

TENANT DEFAULT

by

Julian Greenhill

Julian has a practice which encompasses all aspects of property litigation including landlord and tenant (both commercial and residential), contracts of sale, land options, mortgages, restrictive covenants, easements, and adverse possession, together with property-related professional negligence and other tortious claims. Julian is listed in the Legal 500 as a leading junior for commercial litigation and described as 'knowledgeable and user-friendly'. He regularly gives talks and participates in seminars on property law topics, and related procedural issues.

Introduction

1. The purpose of this short piece is to:
 - (i) bring together in summary the main methods by which a landlord can seek to enforce obligations contained in a lease in the event that the tenant defaults in performing those obligations *during the term of the lease*;
 - (ii) identify some of the considerations that are relevant to determining which remedy or remedies to pursue in a given case.
2. So, the situation under consideration is that the tenant has breached a covenant contained in a lease during the term of the lease. What options are available to the landlord?

Option 1 - Bring a money claim

3. The landlord can seek a payment of money from the tenant. A claim against the tenant for payment of a sum of money can be either a claim for a debt or for damages, depending upon the obligation that has been breached.

Debt claim

4. A debt claim is available where the sum in question is fixed by the terms of the lease. The most obvious example is a claim for arrears of rent. But often there are other sums due under a lease which are fixed in such a way as to be a debt due to the landlord. For example, sums reserved as rent such as insurance premiums paid by the landlord, or service charges will usually be due as a debt. Equally, the landlord has a claim in debt when he has entered onto premises and carried out work to remedy a disrepair where the lease reserves to the landlord a right to do so¹.
5. A debt claim, if it is available, has distinct advantages over a claim for damages. The various rules applicable to a claim in damages (the need to prove loss and causation, and to satisfy requirements as to remoteness and the duty to mitigate) do not apply to a debt claim². And, chiefly for that reason, a debt claim may be readily susceptible to summary judgment under CPR Part 24. So a landlord may be able to obtain judgment against a defaulting tenant in a relatively short space of time on a debt claim.

Damages

6. A claim for damages during the term raises more complex considerations. There are a number of points to bear in mind before concluding that a claim for damages is the best route to addressing the default of a tenant during the term.
7. Three points in particular need to be borne in mind in relation to most claims for damages during the term of the lease:
 - a. Such a claim won't usually change anything on the ground. It does not actually get the covenant performed. So if the landlord's primary concern is the actual act or omission constituting the breach, bringing a claim for damages may afford the landlord little comfort.
 - b. The measure of damages due on such a claim may be hard to assess and small. Often it will simply be the diminution in the value of the reversion subject to the lease which may be a small amount, particularly if there is still quite a long time left to run on the term of the lease. This is because the valuation assumes the reversion is to be valued subject to the lease and so takes account of the right of the landlord to enforce the covenants in the lease.
 - c. All the rules in relation to damages claims generally will apply – it is necessary to prove causation, loss, remoteness, and there will be a duty to mitigate³.

¹ Jervis v Harris [1996] Ch 195

² For example in the case of mitigation see White and Carter (Councils) Limited v MacGregor [1962] AC 413

