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REAL NEWS

SPRING EDITION 2016

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Welcome to the spring edition of Real News, DLA Piper's quarterly guide to key developments in English and Welsh real estate law. In this edition:

Richard Ascroft considers the **impact of a Brexit** on the UK commercial property market (page 03);

Rob Shaw provides guidance on the recent launch of **the alterations protocol** (page 05);

Peter Fletcher looks at the case of Cocking & Cocking v Eacott & Waring where it was held that a licensor can be held liable for **nuisance created by a licensee** (page 07);

Sarah Nunnery Jones provides detailed commentary on a recent Court of Appeal case where an employer who had failed to issue a valid pay less notice could commence a **second adjudication on the same payment application** (page 09); and

I explore the impact of the recent decision of the High Court in EMI Group Limited v O&H Q1 Limited where it was held that **tenants cannot assign to their guarantors** (page 11).

Please do get in touch with any requests for future content.

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HOW MIGHT A BREXIT AFFECT THE UK COMMERCIAL PROPERTY MARKET?

Earlier this year, David Cameron fired the starting gun on whether Britain should continue its membership of the EU. As we all know, the potential effect of a Brexit is a topic which has divided the opinions not only of our politicians but those of our entire nation and beyond.

Whilst researching this article, in the hope of cutting through the sea of conflicting reports from political commentators, and establishing a clearer understanding of those divisions, I looked first to the words of our leaders. Surely that would bring some order to the debate?

First up is George Osborne who has likened a Brexit to a "long, costly and messy divorce". Boris Johnson on the other hand says that leaving the EU would be like a "prisoner escaping jail and a huge weight lifted from British business". David Cameron tells us that leaving the EU would "threaten our economic and national security" and that, despite being guarded on the issue, Teresa May agrees with him. Michael Gove on the other hand says a Brexit would be a positive step for the UK and that, despite having no political allegiances, the Queen agrees with him. The ensuing complaint from Buckingham Palace quickly reaffirmed that the Queen in fact remains "politically neutral". No luck there then.

Not sensing any immediate clarity on the issue, I looked to the words of our elder statesmen, from a generation whose experience and wisdom may have led them to some common ground:

Neil Kinnock, former leader of the Labour party (and former European Commissioner) hit the top of my Google search, with his conviction that the impact of a Brexit would be "seismic", and likened it to "a jump off the edge of the cliff... in which our economic stability is hugely put at risk". Iain Duncan Smith, on the other hand, tells us that, by remaining in the EU, we would be "sailing perilously close to the rocks". Is jumping off a cliff more dangerous than sailing close to the rocks? More to the point, does Teresa May's opinion trump the Queen's (if she has one)? The murky waters were not clearing.

The fact is that, in a sea of conflicting information and opinions, it is impossible to be sure what the impact of a Brexit would be on the UK as a whole, but what about the particular field in which we work? While the health of the UK commercial property market is clearly linked to the general health of our economy, it is easier to be specific as to potential pros and cons of a Brexit when it is applied to a specific sector.

The potential for a positive, or neutral, impact:

- Many believe that, as one of the most liquid and transparent markets in Europe, the UK would be likely to continue to attract substantial investment even if it left the EU. There are legitimate doubts as to whether a Brexit would have a negative impact on the international appetite for UK real estate and some go further by suggesting that any short term political uncertainty might in fact create buying opportunities, resulting in a boost for our property market. Access to the single market is not the only reason that firms invest in Britain.
- Commercial property, particularly in London, is seen as a "safe haven" asset. It generally retains or increases its value and is protected by the stability and security of a liberal democracy. Foreign investors often invest in UK commercial property in order to escape debt crises or other economic problems in their own countries. A Brexit is unlikely to change that.
- It is possible that a weaker sterling could attract more investment into the UK property market. The relative strength of the pound as against emerging currencies has in the past tended to make property investments less appealing to some foreign investors. A Brexit could reverse that situation. When sterling fell during the global financial downturn, many foreign investors turned to the UK and bought up property in prime central locations at relatively cheap prices.

