

TERMINATION AND THIRD PARTIES

by

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Part 1

TERMINATION OF LEASES AND UNLAWFUL SUB-TENANCIES

TOM WEEKES

1. Most leases impose some form of restriction on sub-letting. Typically, the tenant's alienation covenant contains either an absolute prohibition on sub-letting or it prohibits the tenant from granting sub-tenancies without the landlord's consent. It might therefore come as a surprise to some of our landlord clients that, notwithstanding such a covenant, not only is it possible for a tenant, in breach of covenant, to create a valid sub-tenancy, but there are circumstances in which a landlord may be forced, against his will, into a direct landlord-and-tenant relationship with an unlawful sub-tenant.
2. There is a general rule which, it might be thought, would mean that a landlord could *never*, upon the expiry or termination of a tenancy, come into a direct landlord-and-tenant relationship with a sub-tenant (whether lawful or not). A lease is an interest in land¹. A sub-tenancy is a derivative interest that has been carved out of the lease. So, when a head lease comes to an end (by effluxion of time, by the service of a notice to quit, or by some other method), sub-tenancies, together with all other derivative interests, automatically come to an end²: the branch falls with the tree.
3. Notwithstanding this general rule, there are three situations in which a landlord *can* have an unlawful sub-tenant, against his will, foisted upon him. This paper identifies those three situations and considers the extent to which they might operate as a source of injustice to a landlord.

¹ Ignoring, for present purposes, the complication of a "Bruton" tenancy (i.e. a merely contractual tenancy): see Bruton v London & Quadrant Housing Trust [2000] 1 AC 406.

² Pennell v Payne [1995] QB 192. In PW & Co v Milton Gate Investment Ltd [2003] EWHC 1994 (Ch), [2004] Ch 142 Neuberger J held that parties cannot "contract out" of this consequence of the determination of a head lease. Accordingly, a provision in a head lease was ineffective which provided that, upon the service of a tenant break notice, the head lease would determine "subject to any permitted underleases".

The first situation:**an unlawful sub-tenant who successfully applies for relief from forfeiture**

4. If a landlord forfeits a lease, a subtenant - even an unlawful subtenant³ - can apply for relief from forfeiture. So the first situation in which a landlord can have an unlawful sub-tenant foisted upon him is if an unlawful sub-tenant's application for relief from forfeiture succeeds.

5. The various overlapping rules governing applications for relief from forfeiture are unsatisfactorily complex; and, together with the remainder of the law of forfeiture, are in dire need of reform. However, a sub-tenant, when applying for relief from forfeiture, will often⁴ rely upon section 146(4) of the Law of Property Act 1925, which provides that:
"Where a lessor is proceeding by action or otherwise to enforce a right of re-entry or forfeiture under any covenant, proviso, or stipulation in a lease, or for non-payment of rent, the court may, on an application by any person claiming as under-lessee any estate or interest in the property comprised in the lease or any part thereof, either in the lessor's action (if any) or in any action brought by such person for that purpose, make an order vesting, for the whole term of the lease or any less term, the property comprised in the lease or any part thereof in any person entitled as under-lessee to any estate or interest in such property upon such conditions as to execution of any deed or other document, payment of rent, costs, expenses, damages, compensation, giving security, or otherwise, as the court in the circumstances of each case may think fit, but in no case shall such under-lessee be entitled to require a lease to be granted to him for any longer term than he had under his original sub-lease."

³ See Creery v Summersell and Flowerdew & Co Ltd [1949] 1 Ch 751, and Duarte v Mount Cook Land Ltd [2002] L&TR 21.

⁴ Where the ground of forfeiture is a breach of covenant other than non-payment of rent, a sub-tenant can also seek relief under section 146(2) of the 1925 Act. Where forfeiture is for non-payment of rent, a sub-tenant can apply for relief under sections 138 and 139 of the County Courts Act 1984 and section 38 of the Supreme Court Act 1981.

6. So a sub-tenant, on his application for relief from forfeiture, can apply for a vesting order under section 146(4) which, if granted, will create a new lease in favour of the sub-tenant. The terms of that new lease are entirely at the discretion of the court.
7. The court's ability to grant relief from forfeiture to an unlawful sub-tenant is, in practice, unlikely to operate as a source of injustice to a landlord. First, the court has a discretion of the widest variety over whether to grant relief from forfeiture, and, if so, on what terms: see Ewart v Fryer [1901] 1 Ch 499, per Romer LJ at page 516. Secondly, the discretion to grant relief to a sub-tenant (and, even more so, to an unlawful sub-tenant) has been held to be "*a jurisdiction to be exercised sparingly because it thrusts upon the landlord a person whom he has never accepted as tenant and creates in invitum a privity of contract between them*": see Creery v Summersell and Flowerdew & Co Ltd [1949] 1 Ch 751. Thirdly, the fact that any sub-tenancy is unlawful is a factor in determining whether relief should be granted.
8. The Law Commission, in its report recommending the reform of the law of forfeiture (October 2006, Law Com No.303), has recommended retaining the ability of an unlawful sub-tenant to apply for relief following termination by a landlord following a tenant's default⁵.

The second situation:

an unlawful sub-tenancy survives a surrender

⁵ In its report, the Law Commission stated that:

“6.22 Some consultees sought to draw a distinction between “lawful” and “unlawful” derivative interests, arguing that where a sub-tenancy had been granted in breach of a covenant against assignment it would be inappropriate to grant relief entitlement to apply should therefore be limited to lawful sub-tenants. Others, such as Lovells, advocated a more flexible approach whereby unlawful sub-tenants would not be prevented from applying for relief but unlawfulness would be a factor taken into consideration when the court decided whether to grant relief.

6.23 We agree with Lovells that the unlawfulness of the interest should be no more than a factor in determining the grant of relief and that it would be unduly inflexible to deny the right to apply solely on that ground...It would, in our view, be wrong to deny sub-tenants the opportunity to protect their interests, for which they may have paid a considerable premium.

6.24 As explained in Part 5, the court should taken into account the circumstances in which the sub-tenancy was created before making any order. The fact that the interest was created in breach of covenant will therefore be a relevant factor in determining what order to make. If the tenant default complained of is breach of a covenant that prohibits the creation of a sub-tenancy, the sub-tenant is, in the absence of special circumstances, likely to receive little sympathy from the court.”

9. The second situation in which a landlord might find itself in a direct landlord and tenant relationship with an unlawful subtenant arises from the ancient common law exception to the general rule that sub-tenancies (and other derivative interests) automatically fall on the expiry or termination of a tenancy. That exception applies where the head lease has been surrendered or merged⁶.
10. In Doe d. Beadon v Pyke (1816) 5 M&S 146 Lord Ellenborough CJ said at page 154 that it was:
- “...clear law, that though a surrender operates between the parties as an extinguishment of the interest which is surrendered, it does not so operate as to third parties, who at the time of the surrender had rights, which such extinguishment would destroy, and that as to them, the surrender operates only as a grant, subject to their rights, and the interest surrendered still has, for the preservation of their right, continuance.”*
11. Put another way, following a surrender or merger of a head lease, the head lease is treated as notionally continuing for the purpose of preserving the sub-tenancy⁷. A landlord will then find himself, in effect, in a direct landlord and tenant relationship with an unlawful sub-tenant.

⁶ A lease is surrendered when the landlord acquires the tenant’s lease. A merger describes the converse situation where a tenant acquires the landlord’s reversionary interest. In two respects, this common law exception to the rule that derivative interests fall with the expiry or termination of a tenancy has been narrowed. First, at one time (and, apparently, as a result of a concession wrongly made by counsel in Mellor v Watkins (1874) LR 9 QB 400), it was thought that the exception to the general rule applied whenever the head tenant by his own voluntary act determined the head tenancy. So it was once thought that the rule applied, not only in cases of surrender and merger, but also, for example, when a head tenancy had been determined by the tenant serving a break notice or a notice to quit. However, in Pennell v Payne [1995] QB 192 it was held that the common law exception to the general rule was confined to cases where the head lease was determined by a surrender or merger. Secondly, in Barrett v Morgan [2000] AC 264 the House of Lords limited the application of the rule by holding that it applies only to a surrender or merger, properly so called. It does not apply to circumstances in which a landlord and tenant have colluded with each other to bring a head lease to an end by the service on each other of notices to quit or break notice; being a situation which was argued to be analogous with, or tantamount to, a surrender.

⁷ Following a surrender or merger of the head lease, there is neither privity of contract, nor privity of estate, between the landlord and the sub-tenant (see Webb v Russell (1789) 3 Durn & E 393). That was held to prevent the landlord from suing the sub-tenant on the covenants in the sub-tenancy. However, section 139 of the Law of Property Act 1925 has intervened to provide that, upon the surrender or merger of the head lease, the landlord, in effect, becomes the direct landlord of the subtenant on the terms of the sub-tenancy.

12. As Lord Millett explained in Barrett v Morgan [2000] AC 264, the rule that a sub-tenancy (or any other derivative interest) can survive a surrender or merger is based on policy. The reasoning is as follows. A sub-tenant is properly at risk of losing his sub-tenancy as a result of the determination of the head lease at times, and in ways, that are contemplated by the head lease itself: the sub-tenant's lease was created out of the head lease and was, therefore, always subject to termination in accordance with the terms of the head lease. However, the sub-tenant should not be at risk of losing his sub-tenancy as a result of a separate bargain cooked up between head landlord and head tenant; being an agreement that is outside of, and independent of, the head lease.
13. At page 271, Lord Millett said that:
"It is a general and salutary principle of law that a person cannot be adversely affected by an agreement or arrangement to which he is not a party. So far as he is concerned, it is res inter alios acta. It would conflict with this principle if the destruction of a tenancy by surrender carried with it the destruction of the interest of a subtenant under a subtenancy previously granted."
14. Is the fact that an unlawful sub-tenancy can survive the surrender or merger of a head tenancy likely to be a source of injustice to a landlord? Again, usually not. When a tenancy is surrendered or merged, the landlord has the means of preventing being saddled with an unlawful sub-tenant in his own hands. He simply needs to ensure, when negotiating a surrender or merger, that his tenant determines any unlawful sub-tenancy before the surrender or merger takes effect. It is, therefore, obviously essential, when negotiating a surrender or merger, for a landlord to make sure that it finds out what sub-tenancies his tenant has created.

The third situation:

the continuation of an unlawful sub-tenancy by the Landlord and Tenant Act 1954

15. The third situation in which a landlord can become saddled, against its wishes, with an unlawful tenant is as a result of the operation of the Landlord and Tenant Act 1954.

16. The relevant provisions of the 1954 Act are as follows:
- Section 23(1) provides that Part II of the Act applies “to any tenancy where the property comprised in the tenancy is or includes premises which are occupied for the purposes of a business carried on by him or for those and other purposes”.
 - Section 24(1) provides that: “A tenancy to which [Part II] of the Act] applies shall not come to an end unless terminated in accordance with the provisions of [Part II].”
 - Section 65(2) makes it clear that Part II of the Act can operate to continue a sub-tenancy beyond the expiry of the term of a superior tenancy.
17. In D’Silva v Lister House Developments Ltd [1971] Ch 17 Buckley J held, with “some regret”⁸, that the unambiguous effect of those provisions was that an unlawful sub-tenancy with security of tenure under the 1954 Act could survive the expiry of a head tenancy; with the result that the head landlord would, thereafter, become the direct landlord of the unlawful sub-tenant⁹. There was simply no permissible method of statutory interpretation under which the 1954 Act could be interpreted as applying only to lawful sub-tenants (or as enabling only lawful sub-tenancies to subsist beyond the end of a superior tenancy).
18. In 2007 D’Silva was followed in Brimex Ltd v Begum [2009] EWHC 3498 (Ch), [2009] L&TR 21. Restaurant premises in Islington were let under a lease containing a covenant imposing an absolute prohibition on sub-letting. The term of that lease came to an end in May 2006. However, the previous year, the tenant, in breach of the absolute prohibition against sub-letting, had granted a sub-tenancy. It was held that the 1954 Act operated in a way which meant that, upon the expiry of the head lease, the landlord became the

⁸ Page 33H.

⁹ This is not how the Housing Act 1988 operates. An assured tenancy can continue beyond the end of a superior tenancy; but only if the assured tenancy is lawful. Section 18(1) provides that:

“If at any time –

- (a) a dwelling-house is for the time being lawfully let on an assured tenancy, and
- (b) the landlord under the assured tenancy is himself a tenant under a superior tenancy, and
- (c) the superior tenancy comes to an end,

then, subject to subsection (2) below, the assured tenancy shall continue in existence as a tenancy held of the person whose interest would, apart from the continuance

direct tenant of his unlawful sub-tenant - and that would have been the case even if the unlawful sub-tenant had been occupying under a tenancy under which little or no rent had been payable. Again, unsurprisingly, the judge expressed some regret that the 1954 Act operated in this way. Morgan J said that “there will undoubtedly be cases where the superior landlord is worse off because the sub-tenant has the protection of the 1954 Act”.

19. The fact that the 1954 Act can operate to foist unlawful sub-tenants on a landlord is regrettable – in means that, in this respect, the Act fails to strike a fair balance between the interests of landlords and tenants¹⁰.
20. What are the options available to a landlord who, as a result of the operation of the 1954 Act, has had foisted upon him an unlawful sub-tenant? A damages claim could be brought against the former head tenant for breach of the alienation covenant in the head lease – but that would be worthwhile only if the former head tenant is solvent. A claim could be brought against the unlawful sub-tenant for a mandatory injunction requiring the sub-tenant to surrender its tenancy – but only if it could be established that the sub-tenant, when it accepted its sub-tenancy, committed a tort by knowingly and intentionally induced the breach of the alienation covenant in the head lease¹¹. Otherwise, the landlord could terminate the unlawful sub-tenancy and oppose any application for a new tenancy under section 30(1) of the Act – but only if there are any grounds of opposition under section 30(1) that are available to the landlord.
21. The fact that the landlord’s potential remedies in this situation may be of limited practical benefit is, obviously, highly unsatisfactory.

Conclusion

22. A lesson for landlords from all of this is that - when considering forfeiting a lease, or accepting a surrender or merger, or where an immediate tenant has security of tenure

of the assured tenancy, entitle him to actual possession of the dwelling-house at that time”
(my emphasis).

¹⁰ It is surprising that this issue was not addressed when the 1954 Act was substantially amended by The Regulatory Reform (Business Tenancies) (England and Wales) Order (SI 2003/3096).

¹¹ See Hemmingway Securities Ltd v Dunraven Ltd (1994) 71 P&CR 30, and Crestfort Ltd v Tesco Stores Ltd [2005] 3 EGLR 25.

under the 1954 Act – it is important for a landlord to establish what, if any, unlawful sub-tenancies exist.

23. Legal advisers of landlords should bear in mind that a landlord is entitled to *compel* a tenant to disclose the existence of sub-tenancies. That power arises under section 40 of the 1954 Act, which provides that:

“(1) Where a person who is an owner of an interest in reversion expectant (whether immediately or not) on an tenancy of any business premises has served on the tenant a notice in the prescribed form requiring him to do so, it shall be the duty of the tenant to give the appropriate person in writing the information specified in subsection (2) below.

(2) That information is:

...

