Paul M Perell, "Motions to Dispense with a Landlord's Consent to an Assignment or Sublease" (1984) 5 Advoc Q 348.

³³ See: Killick v Second Covent Garden Property Company, [1973] 1 WLR 658; cf: Ashworth Frazer Ltd v Gloucester City Council, supra note 16.

to exercise control over the physical state of his premises by maintaining a veto over any alienation. He might also want to preserve his legal interest in a property.³⁴

It seems arbitrary to limit the court's scope, and indeed, some decisions appear to have had to employ legal gymnastics to contort the facts into a position where they might be said to fall within the confines of this proposition.³⁵ The House of Lords doubted the principle in *Viscount Tredegar v Harwood*,³⁶ and courts in Canada and Ireland have moved away from it, viewing it as excessively narrow.³⁷

It also seems odd that this was adopted as a "proposition of law" by Balcombe LJ, when it was specifically rejected as such by Lord Denning MR in *Bickel*, whose dicta was relied upon by Balcombe LJ in setting out the propositions. Crabb and Seitler now believe this test to have been implicitly rejected by its exclusion from Lord Bingham's overriding principles.³⁸

The contractual approach

This approach, also known as the "the principle of no uncovenanted advantage", ³⁹ is based on the second of Balcombe LJ's propositions and the first of Lord Bingham's overriding principles. It seeks to limit the landlord's power to withhold consent to reasons relating directly to the terms of the lease.

In Lord Bingham's judgment in *Ashworth Frazer*, the principle is stated to be that the landlord's reasons for withholding consent must not be "wholly extraneous and

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³⁴ e.g.:*Lee v K Carter Ltd*, [1949] 1 KB 85; *West Layton Ltd v Ford and another*, [1979] 2 All ER 657; *Bickel v Duke of Westminster*, *supra* note 10. Although the former cases were justified on special grounds, this might be justified as a separate purpose for such a covenant.

³⁵ Kodilinye, *supra* note 5 at 49.

³⁶ Tredegar (Viscount) v Harwood, supra note 11.

³⁷ Shields v Dickler, [1948] 1 DLR 809; Coopers & Lybrand Ltd. v William Schwartz Construction Co (1980), 116 1980 DLR (3d) 450; Federal Business Development Bank v Starr et al (1986), 28 1986 DLR 582 (Ontario Superior Court); Egan Film Service Ltd v MacNamara, [1952] 86 ILTR 189.

³⁸ Crabb & Seitler, *supra* note 19 at 88, although they note that Lord Rodger appears to approve the test in the same case.

³⁹ Crabb & Seitler, *supra* note 19.

completely dissociated from the subject matter of the contract" or "nothing whatsoever to do with the relationship of landlord and tenant in regard to the subject matter of the lease". 41

An example often cited as an application of this principle is the Court of Appeal decision in *Bromley Park Garden Estates v Moss*.⁴² It concerned a landlord who sought to procure a surrender of the lease by his refusal of consent to an assignment, in order to re-let the property together with the restaurant below on conditions more favourable to the landlord. The Court of Appeal drew attention to the drastic implications of the landlord's actions, which would amount to expropriating the tenant of the benefit of the lease. Dunn LJ set out:⁴³

[...] there is nothing in the cases to indicate that the landlord was entitled to refuse his consent in order to acquire a commercial benefit for himself by putting into effect proposals outside the contemplation of the lease under consideration, and to replace the contractual relations created by the lease by some alternative arrangements more advantageous to the landlord, even though this would have been in accordance with good estate management.

West Layton Ltd. v. Ford shows that in considering whether the landlords' refusal of consent is unreasonable, the court should look first at the covenant in the context of the lease and ascertain the purpose of the covenant in that context. If the refusal of the landlord was designed to achieve that purpose then it may not be unreasonable, even in the case of a respectable and responsible assignee; but if the refusal is designed to achieve some collateral purpose wholly unconnected with the terms of the lease, as in Houlder Brothers & Co. Ltd. v. Gibbs, and as in the present case, then that would be unreasonable, even though the purpose was in accordance with good estate management. [Citations omitted.]

⁴⁰ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para [3], citing Houlder Bros & Co Ltd v Gibbs, supra note 27 at 587.

⁴¹ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para [3], citing International Drilling Fluids v Louiseville Investments, supra note 13 at 520.

⁴² Bromley Park Garden Estates Ltd v Moss, [1982] 1 WLR 1019.

⁴³ *Ibid* at 1033.

Jonathan Gaunt has suggested that this rule may be limited in its strictest form to the types of factual scenario encountered in *Bromley Park* or *Houlder Bros v Gibbs*. 44

There is, of course, a need to strike a balance between the rights of landlord and tenant. Clearly, a stipulation that consent may only be withheld if reasonable to do so is intended by the parties (and indeed Parliament, where it is inserted by operation of statute⁴⁵) to limit in some way the power of the landlord to veto an assignment. This would be rendered ineffective if "reasonably" were equated to "rationally" in the economic sense, as was hinted at by the House of Lords in *Viscount Tredegar v Harwood*.⁴⁶ If landlords were permitted to refuse consent whenever it is in their interests, the landlord in *Bromley Park* would have been reasonable in seeking the surrender of the lease so it could be re-let at a higher rent,⁴⁷ and the landlord Council in *Anglia Building Society v Sheffield City Council* could have forced the tenant to find a proposed assignee who intended to convert the unit for use as a retail shop.⁴⁸ A key reason for the popularity of this contractual view is that limiting the landlord to using the withholding of consent to protect interests retained under the lease takes the question out of the hands of the court, leaving it to the parties to determine their respective rights. This is in line with a preference for freedom of contract.

Kodilinye suggested that reasons relied upon by a landlord should be limited to those "(i) ensuring the observance of covenants in the lease; (ii) recovering possession of the premises at the end of the lease; and (iii) any other circumstances expressly agreed in the lease."⁴⁹ While this list covers many of the interests which a landlord might

⁴⁴ J Gaunt, "Principle and Pretext: The rules governing landlords' consent" (1987) 284 Estates Gazette 1371

⁴⁵ Landlord and Tenant Act 1927, s 19(1)(a).

⁴⁶ Tredegar (Viscount) v Harwood, supra note 11.

⁴⁷ Bromley Park Garden Estates Ltd v Moss, supra note 42.

⁴⁸ Anglia Building Society v Sheffield City Council, [1983] 1 EGLR 57.

⁴⁹ Kodilinye, *supra* note 5 at 56.

wish to protect, forcing landlords to ground their decisions in the wording of the lease may not be very helpful, as it may lead to the drafting of unnecessarily complicated leases intended to give the landlord as much cover as possible. Where that has not been done, landlords may ground their refusal in abstruse interpretations of covenants, leading to unnecessarily complex and uncertain litigation.

Crabb and Seitler take a slightly different approach, suggesting a two-stage test for identifying whether a reason for refusal of consent can be justified.⁵⁰ The first stage is to ask whether in fact the landlord's commercial interests will be prejudiced by the proposed disposition. The second stage is to ask whether the commercial interests that might be prejudiced are protected in the lease. Crabb and Seitler's approach is somewhat broader than Kodilinye's in recognising collateral contracts and other implied rights which would have been within the contemplation of the parties at the time of entering into the lease.⁵¹

This interests-based approach is certainly an improvement over a strict contract-based view. It allows interests protected expressly or by implication in the lease to be used as justification for a refusal of consent, even if the particular threat to the interest in question is one that could not have been foreseen,⁵² such as in the Rent Act cases.⁵³ Crabb and Seitler place some restrictions on these rights, however. They argue that a management policy not in place or contemplated at the time the lease was made could

⁵⁰ Crabb & Seitler, *supra* note 19 at 86–87.

⁵¹ See Wilson v Flynn, [1948] 2 All ER 40; Channel Hotels & Properties (UK) Ltd v Tamimi, supra note 18; See also the approach of Crabb towards the judgment in Crown Estates Commissioners v Signet, [1996] 2 EGLR 200; Letitia Crabb, "Leasehold restrictions, anticipated user and estate management" (1999) 115 LQR 191 - 195.

⁵² Crabb & Seitler, *supra* note 19 at 91.

⁵³ The Rent Act cases - and later cases relating to the Leasehold Reform Acts - involved sitting tenants who were not eligible for some form of statutory protection seeking to assign their interests to individuals who would gain statutory protection. The courts took a dim view of assignments effected to gain advantages under such statutes. *In Re Swanson's Agreement*, [1946] 2 All ER 628; *Lee v K Carter Ltd, supra* note 34; *Thomas Bookman v Nathaniel*, [1955] 1 WLR 815.

never reasonably ground a consent,⁵⁴ and that Balcombe LJ's fifth proposition⁵⁵ is on shaky ground.⁵⁶

Straudley Investments v Mount Eden Land (No 1) supports the contractual approach as a general proposition, but in a more qualified manner.⁵⁷ Here, Phillips LJ deduced from the propositions in *International Drilling* that:⁵⁸

- (1) It will normally be reasonable for a landlord to refuse consent or impose a condition if this is necessary to prevent his contractual rights under the headlease from being prejudiced by the proposed assignment or sublease.
- (2) It will not normally be reasonable for a landlord to seek to impose a condition which is designed to increase or enhance the rights that he enjoys under the headlease.

This supports the general tenet of the test proposed by Crabb and Seitler in respect of the principle of no uncovenanted advantage, but is somewhat more circumspect. By qualifying his language, Phillips LJ leaves open the possibility that in a particular case it may be reasonable for a landlord to withhold consent for reasons which are not grounded in the contract itself.

The kinds of reasons which have fallen foul of this principle are where the landlord has sought to regain possession of the premises, ⁵⁹ to prevent another tenant of his from taking up the lease and thereby leaving the landlord with another vacant property. 60 or where a landlord has sought to use his refusal to procure additional

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⁵⁴ Crabb & Seitler, *supra* note 19 at 120; See also Crabb, *supra* note 51.

⁵⁵ That it may be reasonable for a landlord to object to an assignment on the grounds of proposed user, even though that user is not prohibited by the lease.

⁵⁶ Crabb & Seitler, *supra* note 19 at 93 (n46); 107–110.

⁵⁷ Straudley Investments v Mount Eden Land (No 1), [1997] 74 P&CR 306 at 310.

⁵⁸ Straudley Investments v Mount Eden Land (No 1), supra note 57.

⁵⁹ Bates v Donaldson, supra note 26; Bromley Park Garden Estates Ltd v Moss, supra note 42; Dunnes Stores (ILAC Centre) Ltd v Irish Life, [2008] IEHC 1114; Farr v Ginnings, (1928) 44 TLR 249 (Ch). ⁶⁰ Houlder Bros & Co Ltd v Gibbs, supra note 27.

rights from a new tenant.⁶¹ In these cases, the landlord's conduct has been far beyond what might reasonably be expected of a landlord in the context of their relationship, not just of the contract. Additionally, in all of these case, the landlord is adopting a property-led management approach, seeking to secure a greater share of the value of the premises, rather than attempting to add value.⁶²

Some of the more extreme cases falling under this rule could amount to an attempt by the landlord to derogate from his grant. Neuberger J stated *obiter* in *Moss Bros v CSC* that a general policy against a change of use where such was provided for in the lease by a fully qualified covenant might amount to a derogation from grant. ⁶³ Browne-Wilkinson LJ pointed in this direction during his judgment in *Rayburn v Wolf*: ⁶⁴

But it is quite clear that the lease itself envisages not only assignments but also underleases; therefore it is plainly within the purview of this lease that there were to be underleases. So the mere possibility of an underlease being granted by a proposed assignee (being something anticipated by the headlease itself) cannot be a ground for objection.

Indeed, the distinction drawn by Dunn LJ in *Bromley Park* between that case and the cases cited by the landlord as supporting a broader justification for a refusal of consent on estate management grounds is similarly concerned with preventing the landlord from undoing his grant altogether:⁶⁵

in no case has it been held reasonable for a landlord to refuse his consent for the purpose of destroying the lease in question or merging it on terms with another lease in the same building

⁶¹ Young v Ashley Gardens Properties, [1903] 2 Ch 112; Balfour v Kensington Gardens Mansions Ltd (1932) 49 TLR 29

^{(1932), 49} TLR 29.

62 See Elizabeth Howard, "The management of shopping centres: conflict or collaboration?" (1997) 7:3

The International Review of Retail, Distribution and Consumer Research 263. See also 2.3, above.

⁶³ Moss Bros Group plc v CSC Properties Ltd, [1999] EGCS 47.

⁶⁴ Rayburn v Wolf, (1985) P & CR 463.

⁶⁵ Bromley Park Garden Estates Ltd v Moss, supra note 42 at 1020.

As Lord Bingham stated in *Ashworth Frazer*, "while difficult borderline cases are bound to arise, the principle to be applied is clear".⁶⁶ There is indeed a clear link between the cases where a landlord's refusal of consent is said to have been found unreasonable on the basis of this approach. Courts may be wise, however, to avoid tying themselves down with rigid rules, lest they, in the words of Lewison J, "fall into the trap identified by Lord Denning MR in *Bickel v Duke of Westminster*."⁶⁷

The broad approach

What Lewison J referred to as Lord Denning's "trap" is of course the fact that the circumstances in which both landlords and tenants find themselves will tend to vary quite considerably over the course of their relationship, and it will never be possible to identify at the outset all of the myriad possibilities in which consent might be sought.

Some have identified a broad approach in how the courts might deal with assessing reasonableness.⁶⁸ This approach is based on the dictum of Lord Denning in *Bickel*, and rejects firm rules for determining reasonableness on the ground that such rules are antithetic to the flexibility required by courts in assessing reasonableness in a particular set of facts. It might also be said that such strict rules are likely to stymie the effective management of property portfolios in the long run.⁶⁹ Much criticism has been levelled at this approach as failing to protect tenants. Crabb and Seitler argue that it:⁷⁰

[M]inimises the concerns of the tenant but seems even broader in its scope [than the personality/user test] allowing landlords to refuse consent whenever, from their point of view, it is commercially reasonable to do so. It

Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para 3.
 Sargeant v Macepark (Whittlebury) Ltd, [2004] 4 All ER 662 at 677.

⁶⁸ Crabb & Seitler, *supra* note 19 at 91 (n34); Kodilinye, *supra* note 5.

⁶⁹ See the discussion about the need for flexibility in long-term portfolio management at 2.6.2, above.

⁷⁰ Crabb & Seitler, *supra* note 19 at 91 (n34).

would endorse, for example, a refusal of consent on the basis of an estate management policy which was outside the contemplation of the parties when the lease was made.

Perell, on the other hand, argues that the effect of *Bromley Park* is not to move away from a reasonable man test: "Rather, it puts that test in a context."⁷¹ Of course, the lease which created the relationship of landlord and tenant must be considered as part of the context in which reasonableness is assessed, as well as any other agreements or dealings between the parties, commercial factors, and any other relevant aspects of the relationship in which the parties actually find themselves. It is certainly not clear that by requiring a landlord to be reasonable in withholding consent, parties to a lease intend to confine the landlord to only have regard to interests protected under the lease.

Although the judgments of Balcombe LJ in *International Drilling* and Lord Bingham in *Ashworth Frazer* both qualified the approach of Lord Denning MR in *Bickel*, stating that factual reasonableness was subject to other rules, it is not clear how rigidly these should be interpreted.

It is, perhaps, unfortunate that Balcombe LJ chose the phrase "propositions of law" to describe the guidance he set out in *International Drilling*. Lord Denning MR had rejected that very same construction in *Bickel* out of a fear that anything purporting to be a proposition of law may cause difficulties for a future court asked to determine reasonableness in the context of a novel set of facts. The Master of the Rolls made this point even having considered the purported rule which later formed the basis of Balcombe LJ's first proposition. In setting out definite rules beyond the procedural elements required to establish the factual situation – where the burden of proof lies;

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⁷¹ Perell, *supra* note 32 at 356.

whether factual reasonableness should be assessed subjectively or objectively; etc. – the decisions in *International Drilling* and *Ashworth Frazer* risk introducing a rigidity into the law that the factual approach seeks to avoid.

Such conditions applying to the reasons relied upon by a landlord should be distinguished from the type of "guidance" suggested by Lord Denning MR in Bickel. Examples of this type of guidance might be the fifth⁷² or sixth⁷³ principles in International Drilling. Such guidance does not bind a later court's discretion either way, contrary to the expectations of some landlords.⁷⁴ As stated by Lord Rodger when overruling the rule in Killick v Second Covent Garden Property Co, 75 (that a landlord could not reasonably refuse consent to an assignment based on the merely anticipated intended user of the proposed assignee):⁷⁶

It is important not to exaggerate the effect of overruling Killick. In particular, it does not establish any contrary rule of law that it will always be reasonable for a landlord to withhold consent to an assignment simply on the ground that the proposed assignee intends to use the premises for a purpose which would give rise to a breach of a user covenant. While that will usually be a reasonable ground for withholding consent, there may be circumstances where refusal of consent on this ground alone would be unreasonable. As Lord Denning MR stressed, it will depend on the circumstances of the particular case.

There is therefore little danger in allowing the courts discretion. Following on from this, if a rigid test might yield some undesirable results, even though it would arrive at a just result in most cases, it is not suitable. Thus, while the contractual approach presents a compelling argument which is capable of explaining much of the jurisprudence and will likely lead to the correct result in the majority of cases, it

⁷⁶ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para 74.

⁷² That the landlord might refuse consent based on an intended use which is not expressly prohibited in the lease.

⁷³ That the landlord may have to take the hardship of the tenant into account.

⁷⁴ E.g. in International Drilling Fluids v Louiseville Investments, supra note 13; Bromley Park Garden Estates Ltd v Moss, supra note 42.

⁷⁵ Killick v Second Covent Garden Property Company, supra note 33.

should not be adopted as a rule of law if it would lead to the wrong result in some, no matter how few.

The House of Lords in *Ashworth Frazer* endorsed a broadly flexible view of reasonableness: Lord Rodger described the value of a reasonableness test generally as being "precisely because it prevents the law becoming unduly rigid." Approving the statement of Viscount Dunedin in *Tredegar v Harwood* that the reasonableness required of landlords is "reasonableness in the general sense", ⁷⁸ as well as Lord Denning's dicta in *Bickel*, Lord Rodger suggested that the correct test was to "consider what the reasonable landlord would do" in the circumstances. ⁷⁹

The reaffirmation of *Bickel* in *Ashworth Frazer* may hint to a re-emergence of factual reasonableness as the key determinant in these cases. The proposition laid out in *Killick v Second Covent Garden Property Co*⁸⁰ was rejected not because it was deficient as a rule, but because rigid rules are intrinsically unsuitable for determining reasonableness in these cases:⁸¹

[As] Bickel shows, the correct approach is to consider what the reasonable landlord would⁸² do when asked to consent in the particular circumstances. The rule of law derived from Killick introduces a rigidity which makes it impossible to apply that approach.

It is also interesting to examine the language of the passages chosen by Lord Bingham in illustrating his first overriding principle: "Nothing whatsoever to do with" and "something affecting [...] not wholly extraneous[...]" point to a loose guideline rather

⁷⁷ *Ibid*, para [67].

⁷⁸ Tredegar (Viscount) v Harwood, supra note 11 at 78.

⁷⁹ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para [69].

⁸⁰ Killick v Second Covent Garden Property Company, supra note 33.

⁸¹ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para [69](Lord Roger).

⁸² I would submit that it might be more correct to say "what **a** reasonable landlord <u>might</u> do". Given the fourth proposition *in International Drilling*, as affirmed by Lord Bingham in *Ashworth Frazer* at para [5].

than a strict rule. It seems clear from the judgment that it is the broad principle that Lord Bingham affirms, rather than a particular formulation. It also acknowledges the "infinitely various" circumstances which might be faced by the courts in determining reasonableness and how the facts of individual cases may pose problems for such a rule.

Although Lord Bingham's affirmation of a general reasonableness test is subject to the aforementioned principle, the wording of his judgment indicates that the first principle might be interpreted flexibly.⁸⁴ In describing the cases upon which his first principle is based as "of illustrative value", he is leaving it to be decided on a case-by-case basis whether in fact the reason relied on by the landlord falls within the relationship of landlord and tenant. This would allow a broader reasonableness test to be applied in the difficult borderline cases mentioned.⁸⁵

The overall tone of both judgments on reasonableness is similar to that of Lord Denning MR's in *Bickel*. It re-affirms the spirit of Lord Denning MR's dicta: this area of the law concerns aspects of commercial practice that are subject to myriad variables and do not lend themselves to strict rules. A loose formulation of the contractual approach, as adopted by Phillips LJ in *Straudley Investments*⁸⁶ might be a better guide for future courts than the firm application of the contractual approach.

4.2 User

The courts' approach to the reasonableness of landlords' refusals of consent is most developed in the context of disposition covenants, perhaps because landlords' and

⁸³ Bickel v Duke of Westminster, supra note 10 at 524.

⁸⁴ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para 4.

⁸⁵ See, for example: Whiteminster Estates v Hodges Menswear, (1974) 232 EG 715 (Ch); Crown Estates Commissioners v Signet, supra note 51.

⁸⁶ Straudley Investments v Mount Eden Land (No 1), supra note 57.

tenants' interests are more likely to be aligned in the case of user covenants,⁸⁷ because disposition covenants are more likely to be fully qualified than other types of covenant,⁸⁸ or because a change of user is more likely to be sought in the context of a transfer of the property than by a sitting tenant. Due to the lack of litigation on the reasonableness of a refusal of other types of consent, courts have looked to cases on dispositions for guidance.⁸⁹

A landlord's objections to user are also likely to centre on different grounds than an objection to a disposition. It may relate to a concern about the viability of the proposed business, ⁹⁰ or the effect that a change of user may have on the legal rights and obligations attaching to the premises. It is also interesting to note how many of the decisions where a refusal to consent based on user were upheld related to the impact of the proposed user on other property of the landlord. ⁹¹

Many cases concerning user have arisen in the context of a landlord's refusal of consent to a disposition, where the landlord has objected to the intended user of the proposed disponee. Such circumstances bring an additional set of interests into play for the landlord to those involved in disposition without a change of user. A landlord might, for instance, be worried about the premises losing some advantage arising out of a licence or continued user, which could not be regained by a subsequent occupier. The proposed user could damage the value of the reversion by

⁸⁷ As suggested by Lord Neuberger in the forward to Crabb & Seitler, *supra* note 19 at vi.

⁸⁸ There is no statutory implication of words fully qualifying a merely qualified user covenant.

⁸⁹ Anglia Building Society v Sheffield City Council, supra note 48; Tollbench v Plymouth City Council (1988), 56 P & CR 194 (CA); Hillgrove Developments Ltd v Plymouth City Council, (Ch, 10 July 1997)(user); Iqbal v Thakrar, [2004] EWCA Civ 592 (alterations); Laurie Heller, "A statement of principles at last" (2005) 145 Property Law Journal 9. One caveat is that the personality or user approach is inherently unsuitable as a filtering mechanism in the context of user covenants: if a landlord could always withhold consent on the grounds of a change of user, there would be little reason to have the covenant fully qualified.

⁹⁰ International Drilling Fluids v Louiseville Investments, supra note 13.

⁹¹ E.g. Crown Estates Commissioners v Signet, supra note 51; Moss Bros Group plc v CSC Properties Ltd, supra note 63; Chelsfield MH Investments Ltd v British Gas Plc, (1995) 70 P & CR D31.

⁹² And indeed to a change of user not relating to a disposition.

making it more difficult to find a tenant in future, or affect the rent obtainable upon review. In addition, a change of user could have a significant impact on neighbouring properties, whether by causing a nuisance or by removing a benefit arising as a result of the current occupation. In cases involving multiple requested consents, the reasonableness of refusal of consent to assignment and user (as well as to any other consents that might be necessary, such as for alterations) should be addressed together where they amount to one scheme. It may not be appropriate for a tenant to seek consent to a change of user intended to benefit an assignee, as such an application should be made together with the application for consent to assign.

In *Killick v Second Covent Garden Property Company*, 95 the tenant of a property had sought to assign the lease to another company, which was likely to turn it into offices in breach of the user covenant in the lease. The Court of Appeal held that as the landlord would be in the same position legally after such an assignment, being able to enforce the user covenant against the assignee, he could not reasonably refuse consent to the assignment. Although this case was decided before *Bickel*, it came to be interpreted as a rule of law that a landlord could not reasonably object to an assignment based merely on an anticipated breach of the user clause by the proposed assignee, where consenting (with a reserved right to enforce user covenants if necessary) would not affect his legal position after the assignment. 96 This rule was heavily criticised, 97 with Lord Rodger even referring to a description of it as "the refuge of the desperate". 98

⁹³ Crown Estates Commissioners v Signet, supra note 51.

⁹⁴ Lloyd v Earl of Pembroke, [1954] ILTR 40.

⁹⁵ Killick v Second Covent Garden Property Company, supra note 33.

⁹⁶ British Bakeries v Testler, [1986] 1 EGLR 64; Letitia Crabb, "Licences to assign and proposed user" Conv 381.

⁹⁷ Crabb, *supra* note 51; Crabb, *supra* note 96; Luxton, *supra* note 22.

⁹⁸ Ashworth Frazer Ltd v Gloucester City Council, supra note 16, para 66; citing Gaunt, supra note 44.

Although a number of subsequent courts were able to distinguish *Killick*, ⁹⁹ the rule was seen as sufficiently problematic for the House of Lords to address it in *Ashworth Frazer*, striking it down as an inappropriate fetter on landlords' discretion. It is now considered generally reasonable to withhold consent on the grounds that the anticipated user of a proposed assignee would be in breach of a user covenant, although if the user covenant is fully qualified, the refusal of consent to change user must also be reasonable.

Quality of user

The substantive purpose for which a proposed assignee wishes to use a property may not be the only factor relevant to a landlord's decision. As discussed in Chapter 2, the difference between two ostensibly similar uses can be vast in terms of the number and types of customers that they attract, and therefore to the landlord's management plans. Of course in some instances, a landlord's interests in this regard may be capable of being protected through careful drafting of a user covenant, but this will not always be possible. In the absence of a clause such as this, a landlord will most likely be unable to prevent a sitting tenant from making subtle changes to the manner of user, it may be reasonable for a landlord to object to a disposition on such grounds.

⁹⁹ FW Woolworth Plc v Charlwood Alliance Properties, [1987] 1 EGLR 53; Warren v Marketing Exchange for Africa, [1988] 2 EGLR 247.

¹⁰⁰ See 2.6.2, above. Consider, for example, the average customer profile of Waitrose and Iceland supermarkets, or Tiffany's and a Cash Converters jewellers shops. See Ciaran Carvalho & Emma Slessenger, "Getting the mix right" 21 August 1999 Estates Gazette 74.

¹⁰¹ For example, by defining the user through terms such as "high class"; "upmarket"; or "family friendly".

¹⁰² Premier Confectionery (London) Co Ltd v London Commercial Sale Rooms Ltd, [1933] Ch 904; Cf International Drilling Fluids v Louiseville Investments, supra note 13.

In Canada, it has been suggested that even where a proposed assignee intends to use the premises for substantially the same purposes, the subtle differences in the manner of occupation may be relevant in determining reasonableness:¹⁰³

The mere fact that the proposed subtenant is acknowledged to be respectable and responsible does not preclude a landlord from saying that the subtenant is not suitable having regard to all the circumstances, including the circumstances that existed when the head lease was entered into. It is well known that in shopping centres, the 'personality' and use of lead tenants is very important and material factor in the overall value of the shopping centre. I would not like to say that a shopping centre landlord is never justified in withholding consent to a sublease where the sublessee, although respectable and responsible, is nevertheless operating a different class of store, especially in the case of a lead tenant.

4.3 Reasonableness - special cases

There are some cases where, although unreasonable at first sight, a refusal of consent may be justified by reference to some special factor. It had been suggested that the Rent Act cases fell under a special category but it appears that this is not the case. ¹⁰⁴

4.3.1 Express provisions in the lease

In order to avoid any doubt, a portfolio landlord might be tempted to include a list of circumstances in which it would be reasonable for the landlord to refuse consent. The courts have interpreted many of these clauses quite narrowly, even where they are drafted to give the landlord as much manoeuvrability as possible. In *Berenyi v Watford Borough Council* (relating to a user covenant), the council was entitled under the lease to withhold consent to a change of user on the ground "that the trade or business proposed to be carried on is considered by the corporation to be one which

¹⁰³ Canada Safeway Limited and Oshawa Holdings Ltd v Triangle Acceptance Ltd, [1980] 5 WWR 259; applied in Canada Safeway Limited v. Rene Management & Holdings Ltd., [1999] 11 WWR 759; see 2.10.2 for commercial background.