- A Brexit may enhance the UKs position in the world by releasing it from EU rules and regulations which include financial transaction taxes. This could result in an enhancement of London's position as a global capital for financial services, leading to an increased flow of capital into the UK economy which has been key to the UK property market over the last decade.
- Access to the single market has not been the main driver for investment, historically, which suggests that the impact of a Brexit would be negligible. Most foreign capital coming into the UK property market is for investment rather than operational purposes in any event.
- Factors such as our legal system and language, as well as the size, liquidity and transparency of the British market are not a function of our European Union membership, and would remain major drivers for continuing investment.

The potential for a negative impact:

- As things currently stand certain types of businesses (including banks and insurance companies) are permitted to operate across the EU provided that they have a base in the UK. This process, known as "passporting" means that a British bank can carry out its business elsewhere in the EU, from its UK base. The same applies to foreign banks, provided that they have a base in the UK. In the absence of any special arrangement to the contrary, passporting across the EU from a UK base would not be possible following a Brexit making the UK less attractive as a base for financial service organisations wishing to operate across the EU, and potentially forcing institutions to relocate to the continent. This could, amongst other things, put a dent in occupier demand, although there is a counter argument that even if demand from financial services firms was to fall, increased demand from other sectors could help to mitigate the overall impact on vacancy rates and rents.
- It is possible that global organisations and companies could consider reducing their UK operations. Would a Brexit result in occupier nervousness, with a resulting reduction in take-up?
- Changes to freedom of movement provisions could have an impact on the property industry. By way of example, a reduction in workers' migration could have an effect on the cost of construction projects and the free movement of goods and services across the EU could have an effect on property owners, tenants and developers.
- Whilst a reduction in the value of sterling, relative to other major currencies, could increase demand for property, it would at the same time have a negative impact on imports and reduce GDP. A reduction in GDP would in turn hurt rental growth.
- Regardless of what "beneficial terms" the UK may negotiate as part of a Brexit, there would inevitably be a period of uncertainty in the short to medium term. History has shown that periods of uncertainty are rarely a good thing when it comes to investment, whether that be the stock exchange or the property market.
- Research shows that, generally speaking, the commercial property sector does not want the UK to leave the EU. A recent survey undertaken by KPMG found that 66 per cent of real estate experts believed that "Britain leaving the EU would have a negative effect on inbound cross-border investment". Whilst this does not help us with the specifics of why this may be the case, it gives an insight into the sentiments of the industry, and 66 percent is a significant majority.

Summary

In summary, the effect of a Brexit on the UK commercial property market remains very much open to debate. There are numerous arguments for and against, not to mention a substantial body of opinion lying in between, representing those who feel the entire debate is a "nil sum game", that the significance of the vote lies in politics rather than economics, and that the UK economy will remain relatively unmoved whatever the outcome.

Whilst there are no hard and fast ways of predicting what will happen should an exit become a reality, Brexit is something we should all have an opinion on albeit that, ultimately, the decision will be made in the privacy of the ballot box on 23 June 2016.

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THE ALTERATIONS PROTOCOL

The vast majority of commercial leases invariably include an alterations covenant that will either absolutely prohibit alterations or prohibit alterations without the landlord's consent. Such clauses are supplemented by statute and case law, such as section 19 of the Landlord and Tenant Act 1927 which provides that a covenant against making improvements without consent is deemed to be subject to a proviso that such consent is not to be unreasonably withheld.

So where there is such a covenant, the starting point for a tenant who wants to alter its premises is to request consent from the landlord. However, there is no set procedure for making such an application (other than following the terms of the lease, which of course will vary on a lease-by-lease basis) and so there are variations in the way tenants (and landlords) approach matters. As such, even with what might be considered straightforward or minor alterations, there is a wide scope for a dispute to result from such an application between a landlord and tenant.

