

RUNNING UPHILL ON RENT REVIEWS

by

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Introduction

1. When markets fall rent reviews can become hotly contested. The only rental growth which a landlord may be able to obtain from properties in his portfolio is to seek increases on review under existing leases. Where valuation dates are before the market began to slip, landlords will be keen to bring levels up the level they were at that date. Even where the valuation date occurs after the market has started to slip, the landlord will argue about how much the rent has risen since the *last* rent review. Tenants on the other hand, may find themselves locked into leases which require rents to be assessed at levels higher than they would pay if they took new leases. If they are lucky enough to benefit from upwards/downwards reviews, they may have an added incentive to fight.
2. The purpose of this talk is to illustrate how landlords may seek to maximise their returns on rent review and what tenants should be astute to when facing such landlords.

The commercial purpose of rent reviews

3. The “commercial purpose” of rent review provisions in leases is well known. “The general purpose of a provision for rent review is to enable the landlord to obtain from time to time the market rental which the premises would command if let on the same terms on the open market at the review dates. The purpose is to reflect the changes in the value of money and real increases in the value of the property during a long term”¹.
4. The most common method of achieving this purpose is to provide a formula by which a valuer can value a hypothetical lease on terms similar to the existing lease by reference to up to date rents.² The Court of Appeal has said in *Basingstoke & Deane BC v Host Group Ltd*³:

¹ *British Gas Corporation v Universities Superannuation Scheme Ltd* [1986] 1 WLR 398, 401 per Browne-Wilkinson V-C. See too *Equity & Law Life Assurance Society plc v Bodfield Ltd* [1987] 1 EGLR 124, 125 CA per Dillon LJ; *Basingstoke and Deane BC v Host Group Ltd* [1988] 1 WLR 348, 353-355, CA.

² *Basingstoke and Deane BC v Host Group Ltd* [1988] 1 WLR 348, 355, CA

³ *Basingstoke and Deane BC v Host Group Ltd* [1988] 1 WLR 348, 355, CA

Of course rent review clauses may, and often do, require a valuer to make his valuation on a basis which departs in one or more respects from the subsisting terms of the actual existing lease. But if and in so far as a rent review clause does not so require, either expressly or by necessary implication, it seems to us that in general, and subject to a special context indicating otherwise in a particular case, the parties are to be taken as having intended that the notional letting postulated by their rent review is to be a letting on the same terms (other than as to quantum or rent) as those still subsisting between the parties in the actual existing lease. The parties are to be taken as having so intended, because that would accord with, and give effect to, the general intention underlying the incorporation by them of a rent review clause in their lease.

5. In theory, therefore, rents on review should, unless the parties have agreed otherwise, reflect the actual rental value of the lease in the “real” world.
6. If the theory about the commercial purpose of rent review clauses were always reflected in their terms, the rents upon review would reflect the market. When, however, rental growth in the market is “softening”, stagnant or in decline, landlords will often aggressively seek to make up for the loss of growth (or decline) in the value of their portfolios by seeking rent increases upon review because rent review clauses allow them to argue for rent increases which would not actually be available in the “real” world.
7. The purpose of this talk is to give you a flavour of the sort of arguments and issues which can arise. It is not intended to be a comprehensive overview of the law of rent review but it may make you astute to the sort of weapons which a landlord may seek to deploy.

Upwards only clauses

8. The most usual way for a landlord to insure itself against a *fall* in the market is to agree an “upwards only” rent review clauses. While these clauses are no longer invariably found, they are still very common indeed. In a rising market where

landlords have a strong negotiating position, tenants are still often willing to agree them. While not guaranteeing a growth in rent, it will ensure that on a rent review the rent will not fall. Further, because landlords have little to lose in instigating the review procedure (the rent cannot fall) they encourage landlords to argue for rent increases (allowing for settlement favourable to the landlord before the issue is determined by a third party because the tenant does not want to take the risk of a decision which is even more unfavourable to him).

Formulae which inflate the rent payable

9. The landlord will often seek to agree a formula which allows for an increase beyond real market levels. Even if the formula has not been agreed with such a result in mind, landlords may seek to advance constructions which have this result. For instance, before the “presumption of reality” became settled, arguments used to be run over whether the hypothetical lease includes a rent review clause. Depending on the market, a (hypothetical) tenant might well pay more for a lease without a rent review clause knowing that its rent would not be the subject of an increase. It was settled in *British Gas Corporation v Universities Superannuation Scheme*⁴ that clear and unambiguous words will be required if rent review provisions are not to be included in the lease. It is possible, however, to find leases with such clear and unambiguous words⁵.
10. During the last recession one of the most hotly contested issues were those which arose in the “headline rent” cases. As these cases show the Courts are reluctant to construe such formulae in the landlord’s favour in the absence of very clear words. It is illustrative to consider these cases but it is necessary to understand the background.

