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English and Welsh Real Estate
Non-COVID-19 Autumn 2020 round-up

While headlines have, understandably, been dominated for months by the response to COVID-19, this alert looks to summarise the following non-COVID-19 legal developments affecting real estate in England and Wales over the summer of 2020:

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Commonhold – the preferred alternative to residential leasehold?

Commonhold is a means of providing freehold ownership of flats and avoiding the issues associated with residential leasehold (for example, the nature of leasehold as a diminishing asset, ground rents and problems within the landlord and tenant relationship). However, despite being introduced in 2004, commonhold has attracted few enthusiasts – less than 20 commonhold schemes have been established so far. As such, the Law Commission has been consulting on commonhold for some time now, culminating in its report in July 2020 (view here) which makes recommendations aimed at making commonhold "not just a workable alternative to residential leasehold ownership, but the preferred alternative".

The report contains a total of 121 recommendations. Key proposals include making:

a. the conversion of existing leasehold schemes into commonhold easier by relaxing the existing requirement that all leaseholders and mortgagees must agree to the conversion. The suggestion is that conversion should be possible where at least half of the leaseholders in the building support it and that conversion should be permitted without the consent of relevant mortgage lenders. This departure from a unanimous approach throws up a multitude of further issues, including the treatment of non-consenting leaseholders and mortgagees for which the Law Commission makes various recommendations; and

b. the establishment of new commonhold developments easier by recommending, among other things, allowing developers to separate different types of interest in a scheme into sections. Sections would be used to ensure that only owners within a particular section are able to vote on matters affecting that section, and that only those who benefit from a particular service are responsible for paying for it. Under the present law, there is no scope to differentiate different types of occupier within a commonhold scheme. Other recommendations include allowing developers:

    i. wider scope to reserve development rights needed to complete a scheme after it is registered as commonhold; and

    ii. to build up commonhold developments in phases in order to retain maximum control and flexibility over the ongoing development. At present, a developer has to register the whole development as commonhold at the outset.

If the government were to make the Law Commission's vision a reality that is adopted by the market, this would bring about one of the most significant changes in decades in the way in which residential and mixed-use properties can be owned and managed. So, the big question is whether or not the government will follow through and push through these reforms – unfortunately we will have to wait and see.

Ongoing review of residential leasehold

In addition to its report on commonhold, the Law Commission has also released two reports on leasehold home ownership:

- "Buying your freehold or extending your lease" – to view, please click here; and
- "Exercising the right to manage" – to view, please click here.

These reports were driven by the government's desire to reform residential leasehold law. Other plans included banning the reservation of ground rents and the sale of leasehold houses. While there may have been little movement on these issues over the summer, it is unlikely that the government has abandoned its ambition to tackle perceived issues with residential leasehold and therefore we expect this topic to come back onto the agenda in the near future.

New Lease Code 2020

The new code for leasing business premises (the Lease Code) published by the Royal Institution of Chartered Surveyors (RICS) became effective on 1 September 2020 (click here). It takes effect as a professional statement and, importantly, certain parts are mandatory for RICS members and regulated firms. The Lease Code applies to lettings of commercial premises in England and Wales for a term of more than six months with some limited exceptions.

A principal objective of the Lease Code is to improve the quality and fairness of negotiations on lease terms. The mandatory provisions require that negotiations must be approached in a constructive and collaborative manner and with an aim to produce letting terms that achieve a fair balance between the parties having regard to their respective commercial interests. Furthermore, an unrepresented party must be advised of the existence of the Lease Code (and supplemental guide) and recommended to obtain professional advice.

There is also a mandatory requirement for written heads of terms summarising the key specified lease terms. The intention is to assist the parties to make an informed decision about whether to proceed with the lease on those terms and also to make the legal drafting process more efficient. This requirement also applies to lease renewals and extensions save for any terms that are stated to follow the existing lease subject to reasonable modernisation. It will be the responsibility of the landlord or its agent to ensure that the heads of terms (complying with the mandatory provisions of the Lease Code) are in place before a draft lease is circulated.

