# RENEWAL OF BUSINESS TENANCIES: TERMS OTHER THAN AS TO DURATION AND RENT

**Section 35 of the Landlord and Tenant Act 1954**

**"The terms of a tenancy granted by order of the court under this Part of this Act (other than terms as to the duration thereof and as to the rent payable thereunder) … shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court; and in determining those terms the court shall have regard to the terms of the current tenancy and to all relevant circumstances."**

## INTRODUCTION

1. S 35 of the 1954 Act makes provision for determination by the court of terms of a business tenancy other than as to duration and rent upon lease renewal.

## O'MAY

2. Authoritative guidance as to the approach which the court should adopt when applying the section is set out in *O'May v City of London Real Property Co. Ltd*[1]. On the facts of that case the defendant landlord demised premises in a modern office block to the tenants for five years. On the expiry of the term the landlord proposed a new five-year term, but with the obligations as to maintenance, repair and service of the building transferred to the tenants, in return for a small reduction in rent. The proposals would have created a clear lease resulting in the building becoming commercially more valuable. At first instance the court allowed the variation but the Court of Appeal reversed the decision. An appeal to the House of Lords was dismissed on the basis that the court should not sanction a departure from the current lease which was intended to impose such enormously fluctuating obligations on the tenants, whose interest was limited.

3. In essence their Lordships held:
   3.1 the burden of changing the terms of the current tenancy against the will of the other rests on the party proposing the change; and
   3.2 the change proposed must be fair and reasonable.

[1] [1983] 2 AC 726.

4. The dicta of Lord Hailsham and Lord Wilberforce are worth setting out in full. After citing sections 34 (determination of the rent payable under a new tenancy) and 35 of the 1954 Act, Lord Hailsham said this[2]:

*"From these sections I deduce three general propositions. (1) It is clear from section 34 that, in contrast to the enactments relating to residential property, Parliament did not intend, apart from certain limitations to protect the tenant from the operation of market forces in the determination of rent. (2) In contrast to the determination of rent, it is the court and not the market forces which, with one vital qualification, has an almost complete discretion as to the other terms of the tenancy (which, of course in turn must exercise a decisive influence on the market rent to be ascertained under section 34 ). And (3) in deciding the terms of the new tenancy, as to which its discretion is otherwise not expressly fettered, the court must start by "having regard to" the terms of the current tenancy, which ex hypothesi must either have been originally the subject of agreement between the parties, or themselves the result of a previous determination by the court in earlier proceedings for renewal.*

*A certain amount of discussion took place in argument as to the meaning of "having regard to" in section 35 . Despite the fact that the phrase has only just been used by the draftsman of section 34 in an almost mandatory sense, I do not in any way suggest that the court is intended, or should in any way attempt to bind the parties to the terms of the current tenancy in any permanent form. But I do believe that the court must begin by considering the terms of the current tenancy, that the burden of persuading the court to impose a change in those terms against the will of either party must rest on the party proposing the change, and that the change proposed must, in the circumstances of the case, be fair and reasonable, and should take into account, amongst other things, the comparatively weak negotiating position of a sitting tenant requiring renewal, particularly in conditions of scarcity, and the general purpose of the Act which is to protect the business interests of the tenant so far as they are affected by the approaching termination of the current lease, in particular as regards his security of tenure. I derive this view from the structure, purpose, and words of the Act itself. But, if I required confirmation of it, I would find it in the passages cited to us in argument from the judgment of Denning L.J. in Gold v. Brighton Corporation [1956] 1 W.L.R. 1291 , 1294 and of Widgery L.J. in Cardshops Ltd. v. Davies [1971] 1 W.L.R. 591 , 596 (also cited with approval by Shaw L.J. in the instant case). The point is also emphasised by the decision in Charles Clements (London) Ltd. v. Rank City Wall Ltd. (1978) 246 E.G. 739 , where the court*