Fitting out periods

11. A tenant who takes a new lease will usually need to fit out the premises to make them suitable for his occupation. It is common to give the tenant a rent free

⁴ [1986] 1 WLR 398 approved in *Equity & Law Life Assurance plc v Bodfield Ltd* [1987] 1 EGLR 124

period in which to fit out the premises based upon an estimate of how long fitting out will take.

12. A tenant whose rent is being reviewed will already have had the benefit of a period to fit out the premises: he is usually in occupation enjoying the benefit of the lease at the time the review takes place. It is intelligible, therefore, that landlord and tenant should agree that upon review the notional letting should be on terms that the tenant has already had the benefit of a rent free period for fitting out. The tenant is thus prevented from arguing that the reviewed rent should be reduced by reason of the hypothetical letting not taking account of the tenant's need to fit out the premises.

Other inducements

13. In a falling market where supply of premises exceeds the demand for them landlords may give to tenants other inducements to take premises. These may include rent free periods. They may include the landlord making capital contributions to fitting out costs or his taking a surrender (or an assignment) of other premises which the tenant wishes to quit. The "rent" reserved by the lease may be one figure, but in these circumstances the rent reserved by the lease does not reflect what the tenant actually pays for the premises.

Treatment of incentives upon rent review

14. Following the last slump in commercial property prices in the early 1990s it was argued that the drafting of some leases allowed the landlord to achieve a "headline" rent, i.e. the rent which would be agreed to become payable after a rent free period over and beyond that necessary to cover fitting out and granted as an inducement to take the lease⁵. It is certainly possible that the draftsmen thought that this is what they were achieving when they produced the leases.

⁵ See e.g. the lease in *Pugh v Smiths Industries Ltd* [1982] 2 EGLR where the rent review clause was on the terms of the actual lease "but excluding therefrom the provisions of this clause".

⁶ See *Hill and Redman's Guide to Rent Review*, Barnes (2001) para 3.90 for this meaning of the expression "headline rent".

15. On the other hand, to ignore pure inducements which would be given to tenants on an actual letting in the market at the date of the rent review would result in tenants paying *more* than the current market rent for the premises. Given the commercial purpose of rent reviews, this would be a surprising result in the absence of clear words. Indeed, the approach of the Court has been to presume that rent review clauses do not require the determination of a “headline” rent on review.

*Co-operative Wholesale Society Ltd v National Westminster Bank plc*⁷

The rent review clause required the assumption

That any rent-free period or concessionary rent or any other inducement whether of a capital or revenue nature which may be offered in the case of a new letting in the open market at the relevant rent review date shall have expired or been given immediately before the relevant date of review.

This was held to mean that the willing lessee had been allowed into possession to carry out any necessary fitting out work before the date on which the hypothetical lease was granted. Therefore, the only effect which it had was to remove any argument that there might otherwise have been that the willing lessee would negotiate a reduced rent on account of a period for fitting out but not receive any rent free period. (Appeal allowed)

*Scottish Amicable Life Assurance Society v Middleton Potts & Co*⁸

The rent to be agreed or determined was

The best yearly open market rent (at the rate payable following the expiry of any rent-free periods or periods at concessionary rents which might be granted on a new letting of the Demised Premises or of comparable premises in the open market on the relevant Review Date) at which the Demised Premises might reasonably be expected to be let in the open market on the Relevant Review Date without a fine or premium

⁷ [1995] 1 EGLR 97

It was held that the rent should be determined as that which would be agreed after the end of a rent free period for fitting out and *not* at the end of a further rent free period given as a “pure” inducement. (Appeal dismissed)

*Prudential Nominees Ltd v Greenham Trading Ltd*⁹

The rent was to be reviewed on the assumption that

No reduction or allowance is to be made on account of any rent free period or other rent concession which is a new letting might be granted to an incoming tenant.