(b) whether his tenancy has effect subject to any sub-tenancy on which his tenancy is immediately expectant and, if so-

(i) what premises are comprised in the sub-tenancy;

(ii) for what term it has effect (or, if it is terminable by notice, by what notice it can be terminated);

(iii) what is the rent payable under it;

(iv) who is the sub-tenant;

(v) (to the best of his knowledge and belief) whether the sub-tenant is in occupation of the premises or of part of the premises comprised in the sub-tenancy and, if not, what is the sub-tenant’s address;

(vi) whether an agreement is in force excluding in relation to the sub-tenancy the provisions of sections 24 to 28 of this Act; and

(vii) whether a notice has been given under section 25 or 26(6) of this Act, or a request has been made under section 26 of this Act, in relation to the sub-tenancy and, if so, details of the notice or request...”.

24. A failure to comply with a request made under section 40 may be made the subject of civil proceedings for breach of statutory duty, and, in such proceedings, a court may require the tenant to comply with the duty or award damages: see section 40B.

Part 2

“Have You Got It When You Need It?”

Termination and Third Parties in the Context of Tenant Insolvency

CAMILLA LAMONT

1. This talk in our series of three focuses on the particular issues that can arise in relation to the liability and rights of third parties when a commercial lease or the tenant’s continuing liability under it is terminated in the context of tenant insolvency. In particular, how is the position of a third party such as a sub-tenant, former tenant or guarantor different in these situations?
2. Tom has already spoken about the position of sub-tenants when a lease is forfeited. The mere fact that the tenant becomes insolvent does not affect the continued existence of the lease or the rights and liabilities of third parties in respect of it. Of course, insolvency can bring the future of the lease into sharp focus. A landlord wishing to forfeit may, depending on the type of insolvency process in operation, have to overcome additional hurdles, such as obtaining the leave of the court or relevant insolvency practitioner. However, the fundamental position of third parties in the event that the lease is forfeit will be governed by the usual principles. If the lease is over-rented and there are solvent third parties who remain liable on the covenants, the landlord is likely to sit tight. Forfeiting would bring the lease to an end and with it the liability of third parties who are liable under it. In that situation, the liquidator is likely to want to disclaim the lease.
3. In the limited time available, I shall focus on two areas of topical interest in these times of recession.
4. First I shall look at disclaimer, which is a unique method of termination available in the course of liquidation or bankruptcy that has particular implications for third parties. I shall examine recent case law examining the relationship between AGAs and the statutory provisions on disclaimer.
5. Secondly I will go on to talk about voluntary arrangements, in particular CVAs, and the particular issue of continuing third party liability where the tenant is, by the terms of

those arrangements, released from liability under all or some of the lease covenants. There have been several high profile CVAs during this recession, most particularly in the retail sector, such as Powerhouse, JB Sports, Sixty, and Blacks. The increased prevalence of CVAs has in turn led to litigation as to the validity of the highly contentious practice of “guarantee stripping”. To what extent can a solvent guarantor wriggle out of its own obligations by reason of the terms of the tenant’s CVA?

DISCLAIMER

What is disclaimer?

6. The first point to note is that the lease will still continue in existence despite the fact that the tenant is subject to liquidation or bankruptcy.
7. However, the Insolvency Act 1986 (“IA 1986”) enables the trustee of an insolvent individual and the liquidator of a company to disclaim onerous property including leases (see sections 178 and following for companies and section 315 and following for individuals). The provisions are very similar.
8. The power to disclaim is only applies in the context of liquidation (whether voluntary or compulsory) or bankruptcy. It is not a power that is applies during the course of administration, receivership or voluntary arrangements.
9. This talk shall concentrate on the provisions relating to corporate insolvencies. The provisions that apply in bankruptcy are very similar but there are some differences.
10. The liquidator may, by giving a prescribed notice¹², disclaim any onerous property and may do so notwithstanding that he has taken possession of it, endeavoured to sell it, or otherwise exercised rights of ownership in relation to it: *IA 1986, s.178(1)*. This right applies to compulsory and voluntary winding up. The liquidator is no longer required to obtain leave and there is no time limit.
11. “Onerous property” is defined, by *IA 1986, s.178(3)*, as:

¹² For prescribed form of notice see IR 1986, r.4.187 and Form 4.53

- (a) any unprofitable contract, and
 - (b) any other property of the company which is unsaleable or not readily saleable or is such that may give rise to a liability to pay money or perform any other onerous act.
12. A lease which contains covenants on the part of the tenant is onerous even if the rent has been paid up and there is no subsisting breach of covenant: see *Eyre v Hall* [1986] 2 EGLR 95. Leases which are subject to sub-lettings are covered as much as occupational leases. Even though a liquidator will not become personally liable on the covenants in the lease, such ongoing rents may well be treated as liquidation expenses, payable ahead of the liquidator's own fees. A trustee in bankruptcy may become personally liable to perform the covenants. Therefore a lease that cannot be assigned for value will almost always be classed as onerous property.

What is the effect of disclaimer on third parties?

13. The effect of the disclaimer is set out in IA 1986, s.178 (4) as follows. The disclaimer:
- (a) **operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company in or in respect of the property disclaimed; but**
 - (b) **does not, except so far as is necessary for the purpose of releasing the company from any liability, affect the rights or liabilities of any other person**
14. The leading case on the effect of disclaimer of leases on third parties remains *Hindcastle v Barbara Attenborough Associates* [1997] AC 70, HL, as recently considered and applied in respect of an AGA in *Shaw v Doleman* [2009] P&CR 12.
15. In *Hindcastle* the landlord claimed arrears of rent due after the disclaimer of a 20 year lease in an insolvency from: (a) the first assignee of a lease which had placed itself in the

same position as the original tenant by covenanting with the landlord to pay the rent for the remainder of the term of years; and (b) the surety on his guarantee of the performance of the first assignee's obligations for a period of 10 years from the date of the lease. The original tenant was also sued, but had gone into liquidation and took no part in the proceedings on appeal. The proceedings arose from the liquidator's disclaimer of the lease in the liquidation of a company to which the first assignee had sold the lease. Both the defendant first assignee and the surety argued that the disclaimer of the lease operated to terminate their liability.

16. At common law, of course, the termination of the lease would have the effect of releasing the liability of guarantors arising under that lease. Prior to *Hindcastle*, it had been assumed by practitioners that the effect of a disclaimer had been to release the guarantor's obligations in the same way, because there was authority to that effect (*Stacey v Hill* [1901] 1 KB 660). Therefore it became common practice for leases to contain a provision requiring a guarantor to take a new lease of the premises for the residue of the term in the event of a disclaimer.
17. However, in *Hindcastle* the House of Lords overruled *Stacey v Hill*. It held that section 178(4) of the IA 1986 meant that the disclaimer determined the lease and accelerated the reversion as between the landlord and the tenant. However, with regard to the liability of third parties, including the original tenant under the pre-1995 law as well as the first assignee in the position of that tenant and the surety, the lease was deemed to continue and their liability was not affected by the disclaimer. As Lord Nicholls said, at p88G-H,

“the best answer seems to be that the statute takes effect as a deeming provision so far as other persons' preserved rights and obligations are concerned. A deeming provision is a commonplace statutory technique. The statute provides that a disclaimer operates to determine the interest of the tenant in the disclaimed property but not as to affect the rights or liabilities of any other person. Thus when the lease is disclaimed it is determined and the reversion accelerated but the rights and liabilities of others, such as guarantors and original tenants, are to remain as though the lease had continued and not been determined. In this way the determination of the lease is not permitted to affect the rights and liabilities of other persons. Statute has so provided”

18. The notional deemed lease is often described as being notional “like the Cheshire Cat’s grin” despite the termination of the lease. The guarantor is in a difficult position as he will remain liable on the covenants in the lease even though the tenant no longer enjoys any rights to occupy the premises. However, if the landlord actually enters upon the property and retakes possession of it, the guarantor’s obligations will end. As Lord Nicholls said in *Hindcastle*:

“... he will thereby end all future claims against the original tenant and any guarantor, not just claims in respect of the shortfall between the lease rent and the current rental value of the property”

Interpretation of AGAs in light of Hindcastle

19. The Court of Appeal has recently had to consider the applicability of the *Hindcastle* case to liabilities of a third party in respect of a “new tenancy” pursuant to an AGA. *Hindcastle* was a case which concerned the liability of third parties to an “old tenancy”. *Shaw v Doleman* [2009] P & CR 12 concerns the extent of an original tenant’s liability under an AGA given on assignment and expressed to take effect, as is usual, “*throughout the period during which the Assignee is bound by the tenant covenants in the lease*” in the case where the lease is subsequently disclaimed by the assignee tenant’s liquidator under s.178 of the IA 1986.
20. AGAs are subject to certain limitations prescribed by the legislation that created them, the Landlord and Tenant (Covenants) Act 1995 (“the 1995 Act”). An AGA is an exception to the general rule, introduced by section 5(2) of the 1995 Act, that a tenant’s liability ceases on assignment. The most important limitation is that an AGA may not impose on the outgoing tenant “*any liability, restriction or other requirement (of whatever nature) in relation to any time after the assignee is released from that covenant by virtue of this Act*” (section 16(3)(b) of the 1995 Act). Section 16(8) of the 1995 Act also specifically declares that the rules of law relating to guarantees (and in particular those relating to the release of sureties) are, subject to its terms, applicable in relation to any AGA as in relation to any other guarantee agreement.

21. The lease in *Shaw v Doleman* was of a small lock up shop and basement in Petersfield for a term of 10 years from 12 March 2004 at an annual rent of £16,000 subject to review. It was therefore “a new tenancy” within the meaning of the 1995 Act. The Lease contained provisions requiring the provision of an AGA (authorised guarantee agreement) on any assignment. The original tenant, Ms. Shaw then assigned the Lease (with landlord’s consent) to Ceramic Cafe Ltd (CCL). As she was required to do, she entered into an AGA with the landlord, Mrs. Doleman, on assignment. The covenant was to be “*throughout the period during which the Assignee is bound by the tenant covenants in the Lease.*”
22. CCL subsequently went into liquidation and its liquidator disclaimed the Lease under s.178 IA 1986. The landlord, Mrs. Doleman, then sought to recover from Ms. Shaw under the terms of the AGA. Ms. Shaw sought to defend the claim on the basis that her liabilities under the AGA would cease on the termination of the tenant’s liability under the covenants of the Lease on disclaimer.
23. The lower and appellate courts both upheld Ms. Doleman’s claims and rejected the argument put forward by Ms. Shaw that the disclaimer of the Lease brought to an end her liabilities under the AGA.
24. Mummery LJ at paragraph 1 put the dispute into context as follows:

“This appeal is about the grant of a lease, the assignment of it to a company, the tenant’s guarantee of the assignor’s performance of the tenant covenants, the assignee’s insolvency and the effect of the liquidator’s disclaimer of the lease on the guarantee liability to the landlord – in that order. Like the leading authority Hindcastle Ltd v Barbara Attenborough Ltd [1997] AC 70 (Hindcastle) (per Lord Nicholls at 83B) this case “arises out of the recession in the property market”. There is now a new recession in the property market. The dispute is where the loss lies on the insolvency of the corporate assignee. That is nothing new”
25. The Court of Appeal held that the liabilities under the AGA had to be read in light of the effect of s.178 (4) of the IA 1986 as construed in *Hindcastle* case. Whilst Mrs. Shaw’s

liability was expressly linked to whether CCL were liable on the tenant covenants, that had to be considered in light of s.178(4) of the IA 1986.

26. Although CCL were not liable, following disclaimer, to the landlord, the deeming effect of s.178(4)(b) of the IA 1986 was to treat the company as remaining liable on the covenants in the lease, so far as other parties were concerned. On the disclaimer the determination, by virtue of s.178(4)(a) of the 1986 Act, of CCL's liability under the Lease, was subject to the qualification in s.178(4)(b) that, except for the purpose of releasing CCL from liability, the disclaimer did not affect the liability of any other person. The appellant, Ms. Shaw, was such a person with guarantor liability. She remained liable as guarantor, if CCL remained liable. Mummery LJ therefore concluded at para. 36 that,

“It is clear from Hindcastle that, although the Lease was determined and CCL ceased to be liable to Mrs. Doleman under the tenant covenants, CCL was, so far as other parties such as Ms. Shaw were concerned, still bound by the tenant covenants as though the Lease had not been determined.”

27. This case illustrates that an AGA, like any guarantee, is to be construed in light of the statutory deeming provisions in s.178(4) of the IA 1986. This is a sensible decision. Any other interpretation would have seriously weakened the effect of an AGA given under the 1995 Act. However it is open to the parties to expressly agree (in the AGA) that the liabilities therein are to determine on a disclaimer by the tenant's liquidator. In an appropriate case, such a provision might also be implied, but clear words will probably be required in most cases: per Stanley Burton LJ at para. 44. A landlord is unlikely to want to agree to such a restriction. It is precisely in the event of a disclaimer that a landlord will want to preserve a claim against the original tenant under the AGA.

Effect of disclaimer on sub-tenants and vesting orders

28. The effect of the disclaimer on sub-tenants can be described as follows. The lease is determined so far as the tenant is concerned, but not so as to affect the interest of the sub-tenant whose interest continues on the same terms and subject to the same rights and obligations as though the disclaimed lease had continued. However the effect is to extinguish both the landlord's and the sub-tenant's rights against the insolvent tenant. The sub-tenant has the right, if it chooses, to remain in occupation for the term of the disclaimed head lease, provided it pays the rent reserved by that disclaimed head lease and performs the covenants in it: see *Re A E Realisations (1985) Ltd* [1988] 1 WLR 200. There is no contractual relationship between the landlord and the sub-tenant and the landlord cannot sue on the covenants in the head lease or sub-lease. However, if the sub-tenant fails to comply with the covenants in the notional head lease, the landlord will be entitled to distrain or bring forfeiture proceedings. If the landlord forfeits, the sub-tenant is entitled to apply for relief in the usual way, by way of a vesting order under s.146(4) of the Law of Property Act 1925. The right to remain in occupation is a right which is capable of being assigned: *R Thompson & Cottrell's Contract* [1943] Ch 97.
29. A mortgagee is in a similar position to a sub-tenant. So long as he discharges the obligations under the disclaimed "Cheshire Cat" lease, he will retain his rights in the property.
30. It would obviously be unsatisfactory for such state of affairs to continue indefinitely and so the landlord and such third parties are given the right to take steps to bring about a direct contractual relationship between them. Otherwise a situation could arise whereby a third party was effectively liable under the covenants in the lease but had no control or use of the premises in circumstances where the tenant likewise had no right to possession. However, the policy of the Act is to interfere as little as possible with the rights of the landlord.
31. The quid pro is that those persons with an interest in the property, such as sub-tenants and mortgagees and those who retain liability following disclaimer are given the right to apply for a vesting order under s.181 of the IA 1986. This enables them to essentially take

on a newly vested liability in exchange for their continuing liabilities. The upside for the third party is that he obtains an interest in possession and therefore can mitigate his loss by seeking to assign the lease or use the demised premises pursuant to the terms of the lease.

32. There are provisions designed to ensure that third parties are notified of a proposed disclaimer so that they can apply for a vesting order in time. The liquidator is obliged to serve a copy of the notice of disclaimer on every person claiming under the company as underlessee or mortgagee (so far as he is aware of their addresses) before the disclaimer can take effect: see IA 1986, s179(1). The liquidator can also require any person who it appears to him may have an interest in the disclaimed property to declare within 14 days whether he does have an interest in that property. Failure to do so entitles the liquidator to assume that there is no such interest (IR 1986, r. 4.192).
33. A time limit of 3 months from the date on which the applicant becomes aware of the disclaimer or the date of his receiving notice of it (whichever is earlier) is imposed for the making of an application for a vesting order.
34. The court has discretion to make a vesting order on such terms as it thinks fit. However, such an order can only be made where it is just to do so for the purpose of compensating the person subject to liability in respect of the disclaimer. The court's power is limited to vest disclaimed leasehold property in a person (a) subject to the same liabilities and obligations as the company was subject to under the lease at the commencement of the winding up, or (b) if the court thinks fits, subject to the same liabilities and obligations as that person would be subject to if the lease had been assigned to him at the commencement of the winding up. Basis (a) is clearly more favourable to the landlord, as the applicant will become liable to pay accrued liabilities predating the winding up. As the policy is to protect the landlord as much as possible, ground (a) is the most common. This adopts the same approach as would be followed were the landlord to forfeit, as the third party sub-tenant or mortgagee would in those circumstances be liable to discharge outstanding arrears as a condition of relief: see *re Walker, ex p Mills* (1895) 64 LJQB 783.

