



# Quarter-Day

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## To break or not to break?

Keith Conway, London

A solicitors' letter, simply requesting the landowner's solicitors' bank details, was held to be a valid notice extending an option period by a further five years; even though the developer's solicitors never intended the letter to be a notice extending the option period; even though formal board authority for the extension was yet to be given by the developer; and even though payment of the additional £20,000 due to the landowner was not made before the expiry of the initial option period. The High Court's recent decision in *Rennie -v- Westbury Homes (Holdings) Ltd [2007] EWHC 164 (February 2007)* applies the well known House of Lord case of *Mannai Investment Co Limited -v- Eagle Star Life Assurance Co Ltd [1997] AC 749* with perhaps a surprising result.

### THE FACTS

A landowner granted a 10 year option over certain land to a developer housebuilder. Clause 9.1 of the option agreement gave the developer a right to "... at any time during the last year of the Option Period... by notice in writing served upon the [landowner] require such period [i.e. the life of the option] to be extended by 5 years and upon service of such notice and payment to the [landowner] of the additional sum of Twenty Thousand Pounds (£20,000) this Agreement shall be construed as if the Option Period was 15 years." Service of notices was permitted by or on the developer's or landowner's solicitors.

The option agreement expired at midnight on 16 September 2002.

However, the developer's solicitors wrongly believed the option agreement expired on 17 September 2002. On 12 September 2002 the developer's solicitors wrote to the landowner's solicitors: "We shall very shortly be placed in funds for the extension of the option for a further 5 years upon payment of £20,000 by [the developer] (clause 9.1 refers)." The letter then requested the landowner's solicitors to fax their bank details. However, the landowner's solicitors did not respond and on 17 September 2002, the developer's solicitors transferred the £20,000 and faxed the landowner's solicitors confirming this had been done; having by then obtained the correct bank details from a secretary.

# The landowner's solicitors first acknowledged receipt of the £20,000 "relating to the extension of the option...". Then two days later wrote and contended that the extension of the option was invalid and sought to return the £20,000.

The landowner's solicitors first acknowledged receipt of the £20,000 "relating to the extension of the option...". Then two days later wrote and contended that the extension of the option was invalid and sought to return the £20,000. Following this the developer's solicitors alleged that their letter of 12 September 2002 was in fact a valid notice under clause 9.1 and that it was perfectly in order for the £20,000 to be paid within a reasonable time even if this was after the initial 10 year option period.

## THE ISSUES

- Did the letter of 12 September 2002 "require" an extension of the option or was it simply a statement of future intent?
- Would a reasonable recipient of the letter of 12 September 2002 (with knowledge of the factual and contextual background) be left in no doubt that the developer was exercising its right to extend, thereby satisfying the House of Lords test in *Mannai*?
- Did it matter that the developer's solicitors never intended the letter of 12 September 2002 to be a notice under clause 9.1?
- Did it matter that the developer's formal board approval for the extension was only given some days after the letter of 12 September 2002?

## THE DECISION

Mr Justice Henderson held that the option period had been validly

extended. Clause 9.1 only required that two conditions be satisfied. First the notice had to be in writing. Secondly, the notice had to be served on the landowner or its solicitors during the last year of the option period. Whilst clause 9.1 stated that the notice had to "require such period to be extended by 5 years" this aspect fell within the *Mannai* test. It was sufficient that the reasonable recipient with knowledge of the factual and contextual background would understand the letter of 12 September 2002 to be a notice extending the option. Looked at objectively the recipient would understand that the letter of 12 September 2002 was concerned with the exercise of the right to extend the option period under clause 9.1, that the last year of the option period would expire in a few days, that the developer had a unilateral right to extend, that the obligation to pay £20,000 only arose if a valid notice was served, and that there was nothing tentative or perplexing in the letter of 12 September 2002. The developer intended to exercise its right to extend and the letter was emphatic that the £20,000 would be paid shortly. The subjective intentions and understandings of the developer and/or its solicitors were irrelevant. It was inherent in the objective nature of the *Mannai* test that a document never intended by the sender to be a valid notice might nevertheless operate as one and vice versa. There was no timing

requirement in respect of payment. It was therefore to be implied that the £20,000 had to be paid within a reasonable period of time. The developer had done this.