The remainder of the Lease Code is described as "good" or "best" practice. It relates to the negotiations of both the heads of terms and the lease, and prescribes a best practice position on certain key lease terms. For example, landlords should only require the reinstatement of tenant alterations at lease end if it is reasonable to do so; leases should contain provisions on uninsured risks; and conditions to tenant break rights should be limited as directed by the Lease Code. Consideration is also given to including green lease provisions. The Lease Code recognises that there may be "exceptional circumstances" in which it is appropriate to depart from these provisions and RICS may require members to justify any such departure.

The Lease Code also contains a supplemental guide for landlords and tenants which is intended to offer additional guidance for occupiers.

The ongoing saga of GAGAs

It has been over 24 years since the Landlord and Tenant (Covenants) Act 1995 (Act) brought about a radical change in the law of landlord and tenant. However, as the recent case of *EMI Group Ltd v. Prudential Assurance Co. Ltd.* [2020] EWHC 2061 shows, there are still ongoing issues with the way in which some of the provisions of that Act operate in practice.

Following its enactment, a tenant assigning a lease is automatically released from the tenant covenants in that lease from the date of assignment, whereas before it would have remained liable on those covenants for the remainder of the term unless specifically released by the landlord. There are very strict anti-avoidance provisions in the Act. The one circumstance in which an outgoing tenant can remain liable is where it provides an authorised guarantee agreement (AGA) guaranteeing performance of the tenant covenants by the assignee. However, the Act is very clear in that the outgoing tenant can only provide an AGA in respect of its assignee and it must not be required to guarantee performance by any other party.

Pursuant to the Act, on assignment guarantors are automatically released to the same extent as the tenant they are guaranteeing. However, previous obiter comments from the Court of Appeal stated that there is no reason why an outgoing tenant's guarantor cannot guarantee the outgoing tenant's obligations pursuant to an AGA (an arrangement commonly referred to as a GAGA), provided that guarantee does not extend to directly guaranteeing the obligations on the new assignee.

The recent *EMI* case looked at GAGAs. EMI had provided a GAGA to the landlord, Prudential, on the assignment of the lease by HMV to a third party. HMV, the third party tenant and its guarantor each fell into some form of insolvency proceedings leaving Prudential to seek recovery of various rent arrears from EMI pursuant to the GAGA. EMI sought a declaration that the GAGA was invalid as it contravened the anti-avoidance provisions in the Act.

The principal argument advanced by EMI was that the GAGA had been provided in respect of the "Principal" which was defined as "the person who **is or is to become** the Tenant…" (emphasis added). EMI argued that this drafting must refer to a future tenant and, as the Act did not allow a guarantor pursuant to a GAGA to guarantee performance by any party other than the outgoing tenant, this wording fell foul of the anti-avoidance provisions of the Act. As a matter of construction looking at the wording in context, the High Court disagreed. However, the court confirmed that, even if it were wrong on that, it would otherwise have agreed to the deletion of the offending wording, something envisaged by the anti-avoidance provisions of the Act.

Another argument advanced was that HMV as tenant had only been required to give an AGA where reasonable to do so but EMI, as guarantor, was automatically required to give a GAGA (it was not subject to a reasonableness test) and therefore the guarantor was being treated differently to the outgoing tenant. This argument did not succeed. Pursuant to the Act, what matters is that the guarantor is released at the same time as the tenant is released and not the terms on which an AGA or GAGA is required.

While the GAGA in this case was ultimately held to be valid, the case highlights again the importance of taking care when dealing with any provisions involving the Act.

Changes to the planning system

There have been a number of changes and proposed changes to the planning system over the summer. Below is a summary of two of these that will be of wide interest.

For full details of the other changes, please refer to our planning law blog.

New use class

1 September 2020 saw some significant changes to the Use Classes Order in England. In particular, a new use class, Class E, was introduced to cover commercial business and service uses. So, uses previously falling within the old Use Classes B1 and A1-A3 were subsumed into this new use class (with pubs and other drinking establishments, and hot food takeaways now falling outside the Use Classes Order – considered as *sui generis*). One benefit of this is that uses falling within this new Use Class E can, subject to some exceptions, change to another use in that same class without the need to obtain planning permission, thereby more easily facilitating repurposing of premises, particularly on the high street.

A new use class for learning and non-residential institutions (Class F2) and another for local community (Class F1) uses also came into effect on the same date.