35. The court has power to vest only part of the premises demised by the *Cheshire Cat* lease in the applicant, for example where there is a sub-tenant of part. However, difficulties can arise in practice because the court will need to grapple with issues such as liability for common parts and as to the appropriate method of apportioning the rent and other financial obligations. There is no mechanism in IA 1986 as to the method of such apportionment.
36. The terms of a guarantee sometimes provides that in the event of the lease being disclaimed the guarantor will take a new lease from the landlord for the residue of the lease at the same rent. In *Re A E Realisations (1985) Ltd* [1988] 1 WLR 200, the court declined to exercise its discretion to make a vesting order in favour of a guarantor because the same result could have been achieved via this contractual mechanism. Despite the decision in *Hindcastle*, landlords often like to include such provisions in the lease because they can then compel the guarantor to take a new lease without requiring a court order.
37. Where the rent reserved by the sub-lease is higher than that reserved by the head lease, landlords often want to know if they can apply for a vesting order in their own name so as to put themselves into a position of privity of estate and as such take the benefit of the higher rent. However, the answer to this is no. The landlord cannot apply for a vesting order in his own name where it remains open to third parties to make such an application. If he wishes to do so, the landlord will need to invoke the “clearing off” procedure first. This entitles him to apply for a vesting order in the name of the sub-tenant. If the sub-tenant declines to accept such a vesting order, he will be excluded from all interest in the property by s.182(1). Only when all such interests have been cleared off is the landlord entitled to have the lease vested in itself.
38. The order of priority was summarised by Vinelott J in *Re A E Realisations (1985) Ltd* [1988] 1 WLR 200 thus:

“... it is I think, clear that what is contemplated is that an application for a vesting order may be made, first, by a person claiming under the bankrupt as underlessee or mortgagee (and, if more than one, in the order of priority of their respective interests inter se); secondly, if none is willing to take a vesting order by any person “liable either personally

or in a representative character, and either alone or jointly with the bankrupt to perform the lessee's covenants"; and thirdly, by "any person claiming an interest in the lease or under any liability not discharged by it".

VOLUNTARY ARRANGEMENTS

What is a CVA?

39. Part I of the Insolvency Act 1986 introduced an entirely new procedure into UK company law, namely the Creditors' Voluntary Arrangement or CVA. It was introduced to deal with the failure of the former company law identified by the Cork Committee Report (*Report of the Review Committee into Insolvency Law and Practice* (1982) (Cmnd 8558 at paras. 400-403) to allow a company (as opposed to an individual) to enter into a binding arrangement with its creditors for the composition of its indebtedness by some relatively simple procedure in order to avoid formal insolvency. This gives the company a chance to trade out of its difficulties or to secure a more equitable distribution to creditors than might have been achieved through other insolvency processes.
40. The assumption underlying CVAs is that the practical aim of the law should be rescue; getting the debtor back on its feet or maximising value for creditors from what is presently available. Rehabilitate the debtor and draw a line in the sand. There is no expectation that anything will be done by the debtor once rescued to compensate creditors further.
41. A CVA does not result from a court order and/or the actions of a secured creditor as in the case of administration or administrative receivership. It is a compromise agreement between a company and its unsecured creditors. The CVA comprises a set of proposals that are usually put together by a licensed insolvency practitioner appointed as nominee. He will act as the supervisor if the CVA is approved and will collect the assets subject to the CVA and ensure that creditors are paid the agreed dividend.

42. The initiative in setting up a CVA is taken by the directors of the company or, if the company is being wound up, by the liquidator or administrator. It is not however a prerequisite that the company should be “insolvent” or “unable to pay its debts”.
43. The essential element of a CVA is that a 75% majority of a company’s unsecured creditors can bind the remainder to the proposed arrangement against the latter’s wishes. It is this power that has led to challenges by minority landlord creditors indignant that the CVA procedure has been invoked so as to unilaterally impose upon them a fait accompli that is prejudicial to their interests.
44. The Act contains an inbuilt mechanism to ward against such unfairly prejudicial treatment. By section 6 of IA 1986, a person entitled to vote at either of the meetings or a person who would have been entitled to vote at the creditors’ meeting if he had had notice of it, may apply to the Court on one or both of the following grounds, namely that:
- (a) a CVA unfairly prejudices the interests of a creditor, member or contributory of the company;
 - (b) that there has been some material irregularity at or in relation to either of the meetings.

The Court, if satisfied as to either of those grounds, may:

- (i) revoke or suspend any decision approving the CVA; and/or
- (ii) give a direction to any person for the summoning of further meetings to consider any revised proposal.

The ways in which CVAs usually compromise the landlord’s claim against the tenant

45. It is unusual for a CVA to include terms that a lease is actually forfeit or surrendered as the effect of such arrangement, if implemented, would be to let former tenants and their guarantors off the hook. Even if there are agreed terms for a surrender of a closed store

leases incorporated into the CVA, such agreement is unlikely to comply with s.2 of the Law of Property Miscellaneous Provisions Act 1989. However, if in pursuance of such an agreement the landlord and tenant do actually effect a surrender of the lease, then the obligations of any guarantor would come to an end, although any freestanding obligation undertaken by the guarantor to take a new lease would survive: see *RA Securities Ltd v Mercantile Credit Co Ltd* [1995] 3 All ER 581.

46. However, it is not unusual for CVAs to be drafted on the basis that future contingent claims for rent and damages for non compliance with other covenants are compromised, so in effect releasing the tenant from most, if not all, continuing responsibility under the terms of the lease. In everything but name, therefore, as between the landlord and tenant, the lease no longer exists and it becomes necessary to look at the landlord's rights under the lease as against third parties, such as former tenants and guarantors.

47. As a general rule which applies to all contracts of guarantee, if a creditor releases the principal from his debt or obligations by a valid and binding legal agreement, then the surety will be discharged. There are two reasons for this rule. First, as a matter of basic principle, since the contract is one of guarantee, the surety's obligation being to pay the debt or perform the obligation or another, once that payment or obligation has been released, there is nothing left in respect of which the surety can be liable. Secondly, the effect of the release would deprive the surety of his right to pay off the creditor and sue the principal in the creditor's name.

48. However, it has long been established that this reasoning does not apply in circumstances where (i) the creditor reserves his rights against the surety at the time he releases the principal or (ii) where the original contract provides for the enduring liability of the surety notwithstanding the principal's release since in those circumstances the principal has notice of the surety's continuing liability and his consequent liability to indemnify the surety: see *Greene King v Stanley* [2001] EWCA Civ 1966.

49. It is usually the case that guarantees contain express provision providing for continuation of the guarantee in the event of compromise with or insolvency of the principal debtor. In such cases it is not even necessary for the creditor to go to the length of expressing reserving rights against his surety in dealing with the principal: see *Lombard Natwest Factors Ltd v Loutrouzas* [2003] BPIR 444; *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch).

Does a CVA release a surety? – a matter of construction

50. The cases demonstrate a considerable reluctance on the part of the courts to construe the terms of a CVA as having the effect of releasing co-debtors and sureties. The true effect of the CVA is a matter of construction of the relevant voluntary arrangement, on usual contractual principles. A release may be implied, as a matter of construction.
51. In *RA Securities Limited V Mercantile Credit Co Ltd* [1994] BCC 598, a landlord under a pre 1995 Act lease sued an original tenant for arrears of rent where the second assignee and current tenant had gone into a CVA. The landlord claimed both pre-arrangement and post-arrangement rent from the original tenant. The first assignee (but not the original tenant) was summoned to the creditors meeting and was a party to the CVA. Jacob J noted that the CVA “*is not for the benefit of solvent parties who happen to owe debts also owed by the debtor. It would be unfair if a solvent debtor escaped liability as a side-wind of the VA system.*” He recommended that for a CVA effectively to deal with a lease held by assignment, the assignor should be summoned to the creditors meeting. And it would seem correct to add that he should be made a party to the CVA. The judge rejected the suggestion of an accord and satisfaction of the entire debt. The landlords were bound by the CVA but they did not voluntarily accept some other performance. Although a CVA takes effect as a contract, there was no accord in truth; just a statutory binding. The original tenant’s failure to exercise the option to turn up at the creditors’ meeting and argue for some other arrangement did not amount to an accord in the sense of an acceptance.

52. In *Johnson v Davies* [1999] Ch 117, the Court of Appeal held that the question of whether a surety is released by the terms of an IVA is to be answered by reference to the terms of the agreement embodied in the IVA, on usual contractual principles. If, on its true construction, the agreement amounted to an accord and satisfaction, then effect would be given to it so as to terminate the surety's liability even if it did not turn up and the landlord voted against the proposal. In this respect the reasoning in *RA Securities Limited V Mercantile Credit Co Ltd* that a mere statutory binding could not affect an accord and satisfaction of a third party's liability was rejected.
53. In other words it is necessary to examine the terms of the IVA to decide whether the parties to it had intended that rights against a surety be been reserved or not. Historically the question of whether a release of a co-debtor released the other depended on whether the agreement represented a release (which would automatically release the co-debtor) or merely an agreement not to sue (which would not). That distinction was held to be artificial in *Watts v. Aldington*, The Times, 16 December 1993 and was rejected. The true inquiry is as to whether the intention of the parties was to reserve rights against the co-debtor or not. In addressing this question in *Johnson v Davies*, the Court of Appeal held that the Defendants were not released from their obligations under a covenant of indemnity by reason of the terms of an IVA of a co-obligee who was liable, jointly with the defendants, under the same covenant the liability which was the subject of the indemnity. The IVA was inconsistent with any intention to affect an immediate or absolute release of the debts owed by the debtor to his creditors; the bargain in the IVA did not lead to a release by accord and satisfaction of the joint debt owed by H and the defendants to the claimants, such that that debt could no longer be enforced against the defendants. Although it was necessary in order to give efficacy to the arrangement to imply a term that creditors bound by the proposals would take no steps to enforce their debts against the debtor while he was complying, or had complied, with his obligations thereunder, it was not necessary to imply a term that creditors were bound to take no steps to enforce their debts against his co-debtors. The debtor proposed to pay a percentage of his income to the supervisor, on the true construction of the CVA that did not amount to a release by accord and satisfaction. In *Re Goldspan Limited* 2003 BPIR 93 and following

Johnson v Davies, Mr Leslie Kosmin QC dismissed robustly a contention that the IVA of one co-debtor released any claim against a solvent co-debtor.

54. The question whether a reservation of rights of a creditor against a guarantor ought to be implied into an agreement between the creditor and the principal debtor releasing the principal debtor may be a question of fact requiring a trial than a summary determination—see *Finley v Connell Associates* 1999 WL 477.
55. In *Greene King Plc v Stanley* [2002] BPIR 491, the debtor took a loan from Greene King to finance the purchase of the lease of a public house. The loan was secured on the debtor's parents' house. The pub business failed. The debtor was substantially in arrears with payments under the charge. An IVA was proposed under which a sum of money put up by the debtor was shared between the creditors. The debtor was given more time to pay off the secured loan. The duration of the IVA was 1 year. The creditors were paid out but Greene King was not repaid. It took possession proceedings to enforce its security. The supervisor notified creditors that the IVA had been fully implemented, thereby bringing it to an end. The parents sought to defend the possession claim on grounds that under the general law a creditor (Greene King) could not preserve his rights against a surety on the release of the principal debtor unless there is a term in the contract of surety which entitles it to do so. The Court of Appeal disagreed. It could see no relevant distinction between the position of a surety and that of a co-debtor. It had long been accepted that, on the release of a co-debtor, the creditor may reserve its rights against the other co-debtors. The release of the principal debtor discharges the surety as the release of the principal debtor interferes with the surety's right to pay off the debt and sue the principal debtor. However, that right takes effect subject to any reservation by the creditor of its rights against the surety at the time of the release. Therefore, it was open to Greene King to release the debtor whilst reserving its rights against the parents. The reservation became part of the IVA when the existence of Green King's rights against the parents was expressly mentioned in the proposal. A statement in the proposal that "Greene King have a guarantee from my parents secured by a charge on their house" effectively put the creditors on notice of the possibility that Greene King intended to preserve its rights

against the parents. Accordingly, the IVA did not have the effect of releasing the parents from their obligations under the charge.

56. Some ambiguity as to the effect of a CVA has been introduced by certain dicta of Lord Neuberger in a more recent case which might be said to lend support to an argument that a guarantor should escape the hook, either wholly or in part, where the tenant's liability under the covenants in the lease is replaced with a liability to pay a dividend.
57. In *Thomas v Ken Thomas Ltd* [2007] 1 EGLR 31, rent plus VAT was payable monthly in advance under a lease dated 13th May 2004. The tenant paid the rent (but not the VAT) up to November 2004. It did not pay the November rent or the VAT on the previous month's rent. From December 2004 it paid the full amount due on a weekly rather than monthly basis. A CVA was approved which dealt, inter alia, with the arrears of rent due in November 2004 and the unpaid VAT element. The proposal, accepted by the requisite majority of the creditors voting (but against the wishes of the landlord) was to pay 23p in the pound. The landlord sought to exercise his right to forfeit in respect of the November 2004 rent and the unpaid VAT element which, by reason of the CVA, he could not sue for in debt.
58. Neuberger LJ held amongst other things that the landlord could not forfeit the lease for past rent which was caught by the terms of the CVA. The reasoning for this essentially was that the debts of the landlord under the lease had been substituted by a different debt under the CVA. As the right to claim rent had gone, so had any remedy related to it, such as the right to forfeit. If that is right, it could perhaps be argued that the effect of the CVA must be to effect an automatic accord and satisfaction by the loss of the original covenant and its substitution for something else. However, if that is right, this brings into question the entire line of cases decided above and it is doubtful that Lord Neuberger intended such a result. Further, in *Watts v Adlington* itself, the party to the action accepted a new obligation (namely payment by a third party) in substitution for its liability by way of a compromise of his primary liability but the co-debtor was not released and remained liable on the original liability. This is perhaps an argument of last resort. The

real test, in my view, remains whether, in agreeing to accept a dividend payment the parties intended that a third party guarantor should be released, whatever the analysis of the statutory effect of the compromise as between landlord and tenant.

59. I have also seen it suggested that the guarantor's liability could perhaps be reduced accordingly to the amount of the dividend payable¹³. If there is a total substitution of the liability, the guarantor would be released entirely. His guarantee was in relation to the original obligation. I cannot see how it can extend, without his consent, to an entirely new liability, namely the liability to pay the dividend.