¹⁰⁴ West Layton Ltd v Ford and another, supra note 34.

¹⁰⁵ Permissible at common law for user covenants and under section 19(1A) of the Landlord and Tenant Act 1927 (as inserted by the Landlord and Tenant (Covenants) Act 1995, s22) for dispositions (See *Re Smith's Lease; Smith v Richards*, [1951] 1 All ER 346 for the situation prior to the 1995 Act).

would be in conflict with the corporation's interpretation of good estate management." The Court of Appeal held that as the council had not appeared from its minutes to have given thought to the user, they could not rely on the clause cited above. Courts may also interpret the general reasonableness requirement more strictly against the landlord where the lease contains specific reasons for withholding consent, and the landlord seeks to rely on another reason, as has been done in Canada. 107

The inclusion of such conditions in the lease, whether as limits to the fully qualified covenant permissible at common law in respect of user, as conditions precedent to the fully qualified covenant coming into operation, or under section 19(1A) of the 1927 Act in relation to alienation cannot, however, be seen as a win-win situation for the landlord. Although such devices do allow for some degree of manoeuvrability between the extreme positions of absolute prohibitions¹⁰⁸ and fully qualified covenants, and fully qualified covenants, are advised to minimise any restrictions imposed as rent achievable upon review will take into account the real situation facing the tenants, not merely the appearance of a fully qualified covenant.

In their report, the Association of British Insurers' Working Party on the 1995 Act did not recommend including any safeguards into leases to protect a landlord's ability to refuse consent on grounds relating to good estate management, as in its opinion,

¹⁰⁶ Berenyi v Watford Borough Council, [1980] 2 EGLR 38.

¹⁰⁷ Lehndorff Can. Pension Properties Ltd. v Davis Mgmt. Ltd., (1987) 13 B.C.L.R. (2d) 367.

¹⁰⁸ Which give a landlord the greatest amount of control, but could significantly depress rent achievable through initial negotiations and on review.

¹⁰⁹ Which are likely to command a higher rent in return for the landlord yielding some control over the property.

property.

110 Sandham, *supra* note 5; *Report of the ABI Working Party on the Landlord and Tenants (Covenants)*Act 1995 (London: Association of British Insurers, 1996).

refusal on any ground that might be covered by such a covenant would be reasonable in the normal course of events.¹¹¹

Tenant mix covenants

While specific covenants may be useful in preserving freedom of action for landlords, they may occasionally limit a landlord's freedom to make changes. In *Dunnes Stores* (*Ilac Centre*) *Ltd v Irish Life Assurance* the landlord's refusal to consent to a change of user was deemed unreasonable, in part because of the drafting of the fully qualified user covenant. ¹¹² It stated expressly that the landlord must consider the need for uses to be "as diverse as possible" when considering applications for consent to change of user. The landlord had sought to keep the tenant mix to only clothing-related retailers in one part of the shopping centre. It is clear, therefore, that landlords ought to be careful about how such covenants are granted, as they may cause difficulties for the long term management of a centre. ¹¹³

4.3.2 The unreasonable behaviour of others

While it is clear that the landlord may not act unreasonably in refusing consent, a question which has arisen in a number of cases is the degree to which he is entitled to take into account the unreasonable opinions of others.

Tenant relations

In some cases it may not be the landlord who objects to a particular change, but other tenants of the landlord, or their customers. Certainly in the case of tenants, if their objections are not based on anything material, the landlord may not be permitted to

¹¹¹ Report of the ABI Working Party on the Landlord and Tenant (Covenants) Act 1995, *supra* note 110, para 3.4.3.

Dunnes Stores (ILAC Centre) Ltd v Irish Life, supra note 59.

¹¹³ See also Marc E Rosendorf & Jill Reynolds Seidman, "Restrictive Covenants - The Life Cycle of a Shopping Center" (1998) 12 Prob & Prop 33.

take account of their apprehensions.¹¹⁴ This may be different where the tenants were in a position to vacate their properties. Given that these fears would then represent a real situation facing the landlord, some signs suggest he may be allowed refuse on this ground, ¹¹⁵ although this cannot be taken for granted. ¹¹⁶

Superior Landlords

Where a superior landlord's consent is required for a landlord to grant consent, subject to it not being unreasonably withheld, it appears as though a landlord will not be reasonable in relying on an unreasonable withholding of consent by that superior landlord. Thus both the head landlord and the landlord of the subtenant will be unreasonable in withholding consent.¹¹⁷

Market forces and reasonableness

Sometimes the landlord may themselves be subject to wider market forces. For example, the value of the reversion can be affected considerably by the covenant strength of the tenant. On one view, this will at most entitle a landlord who is planning to sell his reversion to take into account the value of the reversion. In *International Drilling*, a question was raised about the relevance of paper value alone in this regard. This again indicates that the courts are more likely to approve the withholding of consent where it is done in pursuit of a business-led management strategy, than when a landlord is basing his decisions on a property-led strategy. 119

In other cases, a landlord might fear his other tenants losing customers as a result of a new (undesirable) tenant moving in, as in *Egan Film Services v McNamara* (where a

116 Houlder Bros & Co Ltd v Gibbs, supra note 27.

¹¹⁴ White v Carlisle Trust, [1976-7] ILRM 311.

¹¹⁵ Ponderosa v Pengap, [1986] 1 EGLR 66.

¹¹⁷ Vienit Ltd v W Williams & Son (Bread Street) Ltd, [1958] 3 All ER 621.

¹¹⁸ International Drilling Fluids v Louiseville Investments, supra note 13; Cf Ponderosa v Pengap, supra note 115.

Howard, supra note 62.

Christian bookshop tenant feared losing customers as a result of a bookmakers moving in next door). 120 Dixon J, in the Irish High Court, held that the landlord was not unreasonable in refusing consent, even though he might not have been reasonable in refusing consent based on his own moral objections. 121

4.3.3 Statutory or freely negotiated

Another question to be asked is whether the origin of a covenant affects the standard of reasonableness to be applied, in particular where it has been implied by statute. If reasonableness is, in the normal course of events, to be assessed by the intentions of the parties, how might it be interpreted in light of the fact that a covenant was inserted by operation of statute rather than by the intention of the parties?

The courts may look to the purpose of a statute to see how it may affect reasonableness. Section 19(1)(a) of the Landlord and Tenant Act 1927 was intended to improve the position of tenants subject to merely qualified disposition covenants and so it will not act to imply into a lease a less favourable covenant than the tenant was able to obtain in negotiations.

The wording of the statute will be essential. Legislatures may not been as content as private parties to leave the interpretation of such covenants to the courts. For example, the Rent Restrictions Act 1946 in Ireland imposed a very severe assignment clause on landlords (under which a landlord could only withhold consent if greater hardship would, owing to the special circumstances of the case, be caused by granting the consent than by withholding it). 122

Egan Film Service Ltd v MacNamara, supra note 37.
 Cf Rodney v Austerfield, [1979] CLY 1572; Schlegel v Corcoran, [1942] IR 19.
 See chapter 6 in relation to legislative policy in this area.

The Irish Supreme Court recently examined section 66 of the Landlord and Tenant Act, 1980 in the case of *Meagher v Luke J Healey Pharmacy Ltd.*¹²³ In that case, Murphy J in the High Court had held that the landlord's consent to assignment had been unreasonably withheld, and had suggested that had the tenant been able to establish loss as a result of the landlord's unreasonable refusal of consent, damages would in principle be payable. Finnegan J, giving the judgment for the Supreme Court, rejected this view. The 1980 Act implies a qualification into any restriction of alienation, but does not place a statutory duty on a landlord not to withhold consent unreasonably. This is in contrast to the decision in *Kelly v Cussen*, which interpreted the Rent Restrictions Act 1946. ¹²⁵

4.4 Reasonableness in the context of a portfolio

Where does this standard of reasonableness leave the portfolio landlord? If the reasonable landlord may only consider the subject matter of the lease in deciding whether to grant consent or may only refuse consent in order to promote interests that are protected in the lease, can a landlord ever take account of tenant mix, externalities or damage to neighbouring property? Ought landlords of property portfolios insist upon absolute user and assignment clauses to avoid the risks of a refusal of consent being challenged? In order to answer these questions, it is instructive to examine how the courts have treated landlords who have refused consent on such grounds.

It has been held or implied in numerous decisions at first instance¹²⁶ and in the appellate courts, ¹²⁷ that landlords are not precluded as a matter of law from

¹²³ Meagher v Luke J Healy Pharmacy, [2010] 3 IR 743.

¹²⁴ Meagher v Luke J Healy Pharmacy, [2005] IEHC 120.

¹²⁵ Kelly v Cussen, [1954] 88 ITLR 97 (Circuit Court, Barra Ó Briain J).

¹²⁶ Redevco Properties v Mount Cook Land, [2002] EWHC 1647 (Ch); Sportoffer Ltd v Erewash BC, [1999] L & TR 433; Whiteminster Estates v Hodges Menswear, supra note 85.

¹²⁷ Tredegar (Viscount) v Harwood, supra note 11; Houlder Bros & Co Ltd v Gibbs, supra note 27.

considering their broader interests in deciding whether or not to give a consent requested by a tenant. It was thought at one time, that the landlords of property portfolios had a very broad discretion to withhold consent in order to promote their own interests relating to the estate to which an individual property belonged. 128 However, the notion that portfolio landlords have unlimited discretion in managing individual properties was comprehensively dismissed by the Court of Appeal in Bromley Park Garden Estates v Moss. 129

The boundary between acceptable management of a property for the benefit of a broader portfolio and an abuse of the landlord's power under the lease to secure a collateral advantage is best understood through the case law. As the courts have taken a similar approach to determining reasonableness in respect of fully qualified user, assignment and alterations covenants, all three shall be addressed together.

4.4.1 The case law

Governors of Bridewell Hospital v Fawkner (the Salvation Army case) is an early reported case of a landlord seeking to rely on apprehended damage to its neighbouring property to refuse consent to assignment. 130 The sitting tenant sought consent to assign the lease to "General" Booth, founder of the Salvation Army, for use as office space. The landlord refused consent on the basis of professional advice that the occupation of the premises by the Salvation Army, even just as office space, could have a detrimental effect on nearby property. This refusal was upheld as reasonable ("not arbitrary" and with "good and sufficient reason") on the grounds that the Corporation, as managers, had to consider "not merely the tenant of any particular premises forming part of that estate, or the rent he had to pay, or the covenants into

 ¹²⁸ Tredegar (Viscount) v Harwood, supra note 11.
 129 Bromley Park Garden Estates Ltd v Moss, supra note 42.

¹³⁰ Bridewell Hospital v Fawkner, (1892) 8 TLR 637.

which he had to enter, but the wellbeing of the whole estate."¹³¹ The Court held that, notwithstanding the virtues of a proposed user in itself, any injury likely to be caused by it to neighbouring property of the landlord could reasonably be taken into account.

In *Re Spark's Lease*, a landlord shared a building with its tenant, including the front entranceway. ¹³² The tenant sought consent to a subletting subject to an identical user clause to that in the head lease, which the landlord granted, subject to the proviso that his consent be required for any further subletting by the proposed sublessee. Swinfen Eady J held that this was a reasonable condition, as the landlord had a direct interest in the user of his neighbour, pointing out that excessive use by any occupant of the common entranceway could damage the value of the landlord's premises. ¹³³

This can be contrasted with the case of *Berenyi v Watford Borough Council*, where the landlord's apprehensions regarding the effect of a subletting on traffic flow were held to be unjustified, as had been found in an appeal of an earlier planning decision by the council.¹³⁴

The landlord in *Houlder Bros v Gibbs* sought to prevent an assignment of a lease with five years left to run to an existing yearly tenant of the landlord in adjoining premises. The landlord's fear was that the proposed assignee would vacate the other premises at the first opportunity, leaving the landlord with a unit unoccupied in an unfavourable letting market. Considering the Salvation Army case, Pollock MR described it as:

¹³¹ Ibid

¹³² Re Spark's Lease, Berger v Jenkinson, [1905] 1 Ch 456.

Compare this to *West Layton Ltd v Ford and another, supra* note 34., where Roskill LJ pointed to the fact that the flat which the tenant proposed to sublet could only be accessed through the shop below as one reason justifying the landlord's refusal of consent.

¹³⁴ Berenyi v Watford Borough Council, supra note 106.

¹³⁵ Houlder Bros & Co Ltd v Gibbs, supra note 27.

an illustration of a withholding of consent on broad grounds bearing upon the estate of the lessor, or it may be on grounds which are important between the lessor and other lessees of that property, or that estate, of which the lessee had cognizance. But I do not think the words of the covenant can be so interpreted as to entitle the lessor to exercise the right of refusal when his reason given is one which is independent of the relation between the lessor and lessee, and is on grounds which are entirely personal to the lessor, and wholly extraneous to the lessee.

The court rejected the landlord's refusal as having no relation to "the relationship of landlord and tenant in regard to the subject matter of the demise". 136

In *Tredegar v Harwood*, the lease of a house included a covenant requiring the tenant to keep the house insured with a particular company (Law Fire) or another responsible company, subject to that other company being approved by the landlord. An assignee of the original tenant had insured the house with a different company (Atlas) in compliance with a term of her mortgage, and the landlord sought to compel her to take out a policy with Law Fire. The reason for the landlord's insistence upon Law Fire was related to his estate management practices. Requiring that all tenants use the same insurers made the sisyphean task of ensuring that all of the thousands of houses in his estate were insured somewhat easier. The Court of Appeal held that the covenant ought to be construed analogously to a fully qualified assignment covenant, and that once the tenant suggested a respectable insurance office, the landlord could not object on grounds unconnected with the relationship of landlord and tenant. Although a majority of the House of Lords rejected this construction, both Viscount Dunedin and Lord Shaw went on to discuss the concept of reasonableness, both suggesting that the landlord's reasons would have been reasonable in any event.

¹³⁶ *Ibid* at 588.

¹³⁷ Tredegar (Viscount) v Harwood, supra note 11.

Questioning the generalisability of the judgment in *Houlder Bros*, Viscount Dunedin stated: 138

I am not inclined to adhere to the pronouncement that reasonableness was only to be referred to something which touched both parties to the lease. I should read reasonableness in the general sense (...)

Lord Shaw expressly referred to the relevance of the property being managed as part of a broader estate, opining that if the clause were subject to a qualification that the landlord could not unreasonably withhold consent to another insurance company being used "it would be wrong to confine the reason in such case to the particular house exclusive of all considerations as to the management of the estate to which it belonged." 139

In *Premier Confectionery v London Commercial Sale Rooms*,¹⁴⁰ one tenant occupied two nearby units owned by the same landlord in a block of buildings under separate leases, entered into approximately one year apart. One, known as the "kiosk", was much smaller than the other and commanded significantly less rent. Each was subject to a qualified covenant against assignment (converted into a fully qualified covenant by the 1927 Act) and a user covenant restricting the premises to use as a tobacconist. Both were assigned together to the plaintiff, which later went into liquidation. The liquidator sought consent to assign the kiosk on its own. The landlord refused to consent to the assignment, pointing to a policy against having two tenants in the same building competing against one another. Bennett J, sitting in the Chancery Division, accepted the commercial evidence as demonstrating clearly that the operation of the kiosk separately to the shop would cause damage to the landlord's interest in respect of the shop, to which a reasonable landlord would have regard if he were so entitled.

¹³⁸ *Ibid* at 78(Viscount Dunedin).

¹³⁹ *Ibid* at 81.

¹⁴⁰ Premier Confectionery (London) Co Ltd v London Commercial Sale Rooms Ltd, supra note 102.

As the leases were made separately, it was argued that the landlord was relying on factors external to the relationship of landlord and tenant, and so the landlord was not entitled to take the apprehended harm into account. Bennett J held that in all the circumstances, the landlord was entitled to take such factors into consideration, although unfortunately scant reasoning is given as to why this would be so. It appears to be based on the personality or user test from *Bates v Donaldson*, with Bennett J linking the refusal to the proposed manner of user and occupation, and indicating a willingness to take into account a very broad range of circumstances, encompassing the relationship between the parties and the landlord's commercial position.

This was accepted in *Re Town Investments Underlease*, a case where the landlord objected to a sublease of part of a property on terms involving the payment of a significant premium in return for rent being set at below market rate.¹⁴³ The landlord feared that the effect of this transaction could be to make it more difficult to charge or rent the property in future. Dankworths J cited *Premier Confectionery* as:¹⁴⁴

[A]uthority for the proposition that, in considering whether to give or withhold consent, the landlords were entitled to consider the effect which the transactions might have upon their ability in the future to let satisfactorily the different parts of their property, particularly in case of default on the part of their tenant in performing his obligations.

In *Whiteminster Estates v Hodges Menswear*, the landlord of a retail unit refused its tenant consent to assign the property to a competitor of the landlord. The unit neighboured the landlord's menswear shop and the landlord feared that if it were to be occupied by a competing store, the landlord's business would be harmed. Although

¹⁴² Premier Confectionery (London) Co Ltd v London Commercial Sale Rooms Ltd, supra note 102 at 912.

¹⁴¹ Bates v Donaldson, supra note 26.

¹⁴³ Re Town Investments Ltd Underlease, McLaughlin v Town Investments Ltd, [1954] Ch 301.

¹⁴⁴ *Ibid* at 314

¹⁴⁵ Whiteminster Estates v Hodges Menswear, supra note 85.

the sitting tenants argued that a concentration of clothing shops could draw in more customers, increasing profitability of individual shops, ¹⁴⁶ Pennycuick VC accepted the landlord's reasoning, holding that the court could only intervene where the landlord's reasons were perverse. The court accepted as a given that a landlord is entitled to take into account reasons not only relating to his interests as landlord but also affecting him in other capacities.

The reasons cited in court by the landlord in *Bromley Park Garden Estates v Moss*¹⁴⁷ related to trying to realise some marriage value¹⁴⁸ of the flat which formed the subject matter of the proceedings and a restaurant below. Recovering possession of the flat would allow the landlord to re-let the whole building on advantageous terms. The landlord relied on a statement in *Woodfall* to the effect that a landlord could reasonably refuse consent to an assignment if to do so is in the interests of good estate management. Although the Court of Appeal accepted that it would be good estate management for the landlord to refuse consent, Dunn LJ distinguished permissible estate management grounds from the case at hand, stating: 150

The cases cited in support of the proposition as stated by Woodfall show that, although the question of unreasonableness depends on all the circumstances of the case, including considerations of proper management of the estate of which the demised premises form a part, in no case has it been held reasonable for a landlord to refuse his consent for the purposes of destroying the lease in question or merging it on terms with another lease in the same building, even though that would probably be good estate management and would be a pecuniary advantage to the landlord.

¹⁴⁶ See discussion of comparison shopping at 2.6.2.

¹⁴⁷ Bromley Park Garden Estates Ltd v Moss, supra note 42.

¹⁴⁸ See discussion of marriage value at 2.5.4.

Woodfall, Landlord and Tenant, 28th ed. (1978) Para 1181. Cf the current statement in William Woodfall, *Woodfall landlord and tenant* (Sweet & Maxwell), sec 11.150.

¹⁵⁰ Bromley Park Garden Estates Ltd v Moss, supra note 42 at 1032.

In both cases the landlords were seeking to uphold the status quo and to preserve the existing contractual arrangements provided by the leases (...) there is nothing in the cases to indicate that the landlord was entitled to refuse his consent in order to acquire a commercial benefit for himself by putting into effect proposals outside the contemplation of the lease under consideration, and to replace the contractual relations created by the lease by some alternative arrangements more advantageous to the landlord, even though this would have been in accordance with good estate management.

Slade LJ also distinguished those cases, pointing to the fact that both of the landlords involved would have suffered detriment if the proposed assignment were to have been permitted. 152

In *FW Woolworth v Charlwood Alliance*, the plaintiff tenant operated a department store which was the anchor tenant in the defendant landlord's shopping centre.¹⁵³ It was subject to a keep open covenant. The landlord refused to consent to an assignment of the lease unless the proposed assignees gave an undertaking that they would be able to comply with the keep open covenant. Judge Finlay QC, sitting in the High Court, held that the landlords were entitled to make their decision having regard to the likely effect of the transaction on the centre:¹⁵⁴

The landlords here are, in my judgment, entitled to consider the likely effect upon their ability to let other parts of the property and, indeed, to obtain the appropriate rents for their other property in the centre. At all material times there was a high likelihood, now shown to be a certainty, that the assignee would not keep the store open and the landlords are entitled to consider the effect which that would have upon their ability not only to let the other property in the centre but to obtain satisfactory rents for them.

152 Ibid at 1025

¹⁵¹ *Ibid* at 1032–3.

¹⁵³ FW Woolworth Plc v Charlwood Alliance Properties, supra note 99.

In *Sportoffer v Erewash BC*, the plaintiffs operated squash courts on property let from the local Borough Council. Over several years since the club's establishment (and through several operators), it reacted to a fall in the popularity of squash by varying the facilities it provided, bringing it into competition with the landlord council's own leisure facilities. Eventually, the owners sought permission to assign the lease to a company operating a chain of health and fitness clubs, which wanted to further diversify the club's offering, including the addition of a swimming pool. The council objected to the change of use, pointing to the detriment it would cause to the council's adjacent swimming pool and other nearby leisure facilities, both by competing directly against them and causing congestion in the car park shared by the squash club and the council's swimming pool. It was argued on behalf of the plaintiff that the second of Balcombe LJ's propositions from *International Drilling* precluded the landlord from considering his interests in respect of other properties belonging to him. Referring to *Whiteminister Estates v Hodge's Menswear*, Lloyd J stated: 156

I would find it surprising if a landlord could not reasonably take into account the circumstances of other property of his own, whether let or in hand, when considering an application for a consent to change of use under a lease. A shopping centre is an obvious example, but not the only case, where estate management considerations may suggest that one type of use be allowed under a lease but others not, because of the circumstances of other adjoining property.

I find nothing in Balcombe LJ's judgment, nor in the case cited by him in relation to the proposition which I have mentioned, which suggests that this is not legitimate or that Sir John Pennycuick's decision in Whiteminster Estates Ltd is wrong. I therefore hold that, following Sir John's decision, a landlord can legitimately take into account considerations relating to adjoining property of his own, whether let or not.

The plaintiff also made a more subtle argument based on the contractual approach discussed above. One of the council's facilities which it feared would be subjected to

¹⁵⁵ Sportoffer Ltd v Erewash BC, supra note 126.

¹⁵⁶ *Ibid* at 454.

competition by the proposed change of use was built in 1987, after the lease had been granted and after the club had begun to diversify its facilities. It was thereby argued that in trying to prevent the change of use, the landlord was seeking an uncovenanted advantage. Lloyd J rejected this argument, preferring to look at the relationship as it existed at the time the consent was sought, and arguing that as the relationship between the parties is bound to change over the course of a long lease, so are the interests each will want to protect:¹⁵⁷

Given that this is a 99-year lease, it seems to me unrealistic to suggest that the only other property which the council could legitimately take into account, and the only other uses of property, are those in existence at the date of the lease. It stands to reason that a landlord would take such a covenant to protect the interests that it needs to protect at any time during the whole term. As local authority, it is bound to have such interests and highly likely that they will change during the period of 99 years.

In a sense, Miss Jackson's proposition was advanced as a forensic one as well as separately as a legal one, namely, that the borough council could not be regarded as entitled to complain of competition, if there be any, with the Albion Centre because they came to the competition. But in my view that is not a fair assessment of the facts.

The recent case of *Sargeant v Macepark* further illustrates these principles.¹⁵⁸ The Defendant tenant operated a hotel next to the claimant's golf course, which was used *inter alia* for management training and conferences. The tenants applied for consent to the construction of an extension. Eventually, the landlords sought to impose a condition on the consent, that the extension only be used for management training conferences, to prevent the tenant from competing with the landlord, which occasionally allowed its premises to be used for weddings and other functions. Lewison J held that the landlord was entitled to insist on a condition to protect its existing business interests relating to weddings, but not to seek to prevent the tenant

⁵⁷ Ihid

¹⁵⁸ Sargeant v Macepark (Whittlebury) Ltd, supra note 67.

from conducting conferences other than management conferences, as the tenant was already pursuing business in this area. Relying on Sportoffer, Lewison J held that: 159

In my judgment there is no rule of law which precludes a landlord from relying under any circumstances on perceived damage to his trading interests in adjoining or neighbouring property as a ground for refusing consent to an assignment or change of use. Whether the particular perception is reasonable and whether, if reasonable, it justifies a refusal of consent or the imposition of a condition, is a question of fact in each case.

Further on, in relation to alteration covenants, he states: 160

(...) in an appropriate case, a landlord is entitled to object to alterations on the ground that he has a reasonable objection to the use that the tenant proposes to make of the altered property, whether that use is the same as or different from the use carried on in the remainder of the property.

To hold otherwise would be to fall into the trap identified by Lord Denning MR in Bickel v Duke of Westminster (...)

Finding on the facts that the landlord's business interests were protected in the lease (there was an express clause prohibiting the landlord from competing with the tenant, save for in relation to a few defined areas of business) but that the covenant as drafted went further than to merely protect the landlord's existing business, Lewison J ruled that the landlords were only entitled to protect their existing business and therefore found the condition to be unreasonable. As in Sportoffer, the court paid attention to the actual state of the relationship between the parties at the time consent was sought.

In Chelsfield MH Investments v British Gas, the defendants had entered into a lease with the plaintiff for a unit in a shopping centre which was subject to a fully qualified covenant restricting user to the sale of gas appliances and related goods. 161 The user covenant was subject to a condition that the landlord could have regard to estate

¹⁵⁹ *Ibid* at 677.

¹⁶¹ Chelsfield MH Investments Ltd v British Gas Plc, supra note 91.

management considerations in deciding whether or not to consent to a change of user. The defendants had sought the landlord's consent to a broadening of the covenant to include the sale of certain other white goods. The landlords refused consent as such a use would be competing with a nearby vendor of electrical appliances, who was also a tenant of the landlord. The landlord had previously enforced that shop's user covenant to prevent it from selling gas appliances in competition with the defendant's shop. Knox J was asked to decide whether an interim injunction should be granted to prevent the tenants from breaching the user clause. Analysing the landlord's reasoning for withholding consent, he said: 162

The evidence now shows that the plaintiff landlord claimed to have a tenant mix policy which they seek to enforce in the Merry Hill Centre and that this includes the avoidance of too great a concentration of similar uses in too close proximity, that this is seen as beneficial by tenants and prospective tenants and that its maintenance has a beneficial effect, as a result, on a rent reviews and thus protects the value of the landlords' reversion in the Centre.

There is some support, on the evidence, for these propositions.

Assessing the defendant's case, Knox J suggested that a landlord will have a significant degree of freedom in designing and implementing tenant mix policies: 163

The highest the case can be put - and indeed was put by Mr Reynolds - is that the plaintiff's policy is insufficiently specific. There is no evidence at all that no reasonable landlord of such premises would pursue a non-specific tenant mix policy and I refrain from expressing views of my own on the subject, conscious as I am of a lack of expert qualification on the subject. But, on the evidence before me, there is now no serious issue to be tried on the specificity of the landlord's tenant mix policy.

A similar provision existed in *Moss Bros v CSC*.¹⁶⁴ In that case, the plaintiff, whose unit in a shopping centre was bound by a user covenant limiting the use of the property to men's outfitters, had sought consent to assign its lease to a chain of video

¹⁶² Official transcript.

¹⁶³ Official transcript.

¹⁶⁴ Moss Bros Group plc v CSC Properties Ltd, supra note 63.

game stores. The landlord objected to the assignment and change of use on the basis that it would interfere with the landlord's policy of grouping fashion retailers in that part of the shopping centre. Like in *Chelsford*, the user covenant was subject to a good estate management exception, and the landlord objected to the change on the ground that it would be contrary to its tenant mix policy. The plaintiff argued that no such policy was in place, or that it was unreasonable. Neuberger J held that although the policy was not formal (other than insofar as the landlord sought to attract anchor tenants), it had in fact been operating a policy of maintaining a retail fashion mix in the relevant part of the centre.

Crown Estate Commissioners v Signet related to a premises on London's Regent Street.¹⁶⁵ The sitting tenants, who operated a jewellers, sought to assign to a company (TTT Moneycorp) who proposed to split the premises into two units: one to be occupied by them as a travel agency and bureau de change and one to be sublet to a fashion retailer. Although the fully qualified user covenant did not expressly allow the landlord to reject a change of user on the basis of inconsistency with the landlord's estate management policies, it was argued that on the facts the refusal was still reasonable.