Therefore, in order to assist the process by which landlord and tenants of commercial leases deal with applications by tenants for consent to undertake alterations the Alterations Protocol has been produced. The explanatory note to the protocol states that it *"is intended to improve the communication between landlord and tenant and establish a timetable for the exchange of information relevant to the tenant's application and the landlord's decision"*. Essentially it aims to encourage the exchange of sufficient information at an early stage to ensure that a tenant's application is dealt with quickly and with less scope for disputes to arise.

The protocol sets out a general structured framework within which applications for consent to undertake alterations should be dealt with by the parties. It is free to use and can be found at www.propertyprotocols.co.uk.

In summary the protocol's elements are:

1. The application for consent

This should be sufficiently detailed for the landlord to understand what exactly the tenant is seeking consent for. The content of an application will depend on the terms of the lease and nature of the proposed alterations, but the application should describe the works (and include plans, drawings and specifications where that would assist) and that information should be provided as a single package.

The application should be served on the landlord in accordance with the relevant procedure set out in the lease.

2. The landlord's response

The landlord should acknowledge the application within 5 working days and at the same time notify the tenant if the landlord does not think the application contains sufficient information or if the landlord requires more time to ascertain what information it might require to deal with the application.

The landlord's response to the application should then be provided within a reasonable period of time (as a delay could result in consent being unreasonably withheld) and should contain sufficient detail for the tenant to understand its position, such as whether consent is given subject to conditions or the basis on which consent is refused.

3. Costs

Leases often require a tenant to meet the landlord's legal and other costs of an application for consent. As such the tenant should offer to provide an undertaking to cover such costs as part of the application.

4. Dispute resolution

Where a dispute arises, the parties are encouraged to consider an alternative form of dispute resolution as litigation should be seen as a last resort. Parties should be aware that if matters do end up in court, a judge will very likely require them to provide evidence that an alternative dispute resolution procedure was pursued (or at least considered).

5. Grant of consent

Where consent is granted, this should be properly recorded and consideration given to any supplementary issues, such as whether there will be an obligation to reinstate at the end of the term.

The protocol is in its early days and is not as yet legally binding on any parties (unless expressly incorporated into a lease) nor is it a mandatory code or a protocol under the Civil Procedure Rules (such as is the case with terminal dilapidations claims). The authors of the protocol have stated that they hope to see it referred to in leases and that it will serve as a "best practice" document for such scenarios. In time, depending on how it is received and deployed, it could be taken up by the courts as a formal protocol if it comes to be seen as a reasonable way of dealing with applications for consent.

Each individual application is fact specific, but the protocol certainly appears to be a sensible process to follow (it also includes its own guidance notes on applications for consent). Even in cases where a landlord wishes to resist an application for consent, the protocol should prove a useful checklist of issues for both landlords and tenants to consider when an application for consent is made, which will assist a party's position if a dispute later arises. We have already advised clients to consider the protocol when making or receiving such an application in order that if a dispute arises, they have all the relevant information to hand and as such can move more quickly towards a resolution.

The protocol will not prevent all disputes, but the authors aim is that it will cut down on minor disputes, speed up the process and lower costs. It is certainly worth consideration when dealing with an application for consent to undertake alterations.

The Alienation Protocol

The authors of the Alterations Protocol have previously issued a protocol for dealing with applications by tenants for consent to assign their lease or underlet. It is free to use and can also be found at www.propertyprotocols.co.uk. It too aims to improve communication between landlords and tenants and minimise the circumstances where disputes may arise on such applications.

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LICENSOR BEWARE!

THE LICENSOR OF A PROPERTY CAN BE HELD LIABLE FOR THE NUISANCE CREATED BY A LICENSEE

(1) Brynley John Cocking (2) Diane Cocking – v – (1) Kim Eacott (2) Angela Waring [2016] EWCA Civ 140

The recent case of *Cocking & Cocking v Eacott & Waring* [2016] reaffirms the position that a licensor of a property can be held liable for nuisance committed by its licensee. It is a clear warning to owners of land that if they allow their property to be let under a licence, in certain circumstances they could find themselves liable for wrongs that their licensee commits.