³ Luminar Leisure v Apostole [2001] 3 EGLR 23

8. Take the specific example of the tenant failing to perform its obligations under a covenant to keep the premises in repair. During the term a claim for damages is rarely the best remedy for disrepair due to:
- a. the application of the Leasehold Property (Repairs) Act 1938. The 1938 Act limits the entitlement of a landlord to sue for damages or enforce forfeiture in the case of a lease granted for a term of not less than seven years which has at least three years unexpired at the relevant time. The regime of the 1938 Act is as follows:
 - i) the landlord may neither sue nor forfeit unless he first serves a notice under s146 of the Law of Property Act 1925 on the tenant informing the tenant of his right to serve a counter-notice under the 1938 Act⁴;
 - ii) within 28 days the tenant can serve a counter-notice the result of which is that the landlord cannot bring further proceedings without the leave of the Court⁵ ;
 - iii) leave will only be given where the landlord can prove on the balance of probabilities that the immediate remedying of the breach is necessary in order to save him from substantial loss or damage by meeting one of five specific grounds set out in the Act⁶; and
 - iv) the court may impose such conditions as it thinks fit⁷.
 - b. the fact that damages for disrepair during the term are limited at common law to the diminution in the value of the reversion⁸; and
 - c. such a claim does not have the effect of getting the repair work actually done.
9. So in the case of disrepair, forfeiture or carrying out the works pursuant to a clause in the lease which permits the landlord to enter onto the premises and remedy the disrepair himself (which gives rise to a debt claim for the monies expended⁹) is likely to be more useful.
10. Nevertheless a claim for damages during the term may be substantial, particularly if the term is nearing its end and the tenant does not enjoy security of tenure with the result that the lease will fall in soon with the covenant breached.
11. In addition, a number of recent cases in the law of damages in contract suggest that the Courts may be more willing to allow a claimant to deprive a defendant of profits made out of a breach of contract. In a case for breach of a restrictive covenant damages can be assessed by reference to a share of the profit made by the

⁴ s1(2), (4)

⁵ s1(3)

⁶ s1(5) and *Landmaster v Thackery* [2003] 2 EGLR 30

⁷ s1(6)

⁸ *Crewe Services and Investment Corporation v Silk* [1998] 2 EGLR 1

⁹ *Jervis v Harris* [1996] Ch 195

covenantor from the breach, that being the price of a hypothetical release of the covenant, regardless of whether injunctive relief is also sought or is even available. But this will only be appropriate if the case is an “exceptional” one in which such a measure is “a just response” to the breach in question¹⁰. What might constitute such an exceptional case is not easy to say, but an example in a landlord and tenant context might be provided by the breach of an absolute covenant against sub-letting which enabled a tenant to extract a far greater revenue from the land that he was paying to his landlord, by virtue of a new use which the parties did not contemplate at the date of the lease¹¹.

12. Furthermore, in the case of a money claim, the landlord may have other persons on whom it can turn to seek relief in respect of a tenant default such as a surety or former tenant. In particular in the case of lease entered into prior to 1 January 1996 (“old leases”) under the old common law rule the original tenant will remain liable on the covenants in the lease throughout the term, though the Landlord and Tenant (Covenants) Act 1995 confers certain protection on a former tenant by requiring, for example, that the landlord give notice in accordance with s17 of the 1995 Act as a precondition to suing in certain cases.
13. These points notwithstanding, often late or non-payment or non-performance is a sign of a deeper malaise in the tenant, of an inability to fulfil its obligations generally. If the tenant persistently fails to meet its obligations the landlord is faced with the unwelcome and onerous prospect of having to bring repeated actions for debt or damages. And none of this is of much use if, absent a substantial surety, you fear that the tenant is impecunious and may not have the money or assets against which to enforce a judgment.

Option 2 – terminate the lease by forfeiture

14. The most obvious alternative is to seek to terminate the lease altogether by forfeiture.
15. Forfeiture of the lease requires that, in addition to there being a breach of covenant:
 - a. There is an express proviso for forfeiture contained in the lease (If there is no such express proviso then the landlord will only obtain an option to forfeit the lease for breach of a “condition” contained within it, in other words an obligation on the part of the tenant which, either expressly or by necessary implication, is an obligation upon the performance of which the survival of the lease is made conditional¹². Timely payment of rent will not usually be a condition of the lease in this sense.
 - b. The landlord must not have waived the right to forfeit for the breach in question. Waiver occurs where the landlord, with knowledge of the breach and before electing to forfeit, does some act which, objectively considered, unequivocally recognises the continued existence of the lease. The classic case of waiver arises where the landlord demands,

¹⁰ Wrotham Park Estate v Parkside Homes [1974] 1 WLR 798; World Wide Fund for Nature v World Wrestling Federation [2008] 1 WLR 445

¹¹ I am grateful to Daniel Hochberg for a valuable discussion on this point.