## PRACTICAL POINTS

- A well drafted option will tend to avoid many of these issues, normally by agreeing in advance (perhaps in a schedule to the Agreement) the exact form of notice required to be served. This will avoid confusion and give less opportunity for a dispute to arise.
- A well drafted option will tend to be specific about the precise date and manner of payment and whether payment must accompany the notice or be paid within a defined period of time.
- Great care needs to be taken if solicitors agree to accept or serve option notices (particularly in respect of lengthy periods ahead). This decision might be utilised by a landowner to claim against a developer that an option had been extended despite that not being the intention of the solicitor or his developer client.



## Code compliant

Nick Lloyd, London

**The new RICS code on service charges will come into force on 1 April 2007. The code is a 'best practice' guide, published in response to the perception that a voluntary code of conduct in respect of service charges was long overdue. It remains to be seen how effective the Code will be as it has no legislative force. The reality is that respectable commercial landlords are likely to be keen to be seen to comply with the code, bearing in mind its status as official RICS material and the possibility that failure to comply with it could be taken into account in any dispute with a tenant as to the service charge.**

### BACKGROUND

A 2005 RICS Tenant Satisfaction Survey demonstrated that tenants were generally dissatisfied with the services they were provided with, were concerned with the lack of communication between landlords and tenants and the inadequacy of dispute resolution options.

The Code reflects the industry's most desirable structure for service charges and most property companies are geared up to bring their standard leases in line with Code standards. However, there is no standard form of service charge clause.

### GENERAL PRINCIPLES

The aims of the Code are:

- **Dispute resolution.** To remove service charges as an area of conflict, and

establish an effective dispute resolution procedure where conflict cannot be resolved.

- **Transparency and communication.** The Code encourages and requires continuous, regular and effective communication as to the planning implementation and review of service charges. When significant variances (the example given being of more than 2% above RPI) in the total annual spend, or where substantial works are planned, best practice requires that the tenant is informed promptly and kept up to date of developments.
- **Not-for-Profit.** The Code acknowledges that there will be an element of 'profit' in terms of an individual supplier's profit element. The emphasis is on value for money, and the services to be provided

must be relevant, appropriate and cost effective. This does not mean that the lowest tender for works has to be accepted - so long as the choice is value for money and an effective option.

- **Deliver a budgetable and forecastable part of a tenant's overheads.** All services are to be provided commercially and professionally. The landlord has to ensure that the standard of service, and the quality and cost of the services are regularly reviewed and that sound management procedures are adopted, so as to provide the tenant with value for money. To that end, service quality has to be appropriate to the location, use and character of the building (which acknowledges that the standard of services may depend on a number of variables).

# Time will tell whether the courts will be persuaded by tenants that the service charge provisions in the renewed lease should differ from the old lease, so as to reflect the Code.

## SPECIFIC CODE PROVISIONS

So how are these principles reflected in specific guidance?

- **Budgets and certificates.** The lynchpin of the financial controls the Code promotes is the issue by landlords of budgets to tenants - at least one month prior to the start of the service charge year - with final accounts within 4 months of the year end.
- **Service standards - Industry standard costs codes.** Contractors and managers will be required to perform according to written performance standards. In brief, the Code incorporates a cost code structure that takes the average of service charges for similar properties and provides a guide to the cost effectiveness of the management service. Performance has to be regularly measured and reviewed against that standard.
- **Management fees.** The fee for the management service must be reasonable and must not be linked to a percentage of expenditure. The price for the management service is to be a fixed fee and may include indexing.
- **Apportionment.** Whatever method is used, it needs to be demonstrably fair and reasonable. An apportionment schedule must be made available to tenants showing the breakdown of apportionments. Tenants are not to be charged for unlet premises, and the landlord should meet the cost of any special concession given to a new

tenant. In addition, the landlord will bear a proper proportion where it also uses the property, for example, as a regional office.

- **Shopping Centre Services.** The Code makes additional provision for shopping centres, retail and leisure parks. The Code recognises that marketing is a cost to be borne by both landlords and tenants; the tenant's contribution should be agreed at the lease negotiation stage. Income derived from the provision of services to the tenant, the financing of which is recovered through the service charge, is to be treated as a service charge credit. A landlord is obliged to have a clear statement of policy on how such income (and costs) is to be allocated.

