LANDS TRIBUNAL FOR NORTHERN IRELAND

LANDS TRIBUNAL AND COMPENSATION ACT (NORTHERN IRELAND) 1964

BUSINESS TENANCIES (NORTHERN IRELAND) ORDER 1996

IN THE MATTER OF AN APPLICATION

BT/36-38/2021

BETWEEN

HERBERT SMITH FREEHILLS LLP – APPLICANT

AND

FITZWILLIAM TRUSTEES NUMBER 1 LIMITED & FITZWILLIAM TRUSTEES NUMBER 2 LIMITED

AS TRUSTEES OF THE TULLYHAPPY PROPERTY UNIT TRUST – RESPONDENT

Re: The Cylinder Building, 3 Cromac Quay, The Gasworks, Belfast

Lands Tribunal – The Honourable Mr Justice Huddleston, President and

Henry Spence MRICS Dip Rating IRRV (Hons), Member

Background

1. The premises occupied by Herbert Smith Freehills LLP ("the applicant") comprise part of the building originally known as Plot 6, 3 Cromac Quay, Belfast and which is now known as the Cylinder Building, 3 Cromac Quay, The Gasworks, Belfast.

2. The applicant occupies part of the ground floor and the entirety of the mezzanine floor and second floor ("the reference property"). The remainder of the building is occupied by a different tenant. Fitzwilliam Trustees Number 1 Limited and Fitzwilliam Trustees Number 2 Limited as Trustees of the Tullyhappy Property Unit Trust ("the respondent") are the landlord for the entire building.

3. The premises that constitute the reference property are held under three separate leases.

4. The first lease is dated 16th December 2010 ("the 2010 lease") between Belfast City Council (1) Ormeau Gasworks Limited ("Ormeau") (2) and the applicant (then known as Herbert Smith LLP) (3). The 2010 lease demised the mezzanine and second floors on the south side of the building for a term of 10 years from 16th December 2010.

5. On the same date as the 2010 lease, the applicant and Ormeau entered into an Agreement for Works. Under this agreement the applicant carried out extensive fitting-out works to convert the part of the reference property demised by the 2010 lease from "shell and core" to a full Grade A Cat A office specification.

6. In or around 2013 the applicant decided to expand and incorporate the rest of the mezzanine and second floors on the north side of the building. At that time Ormeau was in administration.

7. By a lease dated 21st August 2013 ("the 2013 lease") and made between Belfast City Council (1) Ormeau (2) the applicant (3) and the administrators of Ormeau (4) the mezzanine and second floors on the north side of the building were demised to the applicant for a term from 27th June 2013 to 15th December 2020, thus having the same expiry date as the 2020 lease.

8. On the same date the applicant and Ormeau, acting through its administrators, entered into an Agreement for Works. At that time, the part of the reference property demised by the 2013 lease required to be upgraded from "shell and core" to a full Grade A Cat A office specification. As Ormeau was in administration, it could not afford to carry out the works required under the 2013 Agreement for Works. The applicant carried out and paid for all of the works – i.e. those that one might normally associate with being the responsibility of the landlord as well as those of the tenant. The document drew that distinction.

9. The applicant subsequently decided to further expand and, by a lease dated 24th June 2014 ("the 2014 lease") made between Belfast City Council (1) Ormeau (2) the applicant (3) and the administrators of Ormeau (4), the ground floor of the south side of the building was demised to the applicant, for a term from 3rd December 2014 to 15th December 2020, thus expiring on the same date as the 2010 and 2013 leases.

10. The position with the part of the reference property held under the 2014 lease is the same as the parts held under the 2010 and 2013 leases, in that they were in a "shell and core" condition and required to be fitted-out to Grade A Cat A office specification. Ormeau could not afford to pay for those works. The applicant and Ormeau again entered into an Agreement for Works, approximately one month after the date of the 2014 lease, which was materially in the same terms as the Agreement for Works in respect of the parts of the reference property demised by the 2010 and 2013 leases, that is the applicant would carry out and pay for the Grade A Cat A works.

11. The Tribunal has been advised that the applicant spent in excess of £1.8M in relation to the Grade A Cat A works carried out to the premises held under the three leases.

12. The respondent acquired the building from Ormeau in or around September 2014.

13. As the leases have now expired, the applicant has applied to the Lands Tribunal for the grant of a new tenancy under the terms of the Business Tenancies (Northern Ireland) Order 1996 ("the Order"). The parties have been negotiating the terms of a new lease but a preliminary issue has arisen on the question of whether, for the purposes of assessing the rent payable under the new tenancy, the reference property is to be regarded as fitted out to Grade A Cat A or alternatively to a "shell and core" specification.