¹² Doe d Lockwood v Clarke (1807) 8 East 185

accepts or sues for rent falling due after the breach of covenant giving rise to the right to forfeit (though there is no waiver in suing for rent which fell due prior to the breach¹³).

- c. Because the test is objective, waiver can occur by accident or unintentionally¹⁴. In one recent case it was held that the right of a tenant to appropriate payment to a particular debt means that, if a landlord accepts payment towards outstanding rent arrear he is bound by the tenant's appropriation, even if that means the debt is thereby appropriated to a debt arising after the right to forfeit resulting in a waiver¹⁵. If forfeiture is an option a landlord might want to pursue it is essential to make sure that rent accruing due after the right to forfeit has arisen is not demanded or accepted by the landlord. Particularly in a large corporate landlord, this will require immediate and careful management of the different persons or departments at the landlord who are responsible for carrying out the landlord's various functions under the lease. All too often the person responsible for rent collection on behalf of the landlord is not told soon enough to reject the next payment of rent and a waiver occurs.
- d. In cases of non-payment of rent, unless the requirement is expressly excluded by the proviso, the landlord must also have formally demanded the rent.
- e. In cases other than non-payment of rent, the landlord must have served a notice under s146 of the Law of Property Act 1925:
 - i). specifying the breach complained of;
 - ii) requiring the breach to be remedied if possible; and
 - iii) requiring compensation if the landlord requires it.

The only breach irremediable as a matter of law is a breach of a covenant against assignment or underletting – all others turn on their facts and so to be safe the wording requiring a breach to be remedied “if it is capable of remedy” should be included in the notice.

- f. The notice must then give a reasonable time for compliance. It is a question of fact in all the circumstances what constitutes a reasonable time. Logically it is better to err on the side of giving more time rather than less, though the client will often be eager to keep the period as short as possible.
- g. There are a number of exceptions to the application of section 146. In particular in the case of a breach of a condition against bankruptcy s146 does not apply at all to (a) agricultural land (b) mines (c) a public house (d) a furnished house or (e) a case where objectively the personal qualifications of the tenant are important to the preservation of the value

¹³ In re A Debtor [1995] 1 WLR 1127

¹⁴ John Lewis Plc v Viscount Chelsea (1993) 67 P&CR 120

¹⁵ Thomas v Ken Thomas Ltd [2007] L&TR 21

of the property¹⁶. Further, in all other cases of bankruptcy (including company insolvency) s146 only applies for one year from the bankruptcy. After one year the landlord can forfeit without serving a s146 notice and the court has no power to grant relief.

16. Moreover the tenant¹⁷ has the right to seek relief from forfeiture. In a case of non-payment of rent the tenant will generally get relief if he or she pays the arrears and costs within six months of the forfeiture. The discretion to grant relief is based on solid principles and the payment of the arrears is an invariable condition of it being given, though the time within which the payment is to be made is in the discretion of the Court¹⁸.
17. One example of exceptional circumstances that can lead the court to refuse relief is where the landlord has granted a third party an interest within the six month period, but has done so reasonably and injustice would be caused by the grant of relief. In a case where the tenant has led the landlord to believe that relief might not be sought, the Court will consider whether the third party is bound by the claim for relief, or the reasonableness of the third party's conduct in the light of its knowledge¹⁹.
18. In cases other than non-payment of rent the court has a wide discretion²⁰, but the court has always leaned against forfeiture in a case where the tenant can, in substance, remedy the breach and pay the costs of forfeiture – in such a case relief will be granted save in exceptional circumstances.
19. The remedy of forfeiture has a number of advantages:
 - a. relief against forfeiture, if it is sought by the tenant, is usually only given on terms that the breach in question is remedied – so in that case, unlike a money claim, forfeiture does result in the act or omission being put right.
 - b. conversely, if no relief is sought by the tenant, then the landlord will put an end to the lease and can thereby rid himself altogether of an impecunious or troublesome tenant. So where there is a persistent failure by the tenant to perform, forfeiture means the landlord can avoid being faced with the problems of having to keep on suing the tenant if it persists in failing to pay the debt or perform the obligation in question, and then having to recover the sums due out of the tenants assets.
 - c. moreover the landlord can thereby get the premises back earlier than he otherwise would and, in favourable market conditions, may be able to re-let them quickly at a higher rent.
 - d. and once the lease is forfeit damages for breach of the covenant would tend to be measured on the basis that the landlord has vacant possession.