Judge Bromley QC placed great emphasis on the factual background to the landlord's refusal. The judge examined at great length commercial evidence relating to the management of the Commissioners' property. The Commissioners adduced evidence attesting to the importance of having shop frontage displaying finished goods in order to generate comparison shopping across the whole estate.

¹⁶⁶ *Ibid* at 206.

¹⁶⁵ Crown Estates Commissioners v Signet, supra note 51.

Judge Bromley QC accepted this reasoning as sound commercially, before considering whether the landlord was entitled to take into account factors relating to other property owned by it. In deciding that it was reasonable to do so, he considered not only the landlord's right to take the impact of the change of user on other property it managed into account, but also the fact that the common ownership was well known: 167

I use the word "estate" deliberately, since, in my judgment, the commissioners are entitled to look, as landlords, at this whole close-compacted property estate. Nor do I consider that tenants should be surprised at the estate's objectives, provided those objectives fall within the bounds of the reasonable, proper and relevant to the landlord and tenant relationship in question and certainly where the context is apparent to the tenant, as, in my judgment, it was in the present case, to both Signet and to TTT.

In short, the unity of the Regent Street Crown estate is, in my judgment, both relevant and known to tenants. I consider the commissioners in considering an application relating to one only small unit on the estate are entitled to have regard to general estate management considerations of the nature I have identified. It is reasonable for the landlords in the context of this case to do so.

Continuing, he addressed the question of whether the specific policy being pursued by the landlord had to be known to the tenants in order for the landlord to rely on it in refusing consent:¹⁶⁸

Mr Reynolds made the point that these considerations were not generally known. In detail, they may well not have been, but the overall estate unity of ownership and to a considerable extent of management or management potential was certainly generally known.

In my judgment, while the lack of knowledge of policies in a particular case may go to the reasonableness of the refusal, this is not such a case, where the essential estate unity was known and "the retail strength of Regent Street", which is a quotation from the annual report cited above, was public knowledge. In any event, Signet and TTT had only to await the refusal letter to be better informed if they had not known or suspected before, but they elected not to. I add that I do not consider that the commissioners are limited to

¹⁶⁷ *Ibid* at 207–208.

¹⁶⁸ *Ibid* at 208.

objections extant or known at the time of the lease. In my judgment, the reasonableness of the refusal has to be considered at the time of the refusal.

Judge Bromley QC's emphasis on knowledge of the parties, rather than knowledge of the original tenant may be a necessary result of the length of time that had elapsed since the lease was originally granted. Nevertheless, it points to the fact that the court may be willing to look at the parties' relationship as it actually stood. Once it is known that the properties are managed together in accordance with some overall plan, the landlord will be allowed to refuse consent in order to maintain a reasonable lettings policy.

This can be contrasted with the case of *Anglia Building Society v Sheffield City Council*, where the aim of the council was to increase the value of neighbouring property by encouraging the conversion of the premises in question from a service use to a retail use. ¹⁶⁹ The sitting tenants, an employment agency, sought to assign the premises to a building society for use as one of their branches. The landlords submitted that they were entitled as reasonable landlords to seek to maximise the rental value of their portfolio, and that the use of the premises as a building society branch harmed rental values. If the property were to be converted for a retail use, it would boost the rent achievable not only from the property itself, but also from neighbouring property. However, the Court of Appeal noted that the proposed change would have no effect and that any detriment suffered by the landlord was already being suffered. In attempting to force a change of user, the council was seeking to obtain a collateral advantage, which was not reasonable.

In *BRS Northern v Templeheights*, the landlord refused consent to a subletting on the grounds that it would prejudice the assignment of the reversion to Sainsbury's, which

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¹⁶⁹ Anglia Building Society v Sheffield City Council, supra note 48.

was planning to build a supermarket on neighbouring land.¹⁷⁰ The tenant was proposing to assign the premises to Safeway, a competitor of Sainsbury's, which was intending to use it as part of a supermarket development on land adjoining it on the other side to the Sainsbury's development. Neuberger J held in the High Court that the landlord was entitled to take account of its interests in the development of neighbouring land.

The situation in Ireland is similar. In *Rice v Dublin Corporation*, pursuant to a general policy, the local authority landlord sought to prevent premises from being used as a public house.¹⁷¹ Maguire CJ emphasised the need for both the landlord and the court to treat each case on its facts, so that while a general policy might justify a refusal of consent, the landlord should give consideration to the particular facts at hand:¹⁷²

[W]hile it is the duty of the Court to consider each case upon its merits, there is no reason why a landlord may not properly base a refusal of consent upon grounds of general policy in relation to the management of his estate. The question whether the grounds upon which a decision to refuse consent to the alteration of the user of premises is reasonable in reference to a particular case is a matter for the Court. No general rule can be laid down because it is easy to conceive cases in which a refusal to agree to an alteration of user based on a decision of policy in the management of the landlord's estate would be entirely reasonable. On the other hand the Court may hold that such a ground is not a reasonable ground for withholding consent in a particular case.

4.4.2 The position of the portfolio landlord

Although it is clear from the above cases that the landlord is not always confined to considering factors relating solely to the property which is the subject matter of the lease, this may not always be the case. If the contractual approach applies, a landlord will be limited to taking into account interests in respect of other properties which were either expressly protected in the lease, or implicitly because they formed part of

¹⁷⁰ BRS Northern Ltd v Templeheights Ltd, [1998] 2 EGLR 182.

¹⁷¹ Rice v Dublin Corporation, [1947] IR 425.

¹⁷² *Ibid* at 436.

the factual matrix in which the lease was granted. The broad approach would allow landlords somewhat more flexibility, permitting them to consider not only the factual matrix at the time the lease was granted, but the facts - and the relationship between the parties - at the time consent is sought. A third option - the much derided personality or user test - would broaden the field of landlords who may take such interests into account, but limit their reasons significantly.

In order to assess whether the landlord may rely on a particular policy, two questions should be asked. First, is the landlord entitled to rely on reasons relating to other property belonging to it at all, and second, whether the policy itself is reasonable.

When can a landlord consider the impact of a change on neighbouring properties? Certainly in the cases where the landlord expressly reserved the right to impose an estate management policy, such as in *Moss v CSC* and in *Chelsford*, the landlord will be able to take account of other property owned by him. Under the contractual approach, a refusal of consent must be grounded in the lease, although in such cases a refusal may still be unreasonable on the facts.¹⁷³ The state of knowledge of the lessee at the time of the contract would probably also be enough to permit a landlord to reasonably base a refusal of consent on apprehended damage to other property under the contractual approach. Discussing the Salvation Army case, Pollock MR in *Houlder Bros v Gibbs* suggested that a landlord could take into account factors relating to the "due and proper management" of the landlord's property, including other property, or the landlord's relationship with other tenants, once those factors were within the cognisance of the lessee.¹⁷⁴

¹⁷³ Berenyi v Watford Borough Council, supra note 106.

¹⁷⁴ Houlder Bros & Co Ltd v Gibbs, supra note 27 at 583.

In addition to the Salvation Army case, to which Pollock MR referred, the courts in *Sportoffer* and in *Signet* both considered the knowledge of the parties in deciding that it would be reasonable for a landlord to take its interests relating to neighbouring property into account. It appears from some authorities that once the mere fact of common ownership was known to the parties, it will be reasonable in principle for a landlord to consider those properties in coming to any decision on whether to consent. In *Signet*, however, the knowledge that Judge Bromley QC considered was not the knowledge at the time of the lease being granted, but at the time that consent was being sought. This might be as a result of the time that had passed since the lease was granted. In any event, it points to a more flexible judicial approach, taking into account the relationship of the parties as it stood, not as it had initially been created. In contrast, Cumming-Bruce LJ found in *Bromley Park* that it could not have been within the contemplation of the parties that the covenant be used to re-unify the estate of the landlord, which had not been in common occupation immediately before the lease was granted. In contrast,

However, it is not clear that knowledge or contemplation is even necessary for a landlord to take its ownership of neighbouring property into account. *Bromley Park* is not a flat-out rejection of the proposition that a landlord may take account of neighbouring premises in making its decision; in that case, the Court of Appeal rejected the landlord's particular reasons, rather than its contemplation of neighbouring property *per se*. In *Premier Confectionery*, *Re Town Investments Underlease*, *Hodge's Menswear* and other cases, 177 the courts appear to have accepted

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¹⁷⁵ Crown Estates Commissioners v Signet, supra note 51; Sportoffer Ltd v Erewash BC, supra note 126.

Bromley Park Garden Estates Ltd v Moss, supra note 42 at 1031.

¹⁷⁷ Iqbal v Thakrar, supra note 89; Crown Estates Commissioners v Signet, supra note 51; Sargeant v Macepark (Whittlebury) Ltd, supra note 67.

the proposition that a landlord is generally entitled to take its interests in respect of neighbouring property into account in making decisions about consent.

In suggesting that the interests of a contracted purchaser of the reversion might be taken into account, *BRS Northern v Templeheights* widens the range of circumstances in which a landlord may consider the effect of a change on neighbouring property. The interest of the landlord in selling its reversion to allow neighbouring property not owned by it to be developed could not have been in the contemplation of the parties. If the landlord were permitted to consider the interests of a purchaser of the reversion, it follows naturally that the purchaser could also consider those same interests after stepping into the landlord's shoes. Neuberger J appears to have assumed that the landlord was only relying on reasons that the prospective purchaser could have relied upon. Discussing a hypothetical scenario where the proposed assignee could not offer a good covenant, he said: "it would seem absurd that consent could be withheld in such circumstances before the contract was entered into, and after it was completed, but not during the period in between." He went on to say that it will be a matter of fact in each case whether a landlord will be entitled to take account of a particular interest, or whether a refusal is reasonable.

At its most restrictive then, the law permits a landlord to consider the broader estate in which a property is situate if it were so situated when the lease was entered into. This is likely to be a particularly strong argument in shopping centres, ¹⁷⁹ or where the landlord has retained some other control over management. Further still, *Sportoffer* suggest that a landlord will be permitted to take account of interests relating to

¹⁷⁸ BRS Northern Ltd v Templeheights Ltd, supra note 170 at 190.

¹⁷⁹ Crown Estates Commissioners v Signet, supra note 51; Canada Safeway Limited and Oshawa Holdings Ltd v Triangle Acceptance Ltd, supra note 103; FW Woolworth Plc v Charlwood Alliance Properties, supra note 99; Sportoffer Ltd v Erewash BC, supra note 126.

¹⁸⁰ By analogy from *Chartered Trust plc v Davies*, [1997] 2 EGLR 83 (CA).

property acquired after the lease was entered into if it was conceivable at the time that the landlord might acquire such interests over the course of the lease. Finally, if *BRS Northern* represents the law, the court will take a broad view, similar to that taken by the High Court in *Signet*, looking at the facts of the case and the relationship between the parties at the time consent was sought.

Finally, the acceptance by the court of reasons relating to the landlord's own, non-property, business as good justifications for withholding consent¹⁸¹ indicates that the law in relation to consent takes adequate account of the concerns of businesses letting out excess property as part of a Corporate Real Estate Management strategy.¹⁸² This will help to ensure that non-property business can use their property efficiently.

When will a landlord be reasonable in refusing consent to protect neighbouring properties?

Even where a landlord is entitled to consider the impact of a change on its neighbouring properties, this should not be considered a carte blanche to refuse consent whenever there are reasons that are somewhat related to neighbouring property in common ownership.¹⁸³ Again, the contractual approach would suggest that any reasons have to be grounded in the lease or surrounding context; the broad approach assesses the reasonableness of a refusal in the context of all of the facts at the time an application for consent is made; and the personality or user test permits a landlord to refuse consent so long as its refusal can be grounded in an objection to the personality or intended user of a proposed assignee.

¹⁸¹ Re Spark's Lease, Berger v Jenkinson, supra note 132; Whiteminster Estates v Hodges Menswear, supra note 85; Sportoffer Ltd v Erewash BC, supra note 126; Sargeant v Macepark (Whittlebury) Ltd, supra note 67.

¹⁸² See 2.2.2.

¹⁸³ Houlder Bros & Co Ltd v Gibbs, supra note 27; Berenyi v Watford Borough Council, supra note 106; Rayburn v Wolf, supra note 64; Anglia Building Society v Sheffield City Council, supra note 48.

Given the role of landlords of retail developments in managing tenant mix, it appears that the courts will generally permit reasons relating to managing tenant mix, whether a landlord's right to do so is specifically protected in the lease¹⁸⁴ or not.¹⁸⁵ However, the courts will not accept an invocation of tenant mix as definitive proof of the landlord's reasonableness.¹⁸⁶ In order for a refusal on the grounds of tenant mix to be reasonable, it must be based on some apprehension of damage to the trade of neighbouring property or to the landlord's interests. A landlord's apprehension may be as a result of a one-off assessment¹⁸⁷ or of a broader policy.¹⁸⁸ Where it is done as part of a broader policy, it may help to demonstrate that a refusal of consent is not aimed at the tenant in an arbitrary or capricious manner.

As discussed in Chapter 2, it is best practice for landlords of property portfolios to maintain and actively develop management policies to guide the development of their portfolios over time. For retail landlords, this is necessary in order to maintain an appropriate tenant mix in response to changes in the market. The ability to dynamically adjust a tenant mix policy in response to exogenous challenges is the landlord's most important tool in adding value to a retail portfolio, and ensuring the continuing vitality of a retail development. It appears as though the codification of a

¹⁸⁴ Moss Bros Group plc v CSC Properties Ltd, supra note 63; Chelsfield MH Investments Ltd v British Gas Plc, supra note 91.

¹⁸⁵ FW Woolworth Plc v Charlwood Alliance Properties, supra note 99; Crown Estates Commissioners v Signet, supra note 51.

¹⁸⁶ White v Carlisle Trust, supra note 114.

¹⁸⁷ Whiteminster Estates v Hodges Menswear, supra note 85; Sargeant v Macepark (Whittlebury) Ltd, supra note 67.

¹⁸⁸ Crown Estates Commissioners v Signet, supra note 51; Moss Bros Group plc v CSC Properties Ltd, supra note 63; Chelsfield MH Investments Ltd v British Gas Plc, supra note 91.

¹⁸⁹ See 2.6.2. above.

landlord's practices in a policy will help to demonstrate that a particular refusal was not unreasonable. 190

The conflict between the benefits achievable through comparison shopping and the risks of excessive competition damaging the business of existing tenants is a common theme in the case law. Where a landlord is seeking to protect a tenant (or its own business) from competition, the tenant seeking consent may argue that comparison shopping will lead to an overall benefit. ¹⁹¹ Conversely, tenants may seek to challenge a landlord's invocation of the concept where it does not suit their interests. ¹⁹² This seems at first sight like a question which is ripe for adjudication by the courts on the basis of expert evidence, but the courts have shied away from such analysis, not wanting to substitute judicial opinion for that of a landlord. Instead, once the position taken by a landlord could be taken by a reasonable landlord, it does not matter that some (or most) reasonable landlords would take a different position. ¹⁹³ Thus the final leg of Lord Bingham's three overriding principles allows landlords to exercise significant discretion. It is stated concisely by Nicholls VC: ¹⁹⁴

[W]hat has to be shown is that the covenantee's refusal is outside the band of possible decisions which a reasonable body could reach.

This freedom allows a landlord to engage in active management without having to worry about challenges to the overall policy by individual tenants. Once the landlord is entitled to take neighbouring properties into account, and the lettings policy is

¹⁹⁰ Moss Bros Group plc v CSC Properties Ltd, supra note 63; Crown Estates Commissioners v Signet, supra note 51; Chelsfield MH Investments Ltd v British Gas Plc, supra note 91.

Whiteminster Estates v Hodges Menswear, supra note 85; Chelsfield MH Investments Ltd v British Gas Plc, supra note 91.

¹⁹² Moss Bros Group plc v CSC Properties Ltd, supra note 63.

¹⁹³ Pimms v Tallow Chandlers, [1964] 2 QB 547.

¹⁹⁴ Estates Governors of Alleyn's College of God's Gift at Dulwich v Williams, [1994] 1 EGLR 112 at 114.

reasonable, it will provide a solid grounding for decisions by the landlord, unless on the facts some exception to the policy should be preferred.¹⁹⁵

The mere claim of a policy, however, will not be sufficient to protect the landlord's refusal of consent. The courts have been suspicious of professed policies which in reality were just attempts to obtain a pecuniary advantage from the tenant. The way in which a policy is pursued will be equally relevant. While the objectives of landlords in *Signet* and *Anglia Building Society* cases were the same (to achieve a primarily retail tenant mix), the courts' treatment of the two cases was very different. While it is one thing to use the withholding of consent to defend an existing letting policy, using it to effect a new policy is something different altogether. As Dunn and Slade LJJ held in *Bromley Park*, while a landlord might be entitled to withhold consent to protect the position it actually enjoys, doing so in the hopes of improving its position will be unreasonable.

In cases not involving retail developments, it may be difficult to link the interest pursued by the landlord to the contract between the parties. In *Sportoffer v Erewash*, much of the apprehended competition would be faced by a leisure centre that had been opened by the landlord subsequent to the lease being granted. Similarly, in *Sargeant v Macepark*, the court appeared to recognise the right of the landlord to take into account its business at the time consent was sought, rather than having to rely on its position at the time the lease was granted. In these cases, it also appears that the relevant question is not what the parties originally contracted for, but how their relationship operated at the time the request for consent was made. The landlord is

¹⁹⁵ Although landlords should still consider each application on its own merits and should not merely insist on a rigid policy. See *Rice v Dublin Corporation*, *supra* note 171.

¹⁹⁶ Oriel Property Trust v Kidd, (1949) 154 EG 500; Bromley Park Garden Estates Ltd v Moss, supra note 42.

not permitted to use a withholding of consent to unilaterally change the relationship, as was attempted in *Bromley Park* and in *Anglia Building Society*, but is entitled to preserve the relationship as it stood when the request was made, as in *Sargeant v Macepark* or *Signet*. Similarly, the withholding of consent to secure an advantage completely removed from the relationship actually existing between the parties as in *Houlder Bros v Gibbs* will be unreasonable.

Of course the contractual relationship between the parties will form a relevant part of the context in which the reasonableness of a landlord's refusal of consent is determined. It appears, however, that facts arising after the contract is entered into must also be considered. The courts have allowed landlords to take account of how the character of retail developments, ¹⁹⁷ as well as of their own business interests ¹⁹⁸ have changed over the course of the landlord and tenant relationship. While such changes cannot be used as an excuse to compel the tenant to give up any rights, landlords can use the withholding of consent to protect themselves from any damage which might occur as a result of the transaction or change going ahead.

4.5 What does the case of portfolio interests teach about reasonableness generally?

In *West Layton v Ford*, the Court of Appeal rejected the notion that the Rent Act cases had been determined on principles other than those applying to cases in this area generally.¹⁹⁹ In *Bromley Park*, the Court of Appeal again rejected the notion that a special broad exemption applied to landlords implementing estate management policies. It therefore appears that the conduct of portfolio landlords is assessed

¹⁹⁸ Sportoffer Ltd v Erewash BC, supra note 126; Sargeant v Macepark (Whittlebury) Ltd, supra note

¹⁹⁷ Crown Estates Commissioners v Signet, supra note 51.

¹⁹⁹ West Layton Ltd v Ford and another, supra note 34.

according to the same broad principles of reasonableness as those applying to landlords of standalone properties. Embracing a factual basis of reasonableness, any difference is likely attributable to the practical differences between the management of individual and portfolio properties, rather than to principle.²⁰⁰

The portfolio cases are interesting because there are more moving parts to them. Over the course of a lease - especially a long lease - there are changes not only to the market affecting the tenant and to the property market for the property the tenant occupies, but wider economic and commercial shifts: The markets for goods and services offered by neighbouring tenants will also be changing; the effects that each tenant has on the success of others as a result of spill over effects will evolve; and the mix of tenants in a development may change as a result of conscious planning by the landlord or through organic shifts. This is a much more extreme environment than that facing the standalone landlord-tenant relationship, but one which demonstrates why the de facto relationship of landlord and tenant may be more important to the reasonableness of a withholding of consent than the original agreement between the parties.

In the context of an evolving relationship, the original agreement between the parties may not represent the real position in which they find themselves. Of course their relationship will be influenced by the original agreement between them, but as the commercial realities facing both the landlord and tenant are constantly in flux, their business relationship must be allowed to adjust to those factors, without the need for constant re-drafting of their legal relationship. Against this background, it is understandable that a court which is sensitive to the commercial needs of both landlord and tenant would have a view to the factual relationship existing between the

²⁰⁰ See Chapter 2.

parties, by assessing reasonableness in the context in which the landlord has to make a decision.

In the case of portfolio properties, it appears that courts are more likely to give a landlord leeway in seeking to prevent real damage or protect a real benefit to the rest of the landlord's estate, as opposed to merely seeking a pecuniary advantage, through the forced surrender of a lease or the imposition of some extraordinary condition.

While the courts appear to give landlords - and in particular portfolio landlords - much greater freedom in controlling how their property is used than in relation to other aspects of it, the personality and user test alone does not appear to be a reliable guide. Here, commercial best practice and reasonableness also align. Just as active, business-led management of property is encouraged in the professional literature, ²⁰¹ a landlord who engages in it by seeking to create value in their portfolio will not be treated as acting unreasonably where they seek to protect the value they have created. ²⁰²

Cases involving portfolio properties are oftentimes more factually complex than other cases, forcing the courts to look at the reasonableness of the landlord's actions in the context of the relationship between the parties as a whole.²⁰³ While the approach already adopted by the courts in respect of standalone properties, as exemplified by Lord Bingham' three overriding principles from *Ashworth Frazer*, will continue to be used, the lesson to be learned from how the courts have treated reasonableness in the

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²⁰¹ See 2.3; 2.4.3. Howard, *supra* note 62.

²⁰² FW Woolworth Plc v Charlwood Alliance Properties, supra note 99; Crown Estates Commissioners v Signet, supra note 51.

²⁰³ FW Woolworth Plc v Charlwood Alliance Properties, supra note 99; Crown Estates Commissioners v Signet, supra note 51; Sportoffer Ltd v Erewash BC, supra note 126; Sargeant v Macepark (Whittlebury) Ltd, supra note 67; Iqbal v Thakrar, supra note 89.

context of portfolio properties is that ultimately, it is the relationship between the parties which is determinative, rather than the contract originally entered into.

4.6 Conclusions

While the various tests for reasonableness that have been suggested by judges and commentators are likely to provide a good indication of whether a landlord's refusal of consent was reasonable in a given set of circumstances, they should be treated with caution. The principles expressed are relatively clear from an examination of case law but it is doubtful whether any concise expression of them can capture all the nuances of a particular set of decisions, each of which having been based on its unique factual matrix.

Under the most restrictive view, the contractual approach, landlords are entitled to take into account their interests in respect of other properties when the fact of their ownership by the landlord was known to the tenant at the time of entering into the lease. In most settings involving intensive management by a landlord, it will be apparent in the factual matrix surrounding the lease, if not in the lease itself, that the landlord intends to manage the property as part of a larger portfolio.

In actual fact, the view taken by the courts is more flexible. Judges are willing to consider not just the relationship between the parties described in the lease, but the relationship actually existing between the parties at the time consent is sought. This approach allows much more flexibility to landlords in the long-term management of their portfolio than is acknowledged by proponents of the contractual approach. Judges have also tended to give more latitude to landlords' decisions made in pursuit of a business-led strategy. As such, the courts' approach should help to promote long term success of well-managed property portfolios.

Legal and real estate professionals would be wise to examine carefully the judgments from which a particular rule is said to derive before advising on whether a tenant's request might reasonably be refused. The courts have shown their willingness to look beyond general pronouncements on what is reasonable and examine each case on its facts. As Lord Denning suggested would happen in *Bickel*, as one decision has followed another, we have been given a better idea of the likely outcome in a particular set of circumstances, but ultimately the courts have declined to be bound strictly by individual pronouncements. Even where purported rules have not been expressly overturned, judges have sought to distinguish cases on their facts, and have indicated that some rules might be more flexible than they appear.

The overriding principles set out by Lord Bingham in *Ashworth Frazer* will continue to guide most cases, but underlying them, and ready to emerge when called for by the "difficult borderline cases" of which Lord Bingham spoke, is a broad understanding of reasonableness. As the relationship of landlord and tenant progresses, and adapts to changing commercial circumstances, it is only natural that these broader circumstances relating to the relationship of landlord and tenant will become more relevant to the question of the reasonableness of a refusal of consent than the agreement originally struck by the parties. In this respect, the flexible approach adopted by the courts supports the efficient long-term management of portfolio properties, for which flexibility is a key ingredient.

On the other hand, attempts by the landlord to withhold consent in the hopes of unilaterally changing the relationship persisting between the parties will continue to be found unreasonable, no matter how the commercial environment has transformed over the course of the relationship. While a portfolio landlord may withhold consent

to a proposed change of user or assignment which might harm neighbouring property belonging to him, this will not be possible where the harm is not caused by the change. Similarly, the use of a veto may not be used as leverage to secure the return of the reversion. Thus a portfolio landlord cannot use the power to withhold consent as a means of actively directing the tenant mix of a portfolio, but only to passively block harmful changes while permitting changes beneficial to the portfolio.

5. Portfolio landlords and legislative policy

After the judicial approach to reasonableness, the most significant factor impacting on how landlords exercise control over their tenants has been the legislative backdrop to the landlord-tenant relationship. Over the course of the 20th century, the legal environment in which the relationship of commercial landlord and tenant operates experienced fundamental change.¹ This period saw a proliferation of legislation regulating almost all aspects of the relationship.² Some of this change was brought about in order to simplify or modernise the law, as part of broader reforms in property law.³ Much of it, however, involved a rebalancing of the landlord and tenant relationship, largely in response to a perceived power disparity between landlords and tenants. Generally, this meant shifting the balance of power between the parties further towards the tenant by limiting the freedom of landlords to exercise control over let property.⁴

In this context, the position of a landlord of a property portfolio poses a number of challenges for regulators. On the one hand, such a landlord is likely to be able to wield far more power over tenants than landlords of standalone properties: By controlling nearby properties, such a landlord may apply pressure on tenants from multiple sides. A portfolio landlord might also possess "market power", allowing a landlord to distort competition. On the other hand, with the interests of a wide portfolio in mind, such a landlord may have the ability and incentive to manage and

¹ See Stuart Bridge, "Commercial leases past and present: The contribution of the Law Commission" in Susan Bright, ed, *Landlord and Tenant Law: Past, Present and Future* (Hart Pub, 2006) 65. The relationship of residential landlord and tenant experienced even more dramatic change, although the reasons for this are unique to residential property: See David S Cowan, *Housing law and policy* (Cambridge: Cambridge Univ. Press, 2011).

² Law of Property Act 1925; Landlord and Tenant Act 1927; Landlord and Tenant Act, 1954; Landlord and Tenant Act, 1988,; Landlord and Tenant (Covenants) Act, 1995.

³ Bridge, *supra* note 1.

⁴ E.g. Viscount Sumner said that the reforms contained in the Landlord and Tenant (No. 2) Bill 1927 were "always in the interest of the tenant in the first instance." HL Deb 29 November 1927, vol 69, col 334.

develop properties in accordance with a bolder and more long-term vision than the landlord of a single property would be able to.⁵ Such an approach carries with it obvious benefits not just for the landlord, but for tenants and for society as a whole.

The extent to which policy makers have recognised this important role, and taken into account the special characteristics of portfolio landlords will have a significant bearing on whether the potential gains from common ownership of property can be realised.

5.1 Regulating landlords

In order to assess the efficacy of the current regulatory regime, it is necessary to examine why regulation was seen as necessary in the first place. While this chapter will examine the question predominantly in economic terms, it should not be assumed that the sole measure of success ought to be economic efficiency.⁶

Ogus distinguishes between justifications for regulation that are based in economics and those that are justified by some other means.⁷ The "economic" interventions are ones that seek to correct some market failure: in other words, they aim to maximise economic welfare by achieving the same allocation of resources that a perfectly functioning market would.⁸ Such interventions may be designed to account for externalities or to address problems arising due to imperfect information, among other things.⁹

⁵ See 2.7, above.

⁶ See Otto A Davis & Andrew B Whinston, "The Economics of Urban Renewal" (1961) 26:1 Law and Contemporary Problems 105 for a justification of economic welfare as a primary policy goal in the context of land use.