Preservation of rights against third parties not connected with tenant's operation

60. A distinction here can be drawn between the preservation of rights against a third party who is not connected with the current tenant, such as former tenants and their guarantors and those who are, such as the parent company guarantor of the current tenant.
61. In the former category, it is common to find an express reservation of the landlord creditor's rights against such third persons. Whilst the current tenant thereby opens itself up to contingent claims by such persons by way of indemnity, such claims are often compromised for little money as part of the CVA. Therefore the current tenant has little to lose from agreeing to an express reservation provision. This may not be necessary in any event as most guarantees are drawn widely to ensure that they are preserved in the event of the tenant's insolvency or a compromise with the tenant, when they are really needed.
62. Even if the CVA expressly seeks to preserve rights against third parties, that is not necessarily conclusive as to a third party's liability under the terms of his guarantee. Although the landlord and third party guarantors are likely to be parties to the CVA and be bound by it under section 5 of the IA 1986, despite not voting in favour, the effect of

¹³ Property Insolvency, Levaggi and Elford at 5.78

the CVA is to create a series of bilateral agreements enforceable as between the company on one hand and its creditors on the other: see Etherton J in *Prudential Assurance Co Ltd v PRG Powerhouse Ltd* [2007] EWHC 1002 (Ch) at para. 51. A tenant's CVA cannot constitute any agreement, binding or otherwise, between the landlord on the one hand and the third party guarantor or former tenant on the other. In other words if, on a true construction of the terms of the relevant guarantee itself, the liabilities of the guarantor come to an end on a release of the tenant's liabilities under the CVA, then the CVA cannot have the effect of altering that so as to provide for enlargement of the AGA beyond its expressed scope.

63. An original tenant under an "old tenancy" will be liable on the covenants in the lease. If the lease continues, as it often will under the terms of a CVA, there is unlikely to be any mileage in respect of such arguments for the original tenant.

64. However, the position with former tenants and guarantors in respect of "new tenancies" is different. This is because of the restrictions on continuing liability imposed by the 1995 Act. AGAs take different forms. By necessity, they cannot be drafted so as to extend the liability of the former tenant or guarantor beyond the next assignment for such liability would not be an AGA at all. To comply with this requirement, AGAs are often drafted in terms which expressly provide that the liabilities thereunder are not to extend beyond "*the release of the assignee at law*" or similar phrase. For example in *Shaw v Doleman* the covenant in the AGA was to be "*throughout the period during which the Assignee is bound by the tenant covenants in the Lease.*"

65. However, this type of vague drafting opens up a possible argument that the release of the assignee from all liability under the lease as part of a CVA, itself discharges the former tenant/ guarantors' liability under the terms of the AGA, even though the continuance of the third party's liability whilst the lease continues and has not been assigned is not precluded by the 1995 Act, even if the assignee is released by the terms of a CVA. The CVA cannot expressly preserve the liability of the AGA beyond the date on which it would, on its own terms, cease to impose liability on the assignor. This is unlikely to have been

the intention of the parties for it is precisely in the event of the assignee's insolvency that the landlord will want to preserve the right to sue former tenants and guarantors.

66. The outcome of such a dispute will depend on the true construction of the AGA in question, which is likely to involve a detailed examination of the entirety of the AGA and fall to be decided on finer points of contractual interpretation. The decision in *Shaw v Doleman* is likely to be of some comfort to landlords, but the case can be distinguished in the event of a CVA. There would be some force in the commercial argument that the landlord cannot have intended to have taken such a weak guarantee. It is precisely in the event of the tenant's insolvency that the AGA is likely to be resorted to. However, the ratio of the decision in *Shaw v Doleman* was that the terms of the AGA had to be construed against the backdrop of the statutory provisions as to the effect of a disclaimer. The *Cheshire Cat* lease essentially came to the rescue of the landlord in that case. There is no such Alice in Wonderland trickery build into the CVA which is treated as a consensual arrangement (albeit one imposed by statute on the minority and subject to challenge on the grounds of unfair prejudice).
67. It is therefore important for landlords to ensure that guarantees and AGAs are drafted in terms which, whilst not falling foul of the anti avoidance provisions in the 1995 Act, protect the landlord in the event of a release of the assignee as part of the CVA. Ideally this should be expressly provided for.

Guarantee Stripping

68. Whilst a CVA will usually contain express provisions preserving the creditor's ability to pursue third parties, the position is different if that third party is connected with the tenant. Parent companies are usually "the driving force" behind the CVA of a subsidiary. In particular the parent will more often than not be providing the funding by which claims will be compromised with the aim of keeping the subsidiary alive as a going concern. It is perhaps not surprising that parent companies have sought to use the CVA as a means of "guarantee stripping", namely to compromise for little value a guarantee that would

otherwise be enforceable in full against them. The legality of guarantee stripping was considered in the *Powerhouse* litigation. The result is that whilst it is technically possible to do this, a CVA which did would, in practice, be extremely vulnerable to a section 6 challenge on the grounds of unfair prejudice. That, however, may be little comfort to landlords who face an expensive and uphill battle after the event to set aside an otherwise enforceable CVA. The tactical considerations and the danger of the CVA being used cynically to put pressure on landlords was fully explored in the *Sixty* CVA litigation which I shall consider below.

Powerhouse

69. The *Powerhouse* litigation is the collective name given to two test cases heard before Etherton J in the High Court as trials of preliminary issues, namely *Prudential Assurance Co Ltd v PRG Powerhouse Ltd & Ors; Luctor Ltd v PRG Powerhouse Ltd And Ors* [2007] EWHC 1002 (Ch); [2007] Bus.L.R.1771.
70. The litigation concerned the question as to whether the tenant company's CVA which purported to provide for a release of the parent company's guarantees to creditor landlords was effective in circumstances where the majority of creditors who voted for the proposal were unaffected by it. In other words, could *Powerhouse's* CVA be used as a mechanism for stripping out guarantees given by its parent company, PRG Group Ltd?
71. The tenant company was the UK's third largest electrical retailer before it ran into financial trouble. Its directors proposed to close 35 of its underperforming stores but to continue trading out of its more profitable sites which numbered 53. The claimants in each case were landlords of the closed stores who in turn had the benefit of guarantees given by *Powerhouse's* parent company, PRG Group Ltd ("PRG"). Those guarantees had been framed so that PRG's liability was not to be affected by insolvency on the part of *Powerhouse*. Therefore, as Etherton J put it, under the terms of the guarantees "PRG assumed the risk of *Powerhouse's* insolvency". In fact, the tenant had only acquired the business as a going concern in 2003 with the assistance of PRG and, on assignment of the

various leases, the claimant landlords had required parent guarantees in these terms as a condition of giving consent.

72. The tenant company proposed a CVA under which the claims against it arising from the store closures would be compromised but all other claims would be settled in full. The creditors whose rights were to be affected, which included the claimant landlords, would receive under the arrangement a dividend of 28 pence in the pound. The proposed CVA also sought to release the parent company's guarantees in respect of the closed stores as follows:

- Clause 3.12 of the CVA provided that payment of the dividend immediately operated to release all liability of the parent company under any guarantee.
- Clause 3.14 of the CVA provided that the guarantees were treated as released.

73. Perhaps unsurprisingly, Powerhouse did not face much difficulty in getting the proposed CVA approved by the majority of its creditors, who were not affected at all and indeed stood to have their claims settled in full under the arrangement or obtain a dividend of 28 pence in the pound when they would have received nothing on liquidation. The landlord creditors with the benefit of the parent company guarantees were in the minority. Likewise it is not difficult to see why the landlords of the closed stores were up in arms and sought to challenge the validity of the CVA in court. As Etherton J noted, the landlords, who stood to gain the most from an insolvent liquidation stood to lose the most from the CVA.

74. The preliminary issues before Etherton J were as follows:

- Whether any of those guarantees or indemnities had been released by reason of the CVA under section 5(2) of the Insolvency Act 1986 ("the IA 1986");
- Whether, if not, any of the claimants were precluded from otherwise enforcing any of the guarantees or indemnities against the parent company by reason of the CVA; and

- If the CVA did operate to release PRG Group Ltd from its liabilities under the guarantees whether the CVA unfairly prejudiced the claimants' interests for the purposes of section 6(1) of the IA 1986.

75. The answer to the first preliminary issue was “no”. However, the learned judge accepted that there was nothing new in the principle that a CVA could directly and adversely affect the rights of a third party guarantor. In *Johnson v Davies* the Court of Appeal confirmed that payment of a dividend to a creditor pursuant to a CVA can automatically operate, as a matter of general law, so as to discharge the liability of a third party co-debtor or surety. Nevertheless, *Powerhouse* was not such a case, because the general rule was capable of being ousted by express provision in the guarantee retaining the liability of the surety notwithstanding dealings between the creditor and the principle debtor. In *Lombard Natwest Factors Ltd v Koutrouzas* [2003] BPIR 444 it had been held that a surety was not released by an IVA of a co-surety when the guarantee expressly provided that the guarantee would not be affected by indulgence granted to a co-surety. The *Powerhouse* guarantees all contained express provisions to that effect and so effectively PRG Group Ltd had taken the risk of *Powerhouse's* insolvency. Therefore as a matter of general law the guarantees would not “fall in” with the primary debt. He held that a CVA was a hypothetical bilateral agreement between each creditor and the company and that it was the company and the creditor, and not any third party, which had the benefit of and could enforce the rights and obligations under the CVA. Accordingly, sections 1(1) and 5 of the IA 1986 did not operate directly to release the parent company's liability under the guarantees.

76. On the second issue however, *Etherton J* held that clause 3.14 of the CVA (which provided that the parent guarantees were to be treated as having been released) was effective as between the company and the claimant landlords. Therefore clause 3.14 was in principle enforceable by the company as an obligation on the claimant landlords not to claim against the parent company under the guarantees.

77. The learned judge described the claimants' concession, that it is legally possible for a CVA to provide that a creditor cannot take steps to enforce an obligation of a third party to the creditor which would give rise to a right of recourse by the third party against the debtor company (such as payment by a guarantor who can then claim contribution from the debtor), as "plainly right". He held that there was no difference in substance between an obligation of a creditor not to enforce a contract with a third party, on the one hand, and an obligation of the creditor to deal with the third party as if the creditor's contract with the third party did not exist, on the other hand.
78. Therefore although the CVA could not actually effect a release of the guarantee, it could in practical terms do so because the tenant company could enforce the obligation not to claim on the parent company's guarantees by injunction. This is the worrying element of the *Powerhouse* decision that may leave landlords feeling anxious about the real value of a parent guarantee in the event of a tenant's insolvency even where the guarantee is drafted in terms which expressly puts the risk of insolvency on the parent company guarantor.
79. As a matter of construction however, he held that the wording of the CVA in *Powerhouse* did not protect the tenant from any right of recourse PRG would have against it in respect of any claim brought by a landlord of closed premises under a guarantee. Therefore *Powerhouse* had a real financial interest in ensuring that the claimant landlords did not take action against PRG.
80. However, on the third issue (much to the relief of many commercial landlords), he held that the CVA could be challenged on grounds that it was unfairly prejudicial under section 6 of the IA 1986. Etherton J held in no uncertain terms that the CVA unfairly prejudiced the interests of the claimant landlords under section 6 of the IA 1986. It is this element of the decision that has allowed many commercial landlords to breathe a sigh of relief (for now) and has been hailed as a majority victory for landlords.

81. This finding involved an examination of the way in which the court considers an allegation of unfair prejudice. A number of points were made clear.
82. The first point is that the issue whether a CVA unfairly prejudices the interests of a creditor under section 6 of the IA 1986 is to be judged on the information available at the time the CVA was approved.
83. Secondly, establishing “prejudice” will usually be fairly straightforward. It was held that any CVA which leaves the creditor in a less advantageous position than before the CVA – looking at both the present and future – will be prejudicial. It is however, the additional need to show that the prejudice is “unfair” that raises difficulty. As Etherton J stated at paragraph 74:

“It is common ground that there is no single and universal test for judging unfairness in this context. The cases show that it is necessary to consider all the circumstances, including in particular, the alternatives available and the practical consequences of a decision to confirm or reject the arrangement.”

84. The concept of “comparative analysis from a number of different angles” features heavily in Etherton J’s judgment. He identified three such different types of comparison:
- “Vertical” comparison with the position on winding up;
 - “Horizontal” comparison with other creditors or classes of creditors;
 - Comparison with the position if, instead of a CVA, there had been a formal scheme of arrangement under section 425 of the Companies Act 1985 on which the different classes of creditors would have been required to meet and vote separately.
85. On the vertical comparison, if a CVA would be likely to result in a creditor or group of creditors receiving less than they would in a liquidation, then the court would be unlikely to sanction it.

86. The horizontal comparison involves a comparison of the position of different classes of creditor. The concept of unfair prejudice is aimed at disproportionate prejudice on one side or the other. However, the mere existence of differential treatment is not enough to support a finding that the dissentient creditor has been unfairly prejudiced. In some circumstances, differential treatment may be necessary to ensure fairness or to secure the continuation of the company's business which underlies the CVA, for example, where it is necessary to pay suppliers in full in order to ensure that the company can continue to trade.
87. In relation to the third aspect Etherton J also held that, depending on the circumstances, a comparison with what the position would have been on a scheme of arrangement under section 425 of the 1985 Act may be of assistance on the issue of unfair prejudice in a CVA. However, he also agreed that caution must be exercised in carrying out that comparison. The fact that a particular class of creditors could and might have blocked a scheme under section 425 of the CA 1985, whilst relevant and potentially important, does not necessarily mean that they have been unfairly prejudiced within section 6 of the 1986 Act.
88. Applying these tests, Etherton J was very firmly of the view that this CVA was unfairly prejudicial.

Sixty

89. The issue arose again in relation to the *Sixty* CVA. In *Mourant & Co Trustees Ltd & anor v Sixty UK Ltd* [2010] EWHC 1890 (Ch), landlords of two retail units at the Met Quarter shopping centre in Liverpool applied under section 6(1) of the IA 1986 for a revocation of a CVA proposed by the administrators of the tenant, Sixty (UK) Ltd ("*Sixty*") on the grounds of unfair prejudice.
90. In that case these two landlords of closed stores had the benefit of guarantees given by the tenant's ultimate Italian parent company, Sixty SpA. There was no suggestion that Sixty SpA would be unable to meet its obligations under these guarantees.

91. The effect of the CVA, as approved by the 75% majority of creditors, was to release Sixty SpA from all liability under the guarantees upon payment of a sum of £300,000 which was said to represent 100% of Sixty's estimated liability to the landlords on a surrender of the lease. Ostensibly therefore, the guarantors were to receive full compensation. The CVA also provided for two other stores occupied by Sixty to close and for their landlords to receive a dividend of 21% of the estimated liability. Those landlords did not have the benefit of any parent guarantee. All other creditors were to be paid in full. Another feature of the CVA was that another landlord creditor's right to pursue an original tenant, Muji, was preserved and the CVA did not seek to compromise any claim Muji might have against Sixty to be indemnified.
92. It was accepted by the landlords that, as established in *Powerhouse*, a voluntary arrangement made between a tenant and its creditors, including landlords with the benefit of third party guarantees is possible of imposing on the landlords a binding release of their rights under such guarantees, even though the guarantor is neither the company which is proposing the arrangement, nor a party to it. Furthermore, it was accepted that a CVA could have that effect even though the relevant guarantees contain provisions designed to prevent the release of the principal debtor from affecting the creditor's rights under the guarantee.
93. Henderson J allowed the challenge to the CVA. His judgment is in emphatic terms, concluding that it was clear that the application "must succeed". Indeed, he stated that this was a CVA that was "fatally flawed" and "should never have seen the light of day".
94. Applying all of the comparison techniques employed in *Powerhouse*, the judge held that the CVA was unfairly prejudicial to the landlords.
95. On a vertical analysis, it was clear that on a winding up, the landlords would have had the right to enforce the guarantees in full against Sixty SpA for the length of the unexpired term. They also would have had the right to require the parent guarantor to take a new lease for the unexpired term. These contractual rights were of obvious commercial value

to the landlord and formed an important part of the consideration for the package of incentives negotiated with the Sixty Group. There was no evidence that the guarantees would be particularly difficult or time consuming to enforce, even though the parent was Italian. Sixty SpA was a substantial public company with a strong balance sheet and with a reputation to lose. Italy was a member state of the EU and bound by Council Regulation (EC) 44/2001 on jurisdiction and the recognition and enforcements of judgments in civil and commercial matters. The judge indicated that it would require “strong evidence” to persuade the court in such circumstances that the guarantees were of significantly less commercial value than an equivalent guarantee given by a UK company.