This did *not* require a headline rent to be determined. A headline rent must mean an *increase* on the rent that would otherwise be paid on account of a rent free period. The reference to a “*reduction*” in rent could not, therefore, have the effect of prescribing a headline rent. Despite this reasoning, what the draftsman must have meant remains obscure.¹⁰ (Appeal allowed)

*Broadgate Square plc v Lehman Bros Ltd*¹¹

The reviewed rent was to be

The best yearly rent which reasonably be expected to be payable in respect of the premises after the expiry of a rent free period of such length as would be negotiated in the open market upon a letting of the Premises as a whole by a willing lessor to a willing lessee

The wording in this case was held to be unequivocal. The landlord was entitled to a head-line rent. (Appeal dismissed)

16. These four cases establish a consistency of approach. Until the Court of Appeal heard these cases together, landlords had been able to use these clauses to argue for headline rents and that tenants should pay more than the going rate for what they were enjoying. Now if this is to be achieved using words providing for

⁸ *Ibid.*.

⁹ *Ibid.*.

¹⁰ See *Hill and Redman's Guide to Rent Review*, Barnes (2001) para 3.89 n 1 where the author makes an interesting speculation on what was intended.

¹¹ *Ibid.*.

the disregard of inducements, very clear drafting will be needed. For instance, in the subsequent case of *St Martin's Property Ltd v Citicorp Investment Bank Properties Ltd*¹² the Court considered a provision under which the rent was to be ascertained on the assumption that

The said willing tenant or tenants do not seek a rent free period nor any reduction in rent to allow them the equivalent of a rent free period and calculated to allow for any rent free period shall be ignored.

It was held that this clause was sufficiently ambiguous for the court to conclude that the draftsman was not intending a headline rent. Again, however, it is perhaps difficult to see what else he could have meant.

Applying the formula to the facts of a case

17. Landlords may also look at what are seemingly standard formulae and see how they can be exploited having regard to the particular facts of a case. A particularly important example of this is the “disregards” which apply to the hypothetical premises by reference to which the valuation is to take place.
18. Where the tenant has carried out improvements to the premises at his own expense he often believes that he should not have to pay rent for his own improvements and that they should be disregarded on later rent reviews. It has been decided, however, that in the absence of a provision in the rent review clause that tenant’s improvements be disregarded, the reviewed rent (where it is set by reference to the value of the premises) is to be ascertained taking account of the improvements. This is because the improvements become part and parcel of the realty and of the demised premises and a direction in a rent review clause to find the rental value of the demised premises must, in the absence of a stipulation to the contrary, include the value of the improvements¹³.

¹² [1998] EGCS 161

¹³ *Ponsford v HMS Aerosols Ltd* [1979] AC 63, [1978] 2 All ER 837; *Laura Investment Co Ltd v Havering London Borough Council* [1992] 1 EGLR 155.

19. In practice, however, there is now usually a provision in rent review clauses providing that the value of improvements carried out by the tenant is to be disregarded when ascertaining the open market value of the demised premises. What works are to be disregarded will be a matter of the precise terms of the lease and a wise landlord should scrutinize the terms and the premises to be valued closely.
20. For instance, it is common to find provision that improvements carried out by “the tenant” are to be disregarded. Plainly questions may be raised as to who carried out works of improvement. This requirement will be satisfied if the tenant can show that he has made an arrangement with a third party, (typically, but not necessarily, a contract) under which the third party agreed with the tenant to do the specific works involved in effecting the improvements¹⁴. But sometimes improvements will be carried out in other circumstances and it is important to ascertain whether an improvement falls within the wording of the disregard.
21. More likely to be fruitful to the landlord is that it is often provided that the improvements to be disregarded are only those carried out “with the landlord’s prior written consent”. It is important, therefore, that the tenant obtain the landlord’s consent to improvements if he is to ensure they are disregarded upon rent review.¹⁵ It is surprising how often tenants fail to do this. If they do not, the landlord will be entitled to insist that they are taken into account.
22. It is instructive to consider the case of *Hamish Cathie Travel England Ltd v Insight International Tours Ltd*¹⁶. In that case, the High Court held that where works had been completed before the landlord’s consent was obtained they were not to be disregarded upon rent review and it was too late to obtain the landlord’s consent. This seems unimpeachable. On the other hand, the judge also held that one could not read the disregard as applying to improvements “to which the landlord shall have given written consent or in respect of which the landlord’s consent had been unreasonably withheld”. This, however, is doubtful: where the parties have agreed that a landlord’s consent to alterations may not be

¹⁴ See *Durley House Ltd v Viscount Cadogan* [2000] 1 WLR 246, [2000] 1 EGLR 60; *Scottish & Newcastle Breweries plc v Sir Richard Sutton’s Settled Estates* [1985] 2 EGLR 130. There may be some event, such as a provision in a deed, which estops the landlord from contending that it was someone other than the tenant who carried out the improvement: *Daejan Investments Ltd v Cornwall Coast Country Club* (1984) 50 P & CR, [1985] 1 EGLR 77.