## NEW LEASES

The Code does recognise that implementation may present landlords with practical difficulties. The Code states that landlords may have to operate dual service charge regimes and put in place other interim measures to ensure the operation of its services until all leases are on the same basis.

The Code also recognises the limitations to full modernisation of service charge provisions where a tenancy is being renewed under the terms of the Landlord and Tenant Act 1954. Of course, if the parties agree that the renewal lease should reflect the Code, then there is no difficulty. If

agreement can't be reached, the court will need to be given a good reason based on essential fairness, to deviate from the "old lease" terms.

Consequently, time will tell whether the courts will be persuaded by tenants that the service charge provisions in the renewed lease should differ from the old lease, so as to reflect the Code.

## EXISTING LEASES

The Code will not override the terms of existing leases. However, landlords will be expected to match their delivery as closely to the Code as possible, and seek to interpret existing service charge clauses in line with the Code, where possible.

## CONCLUSION

- There is a great deal of detail in the Code which cannot be covered by this article, and owners of premises will need to seek individual and specific advice on how the Code will impact on them.
- The Code will require careful thought as to how the delivery of services is administered, which is likely to mean a thorough review of the relationship between landlords and their managing agents.
- The Code is not intended to be a dry analysis of how service charges should be administered, but is intended to bring about a cultural change in how the industry views service charges.



## No protection for mixed premises

Tara Healy, Sheffield

**In the recent case of *Phaik Seang Tan & Another -v- Julian Sitkowski [2007] EWCA Civ 30* the Courts have again been asked to consider the question whether premises let for mixed business and residential purposes can attract protection under legislation that applies to tenants of residential premises in relation to the residential part of those premises once the tenant stops using the business part of the premises for a business.**

### THE FACTS

Mr Sitkowski was granted a tenancy of 'mixed use' premises on York Road, London in the 1970's by the local authority. He used the ground floor for his electrical retail business and used the first floor as a residence for himself and his family.

In 1989 Mr Sitkowski permanently ceased his business use of the ground floor, but continued living on the first floor of the premises with his family.

In 1990 new landlords (Mr Phaik Tan and Mr Kit Tan) bought the whole of the premises from the London Residuary Board. In October 2003 the new landlords served notice to quit on Mr Sitkowski but Mr Sitkowski and his family remained in occupation of the residential part of the premises. The new landlords also continued to accept rent

from Mr Sitkowski, which was paid by the local authority as housing benefit.

Relationships between the parties deteriorated and the new landlords issued proceedings to recover possession from Mr Sitkowski and his family in the County Court. Mr Sitkowski defended the proceedings, claiming the protection of the Rent Act 1977.

### THE RENT ACT 1977

The Rent Act 1977 gave various forms of protection to tenants of residential premises. Tenancies within the parameters of the Rent Act were known as 'regulated tenancies' and benefited from 'security of tenure', that is to say the rights of a landlord to evict a regulated tenant were quite severely restricted. When a 'regulated tenancy' was ended by a notice to quit, a 'statutory tenancy' would arise automatically, so that the tenant still enjoyed statutory protection.

In order to qualify as a 'regulated tenancy' under the Rent Act the tenancy had to:

- Be of a 'dwelling house';
- Let as 'a separate dwelling'; and
- Not be one that was subject to the separate regime of statutory protection given to business tenancies under the Landlord and Tenant Act 1954.

### THE COUNTY COURT DECISION

The County Court Judge found in favour of the landlords and ordered Mr Sitkowski and his family to leave the premises.

The Judge decided the case on the basis that Mr Sitkowski had not enjoyed protection under the Rent Act in relation to his tenancy when it had been granted because the premises had been let initially as 'mixed use' premises. It followed that at the expiry of the 2003 notice to quit, Mr Sitkowski had not become a statutory tenant under the Rent Act and therefore had no statutory protection. Mr Sitkowski appealed against this decision.

### THE ISSUES ON APPEAL

The landlords argued that there was decided case law binding on the Court of Appeal to the effect that, if a tenancy was granted for mixed residential and business use (and was therefore governed by the provisions of the business tenancies regime of the Landlord and Tenant Act 1954 when that tenancy was entered into) the tenant could not, by unilaterally discontinuing his business use at the premises, gain the protection of the Rent Act in respect of ongoing occupation of the residential part. Mr Sitkowski's tenancy was not of 'a separate dwelling' within the meaning

# This case appears to lay to rest the issue whether 'mixed use' tenancies can acquire the protection given to residential tenancies under the Rent Act when business use stops.

of the Rent Act, because it was a business tenancy under the Landlord & Tenant Act.