96. Henderson J also indicated that it was “unreasonable and unfair” to ask the landlords to give up their guarantees. In times of commercial and financial turmoil, the ability to enforce the terms of the existing leases against the guarantor for a further seven and a half years was a most valuable right and “there was no sufficient justification for requiring the guaranteed landlords to accept a sum of money in lieu”. There is an indication that it would rarely be appropriate to require the landlord to accept a sum of money in lieu of such rights. The judge said that in a time of market uncertainty it will be difficult, if not impossible, to determine what sum will fairly compensate the landlord for the loss of such rights, and in the absence of a compelling justification a landlord should not be forced to accept a sum which is based on numerous assumptions which may or may not prove to be well founded. To adopt such procedure, in circumstances where the solvency of the guarantor is not in question would be *“to undermine the basic commercial function of the guarantee, and to force the landlord to accept a commercially inferior substitute for it”*.
97. In any event, even if that approach were wrong, the judge went on to find that the value of £300,000 assigned to the claims was grossly inadequate. After hearing expert evidence, it was held that a sum in the region of £1million was the least that could fairly be regarded as appropriate. The judge held that the figure of £300,000 was not a genuine estimate of value but was rather a figure which could not be objectively justified and which was dictated to the administrators by Sixty SpA simply because they knew that the unaffected majority would accept the proposal. The figure proposed by Sixty SpA was

based on a “*cynical calculation by it of what it hoped it could get away with*” in light of the fact that they knew that the landlords would face lengthy and expensive court proceedings before the CVA could be overturned”. In so doing the administrators came in for heavy criticism in that they had acted in dereliction of their duty to put forward proposals which they must consider fair to all of the creditors and the company itself.

98. The CVA was also unfair on a horizontal comparison by reference to the treatment of Sixty’s associated companies on the one hand and the landlords of all closed stores on the other. Not only were the majority of creditors to be paid in full, but two of Sixty’s own associates were entitled to the payment of debts due to them by Sixty in full and without deferment whilst landlords of closed stores were required to accept a dividend of 21% of the estimated surrender liability under their leases. Further the preferential treatment given to Muji, whose claim to an indemnity was not compromised was formulated because of the known risk of Muji derailing the CVA. Parity of treatment would have required Muji to be released from its contractual liability to the landlord and for the landlord to be compensated by cash payment of equivalent value. The true complaint was held not to be the fact that Muji as a creditor was treated unfairly well in comparison with the applicants, but rather that the failure to grapple with Muji’s position as a quasi-guarantor led to the Trafford Centre landlord being favourably treated in comparison with the applicants. It was not required to give up a quasi guarantee, whereas the applicants were.
99. The judge concluded with some strong words. The purpose of the CVA was to compel the applicant landlords to give up their rights for a fraction of their fair value, and to improve the group’s negotiating position by forcing the applicants either to accept the CVA (which was bound to be passed by the votes of the creditors who stood to be paid in full) or to embark on lengthy and expensive proceedings to set it aside, which would by itself buy time and subject the applicants to all the uncertainties of litigation. It was clear from the documents belatedly disclosed by the respondents that cynical calculations of this nature were never far from the minds of the Sixty Group. He went on,

“I wish to emphasise that it is the duty of administrators or other office holders, in such circumstances, to maintain an independent stance, to act in good faith, and only to propose a CVA if they are satisfied that it will not unfairly prejudice the interests of any other creditor, member or contributory of the company. The need for a responsible and professional attitude is even more pronounced where the CVA is structured in such a way that it is bound to be passed by the votes of creditors whose position is either unaffected or improved, and where another much smaller class of creditors is to be deprived of valuable contractual rights in reliance on the Powerhouse principle. I do not say that it is necessarily impossible to propose a fair CVA of this type, but the greatest of care is needed to ensure fairness to the latter class, both in the substance of what is proposed and in the procedure that is adopted”

100. Henderson J took such a dim view of the administrators’ conduct that he stated that he was satisfied that there was a prima facie case of misconduct on their part which ought to be considered by the professional bodies to which they were answerable. He therefore directed that copies of his judgment should be sent to the appropriate bodies by which they were licensed to act as insolvency practitioners.

Anything to worry about?

101. The robust approach adopted in the *Sixty* case will give landlords further comfort after *Powerhouse*. The possibility of guarantee stripping opened up in *Powerhouse* will be judiciously monitored, albeit after the event. Whilst the possibility of a fair CVA being proposed which includes an element of asset stripping was clearly left open, in reality it will be very difficult for guarantee stripping to be justified on the critical vertical analysis as in a winding up the landlord would be able to enforce the guarantee in full. Further, there is a suggestion in Henderson J’s judgment that it would be unfair per se to ask a guarantor to accept money in lieu of a contractual guarantee. It is possible that guarantees of little worth could be compromised fairly, for example, if there were real difficulties with enforcement and or a very short unexpired term. In these types of cases, a landlord might actually be prepared to accept the terms of a compromise, if it results in a better outcome than that achievable on a winding up.

102. There remains the practical difficulty that the onus lies on the landlord to challenge the CVA by expensive and time consuming litigation. However, attempts by insolvency practitioners to use a CVA tactically would expose them to the type of criticism seen in *Sixty*. When faced with a proposed CVA which a client considers to be unfair or designed to apply unwarranted pressure, a mere forwarding the judgment in the *Sixty* case to the insolvency practitioner with the juicier passages highlighted might well have the desired effect before the CVA is even put to a vote.
103. Given the possible vulnerability of parent company guarantees in the event that the tenant proposes a CVA, landlords may seek to protect themselves in other ways. For example, they may seek to insist on the parent company (or a special purpose vehicle set up for the purpose with no other creditors) taking the lease instead of the tenant, taking rent deposits (perhaps with regular top up provisions), or requiring greater tenant covenant strength in the first place. One way of avoiding the whole issue is to require security, which cannot be overridden by the CVA by reason of section 4(3) of the IA 1986.

Part 3

“Encounters with Strangers”

Termination and Third Parties
Who Are Not Parties to the Lease, nor Derive Title from It

NICHOLAS TAGGART

Introduction - Who Might These Strangers Be?

1. Camilla and Tom have dealt with the position of mortgagees and sub-tenants, people with property interests connected with the determined lease. I am going to look at the position as regards complete strangers to the landlord and tenant relationship which has been determined. You might think that the answer is relatively simple: strangers become trespassers as against the landlord when the tenancy is determined, so strangers have no rights. They just need to leave, right? Well, it ain't necessarily so....

2. Who might these strangers be? There are lots of possibilities, but I shall just consider a few classes of people, who might have rights that have a bearing on what the landlord can and cannot do with commercial premises.¹⁴ The classes of person I shall consider are as follows:
 - 2.1 People making unmeritorious claims to property interests, which you dispute.
 - 2.2 People legitimately let in by the former tenant as independent commercial licensees, such as franchisees or pop-up shop proprietors;
 - 2.3 Employees of the former tenant;
 - 2.4 Persons who own goods on the Premises. These may be suppliers of goods to the tenant on chattel leases, suppliers of trade goods who have delivered goods

¹⁴ In this context, residential occupiers have a number of additional rights, but if you are interested in resi., you are probably at the Tanfield Chambers seminar on Residential Service Charges. I'll assume that this talk is where all the *grown up* commercial property lawyers are.

but still retain title, or maybe customers of the former tenant, who have left goods at the premises, perhaps for repair or collection later.

Troublemakers - Persons Whose Title You Dispute:

3. We have all been there. Cruising along, waiting for the Bailiff to enforce your order for possession, and up pops some Troublemaker, arguing that they have rights of some sort. It is usually an alleged sub-tenant asserting a continuing sub-tenancy. But it might be more exotic: not so long ago, I had the directors of the company tenant, asserting a constructive trust of the company's demise in their own names, because they had spent their own money improving the premises.¹⁵ If you have forfeited, they may well mess you about with a claim for relief by way of a vesting order on terms you do not want to accept.¹⁶ If you have accepted surrender, obviously you are stuck with a *bona fide* sub-tenant, but you may dispute whether the occupiers are really in sub-tenants.¹⁷ What can you do?

4. (1) *Burden of Proof:* Keep calm and carry on, remembering that the burden of proof is a good start. You should be able to prove your title. If you have obtained possession pursuant to an Order, you have already satisfied the Court of your title, but for Troublemaker. If you have taken a surrender, you should either have a deed or documentary trail which evidences the destruction of the lease. If you have agreed that possession be taken peaceably, you are either fully satisfied that your client has good title to do so, or you really need your head examining.

¹⁵ It did not work: they could not prove they had spent their own money and could not prove the landlord had any knowledge of any works being undertaken by them, as opposed to their company. Nothing to shock the conscience of the Court. See *Cobbe v. Yeoman's Row Management Ltd.* [2008] 1 WLR 1752 (HL) at [95] *per* Lord Walker on not applying the test for a proprietor estoppel mechanically: "If the other elements appear to be present but the result does not shock the conscience of the court, the analysis needs to be looked at again".

¹⁶ Assuming for the moment that, even in this market, the client would rather have the building empty than have these characters in occupation paying something and being liable for rates...

¹⁷ The modern law on this can be best found *per* Lord Millett in *Barrett v. Morgan* [2000] 2 AC 264, 271, (HL) and in *PW & Co. v. Milton Gate Investments Ltd.* [2003] EWHC 1994 (Ch), [2004] Ch 142 (Neuberger J).

5. If you can prove a title, that is all you need. The Supreme Court have recently endorsed that in *Bocardo SA v. Star Energy UK Onshore UK Ltd.*¹⁸ Lord Hope expressly approved the observation of Slade J in *Powell v. McFarlane*, that in the absence of evidence to the contrary, the owner of land with the paper title is deemed to be in possession of the land, as being the person with the *prima facie* right to possession. The law will, “without reluctance”, ascribe possession either to the paper owner or to persons who can establish a title as claiming through the paper owner.¹⁹

6. At that stage, it is up to Troublemaker to establish, on the balance of probabilities, that he has some legal interest that binds you. It is not for you to prove he has no title, all you have to do is show your title and assert that he is a stranger to your title. A cracking example of this is *Filemart Ltd. v. Avery*:²⁰ the trial Judge, on an application to adjourn an application under Order 24,²¹ found that the occupier’s defence was so flimsy, it would not discharge the burden of proof on him to prove a better title than that disclosed by the claimant “paper title”. The Court of Appeal agreed.

7. If you cannot prove a paper title, there is always *Manchester Airport plc v. Dutton and Hall v. Mayor of London*, for as long as either of them remains good law, but that really goes beyond the scope of this talk.²²

8. (2) *Possession of Part:* Assume for a moment that Troublemaker is making a sufficiently plausible case for you to accept that the Court will not dismiss their claim summarily. How can you put pressure on them, to make them either get on with asserting their claim, so the Court can decide it, or just make it too expensive for them to keep messing you about?

¹⁸ [2010] UKSC 35; [2010] 3 WLR 654.

¹⁹ (1977) 38 P&CR 452, 470, approved by Lord Hope at [30]. See also *JA Pye (Oxford) Ltd. v. Graham* [2003] 1 AC 419, [40] *per* Lord Browne-Wilkinson.

²⁰ [1989] 2 EGLR 177 (CA).

²¹ A Part 55 Possession Claim Against Trespasser, if you are but a child.

²² [2000] 1 QB 133 (CA) and [2010] EWCA Civ 817; (2010) 107(30) LSG 12, respectively.

9. One thing you might be able to do is get back part of the premises. Take a situation where the Troublemaker is asserting a sub-tenancy of part, and an entitlement to relief from forfeiture. Say you have sought an order to forfeit a lease of the whole premises. Upon judgment, you get an order confirming that you had forfeited the lease of the whole of the demised premises, as at the date on which the claim for possession was served on the tenant.²³ As you demised it as a whole, and forfeited it as a whole, you cannot but have an order for possession of the whole of the premises. Back in the 20th Century, and for most of the 21st Century so far, you would now be stuck, even though the Troublemaker was asserting a sub-tenancy of part only.

10. The reason you would be stuck is that the 20th Century analysis of an order for possession is that it is an Order *in rem*, only capable of enforcement in respect of the title in respect of which claim had been sought. The Court could not pick and choose who the order was enforced against, precisely because it was an order against the very title itself. If mere trespassers occupied only a part of the physical area comprising Blackacre, the landowner could restrict himself to an order against that part of Blackacre alone.²⁴ But he could not forfeit part of a lease and he could not enforce the order against only some of the people in occupation. It was in the nature of a writ or warrant for possession that is required vacant possession to be delivered up of all the land subject to the order, not just against some of the people on it.

11. Most of us took this to be the law, because of the decision in *R. v. Wandsworth County Court, ex parte Wandsworth London Borough Council*.²⁵ In that case, the Council obtained a possession order against named squatters. When the bailiff sought to execute the Order, he found a different family in occupation. The Registrar²⁶ ordered the bailiff to stop, pending a fresh action for possession against the newly discovered

²³ In other words, the forfeiture is not concluded until the Order is perfected, but its effect is then retrospective: see, for example, *Hynes v. Twinsectra Ltd.* [1995] 2 EGLR 69 (CA); *Meadows v. Clerical, Medical and General Life Assurance Society* [1980] 2 EGLR 63 (Sir Robert Megarry, V-C).

²⁴ *University of Essex v. Djemal* [1980] 1 WLR 1301 (CA).

²⁵ [1975] 1 WLR 1314 (CA).

²⁶ If you are one of the Youth of Today, this is what we called a District Judge in ye olde days.

occupiers. Lord Widgery CJ summed up the problem in a way which gave a clue as to what he was going to decide:

The registrar, bowing to the superior weight of opinion of his brother registrars in London, took the view that where the bailiff going to obtain possession under a warrant for possession finds in possession a person who was not a party to the proceedings before the judge, but who is a stranger, then he must leave that person in possession and await further proceedings directed against that person. In other words, the registrar's standing instructions to his bailiffs seem to have been that if they found this situation, they were to leave the interloper... where he was and await further proceedings being brought by the landlord against the interloper.

Of course the practical disadvantage of that course from the landlord's point of view is that the identity of the squatter can be changed much more quickly than the landlord can bring further proceedings in the county court, and so the landlord is always a lap behind, as it were, and never really catches up.

Lord Widgery then approved this statement by Stamp J in *Re Wykeham Terrace, Brighton, Sussex*:²⁷

It is a truism that an order or judgment of this court binds only those who are parties to or attending the proceedings in which the order or judgment is given or made. This principle is blurred where the action is an action for the recovery of land by reason of the process by which the judgment is executed. The sheriff acting pursuant to a writ of possession will be bound to turn out those he finds upon the land whether they are bound by the judgment or not.