¹⁵ *Hamish Cathie Travel England Ltd v Insight International Tours Ltd* [1986] 1 EGLR 244.

¹⁶ *Ibid.*

unreasonably refused, it is difficult to see how sensibly they could also have intended that a landlord who unreasonably withholds his consent can be entitled to rely upon his unreasonable refusal on subsequent rent review. The “officious bystander” test points to the implication of a term. Nevertheless, this shows the sort of argument which landlords may deploy and on which they can succeed.

23. There are statutory provisions for the disregard of improvements in the Landlord and Tenant Act 1954 s.34. This applies where the court has to determine the rent to be paid under a new tenancy ordered to be granted of business premises. These statutory provisions are sometimes incorporated into rent review clauses. The statutory disregard, however, does not apply to improvements carried out not under the current tenancy and more than 21 years ago, and the disregard only applies where the premises have been comprised in tenancies to which the Act applies at all times since the improvement was completed. If the statutory provisions are to be incorporated into a rent review clause good drafting therefore requires that appropriate modifications are made¹⁷. The statutory provision as enacted in 1954 were substantially modified in 1969⁵ and in some older leases it may be necessary to decide whether it was the original or the amended version which is to apply¹⁸.
24. Possible difficulties for tenants (and gains for landlords) arise where the tenant has carried out the work but before the grant of the current tenancy.
- a. Where the work was carried out under a previous tenancy of the premises by a previous tenant these are not “improvements” to the demised premises as they were let and not improvements by the tenant. The disregard of “improvements by the tenant” will not apply.
 - b. Where the tenant under the current tenancy has carried out the work under a previous tenancy of the premises, it is sometimes argued that if the rent review clause directs that there be disregarded any improvement carried out by “the tenant”, that work is to be disregarded since it was carried out by the tenant. While this will be a matter of construction in each case, in most instances (in the absence of express provision) this

¹⁷ See per Slade LJ in *Brett v Brett Essex Golf Club Ltd* [1986] 1 EGLR 154 at 157.

¹⁸ See *Brett v Brett Essex Golf Club Ltd* [1986] 1 EGLR 154, in which it was held by the Court of Appeal that the reference was to the former unamended version of the Act even though the lease was granted after the amendments had been effected.

suggestion is likely to be wrong. Michael Barnes Q.C. in *Hill & Redman's Guide to Rent Review* states:

“There are two reasons why in such a case the value of the work is to be taken into account. First, the work in question is not an improvement as that word is to be understood in the context of a provision in the current lease. In the provision an improvement means an improvement to the premises as demised, not an improvement which itself created the premises as demised¹⁹.

Second, it may be that the context requires some qualification to be placed on the word ‘tenant’, the obvious qualification being that it means the tenant in his capacity as the tenant under the current lease. A similar qualification had been applied in a similar context by the House of Lords when considering the original provisions of the Landlord and Tenant Act 1954²⁰. It follows that if a tenant taking a new lease wishes that the effect on value of improvements which he has carried out under a previous lease should be disregarded on rent reviews under the new lease he should insist on the inclusion of a clear express provision to this effect. The Landlord and Tenant Act 1954 was amended by the Law of Property Act 1969 so as to provide for such a result when the rent is determined for new leases granted under the Act, but subject to substantial qualifications.”

- c. Where the tenant carries out the work not as tenant under a previous tenancy but in contemplation of the grant of the current tenancy and before that tenancy is actually granted, then it may be that even though

¹⁹ Compare *Brett v Brett Essex Golf Club Ltd* [1986] 1 EGLR 154 the tenants had erected a golf clubhouse on land demised to them in 1973. That lease was surrendered and a new lease granted to them in 1978. The second lease required that under rent reviews there should be disregarded ‘any effect on rent of any improvement carried out by the tenant or a predecessor in title of his otherwise than in pursuance of an obligation to his immediate landlord’. The Court of Appeal held that in the context of the above provision in the second lease the clubhouse was not an improvement and so was not to be disregarded. In *Panther Shop Investments Ltd v Keith Pople Ltd* [1987] 1 EGLR 131 the tenants had during an earlier lease constructed a back extension and a separate storage building on the demised premises. The required disregard was of any improvement carried out by the lessees. Again, it was held that the works had to be taken into account on the ground that an improvement meant an alteration to the existing premises and not some previous works which were a part of the premises as demised. In *Scottish & Newcastle Breweries plc v Sir Richard Sutton's Settled Estates* [1985] 2 EGLR 130 at 137 Judge Baker QC described an improvement as an alteration or addition to a building which the landlord has provided, so that what is contemplated is that the landlord provides a building and the tenant then adds something to it or improves it in some way.

not carried out by the “tenant” before he became tenant (strictly so called) they will be disregarded²¹. The question will be one of construction in the circumstances in each case. If the works were referable to the current tenancy, their value will probably be disregarded, but if referable to some prior interest of the tenant, they will be taken into account²².