The facts

Mrs Angela Waring allowed her daughter, Kim Eacott, to live in her property under a bare licence. Ms Eacott paid no rent and Mrs Waring assisted her daughter financially by paying all bills and maintaining the property. Brynley Cocking and Diane Cocking were the owners of the next door property.

While occupying the property Ms Eacott created two types of nuisance:

1. She failed to control her dog, Scally, who on numerous occasions barked excessively (between 5 and 10 times a month from August 2008 onwards) leading the Cockings to complain of incessant barking.

2. Following on from the noise complaints made about Scally, Ms Eacott repeatedly shouted abuse from July 2009 to July 2011.

Although Mrs Waring was held to not be liable for the abusive shouting, as she was unaware of it until late 2010 and it ceased following the service of an ASBO on Ms Eacott, she was held to be responsible for the barking of Scally, who suffered from separation anxiety.

Legal comment

The position of a licensor is not akin to the position of a landlord in relation to nuisance and this case serves as a useful reminder of that. The landlord of a property will only be liable for nuisance caused by their tenant in exceptional circumstances, such as authorising or participating in the nuisance.

The court compared Mrs Waring to a local authority that allowed travellers to occupy their land and provided them with skips for their rubbish and running water. The travellers occupied the land under a licence, and the local authority was liable for the nuisance they created as they were aware of the wrongs being committed and did not act.

A further factor that counted against Mrs Waring was that as the dispute had progressed, there was a breakdown of the relationship between mother and daughter, which culminated in Mrs Waring serving a notice to quit on Ms Eacott. Unfortunately for Mrs Waring, she didn't enforce the notice to quit and instead opted to fight against her liability following the Cockings' commencement of proceedings. The service of a notice to quit and reluctance to then enforce it clearly demonstrated to the court that Mrs Waring had the power to remove Ms Eacott, but chose not to.

As Mrs Waring had an immediate right to possession of the property, she had control and Ms Eacott at no point had the right to exclude her mother from the property. It has been demonstrated that an owner may be regarded as an occupier of the property for the purposes of nuisance, even if they have allowed others to live or undertake activities on their land, provided they maintain control.

As the Judge said in this case, Mrs Waring had been able to abate the nuisance but chose to do nothing "notwithstanding her daughter's unreliability".

As stated "the fact that Mrs Waring was not liable for each and every act of nuisance alleged did not affect the underlying rationale for the proceedings which were brought to force Mrs Waring to do something about the persistent conduct of her licensee, of which she was, as the judge found, aware for a number of years. Mrs Waring's approach was to argue that she had no responsibility and to reject the reasonable attempts by Mr and Mrs Cocking to compromise the proceedings and save the costs of fighting the action."

The appeal court held Mrs Waring not only liable for the nuisance, but also jointly and severally liable with her daughter for the legal costs of Mr and Mrs Cocking.

The family relationship in this case was an important factor and the wider applicability of these rules in a commercial context remains to be seen. However, it is no longer safe to assume, if it ever was, that letting a premises under a licence will result in no liability for the property owner if the licensee commits a nuisance.

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PAYMENT PROVISIONS IN CONSTRUCTION CONTRACTS – RELIEF FOR EMPLOYERS?

In the case of ***Harding trading as MJ Harding Contractors v Paice and another*** [2015] EWCA Civ 1231 the Court of Appeal agreed that despite failing to issue a valid pay less notice and being ordered by an adjudicator to pay sums claimed, an employer can commence further adjudication to challenge the value of a contractor's (final) application.