⁷ A I Ogus, *Regulation: legal form and economic theory*, Clarendon law series (Oxford: Clarendon Press, 1994).

⁸ See Richard A Posner, "Some Uses and Abuses of Economics in Law" (1978) 46 U Chi L Rev 281 at 288–9 for a discussion of what judicial intervention promoting economic welfare might achieve.

⁹ Ogus, *supra* note 7 at 29–46; 260–61.

Non-economic justifications for such regulation may include distributional factors, paternalism or the promotion of particular societal norms or ideals.¹⁰

5.1.1 The grounds for regulation of commercial leases

Introducing the second reading of the Landlord and Tenant Act 1927 to the House of Lords, Viscount Cave set out some of the legislative objectives underlying the legislation. Referring to covenants restricting disposition, assignment and change of user, he said that:¹¹

All these are, I think, quite reasonable stipulations if they are fairly and reasonably used—used, that is, for the protection of the freehold against depreciation—but sometimes they are used for quite different purposes. It happens rather often that while the landlord has no objection to a change of use or an improvement of his property, he takes care to exact a fine for giving consent to that change, sometimes a fine of considerable amount. In other cases consent is refused without any reason being given, possibly for some prejudice or caprice or for some less worthy motive, and the trader of course suffers. These grievances which I have so summarised are not imaginary grievances put forward with a view to enabling a tenant to acquire someone else's property. They are genuine hardships injurious to trade and industry in this country, and hardships which a reasonable landlord will not impose.

While this speech was made some time ago, it still exemplifies the policy factors at play in the regulation of commercial landlord-tenant relationships. These policy goals have featured prominently in debates surrounding legislative interference in commercial landlord and tenant law, and still shape the challenge of balancing competing interests of landlord and tenant.

Viscount Cave's speech contrasts good management with bad management; virtuous landlords with unscrupulous landlords. This distinction, drawn between the "bad" landlord who is the target of regulation and the "good" landlord who ought to be

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¹⁰ *Ibid* at 46–54; Duncan Kennedy, "Distributive and paternalist motives in contract and tort law, with special reference to compulsory terms and unequal bargaining power" (1981) 41 Md L Rev 563; Alvin E Roth, "Repugnance as a constraint on markets" (2007) 21:3 Journal of Economic Perspectives 37.

¹¹ HL Deb 29 November 1927 vol 69, col 309.

protected from excessive regulation, can be seen throughout parliamentary debates on these issues, from the 1927 Act to the most recent Act in 1995. This might be seen as regulation in line with what Ogus refers to as "community values". While it is clearly seen to be in the public interest for landlords to be permitted to protect their position, profiteering from a power imbalance is another matter. Regulation is seen as necessary in order to protect tenants from the less worthy motives of ruthless landlords. Such prejudices are recognised as harms not only to individual tenants, but to broader national interests. At the same time, those national interests may also be promoted by the prudent management policies of reasonable landlords. A preference is indicated for regulatory intervention which will not harm the position of those benevolent landlords but, in the words of then Home Secretary Sir William Joynson-Hicks MP, "to protect the tenant against the action of a harsh or unconscionable landlord...". ¹³

From a very early stage, economic factors featured prominently in driving and shaping regulation. Viscount Cave's speech implicitly points to the position of commercial property as a factor of production in the wider economy, indicating that unscrupulous behaviour on the part of landlords can impact negatively upon the economy. In more recent times, this has turned into a focus on flexibility and choice in business leases. ¹⁴ This is in response to difficulties which tenants had with rigid institutional leases, ¹⁵ but addresses the same issue of the effect of the commercial property market on the economy in general. Flexibility in leasing arrangements, it has

¹² Ogus, *supra* note 7 at 54.

¹³ HC Deb 7th April 1927 vol 204, col 2307.

¹⁴ Neil Crosby et al, *Monitoring the 2002 code of practice for commercial leases* (London: Office of the Deputy Prime Minister, 2005); Neil Crosby, *An Evaluation of the Policy Implications for the UK of the Approach to Small Business Tenant Legislation in Australia* (University of Reading Research Report. www. rdg. ac. uk/rep/ausleaserpt. pdf and www. rdg, ac, uk/rep/ausleaseapp. pdf, 2006) at 57. ¹⁵ See 2.3, above; Neil Crosby, Cathy Hughes & Sandi Murdoch, "Flexible Property Leasing and the Small Business Tenant" (2006) 23:2 Journal of Property Research 163 at 164–165.

been argued, is important because all tenants have different needs and a one size fits all approach is unsuited to promoting economic growth. In line with a preference for freedom of contract, some policies have sought to promote flexibility by allowing the parties greater scope to negotiate according to their individual circumstances. The insertion of section 19(1A) into the Landlord and Tenant Act 1927 by section 22 of the Landlord and Tenant (Covenants) Act 1995 provides an example of Parliament seeking to promote welfare by facilitating choice. This permits the parties to a lease to specify circumstances in a fully qualified assignment covenant under which it would be reasonable for a landlord to refuse consent. Assuming the parties to know best how to maximise their own welfare, allowing them more scope to tailor the contract to their own needs should lead to more suitable leases.

Economics is concerned with achieving the optimal allocation of productive resources. Another factor which may be considered desirable is achieving a just distribution of outputs within society. Achieving this may involve redistributing wealth through the tax system, or through regulation. Although this may traditionally have been more of a concern in consumer rather than commercial settings, Hughes and Crosby have noted a shift in government policy to include fairness as a goal in addition to efficiency. In her report into the future of high streets, Mary Portas cited fairness between landlord and tenant as a key to ensuring

¹⁶ E.g. Mary Portas, *The Portas Review: An independent review into the future of our high streets* (London: Department for Business, Innovation and Skills, 2011) at 34.

¹⁷ Bridge, *supra* note 1 at 70.

¹⁸ See 3.1.6, above.

¹⁹ An analogous situation from the perspective of Economics and Law is liquidated damages: See L A Stole, "The Economics of Liquidated Damage Clauses in Contractual Environments with Private Information" (1992) Journal of Law, Economics, & Organization 582.

²⁰ See discussion of Pareto efficiency at 2.7.2, above.

²¹ See Kennedy, *supra* note 10; Anthony T Kronman, "Contract Law and Distributive Justice" (1979) 89 Yale LJ 472.

²² Bridge, *supra* note 1 at 70.

²³ Cathy Hughes & Neil Crosby, "The challenge of self-regulation in commercial property leasing: a study of lease codes in the UK" (2012) 4:1 IJLBE 23.

the vitality of the high street, calling for "widespread contracts of care between landlords and their commercial tenants."²⁴

Paternalism is another justification which features in debates relating to regulation of commercial letting. In its strongest sense, paternalism is the substitution of one party's judgment for another's.²⁵ It may be a justification for regulation where policy makers do not think that individuals left to their own devices are capable of making utility maximising choices.²⁶ Paternalist motives are based on the assumption that in some contexts, even if fully informed, some individuals will be unable to make the best choice for themselves. Evidence pointing to the failure of small business tenants to seek better terms than those offered by landlords or to seek commercial lettings advice may point to a need for paternalistic regulation.²⁷

A softer version of paternalism has been suggested as "libertarian paternalism" or "nudge" theory. This involves regulation which does not prohibit conduct which is thought to be welfare reducing, but seeks to steer people towards better choices through the application of behavioural psychology. It may involve changing the default choice, mandating a waiting or "cooling off" period, or presenting information in a way which seeks to lead people to make a particular choice. The procedure for contracting out of the security of tenure provisions under the Landlord and Tenant Act

Oxymoron" (2003) 70:4 The University of Chicago Law Review 1159; Richard H Thaler & Cass R Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Yale University Press, 2008).

²⁴ Portas, *supra* note 16 at 34.

²⁵ Ogus, *supra* note 7 at 51–53.

²⁶ Alan Schwartz & Louis L Wilde, "Intervening In Markets on the Basis of Imperfect Information: A Legal and Economic Analysis" (1978) 127 U Pa L Rev 630.

 ²⁷ Crosby, Hughes & Murdoch, *supra* note 15; Crosby, *supra* note 14; Crosby et al, *supra* note 14.
 ²⁸ Richard H Thaler & Cass R Sunstein, "Libertarian Paternalism" (2003) 93:2 The American Economic Review 175; Cass R Sunstein & Richard H Thaler, "Libertarian Paternalism Is Not an Oxymoron" (2003) 70:4 The University of Chicago Law Review 1159; Richard H Thaler & Cass R

²⁹ Colin Camerer et al, "Regulation for Conservatives: Behavioral Economics and the Case for 'Asymmetric Paternalism'" (2003) 151:3 University of Pennsylvania Law Review 1211.

1954 may provide an example of this.³⁰ The landlord must provide in a specified form, what has been described as a "health warning"³¹ to a tenant before an agreement to exclude the statutory protection can take effect. This may deter tenants from surrendering their statutory rights without proper consideration.

Paternalism (or indeed libertarian paternalism) ought to be distinguished from measures designed to enhance individual decision-making, for example by providing more information. This is an alternate, less intrusive, strategy for addressing market failures arising out of imperfect information among market participants. It has the advantage of leaving the final choice to individuals, who are still assumed to be best placed to maximise their own welfare, but seeks to ensure that individuals are adequately informed in making their decisions.³² Information provision has been at the centre of recent attempts to fix problems in the commercial property market. The *Code for Leasing Business Premises*³³ and its previous iterations have been promoted by successive governments.³⁴ They were designed to increase awareness of commercial factors of relevance to tenants and to reduce rigidity in lease structures, however this approach has not immediately had a dramatic impact on information levels, especially among small business tenants.³⁵

³⁰ Landlord and Tenant Act, 1954, supra note 2, s 38A as inserted by; Regulatory Reform (Business Tenancies) (England and Wales) Order 2003/3096, art 22(1).

³¹ Law Reform Commission, *Consultation Paper on Business Tenancies*, LRC CP 21 - 2003 (Dublin, 2003), para 3.11.

³² Schwartz & Wilde, *supra* note 26.

³³ Joint working group on commercial leases, "The Code for Leasing Business Premises", (2007), online: http://www.leasingbusinesspremises.co.uk/>.

³⁴ Crosby et al, *supra* note 14; Department for Communities and Local Government, *High streets at the heart of our communities: The government's response to the Mary Portas review* (London: Department for Communities and Local Government, 2012).

³⁵ Crosby et al, *supra* note 14.

5.2 Taking account of portfolio landlords

Portfolio landlords are in a unique position, placed to take account of broader interests - including those of neighbouring tenants and to some extent the public at large,³⁶ in making management decisions relating to individual properties. Parliament has in some instances recognised the potential for such control to promote the public interest, and taken account of portfolio landlords in legislating. In debates surrounding the enactment of the 1927 Act, Horace Crawfurd MP spoke up for the ability of portfolio landlords to exercise control over their estates, pointing to the benefits of management by a landlord and the necessity of concomitant restrictions:³⁷

I agree that there is a good deal to be said for the leasehold system when it is properly used, and what is most to be said in its favour is that a good many leasehold estates are well planned. I know that this planning has been accompanied by what I would call something in the nature of restrictions.

Debating similar provisions, Lord Phillimore made a passionate case against excessive interference with the ability of a portfolio landlord to manage the portfolio as a whole:³⁸

I consider that the landlord is a trustee—a trustee for all the property on the estate, to see that no one tenant ruins the property by his or her particular action, and it is very doubtful whether any further restraints should be put upon landlords with regard to such matters as covenants not to use a property for a particular purpose, or covenants not to build in a particular way, than they are under now, because they really act as the guardians of the interests of the whole estate, and it would be a very great pity if their powers in that respect were curtailed.

The need to maintain the position of portfolio landlords as masters of their estates can be linked to the benefits which this can have for all of the landlord's tenants. Lord Phillmore also relies on the noble ideal of a "trustee" or "guardian" landlord,

³⁶ To the extent that consumer decisions affect the landlord's ability to demand a higher rent from tenants.

³⁷ HC Deb 7 April 1927, vol 204, col 2390.

³⁸ E.g. HL Deb 29 November 1927, vol 69, col 354.

protecting the interests of the whole body of tenants and promoting general welfare. This extension of the "good" landlord may point to a legislative preference for the business-led (rather than property-led) approach to property management identified by Howard.³⁹ Landlords following the business-led approach aim to improve the performance of their tenants first and foremost, with increases in the profitability of their portfolio coming as a result of improvements to the tenants' businesses. Thus, measures intended to protect the ability of the portfolio landlord to manage their portfolio as a whole also serve to promote the landlord as a benevolent overseer.

In some cases this recognition of the position of portfolio landlords has taken the form of explicit provisions in legislation enabling portfolio landlords to protect their interests in respect of their portfolio as a whole when managing individual properties. In others, it has resulted in the rejection of otherwise desirable proposed policies. Examples of each will be examined below.

Portfolio landlords may also present dangers to the public good. The ability to exercise control over a number of properties may give a portfolio landlord some degree of market power, insulating them from the competitive forces of the market. This might allow them to force up rents or bestow effective monopolies in some product markets on one tenant, to the detriment of potential competitors as well as of consumers. In reaction to this danger, traditional deference towards portfolio landlords' judgment in imposing restrictive covenants has been displaced by a more cautious approach. Regulation has been imposed in the form of competition law, which takes a measured approach to overseeing landlords' conduct.

³⁹ Elizabeth Howard, "The management of shopping centres: conflict or collaboration?" (1997) 7:3 The International Review of Retail, Distribution and Consumer Research 263. See 2.3, above.

5.2.1 Explicit recognition in law - The "fines" provisions

A number of provisions have been enacted to protect tenants by preventing a landlord from extracting money (generally referred to as a "fine") from tenants in return for a required consent.⁴⁰ In enacting these provisions, Parliament have, however, incorporated some protections for portfolio landlords. For example, section 19(3) of the Landlord and Tenant Act 1927, which prohibits the landlord from demanding the payment of a fine in return for granting consent to a change of use under a merely or fully qualified user covenant, states expressly that it:⁴¹

does not preclude the right of the landlord to require payment of a reasonable sum in respect of any damage to or diminution in the value of the premises or any neighbouring premises belonging to him and of any legal or other expenses incurred in connection with such licence or consent.

Similarly, section 19(2), which implies a reasonableness requirement into all merely qualified alteration covenants, allows a landlord to require the payment of compensation in respect of damage or diminution of the value of his property, including his own neighbouring property, arising out of such an alteration.

The effect of these provisions may be greater than merely to preserve a landlord's contractual right to levy a fine for consent.⁴² In *Holding and Management (Solitaire) Ltd v Norton*,⁴³ a similar provision⁴⁴ was held to go beyond merely permitting the landlord to levy charges contained in the lease relating to its expenses, but justified the demand for payment in respect of the reasonable expenses incurred by the landlord, even where there was no express basis in the lease for such a demand. This suggests that sections 19(2) and (3) themselves provide sufficient grounds for

⁴⁰ Cf Law of Property Act 1925, supra note 2, s 144, which may be contracted around.

⁴¹ Landlord and Tenant Act 1927, supra note 2, s 19(3).

⁴² Cf Letitia Crabb, "A fine point: premiums as covenanted rights" (1993) May/June Conv 215.

⁴³ Holding & Management (Solitaire) Ltd v Norton, [2012] UKUT 1 (LC).

⁴⁴ Contained in the Landlord and Tenant At 1927, s19(1)(a), relating to assignment covenants.

demanding the payment of a fine to compensate the landlord for any damage to his neighbouring property.

In general, what can be seen from the legislature's approach to the levying of fines for landlords' consent is that where a change sought by a tenant of one property could have adverse consequences on other properties owned by the landlord, the legislature will ensure that the landlord is permitted to require the tenant to pay compensation for those consequences.

5.2.2 As a influencing factor in policymaking - Mandatory full qualification

It has, at various times been suggested that absolute user or disposition covenants should have implied into them words fully qualifying any restriction.⁴⁵ Whenever this is raised, it is the suggestion of full qualification of user covenants that seems to draw the most objections. While other reasons (many of which also apply to the insertion of reasonableness requirement into absolute disposition covenants) have been suggested for keeping absolute covenants,46 the role of absolute user covenants in managing property portfolios has played a decisive role in distinguishing user covenants. For example, David Maxwell Fyffe, then Home Secretary, set out the following reasons for not dispensing with absolute covenants in the a debate on the Landlord and Tenant Bill 1954:⁴⁷

One of the recommendations of the Committee was that we should do away with the absolute covenant and it was suggested that it should be converted into a covenant not to act without the consent of the landlord. We accepted that recommendation with reservation, as stated in the White Paper.

⁴⁵ The Law Commission, Codification of the law of landlord and tenant: Covenants restricting dispositions, alterations and change of user, 141 (The Law Commission, 1985); David Llewelyn Jenkins, Leasehold Committee final report, Cmnd 7982 (London: HMSO, 1950).

⁴⁶ E.g. Tenants may be required to pay higher rent under a fully qualified covenant; absolute covenants promote legal certainty. See The Law Commission, *supra* note 45 at 35–42.

⁷ HC Deb 27 Jan 1954, vol 522, col 1771.

It is interesting to see, as we go on with discussions, how far our experience has been changed. One of the objects of a White Paper is to try to test public opinion. A great many professional and other organisations, and also individual members of the public, sent us their views on the White Paper and this proposal about covenants in leases attracted more criticism than anything else.

There were various arguments; a perfectly reasonable one was that the landlord might have let the premises to a particular individual or for a specified purpose at a relatively low rent. If he did that he was entitled to be certain that the benefit of the tenancy at the low rent could not be assigned to someone else and that the premises could not be used for a much more valuable purpose. The argument which I think impressed me most was that the right to impose an absolute covenant is essential for good estate management.

The most comprehensive discussion of the issues involved was contained in the Law Commission's 1985 *Report on covenants restricting dispositions, alterations and change of user.* ⁴⁸ The Law Commission recognised that there may be a case to be made for the modification of very narrow user clauses in commercial leases, due to the risk of changing commercial circumstances but pointed to a number of reasons as militating against the mandatory full qualification of user covenants.

The Law Commission in 1985 was quite ready to imply additional words into absolute disposition covenants, turning them in to fully qualified covenants.⁴⁹ There was some support for this in Parliament.⁵⁰ User covenants have previously been distinguished on the grounds of their centrality to the control of property by portfolio landlords.⁵¹ This factor was critical to the Law Commission's recommendation to retain absolute user covenants.

The Law Commission suggested that such a change would cause an increase in rent (on rent review, although not necessarily initially) for tenants who would otherwise be

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⁴⁸ The Law Commission, *supra* note 45.

⁴⁹ *Ibid*, para 4.31.

⁵⁰ e.g. Lord Meston: HL Deb 16 December 1987, vol 491, col 809.

⁵¹ Jenkins, *supra* note 45, para 312.

subject to absolute user covenants.⁵² The Law Commission was also concerned about the liability of landlords subject to freehold covenants.⁵³ If a landlord bound by a freehold covenant was not able to demand an absolute user covenant from their tenant, they could be liable in damages to the freehold covenantee if it would be unreasonable to withhold consent to a change to the user covenant, and the tenant breached the freehold covenant as a result.⁵⁴

However, the most significant of the Law Commission's objections to the mandatory full qualification of user covenants related directly to covenants which benefit the landlord's other tenants, or other property of the landlord. Pointing to the analogous position of freehold covenants taken for the benefit of land neighbouring the burdened land, the Law Commission's report finds trouble with the anomaly which would arise if absolute covenants were not permissible in a leasehold setting.⁵⁵ Exempting such covenants, however, might exclude a significant portion of the letting market from a new law.

A more serious question was raised in relation to user covenants intended to protect the interests of other tenants of the landlord.⁵⁶ The Law Commission noted the desirability of such arrangements, whether operated at the landlord's discretion, through an obligation on the landlord to enforce covenants, or by tenants in a letting scheme,⁵⁷ pointing to the ability of such cooperation to promote the common interests of a development. It was suggested that such schemes would be impossible in the

⁵² The Law Commission, *supra* note 45, para 4.49.

⁵³ *Ibid*, para 4.38.

⁵⁴ It seems unlikely that a landlord acting bona fide in withholding consent on this ground would be found by a court to be acting unreasonably. See Chapter 4.

⁵⁵ The Law Commission, *supra* note 45, para 4.39.

⁵⁶ *Ibid*, paras 4.40–4.44.

⁵⁷ See 6.3.1., below.

absence of absolute restrictions on user.⁵⁸ If a landlord were in a position to grant consent (which could not be unreasonably withheld) then letting schemes may not be possible, as a landlord would be able to unilaterally alter the obligations between tenants, frustrating the certainty underlying such schemes.⁵⁹

It is not that the Law Commission did not recognise the potential for landlords to act unjustly in refusing to permit a change of user where an absolute covenant had been secured. Their suggested solution to this problem was to expand section 84 of the Law of Property Act 1925 to include all leases, as opposed to just leases of at least 40 years of which at least 25 years have elapsed. Section 84 of the Law of Property Act 1925 empowers the Upper Tribunal to discharge or modify restrictive covenants in certain circumstances. It is primarily designed to affect freehold property but currently extends to certain long leases. The suggested change would allow any tenant to apply to the Upper Tribunal for discharge of or amendment to a restrictive covenant in certain circumstances. Parliament has not, however, made this change.

5.2.3 Competition law

Although the ability of a portfolio landlord to exercise control over how property within the portfolio is used has the potential to create benefits for society through internalising externalities and exploiting economies of scale, it may also carry risks to the welfare of society as a whole. Competitive markets produce goods and services closer to the optimal level than non-competitive markets, promoting social welfare. Where a landlord is able to exercise market power, the gains available to the public

⁵⁸ The Law Commission, *supra* note 45, para 4.51.

⁵⁹ Although it is questionable whether letting schemes present an efficient way of ensuring an efficient mix of uses in a dynamic setting. See 6.3.1, below.

⁶⁰ The Law Commission, *supra* note 45, paras 9.20–9.43.

⁶¹ See 3.2.4, above; *Law of Property Act 1925*, s 84(1)–(1A); Charles Harpum, Stuart Bridge & Martin Dixon, *Megarry & Wade: The Law of Real Property*, 8th ed (Sweet & Maxwell, 2012) at 1422–1423. ⁶² Law of Property Act 1925, s84(12).

through competition may not be realised. Competition law aims to safeguard these gains by preventing competition between market players – a key component of a functioning free market – from being distorted by factors such as the concentration of market power or the erecting of barriers to entry into markets.

Historically, agreements relating to land had been largely exempted from the purview of competition statutes⁶³ and the doctrine of restraint of trade.⁶⁴ Various justifications for this have been suggested, such as the limited geographical effect of land agreements and their positive effect on the property market.⁶⁵

Chapter I of the Competition Act 1998 prohibits agreements between undertakings which have as their object or effect the distortion of competition. However, the Act gives the Secretary of State the power to exclude land agreements – either in general, or of a particular type – from its ambit. A broad exception was introduced by Statutory Instrument, on the grounds that land agreements were unlikely to infringe the Chapter I prohibition and that a failure to exempt them would lead to an excessive workload for the Office of Fair Trading (OFT) as land agreements were notified to them as was required for potentially anticompetitive agreements at the time. This was based on the experience in Ireland after the Competition Act 1992 came into force.

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⁶³ In Re Ravenseft Property Ltd.'s Application, [1978] QB 52.

⁶⁴ Esso Petroleum v Harper's Garage, [1968] AC 269; See: David C Baum, "Lessors' Covenants Restricting Competition" (1965) University of Illinois Law Forum 228.

⁶⁵ Baum, *supra* note 64.

⁶⁶ Competition Act 1998, sec 50.

⁶⁷ Competition Act 1998 (Land Agreements Exclusion and Revocation) Order, 2004; Competition Act 1998 (Land and Vertical Agreements Exclusion) Order, 2000/310.

⁶⁸ Land Agreements Exclusion and Revocation Order 2004: A consultation on the Order's future (Department for Business, Innovation and Skills, 2009), paras 3.3–3.7; See: Vincent Power, Competition law and practice (Dublin: Butterworths, 2001) at 1424–1440; Competition Authority, Notice in respect of shopping centre leases (Dublin: Competition Authority, 1993).

The OFT had the power to withdraw the benefit of an exclusion from a particular agreement, where it considered that the agreement would infringe the Chapter I prohibition in the absence of the exclusion,⁶⁹ although it is unclear whether this power was used in practice.

The problem with the exclusion

Peel notes the contradiction of a restraint of trade doctrine cloaked in the language of "public interest", which effectively ignored the harm to the public which could flow from restrictive covenants in land agreements.⁷⁰ In the United States, legal commentators have for a long time expressed doubts as to the benefits of this special treatment afforded to land.⁷¹

In 2008, a Competition Commission report into the groceries sector found that in some areas, land agreements were being used to prevent suitable sites from being used in competition with major supermarkets, in order to prevent the entry into the market of competitors. It was therefore suggested that the land agreements exclusion should not apply to the groceries sector. The government noted that the land agreements exclusion was anomalous, especially in light of the OFT's view that land agreements were in fact no more or less likely to restrict competition than other types of agreement. While the anticompetitive effects of a land agreement tend to be very local, there are some relevant markets whose geographical scope will be equally restricted. Competition law already takes into account the geographic impact of

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⁶⁹ Competition Act 1998 (Land Agreements Exclusion and Revocation) Order, supra note 67, Art 6.

 ⁷⁰ Edwin Peel, *Treitel: The Law of Contract*, 13th Revised edition ed (Sweet & Maxwell, 2011) at 524.
 ⁷¹ Baum, *supra* note 64; James F Pascal, "Sherman Act Implications of Major Tenant Veto Powers in Regional Shopping Centers" (1972) 29 Wash & Lee L Rev 67; Alan Schapiro, "Exclusive Rights Clauses in Shopping Centre Leases" (1985) 24 Alta L Rev 510; Jay Conison, "Restrictive Lease Covenants and the Law of Monopoly" (1989) 9 Franchise LJ 3; Marc E Rosendorf & Jill Reynolds Seidman, "Restrictive Covenants - The Life Cycle of a Shopping Center" (1998) 12 Prob & Prop 33.
 ⁷² The supply of groceries in the UK market investigation (London: Competition Commission, 2008), para 7.113.

⁷³ Government Response to the Consultation on the Competition Act 1998 Land Agreements Exclusion and Revocation Order 2004 (Department for Business, Innovation and Skills, 2010).

potentially anticompetitive behaviour in the market definition phase. Case by case analysis is likely to provide more consistent results across different relevant markets than broad exclusions.

One of the main reasons for the original exemption was the reporting regime in operation at the time and the fear that the OFT would be inundated with precautionary reporting of land agreements, most of which would not be in breach of the Chapter I prohibition. As this regime was abandoned in 2003 in favour of self assessment by businesses, this justification no longer stood.

Even though the OFT had the power to withdraw the exemption in respect of a particular agreement, this did not have the effect of subjecting land agreements to the same level of scrutiny as other agreements. It entailed a relatively lengthy procedure and even where the exemption was withdrawn from an agreement, it would only come under the scope of the Competition Act from the date of the OFT's order, meaning that that date was the relevant one for the purposes of penalties and other consequences of breach of the Act.

For these reasons, and after a consultation,⁷⁴ the land agreements exclusion order was revoked.⁷⁵ The exclusion ceased to have effect as of April 2011, one year after the making of the Revocation Order, in order to give businesses time to assess their own land agreements for compatibility with the 1998 Act.

The OFT guidance

In advance of the change taking effect, the OFT issued guidance to assist landlords and tenants in assessing whether any agreements to which they were party might be in

⁷⁴ Land Agreements Exclusion and Revocation Order 2004: A consultation on the Order's future, note 68.

⁷⁵ Competition Act 1998 (Land Agreements Exclusion Revocation) Order, 2010/1079.

breach of the Chapter I prohibition.⁷⁶ Whether a particular agreement will have any effect on competition is heavily dependent on the factual matrix of the particular case. This approach allows the law to react to changes in practice and the emergence of unexpected threats to competitive markets. This assessment will involve an economic analysis, which seeks to define a relevant market by reference to the products sold and the area served, and determine whether competition may be distorted by an agreement. In particular, it might look at whether the agreement divides customers between the parties to it, whether it prevents others from accessing the market, and whether there are other, similar agreements in force in the market. Competition law does not prohibit every agreement that could conceivably affect competition. Some agreements may be so insignificant that they will not affect competition, some classes of agreement may be exempted on policy grounds and others will have benefits for society as a whole and so they are allowed, subject to some safeguards. The Law Commission indicated that most estate management related agreements will not be affected by the Competition Act. 77 This is in line with the guidance issued by the Irish Competition Authority for shopping centres.⁷⁸ However, some exclusivity agreements or combinations of agreements effectively granting a monopoly in a market to one tenant may be in breach of competition law.⁷⁹

Crucially for portfolio landlords, Section 9 of the Competition Act 1998 creates an exemption for agreements which are likely to have beneficial effects for consumers.