While it has been common for some time for leases to define permitted use by reference to the Use Classes Order, this is likely to be less prevalent going forward as:

a. most landlords will want to restrict the permitted use to a narrower category of uses than those set out in Use Class E or F; and

b. there is an outstanding challenge to these amendments to the Use Classes Order.

Where parties have exchanged agreements that have yet to complete and which contain reference to use classes, they will want to check whether the reference to those use classes is as at the date of the agreement or the date of completion. If it is the latter, they may want to reconsider whether such references remain appropriate.

Planning reform

In August 2020 the Planning White Paper: Planning for the Future was released alongside a consultation Changes to the Current Planning System.

Between them, they propose radical changes to the local planning system in England, for example:

a. the White Paper aims to introduce a zoning system whereby England is split into three zones, covering areas for: growth, renewal and protection. One important suggestion is that areas that are identified for growth (i.e. suitable for substantial development) would be granted an automatic outline planning permission (possibly a permission in principle), leaving developers needing to only seek detailed consent;

b. the consultation considers proposals to extend the permission in principle regime to major developments, but not including large sites which could deliver 150 dwellings or more than five hectares; and

c. the White Paper also proposes to reform planning obligations and the Community Infrastructure Levy system by replacing them with a nationally-set, value-based flat rate charge, to be known as the Infrastructure Levy.

Consultation on proposals to require additional transparency of contractual controls over land

Earlier this year, the Ministry of Housing, Communities and Local Government issued a Call for Evidence on data on land control which closes on 30 October 2020. The Call for Evidence primarily relates to England but may apply to Wales depending on the agreement of the Welsh government.

The government believes that to unlock development growth, to guide the planning system and to open up the market to smaller developers, it is important that there is clearer information on who controls land. While the register maintained by the Land Registry contains details of land ownership of properties in England and Wales, it does not contain clear details of all contractual controls that may affect a parcel of land (even where the same are protected by way of notice or restriction). By contractual control, the government is referring to arrangements such as conditional contracts, options and pre-emption agreements.

The proposals set out in the Call for Evidence include:

a. collecting data on contractual control arrangements, including granular details such as the nature of any conditionality and pricing. It considers the extent to which this data should be collected in relation to existing arrangements, as well as any future arrangements;

b. placing additional data on the land register and publishing, free of charge, a contractual control interests dataset. In addition, further information would be collated for internal government use only;

c. removing the possibility of using a unilateral notice to protect relevant interests. The benefit of a unilateral notice is that the parties to the interest do not need to submit the underlying documentation to the Land Registry and so it helps to maintain confidentiality. Instead, if confidentiality were an issue and these proposals were effected, the parties would need to submit an application for exempt information when submitting a request for an agreed notice. The problem with this is that not all information can be kept off the public register;

d. considering what consequences should follow from a failure to provide the relevant information.

Full details of the proposals can be found here. Of particular interest will be Appendix A which sets out the proposed data requirements.

This Call for Evidence is part of a much wider government drive for greater transparency around land ownership and control (for example, see our previous alert on the draft Registration of Overseas Entities Bill). While some of these projects have, understandably, been less prominent over the summer, we do expect them to come back onto the agenda in the very near future.

Supreme Court decision on business rates and cash machines

In May 2020, the Supreme Court in *Cardtronics UK Limited and others v. Sykes and others (Valuation Officers)* [2020] UKSC 21 held that automated teller machines (ATMs) situated in supermarkets and other shops:

a. were capable of being separate hereditaments in the right circumstances; but

b. in this case, neither internal nor external ATMs were separately rateable as the storeowners had maintained sufficient control of the sites in contractual, physical and functional terms.

The decision represented a significant victory for both ratepayers, who faced a significant rates burden, and the public at large who will now continue to be able to access funds through ATMs in their local shops. If the decision had gone the other way, the stark reality would be that many communities may have witnessed their local ATMs disappear from their stores. This could have been very significant for those communities where an ATM in a shop was the primary source of accessing funds.

To read more, please click here.

Electronic Communications Code and the Landlord and Tenant Act 1954

Although not a binding decision, the recent County Court judgment in *Vodafone Ltd v. Hanover Capital Ltd* is interesting because it considered the renewal of a telecoms lease pursuant to the Landlord and Tenant Act 1954 (1954 Act) following the introduction of the new Electronic Communications Code in December 2017 (Code).