25. It is also common to provide that improvements shall be disregarded except when carried out pursuant to an obligation to the landlord. This provision is also found in s.34 of the Landlord and Tenant Act 1954. A number of points should be noted.

- (1) An improvement may be carried out by the tenant pursuant to a statutory obligation as well as pursuant to an obligation to the landlord. Covenants in leases often require that the tenant is to comply with statutory obligations. In such a case the improvement is not to be disregarded since, notwithstanding the effect of statute, it is still carried out pursuant to an obligation to the landlord²³.
- (2) Where there is a qualified covenant restricting alterations improvements are often permitted by a licence granted by the landlord. Such licences often contain provisions that the tenant shall carry out the permitted improvements in a certain way, for example to a proper standard, in accordance with specified plans or within a specified time. Such obligations are merely ancillary and are subsidiary to the main purpose of the licence which is to grant permission for the works²⁴. Even a term in a licence that the provisions of the lease shall apply to the altered premises as if the premises in their altered state had originally been comprised in the lease does not prevent the application of the disregard²⁵.

²⁰ *East Coast Amusement Co Ltd v British Transport Board* [1965] AC 58, sub nom *Re Wonderland, Cleethorpes, East Coast Amusement Co Ltd v British Railways Board* [1963] 2 All ER 775.

²¹ Compare *Hambros Bank Executor and Trustee Co Ltd v Superdrug Stores Ltd* [1985] 1 EGLR 99; *Scottish & Newcastle Breweries plc v Sir Richard Sutton's Settled Estates* [1985] 2 EGLR 130.

²² *Scottish & Newcastle Breweries plc v Sir Richard Sutton's Settled Estates* [1985] 2 EGLR 130.

²³ *Forte & Co Ltd v General Accident Life Assurance Ltd* (1986) 54 P & CR 9, [1986] 2 EGLR 115

²⁴ *Godbold v Martin The Newsagents Ltd* [1983] 2 EGLR 128; *Historic Houses Hotels Ltd v Cadogan Estates* [1993] 2 EGLR 151; *Daejan Properties Ltd v Holmes* [1996] EGCS 185. Cf *Ivory Gate v Capital City Leisure Ltd* [1993] EGCS 76.

²⁵ *Historic Houses Hotels Ltd v Cadogan Estates* [1993] 2 EGLR 151

- (3) On the other hand, the licence may expressly provide that the works are deemed to be carried out pursuant to an obligation to the landlord. This must mean that the disregard is not to apply with the result that the valuation on a subsequent rent review is to take into account the improvements in question²⁶.
- (4) If a licence to carry out an improvement requires that the tenant shall remove the improvement at the end of the term that obligation in the licence will not normally be a term of the hypothetical lease²⁷.

Confidentiality

26. Landlords may also seek to influence the outcome of rent reviews by keeping evidence which is harmful to their cases away from the tribunal. Landlords keep comparable transactions and other relevant material confidential. This may have some limited success. In the case of arbitrations, however, a determined tenant with sufficient resources should be able to compel the production of relevant material.
27. The method by which valuers assess the rent on a rent review is to have regard to actual transactions which may then be compared with the transaction assumed to be taking place. By this comparison an inference can be made as to rent which would be agreed on the notional transaction²⁸.
28. In a falling market it may well be in landlords' interests to keep confidential the terms of transactions which may provide evidence of the state of the market and which could be used against them on rent reviews. Landlords, therefore, will commonly seek to keep confidential the terms of comparable transactions.
29. On the other hand, where the rent is to be determined by an arbitrator
 - (1) where the landlord has or has had possession, custody or control of documentation providing evidence of comparable transactions, such

²⁶ *Daejan Properties Ltd v Holmes* [1996] EGCS 185

²⁷ *Pleasurama Properties Ltd v Leisure Investments (West End) Ltd* [1986] 1 EGLR 145.