Mr Sitkowski argued that as he no longer used the ground floor of the premises for his business, he was no longer a protected business tenant and therefore his tenancy could, and did, qualify for the protection of the Rent Act. When the 2003 notice to quit expired, he argued, he was a 'statutory tenant' under the Rent Act and the procedures under that Act had to be followed before he could be required to vacate. The procedures had not been followed and Mr Sitkowski therefore claimed he could not be required to leave the premises.

## THE COURT OF APPEAL DECISION

The Court of Appeal decided that the premises were not 'let as a separate dwelling' within section 1 of the Rent Act because the initial letting was for the purposes of mixed business and residential use. Mr Sitkowski's contention that he had a protected tenancy was rejected.

Guidance as to the meaning of the phrase 'let as a separate dwelling' was provided by the recent case of *Patel -v- Pirabakaran* [2006] EWCA Civ 685, (see Quarterday article, June 2006) in which the Court of Appeal considered similar wording in the context of the Protection from Eviction Act 1977.

In *Pirabakaran* the Court had to consider whether section 2 of the

Protection from Eviction Act 1977, which only applies to premises 'let as a dwelling', extended to premises used for mixed business and residential purposes. The Court decided that it did.

In the *Sitkowski* case the Court had to decide whether mixed use premises were 'let as a separate dwelling' in the context of the Rent Act.

The Court considered its earlier decisions in the context of the Rent Act - *Pulleng -v- Curran* [1980] 44 P & CR 58 and in *Wagle -v- Trustees of Henry Smith Charity* [1990] QD 42: here the Court of Appeal had rejected tenants' arguments that they were protected by the Rent Act when business use of mixed use premises had stopped.

The Court in *Sitkowski* found most of the reasoning in *Pulleng* and *Wagle* either flawed or, in the case of one judgment "incomprehensible". The main issue the Court had to consider in *Sitkowski* was therefore whether or not it was bound to follow these earlier decisions. On this point Lord Justice Neuberger said "... decisions, even of fairly recent origin, of the Court of Appeal in this area are not immune from being overruled by this court if we are satisfied the reasoning does not bear analysis."

The Court was not bound to follow the earlier case law. Unfortunately for Mr *Sitkowski* and his family however, this Court of Appeal reached the same conclusion as the earlier Courts of Appeal had done.

## COMMENT

This case appears to lay to rest the issue whether 'mixed use' tenancies can acquire the protection given to residential tenancies under the Rent Act when business use stops. However, the Court acknowledged that it can look again at issues that have been the subject of earlier, apparently binding cases if the reasoning in the earlier cases 'doesn't bear analysis'. This may be viewed by some as an invitation to challenge apparently settled issues, so watch this space!



## Landlord's duty to mitigate loss

Nick Wood, London

The Courts have recently had to grapple with the question whether or not a landlord is under a 'duty to mitigate' his loss when pursuing a tenant for arrears of rent. This issue was considered by the Court of Appeal in the case of *Robert Reichman & Anor -v- Sarah Beveridge & Matthew Gauntlett (2006) EWCA Civ 1659*.

### THE FACTS

The Defendants were a firm of Solicitors in Hampshire. They occupied office premises under a lease granted in 2000 by the Claimant landlords, for a term of 5 years.

The Court considered that there was 'nothing unusual about the lease'. It was for a 5-year term at a rent of £23,010 per annum payable monthly in advance. The lease was 'contracted out' of the security of tenure provisions of the Landlord and Tenant Act 1954. It contained 'normal' covenants as to repair, alienation, user and forfeiture, the latter of which permitted the landlord to forfeit for non-payment of rent that remained unpaid for 14 days after falling due.

The tenants ceased to practise as Solicitors in February 2003 and then failed to pay the rent that fell due, on 25 March 2003 and subsequently, and later vacated the premises.

In January 2004, the Claimants issued proceedings to recover the arrears - exercising their choice to obtain a money judgment for the sums due to them, rather than ending the lease by forfeiture.