As matters currently stand, where a subsisting telecoms lease (i.e. one entered into prior to the introduction of the Code) comes to an end but has the protection of the 1954 Act, renewal of that lease is to be pursuant to the 1954 Act and not the Code. Once a renewal has occurred, the new lease no longer has the protection of the 1954 Act but is instead protected by the Code.

There were two key issues in this case:

a. the length of the term of the renewal lease and the inclusion of a rolling break. The operator was seeking a relatively short three-year term with the rolling break; the landlord sought a 10-year term with a rolling break after year five. The court decided that, taking account of the need to balance the operator's wish for flexibility against the landlord's desire for certainty, the term of the renewal lease should be 10 years with a rolling break exercisable on six months' notice expiring on the fifth or subsequent anniversary of the term; and

b. the rent. This was to be decided in accordance with section 34 of the 1954 Act. As such, the court had to determine the rent which the telecoms site might reasonably expect to be let on in an open market (by a willing lessor to a willing lessee) on the terms of the tenancy. The difficulty was that in the open market parties seeking new sites would be able to avail themselves of the Code and the requirement, when setting rents, of assuming that the site is not related to the use or provision of an electronic communications network (the "no-network" principle). Importantly, the court decided

the rent based on its value to the operator rather than the value to the site owner (so going against the no-network principle). Among other things, this was because the court felt satisfied that in the open market there would be demand for the site (as there were currently four operators at the current installation) and that that demand would push up the rent to levels reflecting the value of the site to the successful bidder. As such, the rent was set at £5,750, higher than it would likely have been had the renewal been pursuant to the Code rather than the 1954 Act.

This was not the only decision relating to the Code handed down over the summer – please see future alerts for more details.

New methods for executing/ signing real estate documentation

At the start of the year, the Land Registry's general policy was only to accept wet ink signatures. Now, 10 months on, the Land Registry has relaxed its policy to allow two other methods for signing/executing documentation for certain documents:

a. *Mercury* signatures. Subject to compliance with the Land Registry's strict policy on the same, it will now accept *Mercury* signatures on some documents. A *Mercury* signature involves the signatory being sent the final form documents by email, after which they print off the signature pages, sign in wet ink and then scan those pages, ready to return them to the signing co-ordinator by email together with the final form document; and

b. electronic signatures generated through a document-signing platform. Again, the Land Registry has imposed a strict policy for the same. Please see our previous alert for more details.

Given the complex and prescriptive requirements for using either of the above, parties should ensure that they take advice from a real estate specialist early on in the transaction before opting to use either.

Supreme Court decision on restraint of trade

Whilst not an English case, the Supreme Court case of *Peninsula Securities Limited v. Dunnes Stores (Bangor) Limited* [2020] UKSC 35, which was decided in August, is of wider interest to UK real estate, including English and Welsh real estate. A restrictive covenant granted by a landlord of a shopping centre in Northern Ireland to an anchor tenant (undertaking not to develop neighbouring land for a large unit trading textiles, provisions or groceries) was found by the Supreme Court to be enforceable.

The case is a welcome clarification on the law surrounding restraint of trade, in particular the Supreme Court's confirmation that it agrees with the academic world that the "pre-existing freedom" test (i.e. does the clause restrict a freedom the party otherwise enjoyed) is not fit for purpose. Instead, the Court held restraint clauses should now be assessed under the "trading society" test (i.e. does the clause restrict a freedom which is rarely restricted in the circumstances of the case). The decision to abandon the former test in favour of the latter means that parties can properly assess, by referring to commercial norms within the market, whether any trade restrictions imposed by an agreement are likely to be enforceable.

There are clear winners and losers arising from this judgment. While the case concerns premises in Northern Ireland, the decision will be of great interest to retailers who are, or could be, considered "anchor" or "cornerstone" tenants of shopping centres across England and Wales, many of whom will have such clauses in their leases to protect their position within a development. These clauses, and their impact on landlord/tenant negotiations, may be more pronounced than ever given the present state of the retail market.

By contrast, landlords of large retail developments will need to consider whether they can attract larger tenants to their development in the future without having to engage with, or potentially compensate, their existing anchor tenants. Prospective landlords and developers will also need to think carefully before agreeing to such clauses with potential tenants as they may impact the value of the reversion.