14. This is the preliminary issue to be decided by the Tribunal.

The Statute

15. Article 18 of the Order states that the rent payable under a new tenancy is the rent that the holding might reasonably be expected to let in the open market by a willing lessor subject to there being disregarded:

> "18(2)(c) any effect on rent of any improvement –
>
> (i) carried out by the tenant or a predecessor in title of his; or
>
> (ii) where the tenant or predecessor in title of his has remained in occupation of the holding during two or more tenancies, carried out by him or that predecessor in title during a tenancy other than the current tenancy;
>
> **other than in pursuance of an obligation to the immediate landlord**."
>
> [Emphasis added]

Position of the Parties

16. The applicant's position is:

(i) The tenant's works were not carried out by way of an obligation to the landlord and are therefore to be disregarded under Article 18(2)(c) of the Order when assessing the rent. It also argues that the landlord's works (as defined in the Agreements for Lease) were expressly deemed not to be undertaken pursuant to an obligation to the landlord by way of clauses inserted in the leases and that by extension the tenant's works were therefore also to be disregarded;

(ii) For the purposes of assessing the rent payable under the new tenancy, pursuant to Article 18 of the Order, the premises are to be regarded as fitted-out to "shell and core" specification.

(iii) If this result is not achieved by way of disregards in Article 18(2)(c) of the Order, then the applicant argues that there will have to be further exchanges between the experts and perhaps a further hearing to determine the extent of the

applicant's fixtures and fittings, which would then fall to be excluded as not being part of the holding to be valued.

17. The respondent contends that:

    (i) When the contractual documents were read as a whole and given their ordinary and plain meaning, the tenant was under an obligation to the landlord to undertake the works to transform a bare shell into premises fit for the purposes of the tenant – in this case to a Grade A Cat A finish as appropriate for an internationally renowned firm of solicitors.

    (ii) Consequently, for the purposes of the rent review, the experts for the parties should now prepare their reports on the basis that the tenant's works undertaken by the tenant are not to be disregarded under Article 18(2)(c) of the Order and should be rentalised.

Procedural Matters

18. The applicant was represented by Mr Richard Coghlin KC and [Douglas Stevenson BL], instructed by Carson McDowell, solicitors. Mr Stephen Shaw KC and [Keith Gibson BL], instructed by Luke Curran & Co, solicitors, represented the respondent. The Tribunal is grateful to the legal representatives for their helpful submissions.

The Authorities

19. The Tribunal was referred to the following authorities:

- Smith v Chadwick [1882] 20 CH D27
- Manks v Whiteley [1912] 1 CH 735 at 754
- Ridley v Taylor [1965] 1 WLR 611

- Godbold v Martin the Newspapers Ltd [1983] 2 EGLR 128
- Toyota (GB) Ltd v General Assurance (Pensions Management) Ltd [1989] 2 EGLR 123
- Historic Houses Hotels Ltd v Cadogan Estates [1993] 2 EGLR 151
- Cherry Tree Investments Ltd v Landmain Ltd [2013] 2 WLR 481

20. And to the following text:

- Ross: Commercial Leases para 411 "Obligation to the Landlord"

The Issues

21. In his submissions Mr Shaw KC suggested that the following three issues were relevant to the subject reference and required consideration from the Tribunal. The Tribunal agrees:

(i) Fairness

(ii) The Case Law

(iii) The Leases and Agreements for Works

Fairness

22. On behalf of the applicant Mr Coghlin KC submitted:

(i) It was prima facie unfair that the applicant should pay upwards of £1.8M improving and upgrading the respondent's building and then have to pay "double" by having the applicant's works included in the rental value at lease renewal.

(ii) That tenant's works are not normally included in such a calculation as Article 18(2)(c) states that such works should be disregarded, unless carried out as an obligation to the landlord.

(iii) That at the commencement of the proceedings the respondent and the respondent's expert initially took the view that the tenant's works should not be included on the basis that there was no such obligation and that Mr McCombe, the respondent's expert at that time, had submitted an expert report on that basis.

(iv) That as the Leases state that the tenant's works are specifically to be disregarded at rent review, which was then to be based on a shell and core standard the same disregard(s) should apply at lease renewal. It was an absurd situation that the tenant's work were disregarded at rent review but included at lease renewal.

23. In support Mr Coughlin KC referred the Tribunal to the following authorities and specifically extracts from Historic Houses Hotels v Cadogan Estates:

(i) He pointed out that Kane J in that case noted:

> "The economic justification for such a disregard is not far to seek. It is not particularly fair that a tenant, who, at his own expense, voluntarily improves the demised premises, should thereafter have to pay rent not only on what the landlord contributed, the unimproved premises, but also on the improvements."

And

> "There is also force in the submission that had the somewhat startling result contended for by the landlord been intended the parties would have been likely to say so in [clear/express] terms."

And

> "Mr Neuberger, with becoming modesty, described the result for which he contended as in the nature of a windfall for the landlords. I agree it would be a windfall but, in my view, the apple stays on the tree …".

(ii) Turning them to the subsequent EWCA decision in Historic Houses, he cited Dillon LJ:

> "A proviso that improvements at the tenant's expense should be disregarded in fixing the rent is common in rent review clauses and is also included in the provision for determining the rent of a new lease under Part II of the Landlord and Tenant Act 1954. It is there because prima facie it is unfair that a tenant's rent should be increased on account of improvements made at his own expense."

And

> "In my view this makes it very difficult to argue that the tenant would voluntarily have accepted terms having such an effect unless the language of the relevant clause makes this very clear …".

This raises two propositions (i) the question of the fairness of the bargain but also (ii) the need for express or clear language where there is likely to be dispute as to fairness as between the parties.