This exemption is only relevant where an agreement otherwise breaches the Chapter I

⁷⁶ Office of Fair Trading, *Land Agreements: The application of competition law following the revocation of the Land Agreements Exclusion Order*, OFT1280a (Office of Fair Trading, 2011); Richard Butterworth, "The application of UK competition law to land agreements: new guidance from the OFT" (2011):6 Conv 486.

⁷⁷ Office of Fair Trading, *supra* note 76, para 4.11.

⁷⁸ Competition Authority, *supra* note 68.

⁷⁹ Office of Fair Trading, *supra* note 76, paras 4.9, 4.30.

prohibition. Where a party to an agreement can demonstrate that the agreement contributes to some form of advance in production or technology, without going further than is necessary to achieve that benefit, that it does not allow the parties to it to substantially eliminate competition, and that The benefits flowing to consumers from the agreement compensate them for the detriment they suffer as a result of the agreement, it may be exempt. The OFT has pointed to the maintenance of a tenant mix beneficial to customers, and the need to attract new retailers as possible examples of how the exemption might apply. 80

The effect on landlords' management of regulation under the competition law regime is examined at 6.3, below.

5.3 Effect of law – economic analysis

While a multitude of objectives are relevant to the regulation of commercial landlord-tenant relationships, maximising economic welfare appears to take priority. Once other objectives can be met, regulatory systems which better promote the maximising of economic welfare ought to be preferred. In analysing the appropriateness of regulation in this area, it is therefore instructive to examine the extent to which the current law promotes economic welfare and growth.

5.3.1 Portfolio landlords: subjects or instruments of regulation?

Generally, it may be assumed that the landlord is a subject of any regulation intended to govern the landlord-tenant relationship. If the aims of the regulation are to protect tenants from the caprices of unjust landlords, then the regulations constrain landlord behaviour in order to prevent landlords from abusing their powers. This may have roots in the power imbalances often present between landlords and tenants.

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⁸⁰ *Ibid*, para 5.6.

Another key goal of policy makers might be to ensure that land is used efficiently. This might be achieved through the planning system or through common law doctrines such as nuisance.⁸¹ As discussed in Chapter 2, a significant threat to the efficient use of land relates to market failures arising as a result of externalities.⁸² Such externalities will not be eliminated through a market mechanism where transaction costs, which may be significant in complex factual situations, are higher than the gains achievable.⁸³ Bringing a property causing an externality and the property experiencing the external effects into common ownership will internalise the externality, as the common owner will experience all of the benefits and disbenefits of any choice which might otherwise cause externalities. Thus, the common ownership of property is an efficient way of ensuring the optimum allocation of resources.⁸⁴ Thus, the landlord may be in a better place than national regulators to ensure the efficient use of property through the imposition of Pigouvian taxes and subsidies on tenants, or strict regulatory controls over his portfolio.85 This might provide a justification for regulators to grant portfolio landlords enough freedom in the management of their properties to capture these benefits. As such, in one sense, the position of the portfolio landlord might be seen as not subject of regulation, but instrument of regulation.

Regulatory approaches such as planning law or nuisance may be adept at reducing negative externalities, but they suffer from a significant drawback in not being able to mandate activity which would generate positive externalities. 86 Significant costs may

⁸¹ Robert C Ellickson, "Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls" (1973) 40:4 The University of Chicago Law Review 681.

⁸² See 2.7.1, above.

⁸³ R H Coase, "The Problem of Social Cost" (1960) 3 JL & Econ 1.

⁸⁴ Ellickson, *supra* note 81.

⁸⁵ See 2.7.2, above; T S-T Yuo et al, *The management of positive inter-store externalities in shopping centres: some empirical evidence*, Report (University of Reading, 2003).

⁸⁶ Ellickson, *supra* note 81 at 729.

also be involved where a high degree of regulatory oversight is required, as in the planning system. Taking advantage of the fact that landlords' incentives are ultimately driven by the aggregate profitability of their portfolios⁸⁷ may provide a more nuanced approach to supporting growth, while also minimising the costs involved. Portfolio landlords can be seen as having an instrumental role in achieving this aim.

It will be considered whether, and to what extent, the different approach taken by policy makers to portfolio landlords is attributable to the positive impact of good estate management on other policy goals.

Is self regulation the solution?

Self regulation has become a feature of the commercial lettings market in recent years. Successive governments have supported a series of codes of conduct for commercial leasing drawn up by industry bodies.⁸⁸ These codes recommend that landlords should not demand terms more restrictive than needed to protect the landlord's interests.⁸⁹ Policy makers have historically preferred freedom of contract in commercial lettings. 90 Reliance on self regulation permits policy makers to abstain from departing from this trend.

Ogus points to three conditions necessary for self regulation to be in the public interest:⁹¹ There must be some form of market failure in the relevant activity; private law must not be sufficient to remedy the failure; and self regulation must be a more efficient solution than public regulation. It is clear that there are market failures in the

⁸⁷ Where this is the case. See 2.7.3, above.

⁸⁸ Joint working group on commercial leases, *supra* note 33; Hughes & Crosby, *supra* note 23; Department for Communities and Local Government, *supra* note 34.

⁸⁹ Joint working group on commercial leases, *supra* note 33.

⁹⁰ Martin Davey, "Privity of Contract and Leases - Reform at Last" (1996) 59 Mod L Rev 78; Bridge, supra note 1; Sarah Hill Wheeler, The Commercial Leases Code: Tenant's Tool or Landlord's Token? (LLM, University of Northumbria, 2009) [unpublished], para 4.7.1.

91 Anthony Ogus, "Rethinking Self-Regulation" (1995) 15:1 Oxford J Legal Studies 97.

commercial leasing sector arising as a result of externalities and information asymmetry. 92 Private law is well suited to addressing problems arising as a result of externalities, 93 but significant information asymmetries still exist between large and small market participants.⁹⁴ The appropriateness of private regulation is then a question of whether it provides a better solution to the market failures identified than public regulation.

Self regulation may be favoured over public regulation because market participants have a greater knowledge of the industry and will therefore be able to craft more appropriate responses to market failures.⁹⁵ The implementation of a code by an industry body may also lend the regime greater legitimacy amongst landlords than a system of public regulation.⁹⁶ The Royal Institution of Chartered Surveyors (RICS) has played an active role in encouraging responsible behaviour on the part of landlords. Recently, the Institution has released a lease targeted at small retail businesses, which is designed to provide the flexibility necessary in the first few years of trading.⁹⁷ However, the voluntary nature of the industry's efforts still presents a problem. The efforts to improve levels of commercial awareness amongst small business tenants through the use of a code appears to have been a failure, as knowledge of the code itself remains low.⁹⁸ Unscrupulous landlords, who create the need for regulation, are not obliged to abide by the code. The voluntary nature of the

⁹² John Burton, *Retail rents: fair and free market?* (London: Adam Smith Research Trust, 1992); Hughes & Crosby, supra note 23.

⁹³ Ellickson, supra note 81; Robert C Ellickson, Order without law: how neighbors settle disputes (Cambridge, Mass; London: Harvard University Press, 1991). ⁹⁴ Crosby et al, *supra* note 14.

⁹⁵ Neil Gunningham & Joseph Rees, "Industry Self-Regulation: An Institutional Perspective" (1997) 19:4 Law & Policy 363 at 366.

⁹⁶ *Ibid* at 379.

⁹⁷ Royal Institution of Chartered Surveyors, "Small Business Retail Lease", (2012), online: http://www.rics.org/uk/knowledge/more-services/professional-services/small-business-retail-lease/>: Nick Darby, "A welcome addition" (2013) February-March Commercial Property 22.

code and lack of take-up by landlords has been cited as justifying regulatory intervention.⁹⁹

5.3.2 Fines provisions

The primary purpose of the fines provisions appears to be the protection of tenants from unscrupulous landlords, who might use the temporary leverage afforded to him by a tenant's request for consent to extract additional money from the tenant. While much of the rhetoric surrounding this measure was paternalistic in nature, there are also solid economic justifications for it. The effect of the fines provisions preferred in the 1927 Act is to maximise the incentive for the tenant, as the party precipitating any change, to take advantage of opportunities to use premises more efficiently, while compensating the landlord for any losses arising as a result of the change.

The fines provisions under the 1927 Act are confined to prohibiting unscrupulous demands for payment in return for consent. If a landlord were to act perfectly rationally in the economic sense, they would grant consent to a change where the expected benefits of the change to them outweigh their expected costs. The exception for fines intended to compensate landlords for damage to their neighbouring property prevents landlords from being compelled to give consent without compensation where it would damage their legitimate interests.

There are a number of justifiable circumstances in which landlords may withhold consent in the absence of payment. In the case of a standalone landlord, the only cost which a change will normally have is in relation to the property let to the tenant. Portfolio landlords, on the other hand, will want to consider any effect that a change

⁹⁹ Hughes & Crosby, *supra* note 23.

¹⁰⁰ E.g. Lord silken of Durwich, Hansard. HL Deb December 16 1987, vol 491, col 809-810.

¹⁰¹ E.g. Horace Crawfurd MP, Hansard. HC Deb 7 April 1927 vol 204 Col 2390; Sir William Joynson-Hicks MP, Hansard HC Deb 7 April 1927 vol 204 col 2303.

may have on their neighbouring property and neighbouring tenants. Excluding factors external to the parties, such a change would be Pareto efficient as at least one party would benefit (the tenant, who would not have suggested the change if this were not the case) and no one would suffer. As a landlord is able to require the payment of compensation for any negative externalities affecting neighbouring property belonging to them, the costs to them of the change ought to be zero once this has been factored into account. Where a rent review clause is included in the lease, a change to a more profitable user may also lead to an increase in rent at a later stage.

The imposition of a fine in respect of any negative externalities forces a tenant to consider the costs imposed on others (at least within the landlord's portfolio) by any proposed change. Thus, the imposition of a fine in such circumstances can be seen as a Pigouvian tax, intended to internalise the expected negative externalities connected to any contemplated change into the tenant's decision making. A tenant who is required to pay compensation in respect of harm likely to be caused to neighbouring property will only proceed with a change where the expected gain from the change is greater than the harm caused to neighbouring property owned by the landlord. Permitting a landlord to levy such a Pigouvian tax enables him to act as an effective regulator at a local level.

The internalising of externalities through fines provisions may also allow positive externalities to be captured. For example, where a landlord has granted a low profit tenant a lease on very favourable terms in order to create positive externalities, ¹⁰² the "no fines" provision should not allow that tenant to take advantage of that low rent

¹⁰² The Law Commission has suggested that this may be the case in relation to low profit trades which are necessary for tenant mix: The Law Commission, *supra* note 45, para 4.51.

when changing to a more profitable user. ¹⁰³ The low rent can be characterised as a Pigouvian cross subsidy from other tenants to the tenant enjoying low rent, to enable that tenant to operate a business that will generate positive externalities for other tenants. ¹⁰⁴ The reduction in rent, or subsidy, should not exceed the benefit to the other tenants. ¹⁰⁵ If changing the user of this unit would prevent these externalities from accruing (or diminish them), this could be characterised as causing a diminution in the value of the landlord's neighbouring property. Because the discount would not have been higher than this diminution in value, the tenant may be required to pay a fine (presumably in the form of a rent increase) at most matching the value of the positive externalities that will be extinguished. Such a change should not, therefore, proceed unless the aggregate expected value of it is positive, including any externalities within the landlord's portfolio.

The fines provisions, in particular section 19(3) in relation to user, have been criticised on the basis that it is unclear whether they are effective in fulfilling their original purpose of preventing unscrupulous landlords from demanding unreasonable fines. Workarounds exist in relation to merely qualified covenants, ¹⁰⁷ and section 19(3) does not apply to absolute covenants, or changes of user involving alterations. In spite of this, it appears that to the extent that the 1927 Act sought to empower landlords to manage their portfolios efficiently and protect the incentives which help portfolio landlords in their management, it is well crafted.

¹⁰³ As feared by the Law Commission: *Ibid*, para 4.5.1.

 ¹⁰⁴ B Peter Pashigian & Eric D Gould, "Internalizing Externalities: The Pricing of Space in Shopping Malls" (1998) 41:1 Journal of Law and Economics 115.
 ¹⁰⁵ Ibid.

¹⁰⁶ Jenkins, *supra* note 45; The Law Commission, *supra* note 45; Crabb, *supra* note 42.

¹⁰⁷ In Jenkins, *supra* note 45, para 312, it was suggested that a landlord might try to push a tenant to surrender the lease to be re-granted a tenancy with a new user covenant but at higher rent.

¹⁰⁸ Landlord and Tenant Act 1927, supra note 2, sec 19(3).

5.3.3 Mandatory full qualification

As discussed in Chapter 3, tenants bound by fully qualified user covenants are in a much better position to tenants restricted by absolute covenants. In addition to the protection from fines, they are not bound by the restriction to the extent that a landlord has unreasonably withheld consent. 109 Thus, a landlord could not use the withholding of consent to procure a prohibited fine, as might be possible with merely qualified covenants. Nor could a landlord arbitrarily or capriciously prevent a change of user from proceeding. 110 In fact, apart from certainty, the only benefit to a landlord of having an absolute, as opposed to a fully qualified, covenant is the power to withhold consent in circumstances that a court would find unreasonable. 111 It seems, therefore, that mandatory full qualification of user covenants would be apt to protect tenants from unscrupulous landlords. 112 This has not been disputed by the Law Commission or policy makers. 113 Rather, objections have been based upon a preference for freedom of contract or choice; 114 fear of creating legal anomalies between the operation of freehold and leasehold covenants; 115 and decisively, the goal of policy makers to ensure that landlords are free to exercise the degree of control over their portfolios necessary to realise the benefits of common ownership for society. 116 It is the final and most influential of these objections that is the focus of this section.

¹⁰⁹ See Chapter 4.

¹¹⁰ E.g. Berenyi v Watford Borough Council, [1980] 2 EGLR 38; Anglia Building Society v Sheffield City Council, [1983] 1 EGLR 57.

The Law Commission identified this in relation to absolute disposition covenants: The Law Commission, *supra* note 45, para 4.15.

¹¹² Jenkins, *supra* note 45; Law Reform Commission, *The law of landlord and tenant*, 85 (Dublin: Law Reform Commission, 2007).

¹¹³ HC Deb 27 Jan 1954, vol 522, col 1771; The Law Commission, *supra* note 45.

¹¹⁴ *Ibid*, para 4.13.

¹¹⁵ *Ibid.* para 4.38.

¹¹⁶ *Ibid*, paras 4.39–4.44.

Exaggerated apprehensions?

The apprehensions of landlords and regulators about the effects of mandatory full qualification of user covenants may be overstated. To the extent that policy makers seek to ground a rejection of mandatory full qualification in the needs of portfolio landlords, they may therefore be misguided. In 1950, the Jenkins Committee rejected this suggestion on the grounds that any refusal of consent on these grounds would be reasonable. More recently, a working group of the Association of British Insurers, rejected the inclusion in assignment covenants of circumstances related to estate management which would reasonably ground a refusal of consent to assign, on the grounds that any reason which might be included would be reasonable even without the inclusion of the condition.

The value of absolute covenants to portfolio landlords in managing a group of properties is frequently cited. It is not clear, however, that absolute covenants are necessary for this purpose. As is argued in detail in Chapter 4, it is clear that a landlord's interests in respect of their portfolio as a whole will be taken account of by the courts in determining the reasonableness of any withholding of consent to a change of use, as well as alienation. Any reason relating to the landlord's other property which might retrospectively have justified the imposition of an absolute user or disposition covenant is likely to be a reasonable ground for refusing consent. On the basis of all three judicial approaches to reasonableness discussed in chapter 4, 121 portfolio landlords will generally be on good ground in refusing consent to a change of user in order to protect the interests of neighbouring property. Under the broad

¹¹⁷ See 4.4.2, above.

¹¹⁸ Jenkins, *supra* note 45, para 312.

Under Landlord and Tenant Act 1927, supra note 2, s 19(1A), as inserted by the Landlord and Tenant (Covenants) Act, 1995, s22.

¹²⁰ Report of the ABI Working Party on the Landlord and Tenants (Covenants) Act 1995 (London: Association of British Insurers, 1996).

¹²¹ See 4.1.1, above.

approach, a court would look to the commercial realities of the relationship between the parties. Applying this approach, the courts have generally upheld the right of portfolio landlords to withhold consent on the basis of apprehended harm to neighbouring property owned by them. ¹²² Even under the more restrictive contractual approach, portfolio landlords would not stand to lose out from the modification of absolute covenants into fully qualified covenants. The Law Commission assumes that a landlord would only demand an absolute user covenant where there are specific reasons why a landlord would not want to consent to any change of user. ¹²³ Any factor which might sway a landlord to insist upon an absolute user covenant will necessarily have been known to them at the time the lease was granted. Even if they were prohibited from imposing absolute restrictions, a landlord could ensure that the interest which the landlord might wish to protect with an absolute user restriction was clearly within the knowledge of the tenant, and possibly protected in the wording of the lease. Once the relevant interest is made clear in the contract or contractual context, it appears that a landlord would be reasonable under the contractual approach in withholding consent on those grounds. 124

In spite of this, a belief remains that absolute covenants are required by portfolio landlords for estate management reasons in certain circumstances. One problem may be that presumably all of the leases where a landlord believes themselves to be better off with absolute user restrictions are currently bound by absolute user restrictions. Tenants are also likely to be advised against challenging a landlord's refusal of consent unless they have a good chance of winning, because of the cost implications

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¹²² E.g. Crown Estates Commissioners v Signet, [1996] 2 EGLR 200; Sportoffer Ltd v Erewash BC, [1999] L & TR 433.

¹²³ The Law Commission, *supra* note 45 at 386.

¹²⁴ Houlder Bros & Co Ltd v Gibbs, [1925] Ch 575; Bromley Park Garden Estates Ltd v Moss, [1982] 1 WLR 1019.

of losing. This means that very few cases get to court where the landlord has strong estate management reasons for opposing a change of user, and that landlords who are accustomed to using absolute user covenants to protect the interests of their portfolio do not have experience in dealing with fully qualified covenants, and over estimate the "danger" of them. It may therefore be necessary to convince landlords just how reasonable the courts' approach to reasonableness is before a proposal for mandatory full qualification of user covenants can garner widespread support.

Another justification: legal certainty

Regardless of the fairness or efficiency implications of decisions, a case may be made for the retention of absolute user covenants on the grounds of certainty. Under an absolute covenant (or merely qualified user covenant, which has the same effect), it is clear that a landlord will always be permitted to withhold consent to a change in user, whereas the ability of a landlord to prevent a change in the context of a fully qualified covenant cannot be determined until all the facts are known. At the time the tenant seeks to make a change, this certainty would help to reduce the transaction costs entailed in ascertaining whether or not a landlord's withholding of consent was reasonable. Thus, it may be easier for the parties to re-negotiate their respective rights, re-allocating them efficiently. This certainty would also make it easier for parties who comply with the rational expectations model of behaviour to accurately price the lease at the time it is entered into. Absolute user covenants also create certainty for tenants, who can rest assured that the landlord's tenant mix policy cannot be challenged.

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¹²⁵ Coase, *supra* note 83.

The economic model of rationality has, however, come under some scrutiny. ¹²⁶ It assumes that individuals aim to maximise their own welfare and that they in fact make choices which are most likely to achieve this aim. ¹²⁷ In reality, the ability of individuals to make welfare promoting choices is inhibited by a number of factors including imperfect information and a limited ability to process it. The neoclassical economic model assumes that individuals react to such difficulties by only considering the most likely outcomes. ¹²⁸ Behavioural psychology suggests instead that in dealing with such difficulties, people actually use cognitive shortcuts or heuristics when making decisions. ¹²⁹ The use of such heuristics may lead to systematic departures from the model of rationality favoured by neoclassical economics. ¹³⁰ If these biases apply to the commercial lettings market, and lead participants to adopt irrational approaches to valuing lease terms, this may justify paternalistic intervention.

For example, the "availability heuristic" leads individuals to place too much emphasis on salient facts, in a manner inconsistent with the economic rational actor model. ¹³¹ In the context of small business leases, Crosby et al have found that small business tenants tend to focus in negotiations on the terms that are immediately relevant to

¹²⁶ Herbert A Simon, "A Behavioral Model of Rational Choice" (1955) 69:1 The Quarterly Journal of Economics 99; Gary S Becker, "Nobel Lecture: The Economic Way of Looking at Behavior" (1993) 101:3 Journal of Political Economy 385; Christine Jolls, Cass R Sunstein & Richard Thaler, "A Behavioral Approach to Law and Economics" (1998) 50:5 Stanford Law Review 1471; Russell B Korobkin & Thomas S Ulen, "Law and behavioral science: Removing the rationality assumption from law and economics" (2000) 88 Cal L Rev 1051; James C Cooper & William E Kovacic, "Behavioral economics: implications for regulatory behavior" (2012) 41:1 Journal of Regulatory Economics 41.

¹²⁷ Simon, *supra* note 126; Herbert A Simon, "Rationality in Psychology and Economics" (1986) 59:4 The Journal of Business S209.

¹²⁸ A number of problems have been identified with this approach, including the infinite regression of trying to determine which outcomes are the most important to consider. See Gerd Gigerenzer & Reinhard Selten, "Rethinking rationality" in *Bounded rationality: The adaptive toolbox* (Cambridge, Mass: MIT Press, 2001) 1 at 5.

¹²⁹ Daniel Kahneman, Paul Slovic & Amos Tversky, *Judgment Under Uncertainty: Heuristics and Biases* (Cambridge University Press, 1982); Dahlem Workshop on Bounded Rationality, *Bounded rationality: the adaptive toolbox* (Cambridge, Mass: MIT Press, 2002).

¹³⁰ Jolls, Sunstein & Thaler, *supra* note 126.

¹³¹ *Ibid* at 1518–1522.

their business, neglecting terms which are only important in the long run. ¹³² This may justify regulatory intervention intended to promote the long term welfare of tenants.

Other heuristics which may be relevant to regulators include the "endowment effect", which is the phenomenon that individuals tend to attribute a higher value to a thing if they own it.¹³³ Thus, it may be the case that a landlord would not waive an absolute user covenant even where the costs of the change were negligible. Research in this area has not been conducted but may help to inform policy in future.

An alternative: Expanding the power of the court to modify restrictive covenants

The Law Commission did recognise the need for flexibility in leasehold covenants, and the risks of land becoming over burdened with restrictions. In its 1985 report, it suggested extending the procedure for modifying or setting aside covenants under section 84 of the Law of Property Act 1925, to provide additional flexibility for tenants. Under the 1925 Act, the Land Chamber of the Upper Tribunal may set aside or modify a restrictive covenant which has become obsolete because of changes to circumstances; if it impedes a reasonable user without securing practical benefits of substantial value to persons entitled to the benefit of the covenant (or is contrary to the public interest) and money will be adequate compensation; or if the removal of the covenant will not harm the persons entitled to benefit under it. Currently the provision only applies to leases of at least 40 years, of which 25 years or more have expired. The Commission expressed a "desire to make the section available to all

¹³² Crosby, Hughes & Murdoch, *supra* note 15 at 184.

¹³³ Daniel Kahneman, Jack L Knetsch & Richard H Thaler, "Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias" (1991) 5:1 The Journal of Economic Perspectives 193.

¹³⁴ The Law Commission, *supra* note 45, paras 9.27 – 9.43.

¹³⁵ Law of Property Act 1925, supra note 2, sec 84(12).

tenants who may seek its relief", 136 so any changes would likely involve the following elements:

- Reducing the amount of time required to pass on a lease before an application can be made to the Upper Tribunal¹³⁷
- ii. Reducing the length of leases to which section 84 applies ¹³⁸
- iii. Allowing the Upper Tribunal to increase the rent payable to landlords to compensate them for any change to a restrictive covenant in the lease.

The effect of such a provision would be to allow any tenant at any time to make an application to the Upper Tribunal to have a user covenant set aside if circumstances had changed.

There is some merit to this suggestion. The procedure under section 84 is expressly designed to take account of diverse interests, ensuring that all relevant interests are taken into account in a situation where multiple parties have an interest in the restriction sought to be modified. As such, it may be particularly useful in resolving disputes arising under letting schemes. It may also allow those parties to be compensated for any detriment suffered as a result of the change. It would entitle landlords to damages for any disadvantage they might suffer as a result of any discharge or modification, or the difference it might make to the level of rent achievable in the market.

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¹³⁶ The Law Commission, *supra* note 32, para 9.30.

¹³⁷ The Commission unanimously recommended at least a reduction to 14 years, but the majority recommended abolishing the expiry period altogether.

¹³⁸ The Commission recommended reducing this to "perhaps" 21 years.

However, there are also a number of drawbacks to using the section 84 procedure instead of mandatory full qualification. It was designed with freehold covenants in mind, with limited applicability for leasehold covenants only being added in at a late stage. As a procedure, it is more suited to addressing problems related to long-term change in circumstances than the day-to-day movements in the market which may best be addressed by the exercise of a reasonable landlord's discretion. The availability of an expanded section 84 would not, therefore, supersede the case for mandatory full qualification.

5.3.4 Competition law

The government's decision to withdraw the exclusion from competition law that land agreements had enjoyed demonstrates an acceptance of the dangers which can result from the concentration of control of land in too few hands. The decision to remove the exclusion from all land agreements rather than just those preventing competition in the groceries sector creates a uniform regulatory regime positioned to prevent the use of restrictive covenants to distort competition in all sectors. This recognises the dangers which may be posed by the inappropriate exercising of control by portfolio landlords.

The economically informed approach taken by the OFT, which has power to investigate and enforce competition law,¹³⁹ is not likely to disrupt the ability of portfolio landlords to exercise best practice in managing tenant mix or capturing economies of scale.¹⁴⁰ The application of competition law to the property sector allows for a well developed system of regulation to protect against the dangers posed by restrictive covenants, while permitting agreements which, through common

139 Competition Act 1998, ch III.

¹⁴⁰ Office of Fair Trading, *supra* note 76.

management of property, work to promote social welfare. Like the earlier restrictions on fines which sought to protect tenants from disreputable landlords without harming the interests of virtuous landlords, the competition regime is designed to restrict only those practices which seek gain for the parties to an agreement at the expense of society as a whole, and not those intended to benefit consumers through prudent management.

The removal of the exclusion also paves the way for private actions in competition law, as breaches of the 1998 Act may be litigated as a breach of statutory duty.¹⁴¹ The implications of this for portfolio landlords are discussed in detail in Chapter 6 of this thesis.¹⁴² While a regulator is present in the context of competition law, private enforcement would be in line with many other regulatory provisions affecting the landlord-tenant relationship,¹⁴³ and the government has expressed a preference to make private enforcement of competition law more easily accessible.¹⁴⁴

5.4 The balance struck in other jurisdictions

Other jurisdictions have faced similar dilemmas in seeking to reconcile the benefits of common ownership and control of property by portfolio landlords with the risks of unscrupulous landlords abusing their position. Ireland has long restricted the terms which landlords may impose in respect of alienation and user, and in 2007 the Irish Law Reform Commission reiterated support for this approach in a draft updated landlord and tenant bill. Since the 1980s, every Australian state has enacted legislation to protect small business tenants. The balances struck in these jurisdictions

¹⁴¹ E.g. Chester City Council & Anor v Arriva Plc & Ors, [2007] EWHC 1373 (Ch).

¹⁴² See 6.3, below.

¹⁴³ E.g. Landlord and Tenant Act, 1988; Landlord and Tenant Act, 1954.

¹⁴⁴ Department for business Innovation and Skills, *Private actions in competition law: A consultation on options for reform* (Department for Business Innovation and Skills, 2012); Department for Business Innovation and Skills, *Private actions in competition law: A consultation on options for reform - Impact assessment* (2012); Office of Fair Trading, *Private actions in competition Law: A consultation on options for reform - The OFT's response to the Government's consultation* (2012).

may be instructive in considering how regulation might be developed in England and Wales.