The tenants defended the claim arguing that the Claimant landlords had not 'mitigated' (or acted so as to reduce or even minimise) their loss by

- Failing to forfeit the lease;
- Failing to instruct agents to market the premises;
- Failing to accept the offer of a prospective tenant who wanted to take an assignment or a new lease of the premises; or
- Failing to accept an offer from the First Defendant to negotiate payment to surrender of the Defendants' lease.

### THE ISSUE

This raised an interesting issue, namely whether or not a landlord was under a duty to mitigate his loss when seeking to recover arrears of rent. The High Court held that the landlord was under no such duty. The tenants lodged an appeal.

The tenants argued that a lease should be treated as any other contract, and

therefore subject to usual contractual principles such as the duty to mitigate loss.

The courts have stated in the past that leases are subject to usual contractual principles and the Court of Appeal was content that the doctrine of 'mitigation of loss' would apply where a landlord's claim was for damages for breach a covenant in a lease, because this is a claim for compensation for loss suffered by the landlord.

The notable point in *Reichman*, however, was that the tenants' argument was that the principle requiring a landlord to mitigate his loss should apply not only where a landlord sues for damages, but also where a landlord simply sues the tenant to recover arrears of rent, which is purely a claim for a debt.

### THE DECISION

The Court of Appeal decided in favour of the landlords. Examining the relevant case law, the Court held that only in very limited circumstances could an obligation to mitigate loss apply in the context of the recovery of arrears of rent, namely if

- Any loss caused by the lease coming to an end could be adequately compensated for by a damages claim; and

- The landlords' decision not to end the lease (i.e. by forfeiture) was "wholly unreasonable".

As to the first element of the test Lord Justice Lloyd pointed to the fact that if a landlord forfeits and takes back possession of a property following a tenant's default and suffers loss of rent as a result (perhaps because the premises cannot be re-let immediately), the landlord cannot recover those losses from the tenant because English law does not allow for the recovery of so-called 'loss of bargain' damages for any loss of future rent. Therefore an award of damages will not be an adequate remedy for a landlord in these circumstances.

As to the second element of the test, Lord Justice Lloyd said: "Given the extremely limited nature of the test ('wholly unreasonable'), it would have to be an extraordinary case for a tenant to be able to show that the landlord's conduct could properly be characterised in this way".

The Court rejected the tenants' argument in *Reichman*, which effectively was that any landlord, knowing that a tenant had abandoned the premises, ought to take steps to terminate the lease, re-let and then seek to recover any resulting losses from the tenant.

### PRACTICAL POINTS

- Only in very unusual circumstances will a landlord's choice between the

right to forfeit and other remedies for non payment of rent be curtailed by a duty to mitigate its loss.

- *Reichman* serves as a reminder that landlords have a number of options to deal with defaulting tenants, and forfeiture is not always the best of the available options.
- Once forfeit, a lease and any derivative interest, such as a sub-lease, will fall away. Forfeiture will also determine the obligations of any guarantor, sub-lessee (of whole or part) or former tenant still liable to perform the tenant covenants.
- To preserve the benefit of covenants given in a lease and to allow a landlord to consider further options - such as levying distress or serving notice on a subtenant under Section 6 of the Landlord and Tenant Act 1908 (allowing a landlord to recover rents direct from a subtenant until the tenant's rent arrears have been satisfied) - the landlord will need to keep the lease alive.

### NOTES FROM THE EDITOR

1. In the case of *Scottish & Newcastle plc -v- Raguz* the Court of appeal has confirmed the earlier decision of the High Court (see *Quarterday* article, June 2006): Notice under Section 17 of the Landlord & Tenant (Covenants) Act must be served to preserve a landlord's right to pursue against former tenants (or guarantors) 'backdated' arrears generated on rent review.

2. A new revision of the 'Commercial Lease Code' is expected to be published on 28 March 2007. Highlights are expected to include:

2.1 Break clauses should be conditional only on payment of basic rent and vacant possession;

2.2 Underlettings should be allowed at market rent, even if less than passing rent;

2.3 Underleases that exclude the protection of the 1954 Act should not be required to be on the same terms as the lease; and

2.4 Internal non-structural alterations should be notified to the landlord but should not generally require consent.



**N A B A R R O**  
CLARITY MATTERS

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