24. Mr Shaw KC asked the Tribunal to note that, at the time of agreeing the 2010, 2013, 2014 leases the respondent was in financial difficulties culminating in it going into administration. He suggested that there was no option other than the applicant paying for all of the works and for which, in return, they would receive concessions in the various leases. He submitted that this was the commercial deal made between the parties and he referred to the following concessions in the leases and deeds of variation by which certain of the concessions were documented:

(i) The tenant's works were not to be included at rent review.

(ii) 15 months rent free periods.

(iii) There was a cap on service charges of £2 per sq ft.

(iv) Break clause options.

(v) Concessionary rents.

25. He submitted that, as the respondent was in administration, the parties struck a deal whereby the respondent would get the benefit of the improvements at lease renewal in 2020 and the applicant would correspondingly receive significant concessions for the first 10 years of the lease.

26. Mr Coghlin KC responded that the "concessions" were not particularly favourable for the applicant for an outlay of in excess of £1.8M. He also submitted that there was no proof provided that the rents were concessionary within the prevailing market context at that time. This point was raised by the Tribunal and it was confirmed that there was no evidence on what market trends were at that time in terms of these alleged concessions or, indeed, the level of rents at that time.

27. The Tribunal considers it highly unlikely that the applicant, for an outlay of £1.8M would have "struck a deal" to receive limited concessions for the first ten years and then be content to have those "concessions" rentalised thereafter. For such a position to prevail the Tribunal would require either very clear language on the point and/or evidence as to the prevailing market conditions and/or established practices in the market at that time. This is more so when, as the Tribunal pointed out, that 'an obligation' of the type argued for by Mr Shaw KC is often valued in tax terms as a premium – for which the respondent at the time would have been liable.

28. The Tribunal, therefore, agrees with Mr Coghlin KC, the inclusion of the tenant's works at lease renewal are prima facie unfair and would not have been envisaged by the applicant. In that context, however, the Tribunal moved on then to consider the contractual arrangements between the parties under the respective leases and agreement for works, to ascertain

whether the documented position as between the parties could support the argument that the tenant's works could be rentalised on renewal notwithstanding such prima facie unfairness. In other words was there language which clearly imposed such an obligation.

The Case Law

29. Mr Coghlin KC referred the Tribunal to the following authorities from the jurisdiction in England and Wales. Sections in bold are Mr Coghlin KC's emphasis:

30. The first case the Tribunal was taken to was Ridley and Another v Taylor in which the EWCA considered an application to modify a restrictive covenant in a lease. The subject covenant was that the lessee was **not to make any alterations** to the structure and was to keep and use the premises as a private dwelling house only.

31. In 1950 the landlord had granted the tenant a licence **to convert** the premises to 5 flats and thereafter 3 private maisonettes – an action which was otherwise prohibited by the covenant in the lease against making alterations.

32. The licence also gave permission **to use** the premises as 5 flats until 1st February 1956, or until consent was received from the appropriate authorities to convert to 3 maisonettes and thereafter to use the premises as 3 maisonettes.

33. Clause 10 of the licence appeared to impose a positive obligation upon the tenant to convert the premises to 3 maisonettes:

> "The lessee hereby further covenants with the landlord as follows: -
>
> (i) …

(ii) **To complete in a proper and workmanlike manner** and with suitable materials to the satisfaction of the estate surveyor of the landlord and in accordance with the said drawings **the alterations to the said premises and the works consequent thereon** and

(iii) To do all things necessary and make all payments required for complying with the legal requirements of and obtaining the consent of the district surveyor or any other requisite consent or permission … of any appropriate public or local authority to the said alterations and works."

34. It was assumed before the Lands Tribunal that there was **a positive covenant** in the licence to complete the works to convert the premises to 3 maisonettes and argued that the positive nature of the covenant meant that the Lands Tribunal's jurisdiction, which was directed at **restrictive** rather than positive covenants, did not apply. Russell LJ dealt with this argument as follows at 620(12):

> "Before the Lands Tribunal it was assumed that there was in the licence a positive covenant by the lessee to carry out the three maisonette conversion, and before us it was argued that there was no jurisdiction under the section to relieve from that positive obligation. The Lands Tribunal accepted the argument for the lessee that this point was unsound; apparently this argument was that either there was no time within which the positive covenant must be carried out, or that if a reasonable time was to be implied, it had long since gone by, and the obligation had been waived, therefore the modification would not affect the positive covenant. **For my part I have no doubt that the covenant to complete the conversion in Clause 10(11) to the satisfaction of the estate surveyor is not a covenant to carry it out, but a covenant that if it is carried out it will be done in a particular manner. The sanction, if it could be and is not carried out, is that the lessee remains bound by the original restriction in the lease to use as a single private dwelling-house**."

35. Harman LJ dealt with the issue as follows at 616[10]:

"In my judgement, on the true construction of the licence there is no obligation on the tenant, as there was apparently considered to be under clause 10(11), to convert the property in to three maisonettes. The tenant may, if he chooses, continue to use the property as a single private dwellinghouse as in fact he has been doing since 1951 …

That seems to me to be the legal position today apart from the Tribunal's order. The landlord cannot compel conversion in to three maisonettes. He can oblige the tenant, unless he so converts, to use the property as a single dwelling-house and to pay the rent under the lease. The tenant cannot be obliged to convert but may not use the property for letting as five flats."