The facts

Mr Paice and Mrs Springall ("Employer") engaged Harding ("Contractor") under a JCT Intermediate Building Contract 2011. The Contractor terminated the contract and submitted his account for the works. A valid pay less notice was not served by the Employer and the Contractor commenced adjudication arguing that as a result he was entitled to the full amount claimed. The adjudicator agreed and this sum was subsequently paid by the Employer. The Contractor then sought an injunction to prevent the Employer commencing a further adjudication for a decision on the value of the contract works. After an injunction was refused by the Technology and Construction Court ("TCC") the Contractor appealed this decision.

Until the decision by the TCC not to grant an injunction the facts in this case appeared to be following a similar pattern to those in the earlier case of *ISG Construction Ltd v Seevic College* [2014] (albeit ISG was an interim valuation scenario). In ISG, however, a second adjudicator's decision on value was set aside by the TCC on the basis that it related to the same question as previously decided and the adjudicator therefore lacked jurisdiction.

Court of Appeal decision

The Court of Appeal upheld the decision of the TCC and did not grant the Contractor an injunction. It found that the adjudicator had not previously offered any decision on value, it was the failure to serve a valid pay less notice that resulted in the Employer being obliged to pay the sum claimed and this failure should not permanently deprive the Employer of a right to challenge the Contractor's valuation. The Employer was entitled to commence adjudication to assess the value of the termination account and determine sums due under the building contract.

Questions

This decision is likely to be welcomed by employers as preventing what is arguably an administrative error resulting in an irreversible windfall payment to a contractor. On analysis, however, there remain some unanswered questions.

First, whilst the decision does not sit harmoniously with the decision in ISG, the Court of Appeal did not overrule the earlier case and went so far as to state that nothing in ISG contradicts their conclusion that a different regime should apply in relation to final accounts. Whilst this provides relief for employers, it is questionable whether this could be the intended consequence of the Construction Act, which does not draw a distinction between payment provisions in relation to interim applications and those in relation to final accounts.

Secondly, although it seems likely this judgement would be applicable to all final accounts the judgement deals with the valuation of the works upon termination of the contract and as such it is unclear whether the approach of the courts will be that it also relates to other valuations.

Summary

One thing that is clear is that where a payer fails to issue a valid pay less notice they must pay the sum stated as being due in the default payment notice without the need for the amount payable to be valued. There is now case law suggesting that at a later date an employer can refer a dispute in relation to the valuation of the work to adjudication, however, the extent of the ability to do this is not yet clear.

It should not be forgotten that the decision of an adjudicator is only an interim decision and as such a party will be in a position to refer the dispute to an arbitrator/the courts.

Our advice in relation to payment notices remains constant: it is of paramount importance that employers ensure that both they themselves and those tasked with administering their contracts fully understand and strictly comply with the payment notices provisions of the contract. The provisions will be interpreted strictly and the consequences of non-compliance may be far reaching.

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INGENIOUS ARGUMENTS ABOUT THE 1995 ACT FAIL TO GET EMI OFF THE HOOK

EMI Group Limited v O&H Q1 Limited
[2016] EWHC 529 (Ch)

The High Court has considered the validity of an assignment of a lease by a tenant to its guarantor. The anti-avoidance provisions in section 25 of the 1995 Act strictly limit the freedom of contract of parties to leases governed by that Act, broadly, those granted after 1995. Agreements which frustrate those provisions are void – even if they are commercially justifiable. This decision is also highly relevant when doing due diligence on property investments.

After 20 years we are getting a clearer idea of the scope and strength of the anti-avoidance provisions in the Landlord and Tenant (Covenants) Act 1995:

- a tenant which has lawfully assigned its lease can only be made liable under that lease by means of an authorised guarantee agreement (AGA);
- a guarantor to such a tenant can only be made liable under that lease by means of a sub-guarantee under which it backs up the liability of that tenant under an AGA – sub-guarantees were approved in the appeal court's decision in *K/S Victoria Street v House of Fraser (Stores Management) Limited and others* [2011] EWCA Civ 904; and, now
- such a tenant cannot validly assign its lease to its guarantor.