[2] At 740D-741D

*rejected an attempt by the landlord as a means of raising the rent to force on a tenant a relaxation of a covenant limiting user which would have been of no value to the particular tenant, and Aldwych Club Ltd. v. Copthall Property Co. Ltd. (1962) 185 E.G. 219 where the court rejected an attempt by the tenant to narrow the permitted user with a view to reducing the rent.*

*A further point which was canvassed in argument, and with which I agree, is that the discretion of the court to accept or reject terms not in the current lease is not limited to the security of tenure of the tenant even in the extended sense referred to by Denning L.J. in Gold v. Brighton Corporation [1956] 1 W.L.R. 1291 . There must, in my view, be a good reason based in the absence of agreement on essential fairness for the court to impose a new term not in the current lease by either party on the other against his will. Any other conclusion would in my view be inconsistent with the terms of the section. But, subject to this, the discretion of the court is of the widest possible kind, having regard to the almost infinitely varying circumstances of individual leases, properties, businesses and parties involved in business tenancies all over the country."*

5. Lord Wilberforce added the following[3]:

*"The Act, in the portion (Part II) of it which deals with business tenancies, is in the main a discretionary Act, giving wide powers to the judge to grant and settle the terms on which the business tenant is to have a new lease. This applies particularly to sections 33 and 34 , which relate to the duration of the tenancy and the rent. The crucial section, for present purposes, is section 35 which relates to the terms of the tenancy, other than terms as to duration and rent. This section contains a mandatory guideline or direction to "have regard to" the terms of the current tenancy and to all relevant circumstances. The words "have regard to" are elastic: they compel something between an obligation to reproduce existing terms and an unfettered right to substitute others. They impose an onus upon a party seeking to introduce new, or substituted, or modified terms, to justify the change, with reasons appearing sufficient to the court (see Gold v. Brighton Corporation [1956] 1 W.L.R. 1291 , 1294 — on "strong and cogent evidence" per Denning L.J., Cardshops Ltd. v. Davies [1971] 1 W.L.R. 591 , 596 per Widgery L.J.).*

[3] At pp. 747D-H and 748E-749H

*If such reasons are shown, then the court, applying the words "all relevant circumstances," may consider giving effect to them: there is certainly no intention shown to freeze, or in the metaphor used by learned counsel, to "petrify" the terms of the lease. In some cases, especially where the lease is an old one, many of its terms may be out of date, or unsuitable in relation to the new term to be granted. If so or for other good reasons shown, the court has power to order a modification by changing an existing term or introducing a new one (e.g. a break clause, cf. Adams v. Green (1978) 247 E.G. 49 ). Before doing so it will consider any objections by the tenant, and where there is an insoluble conflict, will decide according to fairness and justice. …*

*The landlord's case for a shift of the burdens as I have indicated rests upon two broad foundations. The first is that such a shift is, for quite genuine and respectable reasons, in the interest of the landlord. I accept this; I think that it is shown by evidence that in the present and foreseeable state of the property market, a freehold interest in commercial property, at least in London, commands a higher price if let on "clear leases" — i.e. leases in which the tenants bear all the costs and risks of repairing, maintaining and running the building of which their demised premises form part, so that the rent payable reaches the landlord clear of all expenses and overheads. Thus the landlord demonstrates a genuine interest in departing from the existing terms of the lease. Secondly, the landlord asserts that new leases of property, such as that with which we are concerned, are now granted and accepted by tenants as "clear leases." This too is supported by the evidence. But, in my opinion, though a relevant circumstance it is not decisive. There is no obligation, under section 35 of the Act, to make the new terms conform with market practice, if to do so would be unfair to the tenant. and there is no inherent necessity why the terms on which existing leases are to be renewed should be dictated by those of fresh bargains which tenants may feel themselves obliged to accept. The court has to compare the advantage desired by the landlord with the detriment to be suffered by the tenants and to consider whether any monetary compensation offered against that detriment ought fairly to be imposed upon the tenants in exchange for the acceptance of that detriment. That money is not necessarily fair compensation for a change in existing rights is obvious in itself and is well recognised by the law in relation, for example, to compulsory acquisition and to the granting of damages instead of an injunction.*