36. Mr Shaw KC in his contrary argument suggested that none of the applicant's authorities were on all fours with the facts in the subject reference and, indeed, went further to say that the factual circumstances were far removed. His position was that in all of the quoted authorities the tenants had beneficial use of the premises without the proposed works being carried out and that language under consideration in each amounted to mere permission to carry out inessential works.

37. He argued, however, that in the subject reference the applicant could not physically occupy the reference property without first carrying out the essential works to enable it to occupy as solicitors offices.

38. In Ridley specifically:

    (i) The landlord could not compel the tenant to convert the premises into three maisonettes.

    (ii) The tenant could enjoy the building right from the start of the lease and there was no requirement that he do the works in order to live there.

39. In Godbold, HHJ Blackell-Ord considered whether a rent review clause which required improvements to be carried out under 3 licences should, or should not be, taken into account in fixing the new rent (128[63]). The rent review clause required the following to be disregarded:

> "Any effect on rent of any improvement of the demised premises or any part thereof carried out by the Tenant at the Tenant's expense **otherwise than in pursuance of any obligation to the Landlord** and carried out during the current tenancy or in respect of which the conditions as contained in section 34 of the Landlord and Tenant Act 1954 as amended by section 1 of the Law of Property Act 1969 are satisfied."

40. The landlord relied upon the covenants in the licences in support of the argument that the works carried out under the licences were carried out under obligations to the landlord and were therefore to be rentalised under the rent review clause.

41. HHJ Blackell-Ord framed the question as follows:

> "The question is whether the various covenants by the tenants to do the various works are such as to make them such that they were carried out pursuant to an obligation to the landlord, or not. That depends upon the construction of the respective tenant's covenants and in particular as to whether they are to be construed as imposing a positive obligation on the tenant to carry out the works, or whether simply they impose an obligation on the tenant if he decides to take advantage of the licence, then to carry out the works properly."

The terms of the licences that allegedly created obligations were as follows:

> "**To carry out the said works of alteration in a proper and workmanlike manner using the best obtainable materials** and to comply with the provisions of all Acts of

Parliament and to make good any damage to the demised premises or any part thereof as a result of the works of alteration aforesaid.

(c) To do all things necessary and make all payments necessary for obtaining the consent so far as requisite of any statutory or local authority or owners of adjoining properties and obtain any necessary licence for commencing the aforesaid works of alteration and at his own cost and expense to make good all damage caused through the carrying out of the said works." First Licence 129[65]

And

"5(1) **At its own expense to carry out and complete the said works in conformity with the said drawings and the provisions of the lease in a good and substantial and workmanlike manner** with new good and sound materials within the period and in the manner hereinbefore specified.

(2) Before commencement of the said works to produce to the Landlord for its approval copies of all necessary permissions." Second Licence 129[66]

And

"2. In consideration of this Licence the Tenant hereby covenants with the Landlord as follows:

(1) **At its own expense to complete the said works in conformity with the said drawings in a good and substantial and workmanlike manner** with new good and sound materials **within the period and in the manner hereinbefore specified**.

(2) Before commencement of the said works to produce to the Landlord for its approval copies of all necessary permissions and to comply with the terms and conditions of any such permissions or consent." Third Licence 129[67]

42. HHJ Blackell-Ord rejected the landlord's argument, relying in part, upon the reasoning in Ridley to the effect "that covenants of the nature of which [the court has] been considering are not generally to be construed as imposing positive obligations" 130[68] and continued:

> "… looking at the licences it is clear that they were all granted at the request of the tenant and the language of clause (1) in each case is the **language of permission**. Those claims do not say that it has been agreed that the tenant shall carry out; he is simply granted permission. In my judgement the following clauses are in each case subsidiary to that. Although the wording is different in each case the effect is that the improvements authorised are not to be taken into account in fixing the rent under the present review.

43. Again, Mr Shaw KC considered the facts and circumstances in Godbold were very different from the facts and circumstances in the subject reference. In Godbold, he suggested again, that the tenant was already occupying the newsagents with living accommodation above.

44. He argued that the tenant in that case merely wanted to enhance the existing accommodation which he was already occupying i.e. to build a garage and turn the roof space into two bedrooms. He also wanted to install a new shop front and refit the interior.

45. The character of the works, he suggested, were not essential but were desirable and that it was in the context the court found that the language in the licences was the language of "permission" rather than obligation. This was very different, he argued, to the language in the Agreement for Works in the subject reference, whereby the applicant was obliged to carry out the works, as it could not occupy the premises without first doing so.

46. As part of this debate Mr Coghlin KC referred us to Historic Houses, where Knox J considered a rent review clause in a lease with the following disregard provision:

"any alterations or improvements to the demised premises made by the Lessee (otherwise than pursuant to any obligation of the Lessee to carry out such work) since the commencement of the said term at the sole expense of the Lessee and with the previous consent in writing of the Lessor or the Company."