Facts and decision

This case concerned EMI's attempt to avoid its liability under a lease of a HMV outlet:

- *September 1996:* HMV takes a 25 year lease of a shop in Worcester. EMI guarantees HMV's obligations to perform the tenant covenants in the lease.
- *January 2013:* HMV goes into administration.
- *November 2014*: The landlord, O&H, agrees that HMV may assign the lease to EMI.
- *December 2014:* The assignment of the lease to EMI is completed along with the grant of an underlease to a new company, HMV Retail. Shortly afterwards, EMI outlines to O&H its view that, although the assignment of the lease (and the grant of the underlease) were valid, the tenant covenants in the lease were void under the 1995 Act and so could not be enforced against it.

But the High Court ruled that EMI could not validly take an assignment of a lease from HMV:

- The whole thrust of the 1995 Act was that neither tenants nor their guarantors can validly re-assume their liabilities on permitted lease assignments. That was clear under section 5(2)(a) in relation former tenants and section 24(2) in relation to former guarantors.

- So, if a tenant and its guarantor are each subject to the same (or essentially the same) liabilities in relation to the tenant covenants in a lease, neither can as a result of an assignment of the lease re-assume the same (or essentially the same) liabilities.
- The deal that EMI did in 2014 released EMI from its liability to perform the tenant covenants under its 1996 guarantee. But, at the same moment, that deal made EMI liable to perform the tenant covenants as an incoming tenant. This immediate re-assumption of essentially the same liability by EMI frustrated the operation of section 24(2) and so engaged the wide-ranging anti-avoidance provisions in section 25.

The court then considered which parts of the 2014 deal should be ruled to be void. EMI's idea that the tenant covenants in the lease should be void were dismissed. Instead, the court declared that the assignment of the lease was void as this was an agreement relating to a tenancy which had purported to make EMI liable under essentially the same covenants from which it had just been released. So, HMV is still the tenant of the lease – and EMI is still the guarantor and has not been released from its liabilities under its guarantee.

Key points

- The sort of arrangements concluded in this case are often commercially justifiable. Many investors and occupiers will have entered into similar deals over the 20 years in which the 1995 Act has been in force.
- It is a point to be alert to when doing due diligence on investment property, especially as a review of Land Registry information may well not reveal the sort of issues illustrated by this case. A stand-alone guarantee that has fallen away may not be disclosed. It is also an issue to consider when preparing a property for sale.
- If the assignment to EMI was void, then the underlease to HMV, as a derivative interest, was also void. If EMI had assigned then presumably that assignment any subsequent would also be void.
- This case raises questions across portfolios about the identity of tenants.
- Corporate occupiers who have carried out reorganisations in the belief that they have divested companies of liabilities may be in for a surprise.
- As in this case there will be cases where tenants and guarantors have been dissolved. The case also raises questions about the time limits in leases for calling upon guarantors to take new leases.
- The decision hampers intra-group assignments. Currently, a parent company who guarantees a tenant cannot provide a guarantee for an assignee.

Appeal? Reform?

Will EMI appeal? As the court did not give any credit to EMI's argument that the lease had been assigned but that the tenant's covenants did not bind, it is hard to see what EMI would benefit from appealing. Either EMI remain on the hook as guarantor (as was held) or the assignment would not be ruled to be void in which case EMI would be liable as tenant.

It is clear that reform is needed. The Property Litigation Association and other bodies such as the British Retail Consortium and the British Property Federation have been lobbying in respect of getting reform of the 1995 Act on to the political agenda. The Law Commission has called for evidence and submissions are to be made by the end of June. Proposals put forward by the PLA include the ability for a tenant to assign to its guarantor and the ability for a guarantor to stand as guarantee for an assignee provided that the tenant, guarantor and assignee are all group companies.

For now, unsatisfactory as the position is, it is a case of wait and see. We will of course keep you updated.

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