²⁸ See *Land Securities plc v Westminster City Council* [1993] 1 WLR 286 generally; see also *Living Waters Christian Centre v Fetherstonhaugh* [1999] 28 EG 121.

material can properly be the subject of an order for disclosure in an arbitration²⁹; and

- (2) a third party may be the subject of an order requiring it to produce relevant documentation to an arbitration³⁰.

30. If relevant comparable material is agreed between the parties to the transaction to be “confidential” this should not prevent its disclosure in an arbitration. This issue has been considered in New Zealand. In *Re Dickinson*³¹ a tenant sought on a rent review to put evidence before an arbitrator of comparable transactions which were subject to confidentiality clauses and issued sub poenas against the tenants of the comparable premises requiring them to provide details of the transactions. The landlords of the comparable premises sought to set aside the sub poenas. The New Zealand Court of Appeal held that the Court had jurisdiction to set aside sub poenas at common law as an abuse of process having regard to competing interests including the interest of confidentiality. In this case it declined to do so, Cooke P stating as follows:

It is understandable that an organisation such as [the Lessors]... with very large funds under its care should be anxious to maintain rental levels in its building as high as reasonably possible. Any commercial lessor is likely to have the same approach. Perhaps in these times of economic stringency it is not surprising that confidentiality clauses have begun to appear in commercial leases of this kind. But, for very many years, leases of commercial premises in New Zealand cities have to a large extent been fixed by rent review procedures. They are a major or a least a significant element of the New Zealand economy. Generally speaking, the leases authorising or requiring such procedures speak of market rents or use some similar formula such as fair rent. In *Modick RC v Mahoney* [1992] 1 NZLR 150 this Court stressed the importance of the ability of valuers or umpires to be able to refer to genuine market rents: that is to say rents freely arrived at in negotiation between the parties, by contrast with those arrived at in the captive circumstances of rent fixations.

²⁹ See Arbitration Act 1996 s.34(2)(d).

³⁰ See Arbitration Act 1996 s.43

³¹ [1992] 2 NZLR 43

Such genuine market rentals are not always easy to discover, and when discovered they may be of great importance in assisting an umpire in carrying out his difficult task of assessment. It is a fair inference in the present cases that the rents agreed for [the comparable premises] may well be of true significance for the umpire concerned with the [subject premises]. Of course one infers as much without any detailed knowledge of the situation and without in any respect seeking to fetter him, but it is desirable that he should be able to get at the truth of these allegedly comparable rentals. Plainly, details will be required such as the terms of collateral contracts offering side benefits and the like.

The contention for the lessor of the [comparable premises] does not withstand analysis. In effect it is an attempt, in the interests of lessors, to prevent true market rents from being ascertained. But in the current economic climate it is plainly in the public interest that fair levels of rent be arrived at in our main cities. One has only to consider the apparently extensive unlet areas in newly constructed buildings to appreciate that unrealistically high levels are not in the public interest. One sympathises, as I have said, with the responsibility of the lessor for the funds in its case but, in my opinion, the overriding public interest is in a fair a fixation of market rents as possible.

This reasoning is equally applicable in England. It is hard to fault it. The New Zealand Court of Appeal went on to consider an objection to the sub poenas based on the New Zealand Bill of Rights Act 1990 and gave it short shrift: given that the sub poenas were reasonable to uphold them was in the public interest. Any similar arguments in this jurisdiction based on the European Convention on Human Rights would be treated in the same way.

31. Likewise, if an expert witness has made relevant inconsistent statements in a report tendered in an earlier arbitration, the production of such a report can be compelled by a witness summons and the search for the truth will usually outweigh the confidentiality of the earlier arbitration³².

³² *London & Leeds Estates Ltd v Paribas Ltd (No. 2)* [1995] 1 EGLR 102

32. Similarly, an agreement by a party with another not to give evidence will be unenforceable. In *Harmony Shipping Co SA v Saudi Europe Line Ltd*³³:

If there was a contract by which a witness bound himself not to give evidence before the court on a matter which the judge said he ought to give evidence, then I say that any such contract would be contrary to public policy and would not be enforced by the court. It is the primary duty of the courts to ascertain the truth and when a witness is subpoenaed he must answer such questions as the court properly asks him. This duty is not to be taken away by some private arrangement or contract by him with one side or the other.

In *Fulham Football Club Ltd v Cabra Estates plc*³⁴ it was held that there was no objection on grounds of public policy to a covenant whereby a party to a commercial transaction involving the disposition of land undertook to support, and to refrain from opposing, planning applications by the other party for the development of land. On the other hand, the Court of Appeal made it clear that³⁵

This does not mean of course that a witness could be prevented by agreement from giving evidence on subpoena, because this could involve an interference with the course of justice.