¹⁶ s146(9) of the Law of Property Act 1925

¹⁷ so too do mortgagees and sub-lessees have an entitlement to claim relief and seek that the lease be vested in them

¹⁸ *Eastaugh v Crisp* [2007] EWCA Civ 638

¹⁹ *Bank of Ireland Home Mortgages v South Lodge Developments* [1996] 1 EGLR 91

²⁰ *Shirayama Shokusan v Denovo* [2005] EWHC 2589 (Ch)

20. But nonetheless forfeiture requires careful consideration before it is exercised. In particular:

- a. forfeiture, especially for a breach other than non-payment of rent, is not necessarily a speedy solution. It still requires time eg to serve s146 notices and give time for the breach to be remedied, followed by time to resolve proceedings and / or any claim for relief;
- b. during the so-called “twilight period” after proceedings have been served the landlord can no longer enforce the covenants in the lease against the tenant²¹. If the forfeiture proceedings are contested and / or relief is sought there can be a long period during which it is not known whether the lease has come to an end. During that period the collection of rent and enforcement of covenants in the lease is difficult to achieve;
- c. forfeiture is a drastic remedy. Once the landlord has chosen to forfeit he cannot reverse his decision and it would be a rash landlord who took it for granted that his tenant will seek relief. So the landlord he must be prepared for the property to be vacated. In a falling market the landlord will not easily find a new tenant and may wish he had been left with ongoing remedies against a struggling tenant;
- d. forfeiture will end the lease as against any surety too, though not until the proceedings are finally determined.²²

21. Finally, something should be said about the means by which forfeiture can be effected. Forfeiture can be effected by either peaceable re-entry or service of a claim for possession. The choice between the two methods is an important one. Peaceable re-entry is often favoured by clients as the quickest and most aggressive way of dealing with recalcitrant tenants. But it can cause significant problems for the landlord too in practice - it is a “dubious and dangerous method of determining a lease”²³.

22. Among other things:

- a. It is not available where premises are let as a dwelling²⁴ including mixed use premises²⁵.
- b. It carries a risk of criminal liability. It is an offence to use or threaten violence for the purpose of securing entry to a property if there is someone on the premises opposed to the entry and the person using the violence knows that²⁶. So it is essential to re-enter out of hours, and even then it is important to exercise caution in carrying out the re-entry to ensure no-one is present on the premises.

²¹ Associated Deliveries v Harrison (1984) 50 P&CR 91

²² Ivory Gate v Spetale [1998] 2 EGLR 43

²³ per Lord Templeman in Billson v Residential Apartments [1992] 1 AC 494

²⁴ Protection from Eviction Act 1977, s2

²⁵ Patel v Pirakaraban [2006] 1 WLR 3112

²⁶ Criminal Law Act 1977 s6

- c. If you cannot clearly establish the right to forfeit you may incur liability for unlawful eviction and the other side may be able to persuade a court to grant an injunction letting them back into possession pending determination of an application for relief from forfeiture.
- d. And even if these hurdles can be overcome, it is often the case that the landlord gains little or nothing by actual re-entry because of the right to relief. The tenant retains the right to seek relief from forfeiture where the landlord peaceably re-enters. If the tenant applies for relief from forfeiture, then the position pending the relief hearing is in practice little different to that which pertains while proceedings for forfeiture are pending save that there is the important, and by no means necessarily desirable, distinction that the landlord is in actual possession of the premises. He cannot easily market them but he has responsibility for securing them and becomes bailee of the tenant's chattels.
- e. So, unless there is a good chance that the tenant cannot or will not seek relief from forfeiture, peaceable re-entry may well create more problems than it solves.