*There can be no doubt in my opinion that this detriment is real and serious. Considering only the obligation to bear a proportion of the cost of maintaining and repairing the exterior and*

*common parts of the building, to impose this upon the tenants is something which they may most reasonably resist. They risk incurring a liability which is unpredictable and which may, in the event of a structural defect, be very great. They have no power of precautionary inspection or survey, since they only have access to part of the building. They have no means of verifying that work for which they are charged was necessary at the time, or was truly repair and not improvement, the cost of which ought not to be put on the tenants, nor of controlling what work has been done or how it has been done. As tenants, carrying on a solicitor's business, they have no staff capable of performing these tasks, whereas the landlord, as a large property company with an interest in over 200 buildings in the City of London, has. If work can be ordered and effected by persons, other than those who have to bear the cost, risks of extravagance and misdirection of effort may be created. The same separation of responsibility necessitates a system of charging by certificate and of preventing challenges, except in rare cases, which is of its nature onerous and prejudicial.*

*The character of the two parties' interests in the land — the landlord's an indefinite one by freehold, the tenants' a limited one over a comparatively short period, even though capable of renewal if the tenant so wishes, is such as to call for the assumption of long term risks by the former: his benefit too is long term and will not, according to the evidence, emerge till the 1990's. Transference of these rights to the leaseholders, accompanied, as is inevitable, by separation of control, creates a risk disproportionate to their interest. If it is reasonable for the landlord to wish to get rid of these risks in exchange for a fixed payment (reduction in rent) it must be equally, or indeed more, reasonable for the tenants to wish, against receipt of that reduction, to avoid assuming it. The tenants are being asked to bear all the risks of property management, a business which they have not chosen, being management by others in the interest of those others. The present distribution of burdens is that freely and contractually agreed upon so recently as in 1972. To recast it involves a serious departure from the terms of the current lease. In my opinion, a court which has to have regard to the terms of the current lease ought not to sanction such a departure, and such other circumstances as should fairly be taken into account — the landlord's wishes and the increasing acceptance by others, in different situations, of clear leases — are insufficient to give grounds for so doing."*

**RECENT CASE LAW: A PRACTICAL APPLICATION OF THE O' MAY GUIDANCE**

6. The application of s 35 was most recently considered in *Edwards & Walkden (Norfolk) Ltd v The Mayor and Commonality and Citizens of the City of London*[4] ("the City"), another service charge dispute. The facts of that case are rather unusual but it gives an interesting glimpse into the practical implications of applying the *O'May* guidance in a complex environment.

7. The case involved the renewal of a number of business tenancies of stalls, shops and offices at Smithfield Market. Two preliminary issues were raised, the first involving the impact of the Metropolitan Meat and Poultry Markets Act 1860 on the amount of rent payable by the tenants; the second, with which we are concerned here, being whether the rent should be all inclusive with an element for service charge predicted at the date of grant or should be exclusive with a separate provision made for a variable service charge. The tenants argued for the former whilst the City sought the latter on the basis that the tenants would then bear the true cost to the City of providing services and maintaining the Market.

8. The history of the terms under which the units in the Market were occupied was long and intricate. Over the years there had been various agreements in relation to rent and service charges. There was significant disruption due to works to the three markets making up "the Market" and there was thus agreement that a temporary all-inclusive rent would apply in relation to units in the East and West Markets and one unit in the Poultry Market. There were separate agreements in relation to other units in the Poultry Market. Some of the units were subject to a rent plus variable service charge regime whilst two units were occupied under an all-inclusive agreement. In all cases the parties were in dispute as to what regime should apply when normality returned following the works. Significantly, new leases granted in 2001 of a number of units noted the dispute and said that, upon renewal, the parties would enter into negotiations to determine whether there should be an inclusive rent or an exclusive rent and variable service charge and that, in default of agreement, there would be an application to court in accordance with the 1954 Act.