47. There was also a covenant against alterations in the lease.

48. The question for the court was the effect of the provisions in 7 licences granted by the Landlord to make alterations to the premises. The terms of the licences are summarised at 152[19]. They included the following term, and a number of other terms, not recorded which were concerned with the way the works were carried out:

"**To carry out or cause to be carried out the said works and alterations as soon as practicable after obtaining any necessary further consents and in any event before the date shown in Part IV of the said Schedule hereto** and strictly in accordance with the said Drawing or Drawings with the best materials and workmanship available and to the reasonable satisfaction of the Company's surveyor …"

49. In Historic Houses, the landlord argued that the terms in the licences requiring the tenants to carry out the works at a particular time and to a particular standard meant that the improvements were not done otherwise than pursuant to an obligation to the landlord. Knox J disposed of this argument summarily as follows:

"I can dispose at once of an argument that was advanced on behalf of the landlords, namely that because of the covenant by the tenant in the licence to execute the works by a particular date and up to certain standards, the alterations came within the parenthesis in the disregard provision 'otherwise than pursuant to any obligations of the said lessees to carry out such work'. I do not accept that submission. The **transaction needs to be seen as a whole and remains essentially a licence**. It was described as such. **The obligations were concerned with the mode of execution of**

what was licensed. There is a decision to very much this effect of Judge Blackell-Ord, sitting as a High Court Judge, Godbold v Martin … with which I respectfully agree."

50. The Landlord also urged that the effect of a term of the licence was that the rent review be conducted as if the improvements had always been part of the demise so that they were rentalised under the rent review clause whether or not they were carried out pursuant to an obligation to the Landlord. The term relied upon is set at 152[19] and in the following terms:

> "That when the said works and alterations have been completed all the restrictive and other covenants and provisions contained in the said Lease (including the power of re-entry which shall be deemed also to arise if there shall be a break of any of the covenants or conditions herein contained and on the part of the Lessee to be observed and preferred) shall be appliable to the said premises thereby demised in their then altered state in the same manner and as fully and extensively as if the said premises in their then altered state had originally been comprised in the said Lease …"

51. Knox J also rejected this argument because the contended impact upon the rent review provision was beyond the apparent purpose of the clause in question, and because if the parties had intended the clause to have that "startling effect" they would have said so in clear terms. He stated at 153[2]:

> "There is also force in the submission that had the somewhat startling result contended for by the landlords been intended the parties would have been very likely to say so in terms."

52. It is interesting to note that by the time Historic Houses got to the EWCA, the landlord had abandoned its claim that the improvements were carried out pursuant to an obligation to the landlord. Instead, it argued only that the licences required the notional antedating of the execution of the improvements to the beginning of the lease.

53. The EWCA also rejected this argument on the basis that:

(i) It was prima facie unfair for improvements paid for by a tenant to be rentalised; and

(ii) If an agreement was going to provide otherwise, then it had to do so in clear terms per Dillon LJ at [117]:

> "Such a disregard of alterations or improvements to demised premises made by the lessee at the lessee's sole expense is a very common provision in present rent review clauses and, indeed, it is envisaged in the Landlord and Tenant Act 1954. **The obvious reason is that if a lessee carries out alterations or improvements to the premises at his own expense, and the alteration or improvements will enure to the benefit of the landlord after the expiration of the lease, it would not be fair or reasonable that the rent should be increase on rent review so that, in the inelegant phrase used by Mr David Neuberger QC, the alterations or improvements can be rentalised for the rest of the lease. It is plainly unfair that the lessee, who has paid for the alterations or improvements, should be required from the next rent review date to pay additional rent attributable to them also**."

> "It is a commercial document and it makes no sense at all to me to read the clauses as excluding the disregard in the rent review clause. It is to ensure that the covenants apply, but I do not regard it as extending to exclude the disregard. The words 'as fully and extensively' point that way. Regarding this as a commercial bargain between **the parties I would expect something very much clearer if it was to be established that a disregard normally regarded as fair and reasonable is to be inapplicable** in relation to particular alterations authorised by a range of successive licences. There may indeed be occasions where it would be desired to disregard expenditure on alterations and improvements which were part of the initial bargain between the parties. If such a matter is the subject of negotiation between the parties and is agreed,

one would normally expect it to be provided by express agreement in clear terms in relation to the rent review clause to make it clear what had been agreed. I would not expect a matter so unexpected as overriding the disregard to be dealt with in such an oblique manner as this." 118[6/7]

"A proviso that improvements at the tenant's expense should be disregarded in fixing the rent is common in rent review clauses and is also included in the provision for determining the rent of a new lease under Part II of the Landlord and Tenant Act 1954**. It is there because prima facie it is unfair that a tenant's rent should be increased on account of improvements made at his own expense**." Mr Neuberger QC says that one cannot attach too much weight to the apparent unfairness of the construction for which he contends. We know nothing about how the licence was negotiated, or the commercial reason why the tenant might have been willing to accept a term which appears on the surface to be unfair. But this lease provided in Clause 10 that the tenant was entitled to make internal alterations to the demised premises with the previous consent in writing of the company, such consent not to be unreasonably withheld. It seems to be that if the landlord had insisted, as a condition of granting consent, that the tenant should agree to the rent being reviewed by reference to the value of his own improvements this would have been unreasonable. **In my view, this makes it very difficult to argue that the tenant would voluntarily have accepted terms having such an effect unless the language of the relevant clauses make this very clear**. I do not think that the general fiction that the improvements must be deemed to have been made at the commencement of the term necessarily requires that it should be applied remorselessly to every question which may arise under the lease. For the reasons given by Dillon LJ, **the language does not seem to me nearly clear enough and I, too, would therefore dismiss the appeal**." Per Hoffman LJ 118[7]