Lord Widgery also approved an *obiter* statement of Lord Denning's in *McPhail v. Persons Unknown*:²⁸

A summons can be issued for possession against squatters even though they cannot be identified by name and even though, as one squatter goes, another comes in. Judgment can be obtained summarily. It is an order that the plaintiffs, "do recover" possession.

²⁷ [1971] Ch 204, 209

²⁸ [1973] Ch. 447, 458 (CA).

That order can be enforced by a writ of possession immediately. It is an authority under which any one who is squatting on the premises can be turned out at once.

Lord Widgery concluded:

It seems to me it has always been the law that the sheriff, when lawfully enforcing a warrant for possession, turns out everybody he finds on the premises, even though they are not parties.

12. Apparently, he was wrong about that. Perhaps we should have seen it coming, because Lord Widgery commented, “it is a very short point indeed, and strangely enough it has less authority upon it than I personally would have expected”, even though he was taken as far back as *Upton and Wells Case*, in 1589.²⁹

13. Actually, it seems that an order for possession is an order granted *in personam* after all; or possibly enforced *in personam*. This is the consequence of *Secretary of State for Environment, Food and Rural Affairs v. Meier*, a case in which Secretary of State brought proceedings for possession against persons both known and unknown of a specific location, Hethfelton Wood, and of other woodland managed on his behalf covering an area approximately 25 miles by 10 miles.³⁰ For our purposes, the judgment of Baroness Hale is the starting point, because she could not see what the problem was:

[36] It was held in *R v Wandsworth County Court, ex parte Wandsworth London Borough Council* that a bailiff executing a possession warrant is entitled to evict anyone found on the premises whether they were party to the judgment or not. However, there is nothing to prevent the order distinguishing between those who are and those who are not lawfully there, provided that some means is specified of identifying them. No one would suggest that an order for possession of Hethfelton Wood would allow the removal of Forestry Commission workers or picnickers who happened to be there when the bailiffs went in. In principle, court orders should be

²⁹ (1589) 1 Leo. 145.

³⁰ [2009] UKSC 11; [2009]1 WLR 2780 (SC).

tailored to fit the facts and the rights they are enforcing rather than the other way around.

Slightly difficult to see how the bailiff deals with a “person unknown” who might be a picnicker and a “person unknown” who might be a Traveller.³¹ Or a member of the Travelling community just having a picnic. Whatever, for our purposes this plainly allows the landlord with a Troublemaker in possession of part only to edit scope of the Order he seeks to exclude Troublemaker, pending resolution of Troublemaker’s claim.

14. Just to complete the analysis of *Meier*, Lord Neuberger MR might just have skated over the issue a little:

[76] ... An order for possession only binds those persons who are parties to the proceedings (and their privies), although the bailiffs (and sheriffs) are obliged to execute a warrant (or writ) of possession against all those in occupation: see *In re Wykeham Terrace, Brighton, Sussex... R v. Wandsworth County Court, ex parte Wandsworth London Borough Council ...* It would therefore be wrong in principle for the court to make a wider order for possession against trespassers (whether named or not) in one wood with a view to its being executed against other trespassers in other woods. None the less, because the warrant must be executed against anyone on the land, there is either a risk of one or more of the occupiers of another wood being evicted without having the benefit of due process, or room for delay while such an occupier applies to the court and is heard before a warrant is executed against him.

Not sure if that is quite consistent with Baroness Hale’s judgment, because that seems to be precisely the problem with picking the right picnicker. As for Lord Rodger, he seemed to think the order was good against all the world until someone being turfed out made an application.³²

[6] ... To use the old terminology, the defendant has ejected the claimant from the land; the claimant says that he has a better right to possess it, and he wants to recover possession. That is reflected in the form of the order which the court grants: "that the claimant do forthwith recover" the land- or, more fully, "that the said AB do

³¹ Also, this plainly does not square with Lord Widgery’s reliance on Stamp J in *Re Wykeham Terrace*, which uses the language of an obligation to deliver vacant possession.

³² Lord Collins agreed with Lord Rodger and Baroness Hale; Lord Walker agreed with everybody.

recover against the said CD possession” of the land: see *Cole, The Law and Practice in Ejectment* (1857)... The fuller version has the advantage of showing that the court’s order is not *in rem*; it is *in personam*, directed against, and binding only, the defendant. Of course, if the defendant refuses to leave and the court grants a writ of possession requiring the bailiff to put the claimant into possession, in principle, the bailiff will remove all those who are on the relevant land, irrespective of whether or not they were parties to the action: *R v. Wandsworth County Court, ex parte Wandsworth London Borough Council*. So, in that way, non-parties are affected. But, if anyone on the land has a better right than the claimant to possession, he can apply to the court for leave to defend. If he proves his case, then he will be put into possession in preference to the claimant. But the original order for possession will continue to bind the original defendant. See Stamp J’s lucid account of the law in *In re Wykeham Terrace* ...

15. Oh well. For our purposes, it seems reasonably plain that the net effect of that is that an Order for possession takes effect *in personam*, but the Bailiff can remove anyone who cannot assert a better title, even if they are a stranger to the action.³³ So, the Bailiff can be empowered to pick and choose who to evict.³⁴ Therefore there is nothing wrong in principle with accepting before the Judge that Troublemaker has an arguable defence as to part of Premises, so he can be left in place for now, but that possession of the rest of the Premises can be ordered.³⁵
16. (3) *Damages for Trespass:* What else can we try to put pressure on Troublemaker? We could give him a scare with a chunky claim for damages for trespass, should he fail to prove he has a subsisting right to possession. It is worth a brief re-cap on where the law on damages for trespass has gotten to.
17. The usual measure is still “the ordinary letting value of the land”. In *Swordheath Properties Ltd. v. Tabet*,³⁶ Megaw LJ said that a claimant is entitled,³⁷ without bringing evidence that he could or would have let the property to someone else in the absence of the trespassing defendant, to have as damages for the trespass the value of the

³³ This is Lord Rodger’s and Lord Neuberger’s analysis.

³⁴ This is Lord Rodger’s, Baroness Hale’s and Lord Neuberger’s analysis.

³⁵ This is Baroness Hale’s analysis, which it might be said is not inconsistent with Lord Rodger’s, and Lord Neuberger’s analysis.

³⁶ [1979] 1 WLR 285, 288 (CA). Browne and Waller LJ agreed.

property as it would fairly be calculated. He then went on to say that, in the absence of anything special in the particular case, it would be the ordinary letting value of the property that would determine the amount of damages.

18. Just an aside here: say that Troublemaker is in occupation of the whole of the demised premises, but those premises are part of a larger building or are a unit on an industrial park. If the former tenant would have paid service charges, do not take the passing rent as the value for trespass damages, because there are real difficulties in adding in a restitutionary claim for the services actually consumed by Troublemaker. It is easier, if there is enough money at stake, to get expert evidence of what the rent would be on an *inclusive* basis.³⁸

19. The ordinary letting value of the property might also take into account the sum that the actual landowner would charge the actual trespasser, if they were to have hypothetically reached an agreement for a short-let. This suggestion is made by Lloyd LJ in his speech in *Ministry of Defence v. Ashman*, to which I shall return below.³⁹ Overall, Lloyd LJ dissented, but on this point, there is nothing inconsistent between his approach and that of Kennedy and Hoffmann LJ. Interestingly, this suggestion of a hypothetical letting to the trespasser might cause the valuation of the premises to be higher than the open market rent, as the trespasser is quite likely to be a special purchaser, who will overbid the market on *DeLaforce* principles (the sitting tenant's tendency to overbid the market) if nothing else.⁴⁰ Even more interestingly, Lord Scott's calculation of trespass damages in *Horsford v. Bird* takes exactly that approach, albeit without reference to *Ministry of Defence v. Ashman*.⁴¹ Presumably, the approach to the

³⁷ Well, he actually said "plaintiff", because this was before they changed all the names round for no worthwhile purpose.

³⁸ There is some brief discussion of this in *Shirayama Shokusan Co.Ltd. v.Danovo Ltd (Nº.4)* [2005] EWHC 2589 (Ch); [2005] 44 EG 134 (CS).

³⁹ (1993) 25 HLR 513 (CA).

⁴⁰ *DeLaforce v. Evans* (1970) 215 EG 315 (LT).

⁴¹ *Horsford v. Bird* [2006] UKPC 6; [2006] 1 EGLR 75.

hypothetical agreed licence fee is undertaken along the same lines as set out in the damages *in lieu* of an injunction cases.⁴²

20. As we all know, that is not the only way of calculating the damages. The damages can also be assessed by reference to the value to the trespasser of his occupation, which could be calculated by reference to the cost to the trespasser of alternative accommodation, even if that is higher than the letting value of the land actually occupied. This proposition derives from two separate cases before different constitutions of the Court of Appeal, *Ministry of Defence v. Ashman* and *Ministry of Defence v. Thompson*.⁴³ Hoffmann LJ sat on both appeals, and the following principles can be derived from his judgments:
- 20.1 An owner of land which is occupied without his consent may *elect* whether to claim damages for the loss which he has been caused or restitution of the value of the benefit which the defendant has received.⁴⁴
- 20.2 The fact that the owner if he had obtained possession would have let the premises at a concessionary rent, or may not even have let them at all, is irrelevant for the purposes of the restitutionary claim, as that calculates the benefit the defendant has received, in the circumstances he has received it. A trespasser who has a free choice whether or not to trespass may receive a greater benefit than one whose hands are tied.
21. Note the critical point, for our purposes, is that Hoffmann LJ is clear that the choice between letting value and restitution is the *claimant's*, and he need not elect until just

⁴² I think the best example is still *Amec Developments Ltd. v. Jury's Hotel Management (UK) Ltd.* [2001] 1 EGLR 81 (Mr. Anthony Mann QC, sitting as a deputy judge of the Chancery Division).

⁴³ (1993) 25 HLR 513 and (1993) 25 HLR 552, respectively.

⁴⁴ In *Ramzan v. Brookwide Ltd.* [2010] EWHC Civ 2453 (Ch), Miss Geraldine Andrews QC (sitting as a Deputy High Court Judge) decided that the choice of quantification was for the Court to decide, even though she cited Hoffmann LJ's comments. However, it seems from paragraphs [36]-[37] of the judgment that the Claimant was trying not to actually make an election, but keeping all his options open. The Court can substitute its judgment to make an election, if the party entitled to do so is reluctant: see, in a wholly different context, *Motor Oil Hellas (Corinth) Refineries SA v. Shipping Corporation of India, (The MV "Kanchenjunga")* [1990] 1 Lloyd's Rep. 391, 397-8 (HL).

before judgment.⁴⁵ Now, there may be costs consequences of running both claims that far and abandoning one before trial, but at the stage of just giving Troublemaker some grief, this is a reasonable threat, especially if Troublemaker is trading from the premises he is occupying. That is because the restitutionary element of damages for trespass can go as far as seeking a slice of the gross profits earned by Troublemaker from your premises.

22. This has recently been confirmed by the Court of Appeal in *Stadium Capital Holdings v. St. Marylebone Properties Co.plc.*⁴⁶ There, the trespass was the erection of a commercial advertising hoarding in the claimant's airspace. The trial judge, Sir Donald Rattee, awarded damages on the basis of the entire fee income obtained by the trespasser over the whole period of the trespass. The Court of Appeal thought that was a bit heavy, and sent the matter back to the Judge, but without much in the way of further guidance. Sitting in the Court of Appeal, Peter Smith J:

[12] It is my view, that when one looks at the judgment awarded it is at the very top end of the basis of awarding damages on a restitutional basis. In other words, to attract this kind of award it would have to be regarded as the most serious justification for restitutional damages.

It does appear logical that an award of damages assessed as 100% of gross profits is, by definition, "the very top end". Peter Smith J went on to suggest that perhaps in less serious cases, the starting point might be the net profit, or base the trespass damages on the reasonable letting fee to the actual trespasser.⁴⁷ However, for reasons connected with procedural points and the way the trial had been argued, he did not feel it appropriate to do more than allow the Appeal and send it back to the Judge for him to allow fresh evidence.

⁴⁵ This is said in both cases, but is most conveniently taken from *Thompson* at page 554, because Glidewell LJ and Sir John Megaw (who decided *Swordheath*) both agreed. In *Ashman, Kennedy and Hoffmann LJJ* agreed, but Lloyd LJ dissented. *Thompson* is, therefore, the stronger authority.

⁴⁶ [2010] EWCA Civ 952.

⁴⁷ Paragraph [13].

23. Sullivan LJ was a little bolder: he thought the judge was wrong in principle. He analysed the restitutionary cases as proceeding on the footing of the so-called user principle; that is the hypothetical license fee, “which by definition will not produce a figure equal to 100% of the profits of the unlawful venture”.⁴⁸ What the damages should have been was, however, for the Judge on the re-trial.⁴⁹
24. Be that as it may, for the purposes of putting the squeeze on Troublemaker, bring to his attention that you could elect to go for a serious chunk of his net profits, even if 100% gross is too much, say, 60% of net is going to hurt.... Then make an interim payments application. Keep that simple, and take a passing rent figure if you can, but make the application expressly “without prejudice” to your right to go for restitution later, giving credit for monies received. That might make Troublemaker think about sticking around.

Franchisees and True Licensees:

25. Let us now take another category: the franchisee, pop-up shop proprietor or anybody else running a business as a true licensee of the former tenant or occupier. Let us also assume that this person is plainly not a sub-tenant, and is not asserting that he is. Not a Troublemaker, but someone in deep trouble
26. It is well established that the Courts will grant an injunction to protect the right of a contractual licensee to enjoy his licence. This was the basis on which the National Front got to hold an annual meeting in a municipal hall in Great Yarmouth, in *Verrall v. Great Yarmouth Borough Council*. Lord Denning said this:⁵⁰

Since the Winter Garden case, it is clear that once a man has entered under his contract of licence, he cannot be turned out. An injunction can be obtained against the licensor to prevent his being turned out. On principle it is the same if it happens before he enters. If he has a contractual right to enter, and the licensor refuses to let him come in, then he can come to the court and in a proper case get an order for specific

⁴⁸ Paragraph [17]. For a full analysis of the “user principle”, see *Stoke-on-Trent City Council v. W&J Wass* [1988] 1 WLR 1406 (CA).

⁴⁹ As at the date of writing, the outcome of the re-trial is unknown; if, indeed, it has even happened yet.

⁵⁰ [1981] QB 202 (CA).

performance to allow him to come in. An illustration was taken in the course of the argument. Supposing one of the great political parties - say, the Conservative Party - had booked its hall at Brighton for its conference in September of this year: it had made all its arrangements accordingly: it had all its delegates coming: it had booked its hotels, and so on. Would it be open to the local council to repudiate that agreement, and say that the Conservative Party could not go there? Would the only remedy be damages? Clearly not. The court would order the council in such a case to perform its contract. It would be the same in the case of the Labour Party, or whoever it may be. When arrangements are made for a licence of this kind of such importance and magnitude affecting many people, the licensors cannot be allowed to repudiate it and simply pay damages. It must be open to the court to grant specific performance in such cases.

Conservative Party; Labour Party; National Front; whatever...

27. That was a case where a contracting party sought to repudiate a licence it had granted, and clearly the court has power to enforce contracts which are wrongly repudiated. But here, the intervention of the landlord is not in repudiatory breach of the arrangements between, say, tenant and franchisee: on our assumed facts, he is not a party to that contract. Is a landlord ever bound by a licence granted by his tenant to a stranger?
28. The answer really ought to be no. All a licensee has is the present owner's permission to be there, so that he is not a trespasser as against that owner. This position has been settled law for over 300 years, since Vaughan CJ in *Thomas v. Sorrell*:⁵¹

A dispensation or licence properly passeth no interest, nor alters or transfers property in any thing, but only makes an action lawful, which without it had been unlawful.