9. The tenants argued that they required predictability in terms of future costs and claimed that the City was inefficient and had failed to properly maintain the Market so that a variable service charge would expose them to unacceptable risk of future major expenditure. The judge rejected the argument. He noted that the City proposed that a

[4] [2012] EWHC 2527 (Ch)

neutral building surveyor inspect and report back on the condition of the fabric of the Market and that any necessary work be carried out at its' expense. He found that the City's main expenditure related to the day to day operation of the Market (such as cleaning, providing security, providing electricity and specialist equipment) for the benefit of the tenants and that the City had operated reasonable efficiently. Further, because the tenants of the units in the Market intended to trade for a very long time, they had an interest in the fabric of the building so that sums spent on maintenance benefited landlord and tenant jointly. That contrasts with the circumstances in *O' May* where the court concluded that the nature of the parties' interest in the land was such as to call for the assumption of long-term risks by the landlord.

10. Concerns that the tenants might have as to the services carried out and levels of expenditure were met by City's proposed mechanisms within the service charge regime for review and participation in the standards of service provision and levels of cost. The RICS Code of Practice: Service Charges in Commercial Property (2nd Ed. 2011) recognised that the adoption of a variable service charge to cover the provision of services by a landlord in multi-occupied commercial premises was generally regarded as fair by both landlords and tenants.

**CURRENT LEASE TERMS: DEPARTURE**

11. The most interesting aspect of the case for present purposes[5] is the judge's conclusion that he was entitled to depart from the terms of current leases. Although he noted that the Court should not generally exercise its discretion under s 35 to change the basic parameters of the commercial arrangement between the landlord and the tenant, applying the guidance in *O' May* as a whole, he considered that the City had shown that there were good and sufficient reasons to justify a change in the payment structure.

12. The background to the existing payment structure meant that the weight to be attached to it was diminished and most of the leases expressly recognised the existence of a dispute. In those circumstances the same weight could not be attached to the existing terms of the leases as would be appropriate in a more typical case. Moreover, the structuring of the payment terms as the City proposed would best accord with "fairness and justice" between the parties.

[5] The case is undoubtedly interesting from the perspective of the historian

13. In those cases relating to units in the Poultry Market where the current arrangement was an all-inclusive rent the judge reached the same conclusion. In doing so he found that "all relevant circumstances" as appeared in s 35 included the desirability of having a uniform approach to the calculation and bearing of costs in the Market, applicable so far as possible across all relevant tenancies in the Market generally.

14. The judge considered (the author thinks rightly) his reasoning to be supported by *Hyams v Titan Properties Ltd*[6]. In that case the Court of Appeal had to deal with a similar choice between a simple fixed payment arrangement and a rent plus variable service charge arrangement. The Court allowed an appeal from the order of the county court judge providing for a tenancy with a simple fixed payment arrangement and substituted provision for a variable service charge. Buckley LJ referred to evidence of expert witnesses about modern practice and added his own observations as follows:

*"The witnesses called in the county court included two technical witnesses called on behalf of Mr. Hyams and one called on behalf of Titan Properties Ltd., and in cross-examination each of the witnesses called on behalf of Mr. Hyams agreed that the modern practice in relation to service charges was to make the tenant liable for a proportion of the total costs incurred by the landlord in respect of the provision of services proportional to that part of the building occupied by the tenant; it was established in evidence that the proportion of the building which Mr. Hyams occupied was in fact one-ninth of the building. It was also established that the cost of providing the services for the year 1969–70 was £1,443, one-ninth of which would be approximately £150 a year. It is, I think, evident that the reason for this new practice which was recognised by the witnesses is that in an age of rapidly fluctuating and increasing prices it is a fairer arrangement between landlord and tenant that the tenant should pay a proportion of the cost year by year than that an arbitrary figure should be fixed at the inception of the lease to continue in force throughout, the term as the amount payable in respect of services."*