54. Mr Shaw KC, for his part, said that it was unsurprising that, in Historic Houses, discretionary alteration works desired and carried out by the tenant under the various licences fell to be disregarded at rent review.

55. He accepted that there was "unfairness" in Historic Houses but not in the subject reference and noted that Dillon LJ recognised that:

> "There may indeed be occasions where it would be desired to disregard expenditure on alterations and improvements which were part of the initial bargain between the parties …"

56. The facts, he said, were present in the subject reference. The Landlord here was in administration, and they had a well-regarded tenant. The lease specifically stated that the landlord's works, (even though carried out by the tenant), were to be disregarded but the lease did not specifically state that the tenant's works were to be disregarded. If that was to be the case, he suggested that on a proper construction of the documents, one would have expected it to be clearly stated in the same terms as the exclusion which applied to the landlord's works.

57. He suggested that the present deal was done by the parties on the basis that the tenant got the benefit during the original lease term of not having to pay rent on any improvement works but that the landlord got the benefit when the lease came up for renewal, as the tenant's works then "reverted" to it. The tenant, therefore, gets the benefit of the rent being assessed on the basis of "shell finish" for a decade but after that it had to pay.

58. Mr Shaw KC also argued that the subject reference is concerned with a lease renewal whereas Historic Houses was about a rent review and that it was accepted that the rent review clause in the subject reference clearly disregards the tenant's works, as it is to be assessed as shell finish.

The Leases and Agreements for Works

59. Having considered the various arguments, we turn then to look at the disputed provisions in the subject reference. Mr Coghlin KC referred to clauses particularly relied upon by the respondent as allegedly imposing an obligation owed by the applicant to the respondent to carry out the tenant's works:

> "Clause 2.2.1:
>
> **The Tenant shall use reasonable endeavours to procure that the Contractor shall carry out and complete the Landlord's works and the Tenant's works within nine months from the date hereof in a proper and workmanlike manner and in compliance with the Approved Documents, the Tenant's works specification** and other Requisite Consents, and shall give all notices required by the Requisite Consents provided that the Tenant shall not be obliged to complete the Landlord's works and the Tenant's works within nine months it is prevented from doing so for any matter outside of its control. The cost of completing the Tenant's works will be paid for by the Tenant."

> "Clause 2.2.3:
>
> The Tenant shall use reasonable endeavours to procure that the Landlord's works and the Tenant's works are carried out
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> a) with due diligence and a good and workmanlike manner;
>
> b) using only good quality materials; and
>
> c) in accordance with this agreement, the Approved Documents, the Tenant's Works Specification and the Requisite Consents. In accordance with all statutory or other legal requirements and the recommendations or requirements of the local authority or statutory undertakings; and in compliance with all relevant British Standards, codes of practices and good building practice."

"Clause 2.2.3:

If any defects, shrinkages and other faults in the Landlord's Works or the Tenant's Works appear within the Rectification Period due to materials, goods or workmanship not in accordance with the Approved Documents the Tenant shall notify the contractor who shall be requested to make good such defects, shrinkages or other faults entirely at his own cost unless the Contract Administrator with the consent of the Landlord shall otherwise instruct. If the Contractor fails or refuses to make good within the Rectification Period, then the Tenant shall make good at its own expense."

60. Mr Coghlin KC submitted that insofar as Clause 2.2.1 provides for the Tenant to use reasonable endeavours to ensure that the Tenant's Works are carried out within nine months the clause was not materially different from the clause in Historic Houses (requiring in that case) completion 'as soon as practicable'.

61. The only counter-argument to the proposition that clause 2.2.1 should not be treated in the same manner as the clause in Historic Houses, was that the Agreement for Works in the subject reference does not expressly identify itself as a licence. However, as the label a document gives itself is not definitive, in the Agreements for Works there were, as per Ridley, Godbold and Historic Houses, the use of the same permissive language.

62. Against that background the Agreement for Works, provided a necessary permission to carry out works that would otherwise be prohibited under that lease. It was therefore, in its substantial effect, a licence. If the works were not completed within nine months the position would again be governed by the covenant in the Lease against alterations, as per Ridley.

63. As to the provisions of Clause 2.2.3 Mr Coghlin KC argued that these were simply clauses requiring the Tenant's Works to be completed to a certain standard, if indeed, they were

undertaken at all. That, he argued, put them on all fours with Ridley, Godbold and Historic Houses.

64. As such, he argued, the terms of the Agreement for Works were materially similar to the provisions considered by EWCA and should be treated in the same way, with the result that they should not be construed as imposing an obligation upon the applicant for the purposes of Article 18 of the Order.