33. Of course, it is only in the context of *arbitrations* that these remedies are open to tenants. If the determination of the rent is to be made by a third party as *expert*, then the expert has no powers to require the landlord to divulge relevant material (though it is possible for landlord and tenant to agree between themselves as a matter of *contract* that relevant document must be disclosed). Such an expert has no power at all to require third parties to disclose documents. This makes determination by an expert that much more uncertain unless an expert with detailed knowledge of the particular local market is chosen.

³³ [1979] 1 WLR 1380 at 1386

³⁴ [1994] 1 BCLC 363, CA.

³⁵ *ibid.*, at 391.

Admissibility

34. Questions may also arise about the admissibility of evidence. The relaxation of the hearsay rule makes it harder to keep evidence away from arbitrators or courts³⁶. On the other hand, there are still arguments which landlord may deploy to limit the evidence available to the arbitrator. It is important to be astute to these arguments. One of the most contentious arises when attempting the “profits” method of valuation.
35. The “profits” method of valuation involves a valuer trying to estimate the profit which would be likely to be earned by a tenant who operate a business at premises and then attributes a part of that profit to the rent which such a tenant would be willing to pay. This method of valuation is common in the leisure industry and properties such as car parks where the “comparable” method of valuation is considered unreliable – indeed, it may be impossible to find true comparables.
36. Very often landlords will want to seek what profits the tenant is making. Sometimes, however, tenants will seek to rely upon their trading accounts. Either way the trading accounts cannot be taken into account.
37. In the case of *Cornwall Coast Country Club v Cardgrange Ltd* [1987] 1 EGLR 146 one of the issues on an “open market” rent review was whether the tenant should give discovery of documents relating to the profits earned by its gaming business. Scott J held that there was no doubt that the arbitrator was entitled to take into account the income-earning capacity of the premises but went on to hold (in essence) that unless the evidence would have been available in the market to prospective lessees it was not admissible since it would not have influenced the deal which would have been struck between the hypothetical parties.

³⁶ Civil Evidence Act 1995 s.1. Contrast the previous law: *Town Centre Securities v Wm, Morrison Supermarkets* [1982] 2 EGLR 114; *Rogers v Rosediamon Investments (Blake Market)* [1978] 2 EGLR 48; *English Exporters (London) Ltd v Eldonwall Ltd* [1973] Ch 415.

38. In the case of *Electricity Supply Nominees Ltd v London Clubs Ltd* [1988] 2 EGLR 152 Hoffman J took a similar approach. At 152-153, Hoffman J said (emphasis supplied) he said

In the *Cardgrange* case, which also concerned the accounts of a casino, Scott J followed the principle laid down by the House of Lords in *Lynall v Inland Revenue Commissioners* [1972] AC 680 and held that the only admissible evidence of the profit-earning capacity of the casino was evidence available to a prospective lessee in the open market. In this appeal, Mr Neuberger has submitted that the learned judge was wrong. He said that evidence of actual earnings, even if not available in the open market, was admissible to test the value of expert estimates of what the profit-earning capacity would have been. If it showed, as appeared here to be the case, that actual profits were nothing like what the expert said the market would have assumed, the arbitrator would be entitled to take that into account in assessing the value of the expert's evidence. In my judgment, this submission is based upon a false assumption about the issue before the arbitrator. He is concerned not with the actual earning capacity but with how the market would have assessed earning capacity. The open market may be a false market in the sense that it is based upon false assumptions, but it is still the open market. I do not see how information about profitability which the market did not know can be relevant to the question of what the market would have thought.

The cases in which post-review-date transactions are admissible seem to me to stand on quite a different basis. An open market transaction at a later date may, by applying the presumption of continuity, afford a legitimate basis for an inference that a transaction on similar terms would have taken place at an earlier date. Of course the presumption may be rebutted by showing that the market, at the later date, was possessed of information not previously available. But there is no reason in principle why relevant inferences cannot be drawn from subsequent events. But this is not the kind of reasoning upon which the tenants in this case want to rely. I am therefore not persuaded that Scott J was wrong and I propose to follow his decision.