23. For completeness, it should be remembered that it is now recognised that a lease is capable of being terminated by acceptance of a repudiatory breach of the lease, ie. a breach which is serious enough as to evince an intention on the part of the landlord or the tenant no longer to be bound by the tenancy²⁷ (though it remains unresolved how this interrelates with the remedy of forfeiture and the right to seek relief from forfeiture).

Option 3 – take direct action to remedy the act or omission

24. It may be open to a landlord to take direct action to remedy an act or omission by the tenant. But this remedy will usually only be available if the landlord has expressly reserved to himself a right to take such steps. The most common example of such a reservation is that under which a landlord reserves to himself the right to enter, remedy a disrepair to the premises and then recover the cost from his tenant (the so-called "Jervis v Harris" clause²⁸).

25. Absent such a covenant, and unless a right to self-help arises at common law (eg the breach in question causes a nuisance actionable by the landlord himself which he is entitled to abate at common law), the landlord would be well-advised not to seek to remedy the breach himself by entering onto the premises as that will be a trespass.

26. Reliance on a clause enabling the landlord to remedy the breach in question has several advantages. In the case of remedying a disrepair, the landlord has control over the work and can get them done promptly. Furthermore it is now settled that the landlord can recover the cost of the works as a debt without having to satisfy the requirements of the Leasehold Property (Repairs) Act 1938 or to prove loss etc²⁹.

²⁷ *Hussein v Mehman* [1992] 2 EGLR 87

²⁸ after *Jervis v Harris* [1996] Ch 195

²⁹ *Jervis v Harris* *ibid*

27. However, there is still the need to obtain access from the tenant (or seek an injunction to gain access – which could be refused on the balance of convenience). And the landlord runs the risk in anything other than a clear case of liability for trespass if the right has not arisen or preconditions such as notice requirements are not met. By adopting this remedy the expenditure will fall on the landlord in the first instance and he may not succeed in recovering the costs from the tenant if the tenant becomes insolvent in the meantime. Even if the tenant has the money, the recovery process can be protracted as there may be scope for the tenant to argue that the costs incurred were unreasonable. For all these reasons this remedy is most appropriate where the landlord's overwhelming priority is to ensure the actual act or omission is remedied quickly, even at the risk of bearing the cost himself.

Option 4 – claim for an equitable remedy - specific performance or injunction

28. After some doubt in the past, it is now settled (at first instance) that specific performance is available as a remedy for breach of a tenant covenant in an appropriate case³⁰. Specific performance is an appropriate remedy in the case of a breach of a positive covenant by a tenant to do something other than pay a sum of money to the landlord. Where the tenant has omitted to do something that he should have done an order for specific performance would compel him to correct that omission.

29. The remedy is equitable and thus discretionary and not available as of right. It will usually require the landlord to show that:

- a. damages are not an adequate remedy;
- b. the acts required to be performed to remedy the breach can be clearly and precisely identified;
- c. that none of the other remedies available to the landlord is obviously more appropriate eg entry under a landlord's reservation of the right to enter and carry out the work himself;³¹
- d. the landlord has a legitimate interest in the covenant being performed and is not seeking the remedy for an ulterior purpose; and
- e. the balance of hardship favours the grant of specific performance.

30. As with other equitable remedies, the landlord may jeopardise his entitlement to specific performance if he delays too long in seeking it.

31. Specific performance has the advantage that it gets the covenant performed at the tenant's expense. It approximates most closely to putting the landlord in the position he would have been in had the tenant not defaulted. But the main disadvantage with specific performance is that unless it can be shown to be urgent, the landlord will only get it after trial, and even then by reason of its discretionary nature it is difficult to obtain and uncertain.

³⁰ Rainbow Estates v Tokenhold [1999] Ch 64

³¹ The absence of such a clause was a relevant factor in Rainbow Estates v Tokenhold

32. Conversely, where a tenant has breached a negative covenant in a lease i.e. committed an act it should not have done, it may be appropriate to seek an injunction to prevent future breach. Equally an injunction could be sought to prevent an anticipated breach in an appropriate case such as where the landlord finds out that the tenant is about to make an unlawful assignment, or commence an unlawful use of the premises.