15. Sachs LJ agreed with the judgment of Buckley LJ and added this:

*"It is quite clear that in the conditions which have been over recent years prevailing as regards increases required on expenditure on services the charges for those services should, when questions arise under the Landlord and Tenant Act 1954 , normally be separated from the rent itself. It is equally clear that it is necessary that when a new lease is granted, at any*

[6] (1972) 24 P & CR 359

*rate where the service charge is not merely minimal, there should be inserted in the lease a formula of the type referred to by Buckley L.J.; the simple reason for this is that in no other way can one obtain an appropriate measure of fairness as between landlord and tenant. To try and fix for these somewhat unpredictable increases—and I mean, of course, "unpredictable" as regards percentage—over a period of some five years a fixed mean sum is an exercise which is bound to result in unfairness to one side or the other."*

**IMPACT OF TERMS ON RENT**

16. It was explained in *O' May* that the approach to be taken by the court under Part II of the 1954 Act was to determine the terms of the lease other than as to rent and then to assess a market rent in the light of those terms. In *Edwards & Walkeden* it was common ground that the level of rent payable would vary depending upon where the risk lay for future costs for management and maintenance.

17. There are therefore (although the concept does at first seem a surprising one) circumstances in which a tenant would prefer more restrictive terms because of the corresponding effect on the rent. In *Charles Clements (London) Ltd v Rank City Wall Ltd*[7], for example the landlord sought to vary the user covenant so that consent for change of use could not be unreasonably withheld. If the proviso was included, the rent would be considerably higher. The tenant's evidence was, however, that it did not wish to carry on an alternative business or to assign the premises. In those circumstances it was held that the user covenant should not be varied. The right course was to take the terms of the existing lease as a sufficient guide, and not to make the alteration desired by the landlord since no special reason is shown for it and the tenant objects to it.

18. Similarly in *Amarjee v Barrowfen Properties Ltd*[8] there was an oral periodic tenancy. The tenant sought a user clause restricting his use of the premises to that of furniture and carpet retailing. As the court put it:
*"The plaintiff would like to reap the benefit in terms of rent, of being subject to a clause restricting his use of the premises to that of furniture and carpet retailing. The defendant, for diametrically opposite reasons, contends for a wider user clause."*

[7] [1978] 1 EGLR 47
[8] [1993] 2 EGLR 133, CC

19. The judge held that, had there been a previous lease with an unrestricted user clause, he would not have considered a change to a restricted user clause as being justified. There being no such previous lease, and the tenant having so far at all times restricted his user to furniture and carpet sales, he could see no reason to reject his proposal.

**ADDITIONAL RIGHTS: THE INTERACTION BETWEEN S 35 AND S 32(3)**

20. A further issue arises as to the inclusion in the new lease of rights enjoyed by the tenant in connection with the old lease and the interaction between S 35 and S 32(3).

21. Section 32(3) provides:

*"Where the current tenancy includes rights enjoyed by the tenant in connection with the holding, those rights shall be included in a tenancy ordered to be granted under section 29 of this Act, except as otherwise agreed between the landlord and the tenant or, in default of such agreement, determined by the court."*

22. "The holding" is defined by section 23(3)

*"In the following provisions of this Part of this Act the expression "the holding", in relation to a tenancy to which this Part of this Act applies, means the property comprised in the tenancy, there being excluded any part thereof which is occupied neither by the tenant nor a person employed by the tenant and so employed for the purposes of a business by reason of which the tenancy is one to which this Part of this Act applies."*

23. It is thought (subject to the finding of a judge in a case mentioned below) that neither s 35 nor s 32(3) enable a court to grant to a tenant rights over the landlord's land not enjoyed under the terms of the current tenancy.