Thus, the only rights which the licensee has are contractual or equitable rights, which prevent the licensor from removing the licensee from the premises. These rights do not constitute rights which can give rise to "ownership".⁵² Against the person who granted the licence, in the absence of any contractual provision to the contrary, the licensee has a the right to remain for a reasonable period after the licence is revoked; but again, this

⁵¹ (1673) Vaugh. 330, 351; (1673) 124 ER 1098, 1109.

⁵² Per Fox LJ, *Ashburn Anstalt v. Arnold* [1989] Ch. 1, 9-10 (CA); over-ruled on other grounds in *Prudential Assurance Co.Ltd. v. London Residuary Body* [1992] 2 AC 386 (HL).

is not capable of being described as a property right in respect of which the licensee can claim against the landlord who has terminated the tenancy of the licensor.⁵³

29. So, why am I bothering? I am bothering (and bothered) because of the suggestion that a licence when coupled with an estoppel might be irrevocable. Obviously, it is a Lord Denning case that causes the difficulties with estoppels. In *DHN Food Distributors Ltd v. London Borough of Tower Hamlets*, freehold land was vested in Bronze Ltd., a wholly owned subsidiary of DHN.⁵⁴ Bronze let DHN into occupation. Tower Hamlets compulsorily acquired the freehold from Bronze, and resisted paying DHN compensation because it was a bare licensee, with no compensatable interest in the land. Lord Denning held compensation was payable because there was an estoppel, which made the license binding on third parties.⁵⁵ His reasoning was as follows:
- 29.1 Bronze was a wholly owned subsidiary of DHN. Both companies had common directors running the companies.
- 29.2 Bronze could not determine the licence so as to ruin DHN. The directors of Bronze could not turn out themselves, as directors of DHN. They would be in breach of their duties to both companies if they did so.
- 29.3 Therefore, “the licence was virtually an irrevocable licence”. DHN were in a position to carry on their business on these premises unless and until, in their own interests, DHN no longer wished to continue to stay there.
- 29.4 Therefore, this was a contractual licence which gave rise to a constructive trust, under which the legal owner is not allowed to turn out the licensee.
- 29.5 Therefore, DHN have a sufficient interest in the land to be able to assert their rights against a third party.

⁵³ See the discussion of these rights in *Minister of Health v. Belotti* [1944] KB 298 (CA).

⁵⁴ [1976] 1 WLR 852 (CA).

⁵⁵ At pages 465-6. The cases cited by Lord Denning MR are: *Scottish Co-operative Wholesale Society v. Meyer* [1959] AC 324 at 366, 367; *Binions v. Evans* [1972] Ch 359 (CA); *Bannister v. Bannister* [1948] 2 All ER 70 (CA); *Siew Soon Wah alias Siew Pooi Tong v. Yong Tong Hong* [1973] AC 826 (PC).

30. It might be thought that there are one or two leaps of logic, there. Fortunately, the case of *Ashburn Anstalt v. Arnold* has been described as having “put the *quietus* to the heresy that parties to a contractual licence necessarily become constructive trustees”⁵⁶ and as having “finally repudiated the heretical view that a contractual licence creates an interest in land capable of binding third parties”.⁵⁷ Well, almost. Fox LJ was prepared to accept that a constructive trust might cause a contractual licence to bind a third party, if that party’s conscience was sufficiently affected that it would be inequitable to allow him to take free of the licence.⁵⁸ Sir Nicolas Browne-Wilkinson nailed the lid down even harder, in *IDC Group Ltd. v. Clark* stating that it would take “very special circumstances” and only showing that the third party “undertook a new liability to give effect to” the licence.⁵⁹
31. That really should be an end to it. It probably will not be. Some Denning judgments are dead, but they just will *not* lie down...

Employees of the Former Tenant:

32. The former tenant or occupier may well have had staff on the premises. In law, they are almost inevitably going to be “servants or agents” of the former tenant or occupier, and as such, have no independent rights of occupation of their own.⁶⁰ They will have their own rights in respect of any personal property of theirs left on the premises, but these are the same rights as anybody else might have. I shall consider those under the next heading.

⁵⁶ Per Sir Nicolas Browne-Wilkinson V-C in *IDC Group Ltd. v. Clark* [1990] 1 EGLR 187, 189; approved on appeal [1992] 2 EGLR 184 (CA).

⁵⁷ *Camden London Borough Council v. Shortlife Community Housing Ltd* (1992) 90 LGR 358, 373 per Millett J.

⁵⁸ *Ashburn Anstalt v. Arnold* [1989] Ch. 1, 25 (CA)

⁵⁹ *IDC Group Ltd. v. Clark* [1990] 1 EGLR 187, 190; also approved on appeal [1992] 2 EGLR 184 (CA). There are other cases in similar vein, the most recent of which is *Lloyd v. Dugdale* [2001] EWCA Civ 1754; [2002] 2 P&CR 13, per Sir Christopher Slade at [52] (Mummery and Kennedy LJJ, agreeing).

⁶⁰ As I said at the beginning, I have parked the issues caused by residential occupiers, so I will just remind you that occupiers of flats over commercial premises can be a resi problem - see *Pirabakaran v. Patel* [2006] EWCA (Civ) 685; [2006] 3 EGLR 23.

33. One parting shot, though. If you have taken back possession of premises operating as a going concern -perhaps you are a pub. co. which has taken back possession of licensed premises- it can be tempting to run the business for yourself.⁶¹ This is not the time for a discussion of employment law, and I know nothing, but if this is something you are tempted to do, get some advice as to whether even a temporary use of the previous occupiers' staff is going to give them employment rights as against you under TUPE.⁶²

Persons with Possessions:

34. My last class of characters are persons with possessions. These may be suppliers of goods to the tenant on chattel leases, suppliers of trade goods who have delivered goods but still retain title, or maybe customers of the former tenant, who have left goods at the premises, perhaps for repair or collection later. These people have rights, not to possession, but to have their possessions back. That gives the landlord responsibilities to them and to their possessions.
35. As a matter of law, no matter how the landlord retook possession of the premises, he has probably become an involuntary bailee of the items belonging to third parties left on the premises.⁶³ As such, he acquires liabilities in respect of those items, which override his right to self-redress.⁶⁴ Or, put another way, just because the landlord has a right to remove them from his land, to abate trespass, it does not follow that he can just black-bag them and put them on the street. In fact, quite the opposite.⁶⁵

⁶¹ Indeed, I act for a Pub.Co. that regularly does this to reduce the risk of a future On Licence being refused.

⁶² TUPE is not, apparently, a posh name for a wig, but *The Transfer of Undertakings (Protection of Employment) Regulations 2006* (SI 2006/246). I am, on balance, indebted to my good friend and specialist employment lawyer Charles Ciumei of Essex Court Chambers for disturbing my entirely blissful ignorance of this problem, many years ago.

⁶³ Curiously, there is no direct English authority on this point. There is only one Commonwealth case, *Hanioutis v. Dimitriou* [1983] 1 VR 498, 500, a decision of Brooking J in the High Court of Victoria. It is considered to represent English law by *Palmer on Bailment* (3rd edition, 2009), paragraph 13-011, note 50. It is, perhaps, one of points that is just so obvious (at least to anybody but an Australian) that no-one has ever litigated it.

⁶⁴ *Palmer on Bailment* (3rd edition, 2009), paragraphs 13-001 to 13-013.

⁶⁵ *Hiort v. Bott* (1874) LR 9 Ex 86, 90 *per* Bramwell B (Exchequer Chamber).

... where a man delivers a parcel to you by mistake, it is contemplated that if there is a mistake, you will do something with it. What are you to do with it? Warehouse it? No. Are you to turn it into the street. That would be an unreasonable thing to do.

That comes from the case of *Hiort v. Bott*, one of those cases with facts redolent of law exams. The unfortunate defendant was delivered, by mistake, a railway-waggon load of barley he had not ordered.⁶⁶ Bott then let a con-man, who said he was from the grain-merchants, have the barley and the con-man then ran off with it.⁶⁷ Bott was held liable for the loss of the barley, because he had, in good faith, been conned out of it.

36. There are two morals to this story. First, the landlord cannot just dispose of the goods. Secondly, the landlord who permits someone to collect goods owes the true owner a duty of care to take reasonable steps to establish the *bona fides* of the person doing the collecting. That test is not too onerous.⁶⁸

It should be particularly noticed in this case that the plaintiffs had not, by what they had done, placed the defendant in any position of difficulty, as is often the case with an involuntary bailee (an expression often used in the argument) who has received property into his possession for a purpose which cannot, as it afterwards appears, be exactly carried into effect, and **who does his best and acts in a reasonable manner for carrying into effect the purpose of the bailment.** In such cases the bailee has a duty to perform in relation to the goods, and he is placed in a difficulty in the discharge of that duty by the default of the plaintiff, who ought not to be allowed to complain if, under that difficulty, the bailee has acted in a manner which is considered reasonable and proper.

37. That judgment fairly accurately encompasses the scope of the involuntary bailee's duty of care generally:

37.1 he has a duty to permit the rightful owner, and *only* the rightful owner, to collect the goods;⁶⁹

⁶⁶ (1874) LR 9 Ex 86 (Exchequer Chamber)..

⁶⁷ Insofar as you can run off with a waggon-load of barley.

⁶⁸ At 91 *per* Cleasby B (Exchequer Chamber).

⁶⁹ *Barclays Mercantile Business Finance Ltd. v. Sibec* [1992] 1 WLR 1253 (Millet J).

- 37.2 there is no duty to redeliver the goods to the rightful owner, only a duty to allow him to come and collect them;⁷⁰
- 37.3 he has a duty not to deliberately injure goods in his care;⁷¹ and
- 37.4 he otherwise has a duty to treat the goods in his care in a way which is reasonable and proper in all the circumstances;⁷² so
- 37.5 provided he has done everything reasonable, he is not responsible for loss or damage to the property.⁷³
38. It is not clear what the exact limits of these duties are. To take a practical example, the landlord clearly has a duty to permit the rightful owner of the goods to collect them, but to what extent does he have to facilitate the collection? Lord Denning MR saw the point with his characteristic simplicity:⁷⁴

No one is bound, save by contract, to take a chattel to the owner of it. His only obligation is not to prevent the owner from getting it when he comes for it.

What if the true owner wants to collect the goods at a particularly inconvenient time? Is it lawful for the landlord to say, “not now”? What if the removal of the goods would require facilities to be made available- perhaps only restoration of the power to see what is going on. Does the landlord have to pay for the electricity, or can he refuse?

39. There is no clear answer, but my view is that the landlord can act reasonably in *regulating* access to the premises for the removal of the goods, without incurring

⁷⁰ *Capital Finance Ltd. v. Brsy* [1964] 1 WLR 323, 329 *per* Lord Denning MR (CA). The Defendant’s name is not a typo, despite the apparent under-utilisation of vowels.

⁷¹ *Hiort v. Bott* (1874) LR 9 Ex 86 (Exchequer Chamber)..

⁷² *Hiort v. Bott* again.

⁷³ See also *Elvin & Powell Ltd. v. Plummer Roddis Ltd.* (1933) 50 TLR 158 (Hawke J).

⁷⁴ *Capital Finance Ltd. v. Brsy* [1964] 1 WLR 323, 329 *per* Lord Denning MR (CA). The Defendant’s name is still not a typo. A number of 19th Century cases had held that a landowner could refuse access to the owner of chattels seeking to recover them. They are now of dubious value, in light of this case and *Barclays Mercantile Business Finance Ltd. v. Sibec* [1992] 1 WLR 1253 (Millet J).

liability. Providing that the regulation of access does not, on the facts, amount to a withholding of possession, in a way which denies the owner's right to the goods, it is probably acceptable.⁷⁵

Mere unpermitted keeping of another's chattel is not a conversion of it. There must be some detention consciously adverse to the rights of the owner, such as an assertion of a lien that does not exist. The ordinary way of showing a conversion by unlawful retention of property is to prove that the defendant, having it in his possession, refused to give it up on demand made by the party entitled.

... Demand is not an essential precondition of the tort: what is required is an overt act of withholding possession of the chattel from the true owner. Such an act may consist of a refusal to deliver up the chattel on demand, but it may be demonstrated by other conduct, for example, by asserting a lien. Some positive act of withholding, however, is required; so that absent any positive conduct on the part of the defendant, the plaintiff can establish a cause of action in conversion only by making a demand.

So, in *Mitchell v. London Borough of Ealing*, the Council agreed to store the furniture of an evicted squatter, rather than leave it on the street. The Council's representative got lost, so was not at the premises the goods were stored at when the owner came to collect them. By the time of the second meeting, the premises had been burgled and the goods stolen. The Council were held liable for the loss, because its officer's negligent failure to keep the appointment made it responsible for the goods thereafter. However, it is important to note that the Council were *voluntary* bailees, having moved the chattels to a fresh location. That imposed a higher duty on them to take to take reasonable care of the goods. It is not wholly clear whether a similar failure by an involuntary bailee would have the same effect.⁷⁶

⁷⁵ *Barclays Mercantile Business Finance Ltd. v. Sibec* [1992] 1 WLR 1253, 1257-8 (Millet J).

⁷⁶ Probably: there is a suggestion in the gratuitous, but voluntary, bailment case of *Toor v. Bassi* [1999] EGCS 9 (CA) that an involuntary bailee has no comparable liability, but the case is, with respect, poorly reasoned and badly reported. Further, on the facts, the disputed chattel was a car which was parked on the land adjacent to the premises, but not demised by the lease, with the specific consent of the landlord.

40. Holding onto goods until reimbursement of expenses is agreed is probably going too far: that would seem to me to be akin to exercising a lien, which an involuntary bailee is *not* entitled to in order to recover his costs.⁷⁷
41. To take another particular problem-area, what if the goods left behind need special facilities to store them? In *Hiort v. Bott*, Bramwell B thought that there was no duty to warehouse the barley. But, where a shop assistant found a valuable item of jewellery, evidently lost by a customer, and put it in a desk, rather than securing it, the shop was found liable for the subsequent theft, as it had *not* exercised reasonable care in storing the goods.⁷⁸
42. It may be that the proper view of the cases is that the shop had assumed a more stringent duty of care, when the assistant removing the jewellery to the desk, and only at that point did it become obliged to take proper steps to ensure was not stolen.⁷⁹ In other words, by deciding to deal with the brooch, the shop became a voluntary bailee, who owes the owner a higher duty of care than an involuntary bailee.⁸⁰ It may also be that what is reasonable depends on all the facts: it is not very difficult to ensure a lost brooch is locked away, so it is reasonable to do so. Warehousing a waggon-load of mis-delivered barley is less easily arranged and will cost the involuntary bailee money.⁸¹

⁷⁷ *Binstead v. Buck* (1776) 2 Wm Bl 1117; 96 ER 660. Feed your neighbour's stray pig at your own expense. The Court of Appeal allowed a bailee to retain goods by way of a lien for the cost of storing them in *Gordon v. Gordon* [2002] EWCA Civ 1884, but that case turned on its own very peculiar facts: the lumbered landlord had bought a storage depot and taken an assignment of the storage business, so its lien was established because it was an assignee of a contractual bailment, **not** an involuntary bailee *per se*.

⁷⁸ *Newman v. Bourne & Hollingsworth* (1915) 31 TLR 209 (KBDC, Ridley and Atkin JJ). Approved, *Gilchrist Watt & Sanderson Pty Ltd. v. York Products Ltd* [1970] 1 WLR 1262, 1268 (PC).