5.4.1 Ireland

The Law Reform Commission set out five guiding principles for its consultation on the reform of commercial tenancy law, which indicated a preference for freedom of contract, as well as a desire to keep the law in line with commercial practice. However, this was qualified by the need to protect tenants from unscrupulous landlords: 146

At the very least, there ought to remain those provisions which are designed to prevent unreasonable behaviour or provisions in leases operating unfairly [footnote referring to Part IV of the Landlord and Tenant (Amendment) Act 1980, which implies full qualification into absolute and merely qualified covenants]. Indeed, as indicated later, the Commission takes the view that these provisions should be made more effective.

This represents a longstanding policy preference against allowing landlords absolute discretion in exercising control over their tenants. Yet, the imposition of limits on a landlord's control sits happily with a preference for freedom of contract and commercial practice. The experience in Ireland has been that portfolio landlords are adequately protected by the approach taken by the courts to reasonableness. 148

The twin objectives of ensuring that the law promotes flexibility, choice and efficiency while protecting tenants from unfair behaviour of landlords are in line with the policy factors cited in England and Wales. These objectives are similar to the

¹⁴⁵ Law Reform Commission, *supra* note 31 at 5.

¹⁴⁶ *Ibid* at 39.

¹⁴⁷ The provisions in the 1980 Act repeated provisions in the Landlord and Tenant Act 1931.

¹⁴⁸ E.g. White v Carlisle Trust, [1976-7] ILRM 311; Green Property v Shalaine Modes, [1978] ILRM 222; OHS v Green Property Company, [1986] IR 39; Dunnes Stores (ILAC Centre) Ltd v Irish Life, [2008] IEHC 1114.

policy discussions taking place in England and Wales insofar as flexibility is seen as a key goal, driven by an underlying policy of promoting economic growth.

The Irish system may be improved with the importation of the fines provision from the 1927 Act in England and Wales. The provision for fines under Irish law does not permit a landlord to demand payment for any detriment which a change of user might cause to other property belonging to them, outside of tightly defined causes, which appear to exclude the effect of externalities. Thus a landlord could reasonably withhold consent to a change which might harm neighbouring property, but could not grant consent subject to an increase in rent to compensate for this harm. This is ripe for amendment in line with the stated objective of the Law Reform Commission to ensure that the law "does not force landlords and tenants into arrangements which suit neither group." The combination of this measure with the mandatory full qualification already in place would prevent the workarounds available in England and Wales from being used.

5.4.2 Australia

The regulation enacted in various Australian states since the Beddal Report into problems facing small businesses¹⁵² is particularly relevant in view of the fact that the regulation of commercial landlord-tenant relationships arose as a result of fears that portfolio landlords - in particular the landlords operating large regional shopping centres - were abusing their position in negotiations to the detriment of small business

¹⁴⁹ Landlord and Tenant Act 1927, ss 19(2)–(3).

¹⁵⁰ Landlord and Tenant (Amendment) Act, 1980, s 67(2).

¹⁵¹ Law Reform Commission, *supra* note 31 at 5.

¹⁵² Australia Parliament House of Representatives Standing Committee on Industry, Science, and Technology, *Small business in Australia: challenges, problems and opportunities* (Australian Govt. Pub. Service, 1990).

tenants.¹⁵³ This led to a focus on protecting small businesses.¹⁵⁴ There were also some competition concerns raised.¹⁵⁵

On the other hand, most states have no security of tenure provisions, which Crosby attributes to the need for landlords to maintain control over tenant mix in shopping centres: "The landlord's case for the right to manage the centre seems to hold sway at present over the tenant's claims of misuse of power at lease expiry." ¹⁵⁶

The types of protection granted to small business include the mandatory provision of information and the prohibition of certain terms. Although fully qualified user covenants are not made mandatory, the policy objectives seek to restrain the landlord's exercise of control over user: "While a landlord has a fundamental right of control over the use of its property, this right does not extend to engaging in unfair business practices." Thus provisions governing unconscionable conduct may be invoked where a landlord unreasonably refuses to waive a user covenant.

Difficulties have, however, arisen in targeting small businesses. Crosby and Hughes found that the ability of a business to negotiate effectively with landlords is associated most closely with the number of people it employs. Protecting tenants based on number of employees is problematic, however, as it may lead to harsh outcomes at the

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¹⁵³ Crosby, *supra* note 14.

¹⁵⁴ H Tarlo, "Great Shop Lease Controversy, The" (1983) 13 U Queensland LJ 7. In recent years, the position of small business tenants in England and Wales has become a policy priority: Crosby, Hughes & Murdoch, *supra* note 15; Susan Bright, "Protecting the small business tenant" [2006] 70 Conv 137; Portas, *supra* note 16; Department for Communities and Local Government, *supra* note 34; Royal Institution of Chartered Surveyors, *supra* note 97; See also: Dina Botwinick, Jennifer Effron & John Huang, "Saving Mom and Pop: Zoning and Legislating for Small and Local Business Retention" (2009) 18 JL & Pol'y 607.

¹⁵⁵ Crosby, supra note 14 at 8.

¹⁵⁶ *Ibid* at iii.

¹⁵⁷ *Ibid* at 15–18.

¹⁵⁸ *Ibid* at 48.

¹⁵⁹ Crosby, Hughes & Murdoch, *supra* note 15.

margins.¹⁶⁰ It may also disadvantage small business, who might be competing for the same property against a larger alternative tenant. A landlord would rightly prefer to have a larger tenant if the larger tenant enjoyed less legal protection.¹⁶¹ A common approach in Australia has been to grant protection to tenants based on the size or level of rent and service charges.¹⁶² This is not an effective way of targeting small businesses, as many larger corporations may also be protected, and some small business may escape protection.¹⁶³

5.4.3 Lessons to be learned from Ireland and Australia

The Australian example demonstrates that state intervention can be more effective than purely voluntary self regulation in increasing awareness amongst small business tenants. A variety of measures adopted in different states have been tailored to the needs of a class of tenants believed to be particularly vulnerable. Many of these measures have been largely successful, demonstrating a number of alternatives for protecting small retail tenants. The success of mandatory provision of information in increasing levels of commercial awareness amongst small business tenants demonstrates a potential way forward for the system of self regulation.

The history of mandatory full qualification of user covenants in Ireland demonstrates that this measure, which is largely effective in preventing landlords from abusing their power over tenants, does not prevent landlords from managing their portfolio as a whole in accordance with best commercial practice. This option would work particularly well to promote economic welfare when implemented alongside the existing fines provisions in England and Wales.

¹⁶⁰ Letitia Crabb, "Restrictions on Assignment of Commercial Leases: A Comparative Perspective" (2006) 35:2 CLWR 93.

¹⁶¹ Bright, *supra* note 154.

¹⁶² Crosby, *supra* note 14 at 13–14.

¹⁶³ *Ibid* at 58.

5.5 Conclusion

The intention of policy makers appears to have been to promote economic efficiency by allowing portfolio landlords control over how their properties are used, while balancing the risks to tenants and society of giving landlords too much control. An effort appears to have been made to give the "good", business-led landlord as much scope as possible to deal with his property portfolio as a unit, in order to benefit society as a whole, while attempting to shield tenants from the "unscrupulous" landlord.

The goal of the fines provisions was to (i) prevent unscrupulous landlords from making unreasonable demands for payment in return for consent, while (ii) not preventing portfolio landlords from taking the interests of their other properties into account. They work well insofar as they allow portfolio landlords to manage their portfolios in line with principles of good estate management, They are well crafted to facilitate the management of externalities within portfolios through the use of Pigouvian taxes on tenants, which should in theory allow the landlord to align the interests of individual properties with those of the portfolio, to help ensure an optimal distribution of uses in a development. The provisions fail in respect of (i), however, due to the availability of workarounds.

Much of the policy appears to have assumed that absolute user covenants are only used where the landlord has very good reasons for insisting upon them. Following on from this, the aversion to mandatory full qualification of user covenants is based largely on fears about the impact that such a change might have on portfolio landlords. From the detailed analysis of the case law contained in Chapter 4, it appears that such fears are unfounded. Mandatory full qualification of user covenants

would help to prevent landlords from circumventing the fines provisions, or from otherwise preventing a tenant from changing how a property is used without good reason.

6. The ongoing relationship of landlord and tenant

In Chapter 2, the commercial basis of the landlord-tenant relationship was outlined, with emphasis being placed on the interdependence of landlords and tenants: A landlord's income comes not from the property itself, but from the rent paid by the tenant. Equally, the success of the tenant in a commercial development will be significantly affected by how well the landlord manages the development; in particular, the character of the development and users of neighbouring tenants. Chapters 3 and 4 focused on examining what control the law permits a landlord to exercise over units in a development. Chapter 5 expanded on this, analysing the policy approach taken by the legislature in regulating the control which a landlord might exercise. Chapters 3, 4 and 5 are all concerned with examining how the portfolio management goals of a landlord may justify exercising control in a particular way over individual properties.

This chapter looks at the issue from the other side, asking what influence the needs of a single tenant may have on the landlord's management policy for his entire portfolio. It seeks to identify what control individual tenants might have over the management of a landlord's development, whether by influencing the landlord, asserting rights against the landlord or enforcing covenants against other tenants.

The long term nature of retail developments as business propositions means that the optimal tenant mix will vary over time, and that flexibility is necessary to ensure that returns are maximised. Retail developments may go through a number of redevelopments to keep up with market changes and landlords may favour a shuffle in tenant mix as a cost efficient

¹ Steven R Grenadier, "Flexibility and Tenant Mix in Real Estate Projects" (1995) 38:3 Journal of Urban Economics 357.

² *Ibid* at 373–8.

alternative to making physical changes.³ Any limitations on being able to make such changes will be harmful to a landlord's interests, and so landlords are keen to avoid being tied down by legal obligations,⁴ as the lower the cost of changing tenant mix, the more efficiently the development can be managed in the long term.⁵

On the other hand, tenants may be attracted to a development (and induced to pay a higher level of rent) by their belief in how it will be managed in the future. This belief may be supported by the landlord's plans, the covenants which might be imposed on other tenants in the centre, or assurances given specifically to the tenant. This chapter examines the extent to which these inducements or beliefs may bring about legal obligations.

As discussed in Chapter 5, the control which landlords are often able to exercise over properties may be used to distort competition.⁶ The exemption which land agreements once had from competition law has now been repealed. In light of this, it is examined how competition law may constrain a landlord's freedom in managing lettings policy. Individual tenants may seek to use private actions in competition law to escape restrictions contained in their leases. The implications of this for the landlord's ability to control his portfolio in the long run are assessed.

Legal obligations cannot, however, be the only considerations for landlords and tenants. The difficulty, cost and time required to enforce legal obligations through the courts, as well as the acrimony that is commonly associated with litigation, may act against the interests of both parties. In this context, this chapter also examines briefly how cooperative management

³ Gerard Prendergast, Norman Marr & Brent Jarratt, "An exploratory study of tenant-manager relationships in New Zealand's managed shopping centres" (1996) 24:9 International Journal of Retail & Distribution Management 19.

⁴ Marc E Rosendorf & Jill Reynolds Seidman, "Restrictive Covenants - The Life Cycle of a Shopping Center" (1998) 12 Prob & Prop 33.

⁵ Grenadier, *supra* note 1.

⁶ See 5.2.3, above.

processes might be used to avoid disputes, and the role that might be played by alternative dispute resolution in avoiding the pitfalls of litigation.

6.1 The role of tenants in the management of retail developments

It is in the interest of the landlord of a retail portfolio to manage the development in such a way as to stimulate tenant profitability, which in turn will tend to push up rental values.⁷ This symbiosis is illustrated by Pitt and Musa, who describe a good tenant mix as "a variety of stores that work together to enhance the centre's performance, and operate successfully as individual businesses [...] underlying objective of maximising shopping centre profitability."

Peters argues that it is the tenants, rather than the landlord, who are correctly positioned to dictate the direction of tenant mix in a shopping centre. ⁹ It is certainly tenants who first feel the effects of good or bad tenant mix, and management in general. Where a landlord retains control, this means that a high degree of information sharing is required to ensure that the landlord is able to factor into account, the effects of his management on the tenants. ¹⁰ The length of time between rent reviews or lease renewals, coupled with the unrealistic methods of rent calculation at these points, means that the effect of management may not be successfully captured in the rent payment (which would be the normal signalling method in economic analysis). ¹¹

The ability of a landlord and tenant to work together in pursuit of shared goals has a significant impact on the profitability of both.¹² Taking advantage of the benefits possible in

⁷ John Peters, "Managing shopping centre retailer mix: Some considerations for retailers" (1990) 18:1 International Journal of Retail & Distribution Management 5.

⁸ Michael Pitt & Zairul N Musa, "Towards defining shopping centres and their management systems" (2009) 8:1 J Retail Leisure Property 39 at 52–53.

⁹ Peters, *supra* note 7.

¹⁰ Elizabeth Howard, "The management of shopping centres: conflict or collaboration?" (1997) 7:3 The International Review of Retail, Distribution and Consumer Research 263.

¹¹ Ibid.

¹² Gary Warnaby & Kit Man Yip, "Promotional planning in UK regional shopping centres: an exploratory study" (2005) 23:1 Marketing Intelligence & Planning 43.

a shopping centre or other portfolio setting requires cooperation between neighbouring tenants (possibly mediated through the landlord) as well as with the landlord.¹³ The quality of the relationship may even have a bearing on the environmental performance of buildings.¹⁴

Such cooperation is more likely to be possible where the development manager is located in or close to the centre, and one-on-one meetings may be useful in ensuring that landlords are attuned to the needs of their tenants.¹⁵ Trust is another factor that will have a significant impact on landlord-tenant relations.¹⁶

The lease forms the basis of the relationship, and its structure will play a key role on the level of cooperation, with turnover-related rents and mandatory membership of a tenants' association encouraging close cooperation.¹⁷ This cooperation may not, however, be very prevalent in practice, with parties not viewing the portfolio as a single business with common interests.¹⁹

Tenants' committees

Tenants' committees (or associations) are often used as a means of communication between shopping centre managers and tenants.²⁰ They may meet on a regular basis, and include representatives of tenants and management. Warnaby and Yip identified their role as being to "facilitate relationships, form partnerships and, importantly, communicate..." In some cases, tenants' associations may become involved with broader issues, like managing tenant mix, but

Howard, *supra* note 10 at 267.

¹⁴ Mark Hinnells et al, "The greening of commercial leases" (2008) 26:6 Journal of Property Investment & Finance 541; Gary Pivo, "Owner-Tenant Engagement in Sustainable Property Investing" (2010) 2:1 The Journal of Sustainable Real Estate 184.

¹⁵ Prendergast, Marr & Jarratt, *supra* note 3.

¹⁶ Jane Roberts et al, "Building retail tenant trust: neighbourhood versus regional shopping centres" (2010) 38:8 International Journal of Retail & Distribution Management 597.

¹⁷ Howard, *supra* note 10 at 277–282.

¹⁸ *Ibid* at 267; Peters, *supra* note 7.

¹⁹ Malcolm H Kirkup & Mohammed Rafiq, "Marketing shopping centres: challenges in the UK context" (1999) 5:5 Journal of Marketing Practice: Applied Marketing Science 119 at 132.

²⁰ Warnaby & Yip, *supra* note 12.

²¹ *Ibid* at 51.

the larger tenants are likely to have most sway.²² The existence of an effective tenants' association is cited by McAllister as a source of business value for shopping centres.²³ There is, however, a dearth of empirical work as to the workings of tenants' committees. Informal conversations with two Ireland-based professionals familiar with the workings of tenants' committees suggested that their main function related to marketing and that there was little engagement by tenants due to a perceived lack of influence. This is in line with the need identified by Roberts et al for empowerment of tenants,²⁴ and Howard's findings relating to the adversarial nature of many landlord-tenant relationships.²⁵

6.2 Tenants' rights in the management of the landlord's portfolio

In the absence of cooperation and trust between the landlord and tenant, the parties may seek to fall back on legal rights to protect their positions. As discussed in Chapter 3, portfolio landlords commonly retain significant rights to control aspects of the operation of their properties. The courts have also given portfolio landlords a significant amount of leeway in interpreting the reasonableness of withholding consent.²⁶ In the context of a property portfolio, a tenant is likely to be concerned not only with how the landlord exercises control against him, but also against other tenants. Given the landlord's power to create positive externalities and eliminate negative externalities, a tenant may wish to have some rights to ensure that his landlord exercises control appropriately in relation to neighbouring property.

6.2.1 Specific covenants

In some instances, specific covenants might be included in leases to give tenants some guarantee about how the landlord's powers will be exercised. A covenant might be included

²² Peters, *supra* note 7.

²³ Patrick McAllister, *From rents to revenues: Can property become a service industry* (RICS Education Trust, 2002) at 42.

²⁴ Roberts et al, *supra* note 16.

²⁵ Howard, *supra* note 10.

²⁶ See 4.4. above.

to require a landlord to enforce neighbours' covenants,²⁷ or to dictate what services a landlord ought to provide. A landlord might also be required to exercise his functions according to some independent standard.

Very often, the construction "good estate management" is used to describe such a standard.²⁸ However, there are a number of problems associated with this term. It is not defined by the RICS, or other professional bodies.²⁹ Furthermore, judicial approaches to the term have varied from tautology ("the prudent management of more than one property of a landlord, normally adjoining or at least contiguous"³⁰) to not restrictive of the landlord at all.³¹ If the addition of the words to terms in leases is to mean anything, it must place some limits on how landlords are to behave. The courts have therefore dealt with such covenants on a case-by-case basis.

Good estate management covenants

Many lease agreements with a variable service charge impose strict controls on the services which a landlord can use the charge to pay for.³² While this protects tenants from being forced to pay for unnecessary services, it may cause difficulties by unnecessarily ossifying the services covered by the charge as those seen as necessary at the time the lease was originally drafted.³³ In some cases, leases may give a landlord broader discretion to adapt the services provided to prevailing circumstances. In order to prevent costs to tenants from spiralling out

²⁷ E.g. *White v Bijou Mansions Ltd*, [1938] 1 Ch 351.

²⁸ Boots UK Limited v Trafford Centre Limited, [2008] EWHC 3372 (Ch); Petra Investments Limited v Jeffrey Rogers plc, [2000] 3 EGLR 120; Capita Trust v Chatam Maritime, [2006] EWHC 2596 (Ch); Plantation Wharf Management Company Ltd v Jackson, [2011] UKUT 488 (LC); Romulus Trading Co Ltd v Comet Properties Ltd, [1996] 2 EGLR 70; Irish Life Assurance PLC v Quinn, [2009] IEHC 153.

²⁹ Anthony Banfield, *Stapleton's Real Estate Management Practice* (Taylor & Francis, 2005); Mark Shelton, "What is 'good estate management'?" (2007) 147 In-House Lawyer 104; RICS, *Real Estate Management Guidance*, GN 100/2013 (London: RICS, 2013).

³⁰ Stakelum v Ryan, [1980] 114 ILTR 42 (IECC) at 44; approving Clift v Taylor, [1948] 2 KB 394.

³¹ Bromley Park Garden Estates Ltd v Moss, [1982] 1 WLR 1019. In that case it was held that although withholding consent to an assignment in order to acquire a surrender of the lease so it could be re-let at a premium would be "good estate management", it was not a good reason for refusing consent to assign. See Chapter 4.

³² See RICS, Service charges in commercial property (2nd edition), Guidance Note GN 24/2011 (London: RICS, 2011).

³³ *Ibid* at 15.

of control, the landlord's discretion may be qualified. For instance, the landlord may only be allowed to charge for additional services insofar as they are incurred in the interests of "good estate management". For example, in *Boots UK Ltd v Trafford Centre Ltd*, the landlord's power to pay for promotional activities out of the service charge was limited to "providing other services in each case in the interests of good estate management of a high class shopping centre."³⁴

Plantation Wharf Management Company v Jackson is one of the few cases where the meaning of "good estate management" is discussed explicitly in the context of a service charge.³⁵ Judge Mole QC held that a general service charge with such a qualification did cover the legal costs incurred in recovering service charges from tenants who were unwilling to pay.³⁶ The judge's reasoning was pragmatic, drawing attention to the fact that in the absence of effective enforcement of service charge obligations, the estate could not be managed effectively as a whole owing to free rider problems.

In the case of service charge provisions, good estate management is used to limit the discretion of the landlord. Tenants may also seek to use good estate management covenants to impose positive obligations on landlords. In some leases, typically of premises forming part of property portfolios, terms may be included expressly to ensure the proper management of the development.³⁷ It appears that these covenants are not intended to grant extra powers to the landlord, but rather to limit the exercise of the powers which a landlord has been granted under a lease.

³⁴ Boots UK Limited v Trafford Centre Limited, supra note 28, para 10.

³⁵ Plantation Wharf Management Company Ltd v Jackson, supra note 28.

³⁶ *Ibid*, para 23.

³⁷ Shelton, supra note 29; Susan Bright, Landlord and tenant law in context (Oxford: Hart, 2007) at 306.

In Romulus Trading v Comet Properties, 38 a covenant "to administer the building and the common parts and supervise all requisite works thereto in accordance with principles of good estate management..." in a schedule to the lease linked to a service charge provision was held as not extending to restrict the landlord's letting policy. The plaintiff had let premises from the defendant which it used as a bank, bureau de change and for the renting out of safety deposit boxes. The defendant subsequently let a neighbouring premises to another tenant for a similar use, which the plaintiff claimed was in breach of the good estate management covenant.

Curiously, Garland J went further than merely limiting the effect of the good estate management covenant to the service charge, opining that even if the obligation had extended to cover letting policy, there would be no reasonable cause of action on the covenant, because the general law at the date of the signing of the lease would have permitted the landlord to let a nearby premises to a competitor of the tenant.³⁹ Presumably, had the lease contained a provision expressly prohibiting the landlord from letting a nearby unit to a competitor of the plaintiff, the plaintiff would have a good cause of action, notwithstanding the fact that but for such covenant the landlord would have been entitled to do so.⁴⁰ Perhaps Garland J is implying that had the parties intended the plaintiffs to benefit from exclusivity, they would have entered into an express exclusivity agreement. However, this is not set out clearly in the judgment. If a good estate management covenant is to mean anything, it must restrict a landlord's freedom of action in some respect. Clearly the parties can grant exclusivity to a tenant, so if the good estate management obligation did apply to the landlord's letting policy,

³⁸ *Romulus Trading Co Ltd v Comet Properties Ltd, supra* note 28. ³⁹ *Ibid* at 72.

⁴⁰ E.g. See the exclusivity covenant in *Oceanic Village v Shirayma Shokussan*, [2001] L & TR 35.

surely the question ought to have been whether it was consistent with good estate management to let a nearby unit to a competitor of the tenant.⁴¹

This decision appears to have been justified on the basis of the first reason given by Garland J: That the good estate management obligation was contained in a schedule relating specifically to service charges and the landlord's duties in maintaining the premises, and ought not to have been construed as extending to letting policy. Even had the covenant extended to letting policy, it is not manifestly clear that letting to a competitor of a tenant is bad estate management. However, to the extent that the *dicta* of Garland J purports to provide authority for the proposition that a good estate management covenant will never preclude a landlord from letting a property to a competitor of a tenant, it may not be followed by future courts.

In *Capita Trust v Chatam Maritime*,⁴² the owner of a shopping centre (Capita) had let the whole centre to a company (Chatam) which was to operate it. The head lease contained a covenant requiring Chatam to manage the centre "in accordance with the principles of good estate management". Chatham sought to use negotiations relating to the proposed installation of an anchor tenant to secure a payment from Capita, in return for giving up its break clause. This threatened to derail the arrival of the anchor tenant, which could have jeopardised the future operation of the centre. Pumfrey J accepted that failing to enter into a lease with the willing proposed anchor tenant would be in breach of the good estate management obligation. ⁴³ Considering the suggestion that the covenant was so broad as to be unenforceable by specific performance, Pumfrey J held that, even though the breadth of the covenant might prevent the ongoing enforcement of the obligations under it, the court may still direct the carrying out of a single identifiable act, the non-performance of which would

⁴¹ On which question the courts have given landlords a significant degree of freedom. See: *Chelsfield MH Investments Ltd v British Gas Plc*, (1995) 70 P & CR D31; *Moss Bros Group plc v CSC Properties Ltd*, [1999] EGCS 47.

⁴² Capita Trust v Chatam Maritime, supra note 28.

⁴³ *Ibid*, para 16.

be in breach of the covenant, and which could have drastic implications for the covenantee.⁴⁴ Thus, Chatam was ordered to enter into a lease with the proposed anchor tenant.

In *Irish Life Assurance plc v Quinn*,⁴⁵ the defendant guarantor of a tenant sought to rely on a breach by the landlord of its obligations under a good estate management covenant, to set off a claim for unpaid rent and service charges. The landlord company was alleged to have been in breach of its obligations under the covenant, due to its failure to replace an anchor tenant that had departed the shopping centre, and its failure to maintain properly, the common areas of the shopping centre. It was claimed that this mismanagement had led to a drop in foot fall in the shopping centre. Dunne J rejected the defendant's claim on grounds relating to the late stage at which the issue was raised and the failure of the defendant to set out his claim in detail. The fact that the landlord's management failures had not been raised earlier may suggest that the obligation was not seen by the tenant as having teeth. It would be interesting to see how a court might approach a case such as this in light of *Capita Trust*.

The uncertainty surrounding the term "good estate management" may explain the relative paucity of cases examining such covenants, and the tendency of judges to rely on alternative grounds for their decisions where possible. Guidance issued by the RICS in respect of property management agreements now discourages use of the term in favour of more specific obligations. From a commercial perspective, enhanced cooperation and incentives may be a more appropriate way than contractual stipulations, to ensure effective long-run management by landlords. In the relative paucity of cases examining such covenants, and the tendency of judges to rely on alternative grounds for their decisions where possible. Guidance issued by the RICS in respect of property management agreements now discourages use of the term in favour of more specific obligations.

⁴⁴ *Ibid*, paras 27–29.

⁴⁵ Irish Life Assurance PLC v Quinn, supra note 28.

⁴⁶ RICS, *Commercial property management in England and Wales 2nd Edition*, Guidance Note GN 89/2011 (London: RICS, 2011) Appendix 2.

⁴⁷ William C Wheaton, "Percentage Rent in Retail Leasing: The Alignment of Landlord–Tenant Interests" (2000) 28:2 Real Estate Economics 185; Howard, *supra* note 10.

6.2.2 Non-derogation from grant

In its simplest form, the rule against derogation from grant prohibits the maker of a grant from doing anything to deprive the grantee of the benefit for which purpose the grant was made. 48 In other words, "a grantor having given a thing with one hand is not to take away the means of enjoying it with the other." In the context of landlord and tenant, it will be particularly relevant to the landlord's conduct in using any neighbouring property retained by the landlord. Thus, a tenant deriving title under the landlord of a neighbouring patch of ground let for use as an explosives storage facility was prohibited from constructing buildings nearby that would jeopardise the earlier tenant's explosives licence. 50

Nicholls LJ set out how a derogation from grant might be identified:⁵¹

[It] involves identifying what obligations, if any, on the part of the grantor can fairly be regarded as necessarily implicit, having regard to the particular purpose of the transaction when considered in the light of the circumstances subsisting at the time the transaction was entered into.

These circumstances include express terms⁵² and the surrounding circumstances known to the parties.⁵³ There is a significant degree of overlap between non-derogation from grant, quiet enjoyment and nuisance,⁵⁴ but nuisance claims against landlords based on the conduct of other tenants may be unlikely to succeed in the absence of a derogation from grant.⁵⁵

There are a number of ways in which rule against derogation from grant may affect a landlord in the management of a commercial portfolio. As discussed in chapter 4, the principle may

⁴⁸ Browne v Flower, [1911] 1 Ch 219 at 226; See: DW Elliott, "Non-derogation from grant" (1964) 80 LQR 244; Joanna Sykes, "Taken for granted" (2009) 159:(7350/51) NLJ 29; John McGhee, *Non-derogation from grant* (Keble College, Oxford: Property Litigation Association, 2008).

⁴⁹ Birmingham Dudley & District Banking Co v Ross, (1888) 38 Ch D 295 at 313, Bowen LJ.

⁵⁰ *Harmer v Jumbil*, [1921] 1 Ch 200.

⁵¹ Johnston & Sons Ltd v Holland, [1988] 1 EGLR 264 at 268.

⁵² Petra Investments Limited v Jeffrey Rogers plc, supra note 28.

⁵³ Chartered Trust plc v Davies, [1997] 2 EGLR 83 (CA).