24. In *G Orlik (Meat Products) Ltd v Hastings & Thanet Building Society*[9] the landlord's predecessor in title had granted the tenant a right to park vehicles on land not forming part of the tenant's holding as defined under the Act. Upon an application for a new lease the tenants claimed that it should contain a term permitting them to park motor vans used in their business in such a way that they will, as to part of their width, stand over a part of a yard which belongs to the landlords, adjacent to the land comprised in the lease. The landlords contend that no such term can properly be included in the new lease.

[9] (1975) 29 P & CR 126

25. On appeal the court held that no such term was included in the current lease and that any licence granted by the landlord's predecessor in title was purely contractual and did not bind the current landlords therefore s 32(3) did not apply. There was no finding, and no evidence to support such a finding, that the current landlords were aware of the licence when they purchased the reversion. Not being a term of the current lease the right claimed did not fall to be considered under s 35.

26. In *J Murphy & Sons Ltd v Railtrack Plc*[10] a similar issue arose. The land demised under the tenancy was landlocked and the landlord had no power to grant the tenant access, although the tenant had de facto access because it owned the freehold of two parcels of land bordering the land demised. The lack of access was held to be a material factor in determination of the market rent under s 34. The landlord appealed arguing that the lack of access should be disregarded because the statutory assumption of a willing tenant could not apply where the premises were landlocked. Alternatively it was argued that that, by reason of s 32(3) or s 35 access should be treated as provided under the tenancy. Peter Gibson LJ giving the first judgment of the court said:

*"…as [counsel for the landlord] very fairly conceded, there are great difficulties in his way. In my judgment, those difficulties are insuperable. I cannot see how, under section 32(3), one can treat the tenancy as including rights that simply are not conferred by that tenancy. As for section 35(1), reliance upon that section would mean asking the court to confer new rights in relation to the tenancy that were not granted by the lease, and this court in G Orlik (Meat Products) Ltd v Hastings & Thanet Building Society…was not prepared to accept that that was possible."*

27. More recently in *The Picture Warehouse Ltd v Cornhill Investments Ltd*[11] the tenant of business premises in a building that was mainly used as a multi–storey car park was demised three parking spaces on the first floor. After the expiry of the original term, the tenant agreed with the landlord (and headlessee of the building), to take a new lease. Under the new lease, the tenant would vacate the space that it occupied on the second floor and take up space on the ground floor, and it would also relinquish two of its three parking spaces in return for two designated spaces on land at the front of the building. The landlord was to carry out the necessary building work and the tenant's rent would be reduced by £500.

[10] [2002] 1 EGLR 48
[11] [2008] 12 EG 98

28. A dispute arose between the landlord and the local council, which owned the freehold, regarding the use of the forecourt for parking. The tenant sought assurance from the landlord that parking would be available on that land and the landlord responded that parking would be allowed for a maximum of 30 minutes at a time, so as to avoid further conflict with the council.

29. A lease was entered into in 2003; it made no reference to designated parking spaces. On application by the tenant for the grant of a new lease it sought to include in the grant an express right to park two vehicles on the forecourt for no more than 30 minutes at a time.

30. On the trial of a preliminary issue, the judge found that the tenant granted had a bare licence to park, for no consideration and which could be determined at any time. He declined to include any right to park on the forecourt in the new lease.

31. The tenant appealed, contending that s 32(3), should be read broadly to include rights that, although not included in the tenancy, were enjoyed in connection with it. Jack J dismissed the tenant's appeal. The court could not under s 32(3) grant rights not included in the old tenancy.

32. The judge went on to say, however, that the discretion in s 35 was wider so the court could under that provision grant a right to park notwithstanding that the old lease did not grant such a right. No right to park was granted because, on the facts of the case it was not appropriate to do so.

33. That decision appears to be somewhat in conflict with the Court of Appeal's comments in *J Murphy & Sons* above, although support for the view might be found in *O' May* in which their Lordships stressed the wide nature of the discretion under s 35. There must be a query as to whether the judge was correct, although it does open up possibilities for a challenge to the previously accepted view.

Myriam Stacey

The law is stated as at 17th October 2012