65. As was recognised in Historic Houses, it was prima facie unfair for a tenant to pay for works of improvements to be carried out and then pay again in rent. There must be something more than the absence of the word "licence" in the Agreements for Works in order to bring about such an unfair result, particularly when the rent review provision in the Lease adopted a different approach to the same disregard.

66. The Tribunal was referred to Ross on Commercial Leases which gives an example of the clear provision required in – "Daejan Properties v Holmes [1996] EGCS 185. In that case it was held that a clause in the licence which permitted the tenants to undertake certain improvements to the demised premises and provided that '**the works …. shall be deemed to be carried out in pursuance to an obligation to the lessor**' was clear enough to override the disregard of improvements in the rent review clause in the tenant's lease (with the consequential result that the improvements were rentalised on review)". Mr Coghlin KC argued that there was nothing of equivalent or even approximate clarity in the present documents.

67. In all the circumstances he said that it was clear that, as a matter of contractual interpretation, the Tenant's Works carried out within the Agreements for Works were not carried out under an obligation to the Landlord for the purposes of Article 18 of the Order.

68. Mr Shaw KC counter submission was that the obligation or permission relies on the construction of the Leases and the Agreements for Works within the context that prevailed when they were entered into. The respondent's position is that the applicant had to carry out the works. The building was an empty shell which could not be used if the applicant did not carry out the works. That, he said, in practical terms grounded the obligation.

69. In 2010 (when the first lease was granted) the reference property comprised a very basic structure, located on the edge of the city centre. In 2013 the landlord was in administration and had no resources to develop. As such, the tenant was required to bring the building up to a Category A Grade A building i.e. finishing both the landlord's and the tenant's works. The same position prevailed in 2014.

70. The documentation had express provisions for carrying out all of these works which were paid for and carried out by the applicant in their entirety, and under its supervision and control.

71. Mr Shaw KC also submitted that the respondent conceded that all of the works were in its economic interest.

72. At rent review there was one set of arrangements whereby the rent would be based on a shell finish, but he again maintained that at lease renewal it was necessary to consider Article 18(2)(c) of the Order and the Tenant's works could only be disregarded if they were not done as an obligation to the Landlord.

73. His argument that the applicant had just such an obligation to carry out the works rested on the following propositions:

(i) That It would be absurd for a tenant to sign a lease and not do the works, as they could not occupy without the works being done, unlike the circumstances in the authorities submitted by the applicant.

(ii) That there was a common sense of fairness that a tenant should not pay for works carried out by him but this is not the situation in the subject reference. The applicant has to do the works so that he can occupy the building and couldn't occupy and carry out his business without doing the works.

(iii) That the demised premises, as stated in the 2010 lease, did not exist. The parties anticipated that the works would be carried out by the tenant. The landlord expected that the works would be undertaken and the demise in the 2010 lease (as drafted) only makes sense, therefore, in light of the works to be undertaken by the applicant.

(iv) That the lease envisages the premises will be Category A standard but the documentation taken as a whole requires that the Tenant's Works have to be undertaken for anything to happen.

And that in the context the Leases and Agreements for Works had to be read as a whole (see Smith, Manks and Toyota GB Ltd).

74. He argued that when the contractual documents are taken as a whole and given their ordinary and plain meaning, the tenant was under an obligation to the landlord to undertake the works to convert a bare shell into premises fit for the purposes of the tenant, as an internationally renowned firm of solicitors.

Discussion

75. The Tribunal accepts that the prima facie position is that, as confirmed by all of the submitted authorities, a tenant should not pay rent on works carried out at his own expense. As Knox J put it in Historic Houses:

"The economic justification for such a disregard is not far to seek. It is not particularly fair that a tenant, who, at his own expense, voluntarily improves the demised premises, should thereafter have to pay rent not only on what the landlord contributed, the unimproved premises, but also on the improvements."

76. In the subject reference the respondent only contributed the sub shell premises. The tenant/applicant funded everything else.

77. In Historic Houses Knox J further noted that "… had the somewhat startling result contended for by the landlord been intended it would have been very likely to say so in terms". There were no such terms contained in the subject leases nor the agreements for lease.

78. Mr Shaw KC referred to a commercial deal struck between the parties whereby the applicant would have the benefit of not having to pay for any improvements for the ten year term of the lease, but thereafter the improvements would revert to the respondent.

79. In return, during the ten year term, Mr Shaw KC argued that the applicant would receive incentives comprising concessionary rents, rent free periods, cap on service charges and break clauses, for his outlay in excess of £1.8M.

80. Mr Coghlin KC did not consider this to be a good deal for the applicant. The Tribunal agrees and considers it to be a very poor deal for the applicant for his outlay of £1.8M. It takes this view for a number of reasons:

    (i) There was no evidence before the Tribunal to confirm that the overall terms were concessionary so the Tribunal must take them as being in line with open market practice at that time.

(ii) With regard to the fifteen month rent free periods, up to nine months of these periods would have been taken up with carrying out the tenant's and landlord's works, as detailed in the Agreements for Works and the applicant would not have been in occupation during that nine month period in any case.