Option 5 - Distress or CRAR (Commercial Rent Arrears Recovery)

33. In relation to arrears of rent there is another remedy available to the landlord. Distress for rent is the ancient remedy pursuant to which a landlord can recover arrears of rent, without going to court, by seizing and, if necessary, selling goods found on the premises demised by the lease.

34. This remedy has been abolished and partially replaced with a new regime called Commercial Rent Arrears Recovery ("CRAR") under Part 3 of the Tribunals, Courts and Enforcement Act 2007. But the relevant provisions of the 2007 Act have not yet been brought into force and are not expected to be before the New Year. So, for the present distress remains available to landlords faced with arrears of rent.

Distress

35. As soon as the rent is in arrear, the landlord is entitled either personally or by his bailiff to enter the premises and seize such chattels as are sufficient to provide reasonable security for the outstanding rent and his expenses. No formal demand is required to be made or notice given. But in the ordinary way the landlord must physically enter onto the premises in order to seize goods. It is insufficient to simply post notice of distress through a letter box, and the entry onto the tenant's premises must be lawful.³² Seizure is effected by the goods being identified and a declaration made that they are being seized for distress. The goods can then be held ("impounded") until payment or sale of the goods to realise the arrears.

36. However, the landlord has no entitlement to distrain for any greater amount than is due to him in an action for recovery of rent. So, for example, the entitlement to distrain can be defeated by a cross-claim for breach of covenant by the landlord.³³ And certain goods are protected from distraint such as goods in actual use, perishables, tools, books and other equipment necessary for the personal use of the tenant in his trade. And fixtures, not being chattels, also cannot be distrained upon.

CRAR

37. When distress is eventually replaced by CRAR, the entitlement of the landlord to enforce though the seizure of goods will be significantly curtailed but, within narrower confines, preserved.

³² Evans v South Ribble BC [1992] QB 757

³³ Eller v Grovecrest Investments Ltd [1995] QB 272

38. The new regime will apply only to commercial premises where the lease is evidenced by writing.³⁴ It can be used to recover rent (and interest and VAT thereon) but not any other sum, even if reserved as rent³⁵. So it cannot be used to recover service charges. The arrears in question will be required to reach a statutorily prescribed minimum amount (which has not yet been set) and the amount recoverable is reduced by permitted deductions including any set-off for a cross-claim.³⁶
39. Enforcement must be carried out by an authorised enforcement agent. Notice of enforcement has to be given to the tenant in advance, and in response the tenant is entitled to apply to the court and seek that the notice of enforcement be set aside or the CRAR process stayed.³⁷ Further the landlord is entitled to serve notice on a sub-tenant identifying the amount of the arrears due to the landlord and requiring that the sub-tenant pay his rent directly to the landlord until the notified amount has been discharged³⁸.

Remedies not mutually exclusive

40. These different remedies are by no means mutually exclusive. For example, a claim for forfeiture would usually also include a claim for damages, as would a claim for specific performance which would include a claim for damages in the alternative in case the Court refused specific performance.
41. But a claim for forfeiture cannot be combined with a claim for specific performance as the two are inconsistent, forfeiture being the exercise of an option to terminate the lease, and specific performance being a claim for an order that the lease be enforced in accordance with its terms. Forfeiture by proceedings will be rendered ineffective by the inclusion of a claim for specific performance of the lease sought to be forfeited.³⁹

³⁴ ss74, 75 of the Tribunals, Courts and Enforcement Act 2007

³⁵ s76 of the Tribunals, Courts and Enforcement Act 2007

³⁶ s77 of the Tribunals, Courts and Enforcement Act 2007

³⁷ s78 of the Tribunals, Courts and Enforcement Act 2007

³⁸ s81 of the Tribunals, Courts and Enforcement Act 2007

³⁹ Calabar Properties v Seagull Autos [1969] 1 Ch 451