Elliott, *supra* note 48; Ian Loveland, "Fixing landlords with liability for the anti-social behaviour of their tenants: Stretching the orthodox position: Part 1" (2005) Journal of Planning and Environmental Law 273.
 Chartered Trust plc v Davies, supra note 53; Susan Bright, "Liability for the Bad Behaviour of Others" (2001)

^{21:2} Oxford Journal of Legal Studies 311.

restrict how the landlord may deal with the tenant individually.⁵⁶ It was held in *Rayburn v Wolf* that a landlord of an apartment block was not permitted to have a policy of never granting permission to sublet, because the leases anticipated permission being granted in some situations.⁵⁷ Neuberger J's *dicta* in *Moss v CSC* referred to the principle explicitly.⁵⁸ For present purposes, it is a different application of the principle that is relevant. Where the landlord grants a lease to one tenant for a particular purpose, that tenant may seek to rely on the principle to challenge how the landlord uses neighbouring property (or permits it to be used).

An early case involving a retail development was that of *Port v Griffith*.⁵⁹ The plaintiff let a unit from the landlord for use as a shop selling wool and general trimmings. Subsequently, the landlord let a neighbouring unit to a different tenant for a very similar use. The first tenant claimed that the second lease was in derogation of the grant made in the first lease, as the competition from a neighbouring tenant made the unit less suitable for its intended use. Luxmoore J in the High Court rejected the claim, holding that it could not have been within the reasonable contemplation of the parties that the restrictive user covenant would prevent the landlord from letting nearby property to a competitor of the tenant. He noted that competition from a neighbouring tenant did not necessarily make the tenant's premises less fit for carrying out the tenant's business, but merely had as an incidental effect, the reduction of profitability.⁶⁰ The *Port v Griffith* principle was upheld in *Romulus Trading v Comet Properties*, a more recent case involving similar facts.⁶¹

⁵⁶ See 4.1.1.

⁵⁷ Rayburn v Wolf, (1985) P & CR 463.

⁵⁸ Moss Bros Group plc v CSC Properties Ltd, supra note 41.

⁵⁹ *Port v Griffith*, [1938] 1 All ER 295.

⁶⁰ See also *O'Cedar Ltd v Slough Trading Co Ltd*, [1927] All ER Rep 446, where the conduct of another tenant claiming under the landlord caused the fire insurance premiums payable by the tenant to increase. This was held not to amount to a derogation from grant as it did not make the premises less suitable for their intended use, instead merely making it more expensive.

⁶¹ Romulus Trading Co Ltd v Comet Properties Ltd, supra note 28 (See text n28 for facts).

The position may, however, be different in the presence of special circumstances. In *Oceanic* Village v Shirayma Shokussan, the landlord had let premises to the claimant tenant for use as the London Aquarium gift shop.⁶² The lease prevented the landlord from permitting the operation of any other gift shop within the building, but the landlord later proposed building a kiosk in front of the building for use as a gift shop. While the proposal was held not to be in breach of the express covenant, Nicholas Warren QC, sitting as a deputy High Court Judge, held that it would be in derogation of grant. The special characteristics of the arrangement between the parties, such as the restrictions on how the shop was to be run, demonstrated that the intention of the parties was for the shop to be "the" aquarium gift shop, and that this particular purpose included exclusivity as regards the sale of aquarium-related products.

In the absence of special circumstances, it appears that a landlord will not be precluded from letting property to a competitor of a tenant by the duty not to derogate from grant. It is interesting to contrast this position with the law relating to the reasonableness of withholding a landlord's consent.⁶³ While the *Port v Griffith* principle holds that it is not generally expected that a landlord will refrain from letting property to competitors of his tenants, he may be reasonable in withholding consent in order to protect a tenant's business, ⁶⁴ or even his own business⁶⁵ from competition. This demonstrates the broad discretion allowed by the courts to landlords in the management of commercial property portfolios.

What is not settled, however, is how the rule might apply in the context of a shopping centre, or where there is a known tenant mix, in the context of management or lettings policy at the time the lease is entered into. In Chartered Trust v Davies, the defendant tenant had taken a lease of a unit in a retail development marketed as a premium shopping mall, stated to have a

⁶² Oceanic Village v Shirayma Shokussan, supra note 40.

 ⁶³ See Chapter 4.
 64 Chelsfield MH Investments Ltd v British Gas Plc, supra note 41.

⁶⁵ Whiteminster Estates v Hodges Menswear, (1974) 232 EG 715 (Ch).

"high class retail" lettings policy.⁶⁶ After a difficult first few years of operation, the landlord accepted a pawnbroker as a replacement tenant in one of the mall's units. The pawnbroker's advertising and loitering customers had caused difficulties for the defendant. The Court of Appeal held that because, *inter alia*, the landlord had retained some control over common areas of the mall, and could charge a service charge, there was an expectation that the landlord would exercise that power to protect the tenants. Henry LJ set out:⁶⁷

From the lease, one gets a clear recognition by the landlords that the enjoyment of the benefit that the tenant took under the lease here depended, in part, on the actions of the landlords in letting and controlling the remaining units in, and the common parts of, this small retail development.

The landlord was therefore found to be in derogation of grant in failing to control the exercise of the pawnbroker's business, which created a nuisance for the defendant (although not in letting to the pawnbroker *per se*).

A similar situation had occurred in *Hilton v James Smith & Sons (Norwood) Ltd.* ⁶⁸ In that case, other tenants of the landlord were blocking a passageway owned by the landlord, which the plaintiff had a right to use. The Court of Appeal relied on the law of nuisance, holding that by its failure to prevent the nuisance in the common area still controlled by it, the landlord had continued the nuisance.

In *Platt and Others v London Underground*,⁶⁹ the defendant landlord had let to the claimant a kiosk at an exit from its train station for use as a shop. The tenant claimed that the landlord was in derogation of grant in closing the exit for most of the day, thereby depriving the kiosk of customers. On the basis of correspondence conducted in connection with the negotiation of the lease, and the common knowledge that the success of the kiosk would be dependant on

⁶⁶ Chartered Trust plc v Davies, supra note 53.

⁶⁷ *Ibid* at 86.

⁶⁸ Hilton v James Smith & Sons (Norwood) Ltd, [1979] 2 EGLR 44.

⁶⁹ Platt and others v London Underground Ltd, [2001] 2 EGLR 121.

custom from passengers exiting the station, Neuberger J held that the parties contemplated that the exit would remain open for most of the time the station operated. The landlord was therefore in derogation of grant in failing to keep the exit open.

In *Petra Investments v Jeffry Rogers*, the issue of the obligation of a landlord to consider the interests of existing tenants when seeking to adapt a centre was addressed. The defendant tenant had taken out a lease in a new shopping centre, which was intended to attract "locally resident middle-aged women". After trading difficulties, a new landlord made changes to the centre, and introduced new tenants, including a Virgin Megastore, which attracted a substantially different group of customers to those originally targeted. The defendant claimed that the landlord was in derogation from grant in effecting a fundamental change to the centre through alterations of the physical structure, change to the tenant mix, and advertising focus. Hart J expanded upon the Court of Appeal's judgment in *Chartered Trust*, holding that in the context of the centre, the landlord had a duty to consider the expectations of existing tenants. This would mean not doing anything "reasonably foreseeable as rendering a particular lease materially less fit for the commercial purpose for which it had been granted."

Although the existence of a landlord with some powers to control a centre will not necessarily imply a duty to exercise those powers for the benefits of tenants, *Chartered Trust* and *Petra Investments* demonstrate that the courts will be attentive to the particular characteristics of retail developments in determining the scope of a grant. The obligation not to derogate from grant may give tenants some protection from the failure of an apathetic landlord to exercise control over the common areas of a development, and from manifestly harmful change to the character of a development. On the other hand, the courts have shown sensitivity to the need for retail developments to change over time in response to market shifts. As demonstrated in

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⁷¹ *Ibid* at 128

⁷⁰ Petra Investments Limited v Jeffrey Rogers plc, supra note 28.

Petra Investments, any right of a tenant's will only be to prevent the landlord from acting in a manner likely to cause harm to their business, not to preserve the state of the development at the point in time the lease was granted.

6.2.3 Remedies

The remedies available to tenants, either in relation to a breach by a landlord of a specific covenant or a derogation from grant, may be limited. The most valuable remedy for a tenant in some circumstances may be specific performance or an injunction, but there are a number of difficulties in seeking either. In particular, where a tenant seeks specific performance, he may encounter problems if the obligation is of an ongoing nature or would be difficult for the court to police.⁷² The court will also look to the hardship that might be suffered by both parties.⁷³

In the extreme, a tenant may seek to repudiate a lease because of the landlord's conduct. It is certainly possible in principle to repudiate a lease on the grounds of a landlord's derogation from grant, ⁷⁴ or breach of covenant, ⁷⁵ however this may not be available in many cases. ⁷⁶

6.3 Competition law and lettings policy

After the repeal of the Land Agreements Exemption Order, the ability of a landlord to set a lettings policy may also now be constrained by the Chapter I prohibition contained in the Competition Act 1998 (the 1998 Act).⁷⁷ The Chapter I prohibition outlaws agreements

⁷² Co-operative Insurance v Argyll Stores (Holdings) Ltd, [1998] AC 1 (HL). See 3.3.5, above. See the cases

listed in *Hanbury & Martin Modern equity*, 19th ed ed (London: Sweet & Maxwell / Thomson Reuters, 2012) at 773.

⁷³ *Posner v Scott-Lewis*, [1987] Ch 25 at 36.

⁷⁴ Chartered Trust plc v Davies, supra note 53. In that case the landlord's breach was not sufficient to justify repudiation.

⁷⁵ Nynehead Developments Ltd v RH Fibreboard Containers Ltd, [1999] 02 EG 139.

⁷⁶ Ibid; following Hongkong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd (The Hongkong Fir), [1962] 2 QB 26.

⁷⁷ See 5.2.3, above. Competition law is governed at an EU level where there is some cross border element, but this is unlikely to be the case for land agreements, due to their inherently localised nature.

between undertakings⁷⁸ which have as their object or effect the prevention, restriction or distortion of competition within the UK or any part of the UK.⁷⁹

The Office of Fair Trading (OFT) has issued guidance on the effect of competition law on land agreements. 80 Agreements which may be affected include exclusive user covenants, as well as groupings of restrictive covenants which may combine to affect competition.⁸¹ Such agreements may act as barriers to entry, protecting existing market participants from competition. The Irish Competition Authority's guidance on restrictive covenants in shopping centres is also instructive, as the domestic competition regime in both jurisdictions is modelled on EU competition law.⁸²

Land agreements continue to be excluded from the scope of competition law to the extent that they are planning obligations under sections 106 and 299A of the Town and Country Planning Act 1990. 83 Additionally, agreements which potentially restrict competition in some way may not be affected by the 1998 Act if their impact is relatively small, or if they can be justified as necessary or beneficial for consumers under section 9 of the Competition Act 1998.

6.3.1 What agreements may be affected?

First and foremost, landlords should be aware that they may not seek to use land agreements to prevent, restrict or distort competition. Where such is found to be the object of an agreement, it will automatically fall foul of the Chapter I prohibition. This has nominally

⁷⁸ "Undertakings" are not defined in the 1998 Act but the European Court of Justice has defined it as "entity engaged in an economic activity" - Höfner and Elser v Macrotron, [1991] ECR I-1979 C-41/90. "Offering goods and services on a given market" is the defining characteristic of economic activity - FENIN v Commission, 2006 [2006] ECR I-6295 C-205/03. Therefore commercial landlords and tenants are both invariably undertakings for the purpose of competition law, and commercial leases will therefore be agreements between undertakings.

⁷⁹ Competition Act 1998, s 2.

⁸⁰ Office of Fair Trading, Land Agreements: The application of competition law following the revocation of the Land Agreements Exclusion Order, OFT1280a (Office of Fair Trading, 2011).

⁸¹ *Ibid*; Competition Authority, *Notice in respect of shopping centre leases* (Dublin: Competition Authority, 1993).

⁸² Competition Authority, *supra* note 81.

⁸³ *Competition Act 1998*, sec 3(1)(c); sch 3.

been the law in relation to land agreements since the coming in to force of the 1998 Act, but it has been noted that some undertakings operated under the impression that land agreements did not have to comply.⁸⁴

De minimis exception

Whether a land agreement will be considered to have an appreciable effect on competition will depend on a number of factors. First, there is an exemption for agreements between small undertakings (the *de minimis* exception). This is set out in the European Commission's notice on agreements of minor importance, ⁸⁵ which applies equally to EU law and Chapter I of the 1998 Act. ⁸⁶ As leases are most likely to be "vertical" agreements, only agreements between undertakings with a combined market share of 15% or more in a "relevant market" will be considered by the OFT.

There are some circumstances where land agreements entered into by portfolio landlords may be horizontal. The type of agreement considered in *Slough Estates v Welwyn Hatfield District Council*, 87 where two competitor centres sought to coordinate tenant mix, is one example. In that case, it was the competitor centres which entered into an agreement. Another might be in the case of a letting scheme, as in *Williams v Kiley*. 88 In such a case, it is the competitor tenants who agree covenants with a landlord for the benefit of each other.

The market is defined both in terms of the product and geographical area served. These are examined based on both supply- and demand-side substitutability.⁸⁹ This is assessed by

⁸⁴ Competition Commission, *The supply of groceries in the UK market investigation* (London: Competition Commission, 2008).

⁸⁵ Commission notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1) of the Treaty establishing the European Community, OJ C 368/13 22.12.2001.

⁸⁶ Competition Act 1998, supra note 79, sec 60.

⁸⁷ Slough Estates Plc v Welwyn Hatfield District Council, [1996] 2 EGLR 219.

⁸⁸ Williams and another v Kiley (trading as CK Supermarkets Ltd), [2002] All ER (D) 301 (Nov).

⁸⁹ Office of Fair Trading, Market definition: Understanding competition law (2004).

examining how consumers, competitors and potential competitors of a firm might react to a small but significant non-transient increase in price.⁹⁰

Product scope is defined by the products that consumers might switch to in the case of an increase in price of the product in question. Who is a direct competitor is, therefore, defined by consumer (demand-side) substitutability. Whether a coffee shop, for example, will be in the same market as a restaurant, will depend on whether some consumers would react to an increase in price at the coffee shop by switching custom to the restaurant.

Geographic scope is determined by the distance that consumers will travel for an alternative in response to an increase in price. The further that customers will be willing to travel for a cheaper alternative, the larger the geographic scope of a product. The size of geographical markets varies hugely between different product markets. The market for commercial airliners is global, but the market for freshly brewed coffee might only extend to the end of a street. The definition of the geographic scope of a relevant market will be crucial for the assessment of land agreements under competition law. Most land agreements will have limited geographic effect, and so in many cases, it is only likely to be relevant markets with very narrow geographic scope which will not allow land agreements to avail of the *de minimis* exemption. Relevant markets in this category will include those such as the market for freshly brewed coffee, as consumers are not likely to travel very far in search of a substitute. The OFT has used the catchment area of a retail store as an approximation of geographical scope.⁹¹

An undertaking may also be subject to competitive constraint from producers outside its industry. If a producer were to increase prices above a competitive level, others may enter the

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⁹⁰ *Ibid*; European Commission, *Commission Notice on the definition of relevant market for the purposes of Community competition law*, Official Journal C 372, 09/12/1997 P. 0005 - 0013;.

⁹¹ Office of Fair Trading, *supra* note 80, paras 3.19–3.23.

market in search of supernormal profits. Potential competitors who could easily enter into competition with an undertaking will also, therefore, be included when defining the market. The degree of any barriers to entry will be significant in assessing potential competition.

The OFT has indicated that it would be relatively sympathetic towards tenant mix policies, but landlords would be advised to ensure that theirs do not amount to a series of parallel agreements which have the cumulative effect of restricting competition. The Irish Competition Authority, which encountered the problem some time ago, suggested that the tenant mix strategies commonly employed in shopping centres were generally procompetitive rather than anticompetitive and so were unlikely to infringe the equivalent Irish provision. 93

The Section 9 exclusion and land agreements

Land agreements which appear to fall foul of section 2 of the 1998 Act may still be valid where they meet the criteria set out in section 9. It is up to the parties to demonstrate that an agreement meets these criteria. Section 9 requires that:⁹⁴

- 1. The agreement leads to productive or technological gains
- 2. The agreement is not more restrictive than it needs to be in order to realise those gains
- 3. Consumers get a fair share of the gains achieved; and
- 4. The agreement does not allow the parties to it to eliminate competition

In relation to the first criterion, a distinction must be drawn between agreements which seek to benefit the parties through advance in production, distribution or technology and those

⁹² Office of Fair Trading, *supra* note 80.

⁹³ Competition Authority, *supra* note 81, para 10.

⁹⁴ The order of the criteria in the Act is different from that given here. This order is suggested by the OFT for use when analysing agreements: Office of Fair Trading, *Agreements and concerted practices: Understanding competition Law* (2004) at 24–28.

which merely seek to shuffle the market into a more favourable shape for the parties to the agreement. It is only agreements which are likely to create an aggregate benefit which may enjoy the benefit of this exemption. Agreements which allow for the creation of positive externalities, for the opening of new retail units or the maintaining of a tenant mix policy in some circumstances, for example, may come under this.⁹⁵

Landlords should give some thought to the way that agreements are structured in order to meet the second criterion. A new anchor tenant might need a period of exclusivity in order to make its investment economically viable but these terms should not be any more generous than would be required to meet this bare viability threshold. For example, it should not give exclusivity in a broader range of goods or for a longer period than would be necessary to secure the benefits.⁹⁶

The benefit to consumers required under the third criterion may be in the form of increased choice, a better layout of retail outlets or lower prices, but the benefit must exceed the cost to them from the harm caused to competition by the restriction. This will have to be assessed on a case-by-case basis.

Finally, potential competition must be considered as well as existing competition for the purposes of the fourth criterion. Exclusivity agreements and networks of user covenants have the potential to create substantial barriers to entry. The same could apply to the type of "land banking" agreements entered into by supermarkets, as identified by the Competition Commission, which have the potential to lock out competitors who would need very specific types of property to enter the market.⁹⁷

⁹⁵ Office of Fair Trading, *supra* note 80, para 5.7.

⁹⁶ *Ibid*, para 5.13

⁹⁷ Competition Commission, *supra* note 84; Office of Fair Trading, *supra* note 80, para 5.23.

6.3.2 Enforcement

Breaches of the Chapter I prohibition may be addressed by the OFT, or through private litigation.

Enforcement by the OFT

The OFT may investigate a breach of the 1998 Act of its own accord, or as a result of a complaint being made to it, once it has "reasonable grounds" for suspecting that there has been a breach of competition law. 98 It may require the production of documents or the giving of information by anyone thought to have relevant information, 99 and it has a range of other search powers. 100

The OFT may accept commitments from a party under investigation while an investigation is underway. 101 If it does so, it shall desist with its investigation to the extent that its concerns are allayed by the commitments. 102 These commitments are enforceable in the High Court. 103 Where the OFT finds that an agreement breaches the Chapter I prohibition, it may direct the parties to the agreement to alter or terminate it. 104 Where the parties fail to comply with the OFT's direction, the OFT may apply to the High Court enforce compliance.

Private enforcement

The OFT is unlikely to take action in the case of smaller alleged breaches, ¹⁰⁵ which, together with the limited geographic scope of land agreements means investigations relating to tenant mix are likely to be exceedingly rare. It may, however, be open for individuals disadvantaged by a particular agreement to challenge it on grounds of its breach of competition law. Private

⁹⁸ Competition Act 1998, s 25.

⁹⁹ Competition Act 1998, s 26.

¹⁰⁰ Competition Act 1998, ss 27–29.

¹⁰¹ Competition Act 1998, s 31A.

¹⁰² Competition Act 1998, s 31B.

¹⁰³ Competition Act 1998, s 31E.

¹⁰⁴ Competition Act 1998, s32.

¹⁰⁵ Office of Fair Trading, *Prioritisation Principles*, OFT 953 (Office of Fair Trading, 2008).

claims may be pursued in the national courts under Article 101 TFEU, ¹⁰⁶ and damages may be awarded by UK courts for loss sustained by one party as a result of the other's anticompetitive behaviour. ¹⁰⁷ However, where the impugned agreement relates to land, it is more likely that an action under Chapter I of the 1998 Act will be appropriate, as no cross border element is likely to be present.

The availability of damages is not specifically provided for in the 1998 Act, but breaches of the 1998 Act may be litigated as a breach of statutory duty. Normally this tort does not allow damages to be awarded for types of loss which the statute was not intended to prevent, and the objectives of competition law will often not coincide with the loss suffered as a result of its breach. The EU legal principle of effectiveness may, however, guarantee a right to damages for breach of EU competition law, and such damages should be available under the UK regime. The EU legal principle of effectiveness may are should be available under

For many litigants, however, the goal in pursuing an action in competition law may be to have an anticompetitive agreement declared void. Any agreement – or any part thereof – which is in breach of section 2 of the 1998 Act will be void and unenforceable. Competition law may, therefore, be used to challenge a user or exclusivity covenant in a lease, either proactively or in defence to a case brought by a landlord for breach of covenant. This

¹⁰⁶ Reg 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, Article 6.

¹⁰⁷ Courage v Crehan, [2001] ECR I-6297 C-453/99.

¹⁰⁸ E.g. Chester City Council & Anor v Arriva Plc & Ors, [2007] EWHC 1373 (Ch).

¹⁰⁹ Crehan v Inntrepreneur Pub Co, [2004] EWCA 637.

Competition Act 1998, s 60; See Richard Whish, Competition law, 7th ed ed (Oxford: Oxford University Press, 2012); David McFadden, The private enforcement of competition law in Ireland (Oxford: Hart, 2013). Competition Act 1998, sec 2.

¹¹² As suggested by Buxton LJ in Williams and another v Kiley (trading as CK Supermarkets Ltd), supra note 88.

might also be pursued in order to challenge the validity of an absolute user covenant. This could be of particular concern to landlords seeking to maintain a tenant mix policy.

It must be examined in light of contract law in individual cases, whether the void provisions of an agreement are severable or whether the whole agreement falls with them. They will be severable from the lease and the lease will stand where the promise is of a kind which may be severed, where it can be severed without redrafting the agreement between the parties and where severance does not alter the nature of the agreement. The kinds of covenant which may be severed in the event of illegality have not been precisely defined, although it appears that covenants in restraint of trade fall under this category. In *Chemidus Wavin Ltd v Société pour la Transformation*, the Court of Appeal ruled that a minimum royalty clause in a patent licence agreement was severable from other conditions that were in breach of EU competition law.

Where the OFT has previously examined an agreement, the High Court will be bound by the decision, once the time to appeal has elapsed. This may facilitate action by a party that has been harmed by an anticompetitive agreement. However, given the complexity of the law in this area, and the difficulty of proving the relevant facts, private enforcement of competition law has not had great success in the UK in cases where the OFT has not made a decision. The Government has expressed a desire for private enforcement to play a greater role in

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¹¹³ The Irish Competition Authority considered it relevant to its finding that user covenants were unlikely to breach competition law that all user covenants are fully qualified under Irish law - Competition Authority, *supra* note 81, para 14. Perhaps the withholding of consent by a landlord could be challenged if it was done to preserve a harmful monopoly. See Chapter 4.

¹¹⁴ See: Inntrepreneur Estates Ltd v Mason, [1993] 2 EGLR 189; Inntrepreneur Estates (GL) Ltd v Boyes, [1993] 2 EGLR 112 (CA).; Edwin Peel, Treitel: The Law of Contract, 13th Revised edition ed (Sweet & Maxwell, 2011) at 531–565...

¹¹⁵ M J Trebilcock, *The common law of restraint of trade: a legal and economic analysis* (Toronto: London: Carswell Sweet & Maxwell, 1986) at 242–245.

¹¹⁶ Chemidus Wavin Ltd v Société pour la Transformation, [1978] 3 CMLR 514.

Competition Act 1998, s 58A; McFadden, supra note 110.

¹¹⁸ See: Whish, *supra* note 110 at 316.

competition law, in harmony with the institutional enforcement regime. Proposals for reform are currently being discussed. Private enforcement of competition law may in future become a viable avenue of litigation for tenants faced with absolute user covenants and intransigent landlords.

6.4 Direct enforcement of covenants against neighbouring tenants

In some cases, a tenant may be able to directly enforce a covenant in the lease of another tenant. Such circumstances will provide a tenant with a much greater degree of security than were he reliant on the landlord to enforce such covenants. Direct enforcement by a tenant may be necessary because neither the landlord, nor any other central actor, may be in a position of power to control and guide the ongoing management and evolution of a development. In such cases, the initial negotiation stage will be very important as it will govern how the development is run, as there may be less scope for variation in the terms of a development's operation where covenants are enforced by tenants rather than a landlord.

Normally, covenants are only enforceable by those with privity of contract or estate with the covenantor. Tenants may, however be able to avail of an exception to this rule to enforce a covenant against a neighbouring tenant, such as the case of a letting scheme, or a statutory exception under section 56 of the Law of Property Act 1925, or the Contracts (Rights of Third Parties) Act 1999.

6.4.1 Letting Schemes

Development schemes are an exception to the normal enforceability rules relating to covenants. In the context of leasehold developments they are known as letting schemes and allow any tenant who is a part of the scheme to enforce restrictive covenants against any other

¹¹⁹ Department for Business Innovation and Skills, *Growth, competition and the competition regime - Government response to consultation* (2012) at 59.

¹²⁰ Department for Business Innovation and Skills, *Private actions in competition Law: A consultation on options for reform* (2012). See also: Office of Fair Trading, *Private actions in competition Law: A consultation on options for reform - The OFT's response to the Government's consultation* (2012).

tenant in the scheme, regardless of when either party joined the scheme. They have been described as a "local law", "calculated and intended to add to the security of the lessees, and consequently to increase the price of the [relevant property]." In the context of retail developments, they may be particularly useful in assuring a tenant of the character of a new development, where other tenants' user covenants are enforceable by the tenant.

Lord MacNaghten expressly tied the justification for such schemes to enforcing promises made to promote interests shared by the parties:¹²³

This restriction was obviously for the benefit of all the lessees on the estate; they all had a common interest in maintaining the restriction. This community of interest necessarily, I think, requires and imports reciprocity of obligation.

Traditionally, for a scheme of development to arise, the conditions laid out in *Eliston v Reacher* had to apply.¹²⁴ These were, (i) that both the party trying to enforce the covenant and the party subject to it had to derive their title from a common vendor, (ii) that this common vendor had laid out a defined area of land in lots for sale subject to similar restrictions which were consistent only with the existence of a building scheme and for the benefit of all the lots forming part of the scheme, and (iii) the original purchasers from the common vendor understood that the restrictions were for the benefit of the other lots forming part of the scheme.¹²⁵

These conditions have been subtly narrowed down over the years and Harpum et al have identified "two prerequisites"; reciprocity, and the existence of a defined area which the scheme covers, now necessary for the creation of a scheme of development. The focus is

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¹²¹ Reid v Bickerstaff, [1909] 2 Ch 305 at 319 (Cozens-Hardy MR).

¹²² Spicer v Martin, [1886-90] All ER Rep 461 at 467.

¹²³ *Ibid*

¹²⁴ Elliston v Reacher, [1908] 2 Ch 374 (Parker J), Approved by the Court of Appeal in [1908] 2 Ch 665 (CoA).

¹²⁵ Elliston v Reacher, supra note 124 at 384.

¹²⁶ Charles Harpum, Stuart Bridge & Martin Dixon, Megarry & Wade: The Law of Real Property, 8th ed (Sweet & Maxwell, 2012) at 1416–1419.

on the intention of the parties, in particular the intention that: the restrictions be for the benefit of the development as a whole, and that the covenants could be enforced by any of the tenants. A letting scheme will not necessarily arise whenever each lease in a development contains similar restrictive covenants, if intention cannot be shown to create the restrictions for the benefit of other tenants who would have power to enforce them.¹²⁷

In *Wiliams v Kiley*,¹²⁸ a local authority had let out a parade of shops in Swansea, each of which was bound by a positive covenant to carry on a particular trade, which trade was defined to exclude a list of trades corresponding with the permitted users of other shops in the development, coupled with a restrictive covenant not to use the premises for anything else. Additionally, there was provision for the landlord's agent to resolve disputes between the tenants as to permitted user. The Court of Appeal emphasised the complementary nature of the permitted user covenants as well as the dispute resolution mechanism, which clearly envisioned a tenant seeking to rely on the user covenants to prevent another tenant from encroaching on its business, to find that there was an intention that the covenants be mutually enforceable by the tenants. Buxton LJ approved of the approach taken in the Canadian case of *Russo v Field*,¹²⁹ which required a clear intention on the part of the parties to the lease to create a letting scheme where its effect could be to foreclose competition.¹³⁰

As noted in the Law Commission's 1985 report on covenants restricting dispositions, alterations and change of user, the mandatory full qualification of user covenants may interfere with the successful operation of letting schemes.¹³¹ In *Andrews v Sohal*, the existence of a fully qualified user covenant was cited alongside other factors by Terence

¹²⁷ In Re Wembley Park Estate Co Ltd's Transfer, [1968] Ch 491.