(iii) There was no evidence before the Tribunal to confirm that a cap on service charge of £2 per sq ft was concessionary at that time or, indeed, in the context of other lettings.

(iv) The Leases were signed 2010 to 2014, in the middle of the economic downturn which commenced in 2008. Incentives such as rent free periods, concessionary rents, break clauses and cap on service charges would have been the market norm during that period.

81. With regard to the "deal struck" between the parties, as submitted by Mr Shaw KC, the respondent must not have initially between aware of that "deal", as, at the outset of the reference to the Tribunal, and indeed, for a significant period of time, the respondent and its expert had been proceeding on the basis that the tenant's works should be disregarded for the purposes of assessing the lease renewal rent. The Tribunal would have been surprised if the issue had not been raised and fully ventilated at the point when the respondent acquired the subject property. That due diligence would have, presumably, raised the issue so the volte face in approach is even more remarkable.

82. Whilst the Tribunal does accept, however, that after receiving alternative professional advice the respondent was entitled to change its mind, the Tribunal finds it difficult to believe that the applicant would have agreed to such an unfavourable deal – very limited concessions for an outlay of £1.8M and, if it did so, would have expected it to be very clearly documented. As per Dillon J in Historic Houses:

> "In my view this makes it very difficult to argue that the tenant (in the subject reference a firm of international solicitors) would voluntarily have accepted terms having such an effect unless the language of the relevant clause makes this very clear."

83. In the present case Mr Shaw KC relied upon the economic reality of the situation at the time the documentation was entered into coupled with the practical reality that the works had to be done by someone to argue that an obligations existed. The documentation on any straightforward interpretation does not justify that conclusion. The disparity between the specific disregard for the Landlord works is cited – as is the fact that the same clarity did not attend the drafting in relation to the Tenant's Works and the corresponding absence of a disregard, however, that argument is a long way from saying that there was a positive obligation to do the works expressed anywhere in the documentation.

84. Mr Coghlin KC's position with regard to the Agreement for Works was that they were basically licences which permitted the applicant to carry out works which were prohibited by the Leases. The Tribunal agrees with that contention and interpretation.

85. The Tribunal refers to the following quote from Russell LJ in Ridley:

> "For my part I have no doubt the covenant to complete the conversion in clause 10(11) to the satisfaction of the estate surveyor is not a covenant to carry it out, but a covenant that if it is carried out it will be done in a particular manner. The sanction, if it could be and is not carried out, is that the lessee remains bound by the original restriction in the lease to use as a single private dwellinghouse."

86. Mr Coghlin KC submitted, therefore, in the subject reference, the only obligation on the applicant was to carry out the works to an agreed standard and within a certain timescale. If it failed to deliver on these obligations the Agreements for Works would have to be renegotiated, as the applicant would be prohibited from carrying out any further works under the terms of the lease.

87. The Tribunal agrees with Mr Coghlin KC, the only obligation on the applicant was to carry out the works to a certain standard and within a certain time period.

88. In addition, if the respondent is correct that the tenant's works shall not be disregarded in assessing the rent for the new lease, to give effect to this position would require a total recasting of the rent review provisions.

89. Under Article 19 of the Order the terms of the old lease are the starting point for the terms in the new. Under the old lease the rent review is to be carried out on the basis that the tenant's works are to be disregarded. That is the position that should properly be the basis of the new lease and is entirely consistent with both Article 18 and a proper interpretation of the documentation.

Conclusions

90. The Tribunal finds the following to be relevant:

(i) It is prima facie unfair to expect the applicant to pay rent on works which he completed at his own expense.

(ii) The "deal" referred to by Mr Shaw KC was (absent cogent evidence to the contrary) a very poor deal for the applicant in terms of his £1.8M outlay.

(iii) The applicant, a firm of international solicitors, could not have envisaged paying or agreeing to pay rent on works for which they incurred a £1.8M outlay.

(iv) If this was to be the "startling effect" envisaged by the parties then it should have been recorded in precise terms in the Leases and Agreements for lease and on a proper consideration of those documents no such clarity of language existed.

(v) The Agreements for Works permitted the applicant to carry out works which were otherwise prohibited by the Leases. They should be construed as permissive rather than as a positive obligation to carry out the works.

(vi) The tenant's works were carried out not as an obligation to the landlord but to facilitate the applicant's occupation of the reference property, as the respondent did not have the resources to carry out the works.

(vii) Properly construed the only obligations on the applicant was to carry out the works to an agreed standard and within a certain time period.

(viii) To include the tenant's works at lease renewal and then to disregard them at subsequent rent reviews makes a mockery of the rent review provisions and would be patently unfair.

(ix) Terms similar to those in the subject Leases and the Agreements for Works were considered in the authorities in England and Wales and the Courts in that jurisdiction decided that these similar terms were permissive.

91. The Tribunal therefore orders that, in the interests of fairness and as a matter of law, the tenant's works should be disregarded in assessing the rent under the new lease.

4th May 2023

The Honourable Mr Justice Huddleston, President and Henry Spence MRICS Dip.Rating IRRV (Hons), Member Lands Tribunal for Northern Ireland