⁷⁹ This is the view of the learned editors of Beale *et al Chitty on Contracts* (29th edition, 2004 and 1st supplement, 2004), volume 1, paragraph 33-036.

⁸⁰ This is the view of *Palmer on Bailment* (3rd edition, 2009), paragraph 13-015

⁸¹ I prefer this rationalisation, which is advanced as an alternative view by Professor Palmer in *Bailment* (2nd edition, 1991) page 684. If you find yourself really fascinated by this subject, my former pupil turned academic and Specialist Editor of *Palmer on Bailment*, Assistant Professor Charlotte Woodhead, now of Warwick University, gave a paper to the 7th Biennial Conference on Property Law in Cambridge on bailment issues arising from human remains stored in museums. Read her paper at <http://www.propertylaw2008.co.uk> or get a life. Your call.

43. Does the involuntary bailee’s duty to redeliver goods to the true owner impose an obligation to find the true owner? In our context, possibly yes. In *Parker v. British Airways Board*, the Court of Appeal had to consider liability for property which had been lost “air-side” at Heathrow.⁸² The Court of Appeal held that the exercise of control of access to the premises on which the item was lost was a right which gave rise to a corollary duty. That duty was to make reasonable efforts to find the true owner and notify him of the whereabouts of the goods. Donaldson LJ even went so far as to say there might be a limited duty to actively look for any items which might have been left behind.⁸³

An occupier who manifests an intention to exercise control over a building and the things which may be upon or in it ... is under an obligation to take such measures as in all the circumstances are reasonable to ensure that lost chattels are found and, upon their being found, whether by him or by a third party, to acquaint the true owner of the finding and to care for the chattels meanwhile. The manifestation of intention may be express or implied from the circumstances

Obviously, the context is different, as that was a case of lost property in a building often open to the public.

44. The duty to look for the owner changes, however, when the landlord needs to move or even dispose of the goods. Once he wants to deal with them in some way, the landlord has an obligation to make “reasonable enquiries” over a “reasonable period” to establish whether or not the true owner can be found, so that he can be asked to collect his goods.⁸⁴ What you have to do, and how long you have to do it for is fact-sensitive: you have to work harder if you find an obviously valuable piece of jewellery at the back of a cupboard in a house than if you find a rusty old bike in a ditch at the bottom of its garden. In the context of vendor and purchaser, the obligation to take

⁸² [1982] 1 QB 1004 (CA).

⁸³ At 1018.

⁸⁴ *Palmer on Bailment* (3rd edition, 2009), paragraph 13-25 . I will come onto to what to do when you can or cannot find the owner below: for now, I am just dealing with the duty to look for the owner.

steps to find the previous owner of goods before dealing with them has been recently expressed this way:⁸⁵

If the circumstances ought to put the purchaser on notice that the property might not have been abandoned, an enquiry of the vendor or the vendor's agents or solicitors as to whether the property had been abandoned would be appropriate and, of course, if the presence of the property is causing inconvenience to the purchaser, the purchaser would be entitled to make the enquiry by way of a complaint as to the failure to give vacant possession. Whether the purchaser is obliged to wait for a response to the enquiry before doing anything with the property would depend upon the circumstances. The more valuable (whether in monetary terms or as a personal item) the property might possibly be, the more the purchaser might reasonably be required to await a response before treating the property as if it had been abandoned. The less valuable the property appears to be, and in particular if its continued presence on the property is causing inconvenience to the purchaser, the more reasonable it might be for the purchaser to treat the property as having been abandoned if it has not been collected or claimed within a reasonable period of time. I have used an example of residential premises but of course in the case of commercial premises the variety of circumstances that might arise is almost limitless. Although at least, in the case of commercial premises, there would be a diminished prospect of finding property which was merely of personal, sentimental value.

There seems to me to be no reason why these principles should not also apply to lumbered landlords.

45. As has been seen from the case of the lost jewellery, the landlord who simply finds personal property on the premises and leaves them there has very few responsibilities. However, that rather overlooks the landlord's need to make use of the premises. Really, the involuntary bailee's biggest problem, apart from just wanting his premises back, is that he might be entitled to damages for trespass, but he is *probably* not otherwise entitled to recover any storage costs. Lord Diplock, in *China Pacific SA v.*

⁸⁵ *Robot Arenas Ltd. v. Waterfield* [2010] EWHC 115 (QB) (Colin Edleman QC, sitting as a Deputy Judge of the Queen's Bench Division). More on this case below...

Food Corporation of India, “The MV Winson”, observed that the right of a bailee to recover his expenses was, in his *obiter* view, limited to cases of necessity:⁸⁶

I agree that there is no general right of a bailee to be reimbursed expenses incurred in fulfilling his duty to safeguard bailed goods; and I agree that there was an element of necessity in the cases relied on by [*the bailee*] under this head. But I think that it puts it too narrowly to say that such are the only circumstances in which the law will import an obligation to reimburse - unless, indeed, one is prepared to go further and argue that only a bailee who is an agent of necessity is entitled to reimbursement. No authority so stipulates. The relevance of necessity in the cases relied on by [*the bailee*] is, in my view, that justice calls for reimbursement in such circumstances: the emergency imposes obligations on the bailee beyond what will generally be contemplated on a bailment.

This was a case about wheat, not barley. The claimant salvage company had salvaged a boat, and in the process they off-loaded its cargo of wheat and stored it. They got their costs, but as voluntary bailees, not involuntary bailees. That an involuntary bailee cannot recover his costs has actually been decided, but only a first instance.⁸⁷

46. So, what then can a the landlord do to rid himself of the unwanted goods? The rescue comes in the form of the Torts (Interference With Goods) Act 1977. This Act provides a mechanism by which someone stuck with goods they do not own to dispose of them. The Act does not apply to every bailee, but it does apply where:⁸⁸

46.1 the owner of the goods is in breach of an obligation to take delivery of the goods; or

46.2 such an obligation could be imposed by communication with the owner, but he cannot be found; or

⁸⁶ [1982] AC 939, 960-1 (HL).

⁸⁷ *Kolfor Plant Hire Ltd. v. Tilbury Plant Hire Ltd* (1977) *Times* 17th May or (1977) 121 Sol.Jo. 390 (QBDC); *Jefferson Ltd. v. Burton Group Ltd.* (Popplewell J., unreported, 1984) referred to *Palmer on Bailment* (3rd edition, 2009) at paragraphs 13-014 and 13-028.

⁸⁸ Section 12(1).

- 46.3 the person in possession of the goods could reasonably expect to have them removed if he asked the owner to remove them, but he cannot find the owner.
47. Given the implied obligation to cease trespassing if possession is demanded, it seems to me that the landlord who finds himself in possession of the goods, even of a stranger, not a former tenant, falls into at least the latter two of those categories in any given situation. The tenant should have removed his things by reason of the obligation to give vacant possession, and once asked to cease trespassing, there is a reasonable expectation that he should do so.
48. There is a suggestion in a footnote to *Clerk & Lindsell* that these provisions do not apply to an involuntary bailee.⁸⁹ There is no explanation as to why, but my guess is that the learned author is of the view that a gratuitous bailee cannot bring himself within the categories in section 12(1) I have discussed. I do not think that this is right, at least in this case, for the reasons I have given.
49. If the landlord can find the owner, then to take advantage of the Act, he must serve a notice on him, requiring removal of the property, or threatening him with sale of the property.⁹⁰ The notice must give the owner a reasonable time to collect the goods before they are sold: obviously, the length of the reasonable time is a matter of fact. However, if a claim for money is made in the notice - which is unlikely in this scenario - then the notice period has to be at least three months.⁹¹
50. There are no deemed service provisions, although recorded delivery is required for a notice threatening sale.⁹² The addresses to which the letter is to be sent include the last known address or the registered or principal office of a body corporate. The text of the notice itself needs some thought: the Act requires that the landlord “give sufficient particulars of the goods”. This is a practical problem if the landlord has large quantities

⁸⁹ Brazier *et al Clerk & Lindsell on Torts* (19th edition, 2006), paragraph 17-19, footnote 83.

⁹⁰ Section 12(2).

⁹¹ Schedule 1, paragraph 6(3).

⁹² Schedule 1, paragraph 1(3)(a) to require collection; paragraph 6(1)(a) to force sale. Recorded delivery is required by paragraph 6(4).

of material to describe, or has a load of old dirty washing he does not particularly want to investigate. In this context, a brief written description augmented by some photographs of the items might be useful.

51. If the owner does not collect in accordance with the notice, or cannot be found after “reasonable steps” have been taken to do so, the landlord can sell the goods. What amounts to “reasonable steps” is always a question of fact, but there are a number of cases in leasehold enfranchisement about acquiring land from absentee landlords, which give a steer. In short, writing to every known address, including that of known agents (solicitors and managing agents), leaving notices at the premises and placing advertisements in some local and national newspapers usually suffices.⁹³
52. If the landlord ends up selling the goods, he must account to the owner for the proceeds of sale, less any costs of sale incurred on the basis that the landlord adopted the “best method of sale reasonably available”.⁹⁴ Making sure that one has evidence of what steps were taken to ensure the method was the best available will be important. A well-publicised auction is often a safe method, but if the reality is a rag-and-bone man is the only one who will be interested, then at least get a couple of quotes.
53. The cautious landlord might also ask for the Court to sanction the sale or disposal of the goods if the former tenant cannot be found, or will not come and collect. There is a specific procedure under section 13 and Schedule 1 of the Act. It is always a good idea to consider this procedure, but particularly when the owner cannot be found. In those circumstances, my experience is that such applications are very quick and very easy. Most Masters or District Judges will be interested in checking that a form of substituted service has been used which has a reasonable chance of bringing the proposed disposal to the owner’s attention, but once they are satisfied the landlord has done his best, they are very relaxed about ordering a disposal.

⁹³ For some reason, most District Judges prefer to direct the national advertisements be placed in *The Times* and *The Daily Mail*. There is probably a PhD thesis in sociology in there, somewhere.

⁹⁴ Section 12(5).

54. If the landlord takes the view that the items left in the premises are genuinely rubbish, he may take the view that the tenant has simply abandoned them and either destroy the goods or otherwise treat them as he sees fit.⁹⁵ The law on abandonment is a bit tricky, but a recent case has helped a little. In *Robot Arenas Ltd. v. Waterfield*, the claimant owned the set once used to film the TV series “Robot Wars”.⁹⁶ It was allegedly stored in a hanger on a disused RAF airfield, although in due course, the Judge found as a fact that the bulk of it had been removed and only some odds and ends left behind. The new owner concluded the stuff left behind was rubbish and “skipped it”.⁹⁷
55. The Judge considered first whether the stuff left had been abandoned. He divided abandonment into two categories:⁹⁸
- 55.1 someone who loses something might abandon the search for the lost item, but he does not abandon his right and title to the goods. In that case, finders is not keepers in law.
- 55.2 In contrast, someone may abandon the goods physically, with the intention of divesting themselves of the right of legal ownership, not just physical possession. It is only in that case that, at least lawfully, “finders keepers”.
56. The practical difficulty is identifying whether goods have been abandoned in that second sense is not without its difficulties. The Judge in the *Robot Wars* case held that abandonment is only a defence to a claim for conversion if there was clear evidence of an intention by the previous owner to divest himself of ownership, coupled with some physical act of relinquishment. Moreover, the Judge accepted it as common ground

⁹⁵ *Elwes v. Brigg Gas Co.* (1886) 33 Ch.D. 562 (Chitty J) said so in terms, but more modern cases are less definite: see *Re Hillier's Trusts* [1956] Ch 622, 633-4, *per* Jenkins LJ (CA); *Westdeutsche Landesbank Girozentrale v. London Borough of Islington* [1996] AC 669, 708 *per* Lord Browne-Wilkinson (HL); *Pierce v. Bemis* [1986] QB 384 (Sheen J).

⁹⁶ [2010] EWHC 115 (QB) (Colin Edleman QC, sitting as a Deputy Judge of the Queen's Bench Division).

⁹⁷ The stuff was not cut up by *Robot Wars*' famously savage House Robots, “Sgt. Bash” and “Dead Metal”, but by some bloke in a white van. Shame.

that it was no defence that the landowner had a reasonable belief that the goods had been abandoned: the landlord had the burden of proving the goods were abandoned.⁹⁹ This is important, as there is some *dicta* in other cases to the effect that an intention to abandon can be established objectively, from all the facts, but it is not clear whether the owner's own evidence can contradict the apparent, or objective, intention.¹⁰⁰ It follows that a landlord seeking to make out that goods have been abandoned will have a real job on his hands, if his decision is subsequently challenged: "don't try this at home"...

57. Lastly, there may be issues with liens. If goods have been brought onto the premises by a stranger and deposited with the then-occupier to undertake repairs to them, the goods will be subject to a lien for the fess for undertaking the work.¹⁰¹ As against the persons who deposited the goods, the landlord would have no right to retain the goods, provided that the person claiming them could demonstrate they were the rightful owner. If the repairs had not been undertaken, the landlord would be free to hand them over, once satisfied as to ownership.
58. However, if the work had been undertaken, the former tenant would be entitled to retain them until he was paid for his work. The landlord may risk a claim of wrongful interference with the contract to repair, if he breached the lien.¹⁰² In those circumstances, he would have to collect the fee due, and account to the former tenant for the money. In cases involving a few low value items, that is probably enough. But

⁹⁸ At paragraph [13], applying *Palmer on Bailment* (3rd edition, 2009), paragraph 26-0121.

⁹⁹ At paragraph [14], applying *Palmer on Bailment* at paragraphs 13-044, 13-045 and 26-030.

¹⁰⁰ *Pierce v. Bemis* [1986] QB 384 (Sheen J). This was a case of an abandoned ship. No-one asked the survivors of the wreck if they intended to abandon their property rights or were simply being pragmatic about the wisdom of remaining on a sinking ship to assert their property rights. Now, I've seen *Titanic*, and I reckon... In the *Robot Wars* case, the Judge - with respect - fudged it by stating the test as requiring objective evidence of subjective intention, but partially as he found the evidence of the owners of the set to be unreliable: see paragraphs [86]-[88].

¹⁰¹ The "unpaid mechanic's lien": *Hatton v. Car Maintenance Co.Ltd.* [1915] 1 Ch 621, 624 (Sargant J).

¹⁰² This is because the lien is an implied term in every contract where goods are deposited, unless that implied term is excluded or enhanced by the actual contract: *Bevan v. Waters* (1828) 3 C&P 520; 173 ER 1143 *per* Best CJ.

what if the land repossessed was a garage: with a lot of high value items, it could be worth asking the court to decide the issue by way of an interpleader action.

59. And finally, if it does go wrong, there are some interesting issues on damages for breach of duty by bailees, and two quite recent cases: *New v. Gromore Ltd* and *Year worth v. North Bristol NHS Trust* for example.¹⁰³ But that issue is really outside the scope of this talk.

Conclusion - If This Was More Than Just a Brief Encounter...

60. Had we more time, there are plenty more interesting related topics out there. For example, there are statutory utilities companies: did you know telecom operators have a statutory right not to be treated as a trespasser in certain circumstances, even if they are actually trespassing?¹⁰⁴ But this talk has been quite long enough without worrying about things like that. Perhaps another day.

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¹⁰³ Respectively, [2009] EWHC 2807 (Ch) (Christopher Pymont QC, sitting as a Deputy High Court Judge) and [2009] EWCA Civ 37; [2010] QB 1 (CA).

¹⁰⁴ *Electronic Communications Code 2003*, paragraph 21(9).