¹²⁸ Williams and another v Kiley (trading as CK Supermarkets Ltd), supra note 88; see also: Gary Webber,

[&]quot;Restrictive User Covenants in Leases: Enforcement by Neighbouring Tenants" (2003) 7:2 L & T Review 29.

¹²⁹ Russo v Field, (1970) 12 DLR (3d) 665.

¹³⁰ Williams and another v Kiley (trading as CK Supermarkets Ltd), supra note 88, para 47.

¹³¹ Draft Landlord and Tenant Bill, Law Reform Commission, 2007, para 4.42. See also 5.2.2 above.

Cullen QC, sitting as a deputy High Court Judge, as tending to exclude the existence of a letting scheme.¹³² This can be contrasted with *Pearce v Maryon-Wilson*, where Luxmoore J held that the existence of a building scheme did not preclude a landlord from granting consent to a variation of the user clause of one or more properties in the scheme, if permitted by the lease.¹³³ Cozens-Hardy MR in *Elliston v Reacher* suggested that a power of the vendor to withdraw some property from the scheme should be considered in determining whether a scheme existed, but would not be fatal to the existence of one.¹³⁴ The ability of a landlord to consent to a change in the scheme may, nonetheless, make the scheme less valuable to a tenant, as it reduces the security provided by the scheme.

Although letting schemes appear to have been prevalent in retail developments in Canada, ¹³⁵ their use in the commercial leasehold context in England and Wales seems to be rare. ¹³⁶ This may be because the active management role that most commercial landlords intend to take would place them as the ideal enforcer of leasehold covenants, because a wider range of enforcement options is available to a landlord, or because of a number of drawbacks that development schemes may have for the management of commercial developments.

Difficulties with letting schemes

From a tenant's point of view, the major advantage of a letting scheme is that they may directly enforce restrictive covenants (such as user covenants) against neighbouring tenants and may therefore preserve any advantages a tenant has in a retail development. Their ability to protect tenants from the changeable designs of a landlord could make letting schemes quite valuable to tenants. In a set of facts like those present in *Petra Investments* or *Capita Trust*, a letting scheme might protect a tenant from wholesale change to the character of a

¹³² Andrews v Sohal, [1989] EGCS 12.

¹³³ Pearce v Maryon-Wilson, [1935] Ch 188.

¹³⁴ Elliston v Reacher, supra note 124 at 674.

¹³⁵ Scharf v Mac's Milk Ltd, (1965) 51 DLR (2d) 565; Russo v Field, supra note 129; Spike v Rocca Group, (1979) 107 DLR (3d) 62; Salmon Arm Pharmacy Ltd v RP Johnson Construction Ltd, [1994] 9 WWR 214; Liquor Depot at Riverbend Square Ltd v Time for Wine Ltd, [1997] 8 WWR 656.

¹³⁶ Williams and another v Kiley (trading as CK Supermarkets Ltd), supra note 88; Webber, supra note 128.

development. The corollary of this is that letting schemes introduce for the landlord, a potentially dangerous rigidity in estate management policy.

Such rigidity will not only harm a landlord. Tenants may also find themselves constrained by covenants into lines of business which have been rendered obsolete or unprofitable by changing markets, without agreement from other tenants in the scheme. Because of a landlord's financial interest in the success of his tenants, a landlord may be more likely than a neighbouring tenant to waive overly restrictive covenants or provide special accommodations to help the tenant's business to adapt. Tenants do not enjoy protections from other tenants in a letting scheme similar to those relating to applications for consent to change of user. More importantly, in the long run, it may be very difficult to agree a redevelopment of a scheme which has become outdated, if the agreement of all tenants is required. A landlord not bound by a letting scheme would be in a far better position to reorganise a development which has become outdated.

Once the first property is let out, the letting scheme comes into existence and binds the whole area of the development, whether or not the landlord retains possession of the rest of it. 137 Thus, from very early on in the development, a landlord may be constrained, especially if the development is not a success.

An application may be brought under section 84 of the Law of Property Act 1925, but this option is only available for long leases where some of the term has already elapsed. 138 One effect of the Law Commission's 1985 proposal for the expansion of the section 84 regime would be to bring a greater level of flexibility into letting schemes.

 ¹³⁷ Brunner v Greenslade, [1971] Ch 993.
 138 See 3.2.4, above.

6.4.2 Statutory exceptions to privity

Section 56 of the Law of Property Act 1925 provides that a party may take the benefit of a covenant notwithstanding the fact that he was not a party to the deed granting it. As such, where the deed granting a lease bestows the benefit of a covenant on a neighbouring tenant (whether individually or as part of a defined class), that covenant will be enforceable by the neighbouring tenant as original covenantee and by his successors in title according to the usual rules of enforcement.

Tenants may also be able to enforce the covenants in other tenants' leases under the provisions of the Contracts (Rights of Third Parties) Act 1999. This will be available where the contract expressly permits the tenant to enforce the covenant, ¹⁴⁰ or where it purports to confer a benefit on the other tenant. 141 The Act may be excluded expressly or by implication in a lease. 142

6.4.3 Individual enforcement and the collective good

In either of the above cases, the tenant will be entitled to enforce covenants against neighbouring tenants. This may be detrimental to the success of a development as a whole. Howard's description of shopping centres as adversarial settings indicates that giving legal rights to individual tenants is unlikely to create mutual gain or to realise the benefits achievable as a result of grouping the tenants together. 143

Letting schemes and the 1999 Act create firm property rights, ¹⁴⁴ enabling tenants to protect their position within a development. As discussed in Chapter 2, the Coase theorem suggests that where property use rights are present, an optimal mix of uses will still be achieved unless

¹³⁹ There is some uncertainty about whether the covenant must benefit the third party or be expressed to be made with the third party: See Harpum et al, supra note 126 at 1374–1376. The provisions of the Contracts (Rights of Third Parties) Act 1999 appear to supersede any difficulty.

¹⁴⁰ Contracts (Rights of Third Parties) Act 1999, s 1(1)(a).

¹⁴¹ *Ibid*, s 1(1)(b).

¹⁴² *Ibid*, s 1(2).

¹⁴³ Howard, supra note 10 at 269.

¹⁴⁴ See *Contracts (Rights of Third Parties) Act 1999*, s 2: the original parties to a contract may be precluded from varying it without the consent of a third party who is entitled to enforce it where their reliance upon it has been notified to the parties.

transaction costs prevent agreement. 145 Given the complexities of letting schemes, and the number of competing interests that may be present among members of a letting scheme, were each tenant to have a veto over any change, transaction costs involved in obtaining permission from all tenants would be very high. It is, therefore, unrealistic to think that the parties to a letting scheme will be able to negotiate as efficient a mix of uses as a portfolio landlord could. Letting schemes are, therefore, unlikely to permit the same degree of dynamic flexibility as management by a single landlord.

6.5 Dispute resolution

It has been assumed thus far in this thesis that litigation is the default form of dispute resolution. The use of the courts in commercial disputes has a number of distinct advantages, such as perceived impartiality, the finality (subject to appeal) and enforceability of judgments, and the certainty provided by a large body of precedent. There are, however, also a number of significant drawbacks to court proceedings, such as their cost, the time it takes to bring a case to trial, and the fact that sensitive commercial information may make its way into the public domain through a court hearing. Additionally, in the context of an ongoing relationship, the adversarial nature of court proceedings can taint the relationship between the parties and hamper future cooperation. 147 It is in light of these factors that attention has turned to alternative dispute resolution (ADR).

Special court procedures

It should be noted that some of the problems traditionally associated with litigation may be mitigated by the provision of special court procedures. The use of lower courts for routine applications, ¹⁴⁸ or the provision of special procedures to speed up cases ¹⁴⁹ may help to reduce

¹⁴⁵ R H Coase, "The Problem of Social Cost" (1960) 3 JL & Econ 1. See 2.7.2.

¹⁴⁶ See 2.7.2, above.

¹⁴⁷ Barbara Yngvesson, "Re-examining continuing relations and the law" (1985) Wis L Rev 623 at 624.

¹⁴⁸ E.g. Landlord and Tenant Act, 1954, s 53.

¹⁴⁹ CPR Part 8: CPR 56.2: CPR PD 56.

costs and delay, but still force the parties into an adversarial competition and are limited in the available range of remedies.

6.5.1 Advantages of alternative dispute resolution

By its very nature, litigation is often inimical to a healthy ongoing relationship between the landlord and tenant. Even where the dispute arises because one party is trying to discontinue the relationship, there is always a risk that they will not prevail and the two parties will have to go on working together after the dispute is settled. This may prove to be particularly problematic where the nature of the relationship requires that the parties work closely together, as may more often be the case with retail developments than with standalone properties.

A deeper problem relates to the nature of the remedies available. As already discussed, certain remedies may not be available in court, such as specific performance of a keep-open covenant.¹⁵¹ Mandatory injunctions are also likely to be unsuitable for ensuring that the landlord fulfils its management functions on an ongoing basis.¹⁵² In some circumstances, the parties may not have much to gain from merely insisting on their rights. The enforcement of a right may prejudice one party severely with little gain to the other.¹⁵³ While it is always open to parties to negotiate in the wake of a court judgment to arrive at a better solution (and this should happen in the absence of transaction costs¹⁵⁴) this rarely happens in reality.¹⁵⁵ Discussion between the parties may be the most effective way of promoting their common, as well as individual, interests.

¹⁵⁰ Yngvesson, *supra* note 147 at 624.

¹⁵¹ See 6.2.3, above. *Co-operative Insurance v Argyll Stores (Holdings) Ltd, supra* note 72.

¹⁵² Cf Capita Trust v Chatam Maritime, supra note 28.

Although, this may be taken into account in some legal contexts: see the 6th of Balcolmbe LJ's propositions in *International Drilling Fluids v Louiseville Investments*, [1986] 1 Ch 513.

¹⁵⁴ Coase, *supra* note 145.

¹⁵⁵ W Farnsworth, "Do Parties to Nuisance Cases Bargain After Judgment? A Glimpse Inside the Cathedral" (1999) The University of Chicago Law Review 373.

Howard argues that the legal basis of the landlord-tenant relationship encourages conflict, pitting landlords against tenants in an adversarial contest, which does not promote mutual gain. Negotiation strategies may be competitive, where a hard line is taken, aiming to secure as much as possible for the negotiator's own side; or cooperative, where a negotiator offers concessions and supplies a lot of information in order to ensure that a solution is arrived at. In an adversarial setting, competitive bargaining is encouraged, which may lead the parties to focus on their positions, rather than trying to agree a mutually beneficial solution. This approach is not ideally suited to promoting the interests of both parties.

Fisher and Ury suggest an alternative negotiation style, aimed at promoting the interests of all parties in a negotiation. Principled negotiation involves co-operative problem solving which may yield results superior for both parties to insisting on their rights. Methods of dispute resolution which focus on achieving consensual agreement may be best at encouraging such win-win resolutions, as parties will only agree to a settlement in such a scenario where the solution is no worse than proceeding to court (the "best alternative to a negotiated agreement"). ¹⁶⁰

In the context of landlords' consents, time will often be of the essence. Excessive delay on the part of a landlord may frustrate the object of the consent application. This was the rationale behind the procedural duties imposed upon landlords in dealing with requests to assign by the Landlord and Tenant Act 1988, ¹⁶¹ and for the Irish Law Reform Commission's recommendation to introduce similar provisions in relation to all consent applications. ¹⁶² This point was also specifically raised by one Irish property professional in an informal

¹⁵⁶ Howard, supra note 10.

¹⁵⁷ Gerald M Levy, "Resolving Real Estate Disputes" (1999) 24 Real Estate Issues 1 at 3.

¹⁵⁸ Roger Fisher & William Ury, *Getting to yes: negotiating an agreement without giving in*, 2nd ed ed (London: Random House Business, 2003).

¹⁵⁹ *Ibid*.

¹⁶⁰ *Ibid* at 101.

¹⁶¹ See 3.1.5, above.

¹⁶² Draft Landlord and Tenant Bill, supra note 131, sec 34–35.

conversation about areas for reform of the law in Ireland. The landlord is not, however, the only source of delays. Bringing a case to court can cause substantial delays, having a similar effect on the proposed transaction. While damages may be sufficient to compensate a tenant for a failed assignment, that may not be the case for other types of consent sought, where the risk of losing first mover advantage in changing user, or the costs related to a delayed refurbishment may not be readily quantifiable.

Litigation may also be more expensive than other forms of dispute resolution, ¹⁶³ and the courts may not be as well placed to understand the commercial realities facing the parties as an mediator or arbitrator with practical expertise. However, the less formal and less expensive methods of ADR, such as mediation, may not result in any settlement, and so may merely prolong and add expense to the resolution of the dispute, which may still end up in court. The success of voluntary ADR options depends on the commitment of both parties to finding a resolution to their dispute.

6.5.2 Methods of dispute resolution

ADR is a catch-all term used to describe any non-litigation dispute resolution process. This may include negotiation, mediation, arbitration, expert determination and a range of combinations of different approaches. Negotiation is practiced throughout the relationship of landlord and tenant and may be attempted at several stages of a dispute, from when it originally arises to final attempts at settlement pre-trial. Kheel described negotiation as "the primary method of conflict resolution." 164

¹⁶³ Susan H Blake & Julie Browne, *A practical approach to alternative dispute resolution* (Oxford: Oxford University Press, 2012) at 13, although this is not necessarily the case.

¹⁶⁴ Theodore W Kheel, *The keys to conflict resolution: proven methods of settling disputes voluntarily* (New York; London: Four Walls Eight Windows; Turnaround, 2001) at 13.

Mediation involves a negotiation between the parties which is facilitated by a neutral third party. It aims to help the parties to come to a consensual agreement. A successful mediation will result in an enforceable agreement but because of the consensual nature of the process, agreement is not guaranteed. Although a contract may include a mediation clause, because of the consensual nature of the process, it cannot avoid the possibility of a dispute ending up in court.

The flexibility provided by mediation allows the parties to tailor the process to fit their needs. ¹⁶⁶ If successful, it is generally quicker and cheaper than litigation. The consensual nature of the process makes it particularly useful for maintaining good relationships between the parties, and the understanding which mediation seeks to achieve may be helpful in avoiding future disputes. It also allows for more inventive solutions than would be available in court, especially considering the difficulties with mandatory injunctions discussed above.

In contrast to mediation, arbitration does not result in an agreed settlement. Rather, an independent arbitrator decides on the solution to a dispute, which is binding on the parties. It is much more like litigation than mediation, with submissions made by both sides, but can be more flexible than litigation. The parties must agree to the determination of a dispute by arbitration. It may be provided for in the lease, or may be agreed between the parties after the dispute has arisen. Arbitrations in England and Wales are governed by the Arbitration Act 1996. The decisions of an arbitrator are only appealable in the courts on narrow grounds. 167

In some cases, where a dispute resolves around the determination of a particular technical question, such as the appropriate level of rent, it may be appropriate to appoint an independent expert to adjudicate. This is similar to arbitration but much more limited in

 $^{^{165}}$ Although the parties may initially meet separately with the mediator. Blake & Browne, *supra* note 163 at 28. 166 *Ibid* at 205.

¹⁶⁷ Arbitration Act 1996, ss 67–69.

scope. Many rent review and service charge clauses contain procedures for assessing an appropriate amount in the event of dispute, although this procedure is not commonly used in relation to other landlord-tenant disputes. Expert determinations are not regulated and the terms of reference should be agreed by the parties before commencing. The parties must also agree on how an independent expert might be appointed. Depending on the terms of the adjudication, expert determination may give the adjudicator a greater degree of freedom in using their own knowledge in coming to a determination than an arbitrator would have. Section 19(1C) of the Landlord and Tenant Act 1927¹⁶⁸ allows the parties to specify in a lease or another agreement prior to an application for consent adjudication by an independent expert as the means for determining the reasonableness of the landlords withholding of consent. This may be useful to parties wishing to avoid costly and time consuming litigation regarding consents for alienation.

In addition to the dispute resolution techniques described above, a number of hybrid techniques may be used, which seek to capture some of the benefits of different approaches. "Med-arb" and "arb-med" seek to achieve the benefits of a voluntary agreement between the parties for their ongoing relationship, while availing of a fall back position provided by an adjudication. The procedures are flexible and should be designed to cater to the needs of the parties.

6.5.3 Dispute resolution in the property context

By their very nature, landlord and tenant disputes tend to have a number of characteristics which may pose dilemmas for the parties in trying to promote their individual interests, as is the case in litigation. Such disputes are generally in the context of ongoing relationships; they are very often time sensitive; they involve very complex questions relating to commercial practice; and because of the foregoing, resolving them by litigation can be very expensive.

¹⁶⁸ As inserted by the Landlord and Tenant (Covenants) Act 1995, s22.

For those reasons, litigation often may not be the appropriate way to resolve landlord/tenant disputes.

However, the parties themselves may see their relationship as more adversarial than cooperative. 169 This points to a divergence between the approach advocated by the literature and commercial practice. This zero sum approach to conflict between the parties may make litigation seem like a more attractive option than negotiation, especially if one party perceives that they will get a fairer hearing in court. 170

Although arbitration or expert determination clauses are quite common in relation to rent reviews, ADR has not seen widespread use beyond this in the commercial landlord/tenant context. Bright notes that leases often do not contain adequate mechanisms for resolving landlord/tenant disputes. 171

One area which is a constant source of disputes - that of seeking consent from the landlord often ranks low in terms of tenant satisfaction.¹⁷² A number of commentators have suggested the use of ADR as a way of cutting costs and speeding up the resolution of disputes relating to consent. 173 Fisher and Ury note that the use of objective standards is necessary to get away from the traditional form of adversarial positional bargaining. ¹⁷⁴ Individuals will tend to point to examples which are most favourable to their position in negotiations as a result of self-

¹⁶⁹ Tenant Satisfaction Index (London: RICS, 2005). This was also alluded to in informal discussions with property professionals in Ireland.

¹⁷⁰ Suggested by an Irish Chartered Surveyor in conversation.

¹⁷¹ Susan Bright, "Protecting the small business tenant" [2006] 70 Conv 137 at 153.

¹⁷² Tenant Satisfaction Index, note 169; Property Industry Alliance, Occupier Satisfaction Survey 2012 (London, 2012); Property Industry Alliance & CoreNet Global, Occupier Satisfaction Survey 2011 (London, 2011); Property Industry Alliance & CoreNet Global, Occupier Satisfaction Survey 2010 (London: RICS, 2010).

¹⁷³ Andrew Chesser, "Property / Landlord & tenant: Giving the go-ahead" (2011) 161 NLJ 1204; Letitia Crabb & Jonathan Seitler, Leases: covenants and consents, 2nd ed (London: Sweet And Maxwell, 2008); Michael F Donner & Dennis L Greenwald, "Alternative Dispute Resolution for Real Estate Disputes - Is ADR Really Faster, Better, and Cheaper" (2006) 20 Prob & Prop 36; Levy, supra note 157.

¹⁷⁴ Fisher & Ury, *supra* note 158.

serving bias,¹⁷⁵ so it is important to have certainty in the criteria used.¹⁷⁶ Objective criteria used in relation to a dispute concerning consent might include professional practice or the likely outcome of a case, should the dispute go to court (or to trial if litigation has begun). As discussed in Chapter 4, the court's assessment of reasonableness is often heavily reliant on expert evidence, and decisions are generally consistent with best commercial practice.¹⁷⁷ It appears that given the time-sensitive nature of such disputes and the need for expertise in determining the reasonableness of a refusal of consent in many cases, some form of alternative dispute resolution may create benefits for both landlords and tenants.

6.6 Conclusion

Many of the problems in the landlord-tenant relationship appear to stem from the fact that the legalistic nature of leases creates an adversarial relationship. Neither giving tenants additional rights to pursue their own interests against one another, nor specific enforceable rights against landlords to manage a centre in accordance with some standard of best practice will address this issue, due to the complexities involved. Both approaches encourage the parties to continue to engage adversarially; and not to do anything beyond what is required and insisting upon their own rights.

Ensuring the long term prosperity of both landlords and tenants may require non-legalistic approaches, focusing on communication and cooperation between landlords and tenants. As overseers of a portfolio of properties, landlords are well positioned to manage each property in the interests of all tenants, but they need the information and incentives to fulfil this role to best effect. Drafters of leases seeking to ensure the long-term success of tenants and landlords in property portfolios might do well to look at the commercial literature reviewed in

¹⁷⁵ Linda Babcock & George Loewenstein, "Explaining Bargaining Impasse: The Role of Self-Serving Biases" (1997) 11:1 The Journal of Economic Perspectives 109; George Loewenstein et al, "Self-Serving Assessments of Fairness and Pretrial Bargaining" (1993) 22:1 The Journal of Legal Studies 135.

¹⁷⁶ Fisher & Ury, *supra* note 158.

¹⁷⁷ See 4.4.2, above.

Chapter 2, and focus on ensuring that effective mechanisms exist for cooperation between landlords and tenants, that tenants share enough information with landlords for landlords to manage their portfolios effectively in the interests of tenants, and that the interests of landlords and tenants are aligned through appropriate incentives.

Given that some of the most important terms in a lease from the perspective of the ongoing management are drafted by lawyers, it can hardly be surprising that the relationship is later characterised by a legalistic, adversarial style. In order to steer away from conflict, and ensure that both landlord and tenant can continue to benefit from the relationship as the commercial environment changes, the parties would be advised to focus on incentives rather than just rights. An economically informed approach to drafting leases would help to ensure that the incentives of the parties are aligned, rather than trying to regulate their conduct through rules, which may cause conflict later in their relationship.

Where disputes do arise, alternatives to litigation such as mediation, arbitration and expert determination may provide faster, more cost effective and more amicable solutions. Lease drafters should consider including terms to encourage the uptake of ADR, in order to promote the long term success of both landlords and tenants.

That is not to say that legal principles have no role in ensuring a healthy and mutually beneficial long-term landlord-tenant relationship. The courts' evolving attitude to the ancient doctrine of non-derogation from grant is a recognition of the mutual dependence of landlords and tenants in portfolio settings. The approach adopted in *Chartered Trust* and later in *Petra Investments* deftly balances the expectations of individual tenants and the need of landlords to adapt to changing commercial situations. This provides some level of security for tenants while allowing landlords to realise the potential benefits for all parties arising out of flexible centralised control of a broad portfolio. The position of judges, looking at the factual

circumstances of the dispute in question is far better suited to regulating the relationship by legal means than the drafters of a lease looking forward into an unknown future.

Finally, it does not appear as though the application of competition law to land agreements will have any significant impact on the management of property portfolios. Individual tenants may seek to rely on the Chapter I prohibition in seeking to escape restrictive covenants, but the difficulties currently present in relation to private enforcement of competition law are likely too extreme to be overcome by most private litigants. This may change depending on how the Government approaches reforms of private enforcement.

7. Conclusion

The centralised management of a group of commercial properties has the potential to yield significant benefits over diffuse control of the same properties. Such benefits may include the internalising of externalities experienced between the properties, as well as economies of scale and scope. Common ownership of the properties may provide an opportunity for their management to be coordinated. Portfolio landlords are therefore in an ideal position to capture many of these potential benefits, not only for the landlord, but for tenants within the portfolio, and for society as a whole.

As seen in Chapter 2, active, business-led approaches to property management are more suited than traditional property-led management styles, to ensuring that the potential gains from agglomeration are realised. By prioritising the needs of tenants' businesses, landlords stand to benefit from increasing rent potential resulting from higher tenant profitability. Broader society also benefits from the increases in productivity arising as a result of such cooperation between landlords and tenants.

Landlords who take such an approach have been supported and protected by judges and regulators. The judicial approach to reasonableness is most lenient in regard to refusals of consent designed to prevent damage to neighbouring property and tenants, in pursuit of such a business-led approach. Similarly, legislators have frequently expressed desires to protect portfolio landlords insofar as they wish to manage their portfolios for the benefit of all. This has had a significant impact on policy making, mediating the general trend towards greater protections for tenants from unscrupulous landlords. This can be seen in the "neighbouring property" exemption to fines provisions and the rejection of proposals to fully qualify all user covenants. However, it appears in the latter instance that concerns of legislators are overstated, and that the full qualification of user covenants could be mandated without a

negative impact on business-led portfolio landlords, given the courts' approach to refusals of consent intended to protect the position of the portfolio, following a business-led approach.

For a portfolio landlord to continue to realise the potential benefits of common management in the long run, he must adapt his management policies in response to changes in the external environment. In order for a landlord to react flexibly to such changes, his powers to exercise control over properties in the portfolio must not be excessively restricted, or must change in response to market shifts. Strict contractual governance of how the landlord should exercise his powers is likely to inhibit this.

The courts' approach to reasonableness in the context of landlords' consents enables landlords to exercise flexible control over the duration of a lease. Although many commentators have suggested a contractual approach to reasonableness, which would limit the landlord to considering interests protected in the lease, the courts have been more flexible, recognising the need for management priorities to change over time. Reasonableness is used in contracts precisely because it allows a court to make a decision appropriate to the circumstances of the dispute. The courts have determined reasonableness in the context of the relationship of landlord and tenant as it actually stood when consent was sought, not as the lease created it. This allows for the relationship to change dynamically on an ongoing basis in response to commercial challenges, without the parties having to constantly redraw their agreement.

The courts have also shown an appreciation for the need for flexibility in defining the scope of a grant for the purposes of non-derogation from grant.

Nevertheless, the need for flexibility should be taken into account by the parties when drafting their lease. Tightly drafted terms may cause conflict between the parties as their relationship develops and the commercial context in which they operate evolves. Rigid obligations may give parties powerful weapons with which to attack one another, but this may

only lead to conflict. Giving tenants enforceable rights in the management of a portfolio, whether against the landlord or other tenants, may also undo some of the good that can be achieved by common management. For these reasons, landlords should be careful to avoid giving tenants such rights unless necessary for a particular purpose. Focusing on aligning the interests of landlord and tenant provides a way for the parties to ensure that each party will act in the interests of the other, while allowing for flexibility. This may include the use of turnover leases. Shifting the focus of landlord-tenant relationships from adversarial to cooperative may require significant changes in commercial practice, with increased emphasis on communication and information sharing between landlords and tenants. Approaching the issue from a commercial, rather than a legal, perspective may, therefore, be more effective in achieving the aim of co-operation through alignment of interests. The use of non-litigation dispute resolution procedures may help to refocus the landlord-tenant relationship to encourage co-operation.

The wording of a lease will be critical in determining how the landlord may exercise control over dispositions, user or common areas in a development. However, the broad factual matrix surrounding the negotiation of a lease may be just as important in delineating the control which a landlord may exercise. The circumstances in which the lease was signed will affect the expectations of the parties entering into the lease, which frames their ongoing relationship. From a legal point of view, the expectations of tenants may also have consequences on the landlord's ability to exercise control over his tenants. The contractual approach to reasonableness, which marks the low water point of a landlord's ability to reasonably withhold consent, is heavily dependent on the expectations of the tenant at the time the lease was entered into. The extent of the duties imposed on a landlord by the doctrine of non-derogation from grant will also depend on what the parties expected the grant to be. Landlords might wish to reserve significant powers of control in order to ensure that they will

not be held to have been unreasonable in withholding consent to a change of user or assignment, but this may create an expectation that the powers will be used to protect a tenant. Drafting leases to describe the powers of control retained by landlords is therefore a subtle balancing exercise.

Finally, it is not expected that the application of competition law to land agreements will impose any significant constraints on the way landlords manage their portfolios. While the benefits to be had from common ownership and control are significant, the fact that such control is relatively localised means that property portfolios are still subject to competition from outside. Even if an agreement may stifle competition, it is unlikely that the effects will be large enough for regulators to intervene. Unless and until private enforcement of competition law is reformed to be a realistic option for tenants wishing to challenge agreements they see as anticompetitive, competition law is unlikely to trouble portfolio landlords.

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