39. Subsequently, Browne-Wilkinson V-C in *Urban Small Spaces Ltd v Burford Investments Co Ltd* [1990] 2 EGLR 120 confirmed that these cases represent the law. He plainly considered that he was bound to assume the *Electricity Supply Nominees* and *Cardgrange* cases about the admissibility of evidence. In that case an arbitrator made an order for disclosure of documents relating to rents received by the tenant from licensees occupying parts of the premises. He held that the fact that documents might be inadmissible in evidence was not in itself a reason for refusing disclosure and he refused to overturn the arbitrator's decision. The Vice-Chancellor said (emphasis supplied):

Assuming, as I must for present purposes, that the decisions of Scott J in *Cornwall Coast Country Club v Cardgrange Ltd* and Hoffmann J in *Electricity Supply Nominees Ltd v London Clubs Ltd* are correct as to the admissibility of such evidence for the purpose of fixing the rent, the question of what is a discoverable document is not limited to documents admissible in evidence: all information and documents which may be used either in making the parties' case or in destroying the other parties' case must be discovered."

40. "Such evidence" mentioned by the Vice-Chancellor (as he then was) was information "which would not be available to the public at large in negotiating the hypothetical rent" (not simply trading account evidence). The Vice-Chancellor plainly considered that Scott J and Hoffman J had held that such evidence was *inadmissible*.
41. This is the state of the law. It is fair to say that many surveyors do not like it. It prevents them having regard to the most obvious and reliable evidence as to what the premises are actually worth. Are there ways around this? It has been suggested that the provisions of the Arbitration Act 1996 which came into force after these cases were decided provides a way around the authorities. Under the Arbitration Act 1996 s. 34(2)(f), "subject to the right of the parties to agree any matter" (under s.34(1)), the arbitrator has a discretion whether or not to apply "strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material". It is highly doubtful whether this suggestion is correct.

- (1) It is axiomatic that a decision which takes into account immaterial matters is unlawful: this is a well established principle see e.g. *Hollington v F. Herthorn & Co* [1943] 1 KB 587; *Associated Provincial Picture Houses v Wednesbury Corpn* [1948] 1 KB 223. If *Cardgrange* and the subsequent cases are correct, then it is inherent in the exercise of ascertaining an “open market rent” in accordance with the formula agreed that only matters known to the open market are material: that is the nature of the exercise which the parties have agreed must be undertaken. To have regard to such matters would be unlawful and an arbitrator cannot exercise his power under Arbitration Act 1996 s.34 to render material that which is immaterial.
- (2) To have regard to such matters would go behind what the parties have agreed (if *Cardgrange* is correct) as an inherent part of the formula. The arbitrator’s power is expressly subject to the right of the parties to agree any matter. The power under section 34 cannot be used to re-write what the parties have agreed in the rent review clause.

Restrictions on alienation

42. The final way which I want to consider in which landlords may seek to protect their positions on rent review is to put restrictions on alienation in order to limit transactions which might prove unwelcome to the landlord on rent review. Such terms, if carefully drafted, may be effective. Whether tenants can be persuaded to accept such terms will very much depend on the state of the market when they take their leases and whether they have been well advised.
43. Comparable transactions may comprise sub-lettings or assignments of comparable premises. They may even include sub-lettings and assignments of the premises demised by the lease in respect of which the rent review is taking place. Landlords may seek to restrict these transactions if they will have an adverse affect on the value of their premises.

Absolute prohibitions on alienation

44. A landlord may place an absolute prohibition on alienation. This is unlikely to prove acceptable to most commercial tenants. Further, unless such a clause was to be disregarded on rent review, it might well have an adverse affect on the rent which was to be fixed for the premises.

Qualified prohibition on alienation

45. The landlord may seek to limit alienation without his consent. In such circumstances, the law implies a term that such consent is not to be unreasonably withheld³⁷.
46. The landlord is entitled to be told the true nature of the transaction, and in the case of an underletting is entitled to be told the terms on which the underletting is to be taken place.³⁸ The provision to the landlord of “heads of terms” may be sufficient for the landlord to make its decision but it may still be reasonable to require further approval of detailed terms³⁹. A landlord may not, however, be entitled to be told the amount of a premium payable on an assignment⁴⁰.
47. Where a tenant proposed to underlet part of the demised premises at a substantial premium and at a rent that fell well below the market rent obtainable for the premises, and it was shown that the proposed rent was so low as to raise reasonable doubts as to the landlord being able to recover the full amount of arrears under Law of Distress Amendment Act 1908 s.6, it was held that the landlord’s refusal of consent was reasonable. The possible deficiency of undertenants’ rents in case of distress and the fears which might be entertained by a prospective purchaser or mortgagee from the landlords were sufficient justification for the defendants’ refusal of consent to the proposed underletting.⁴¹

³⁷ Landlord and Tenant Act 1927 s.19(1).

³⁸ *Fuller’s Theatre and Vaudeville Co v Rolfe* [1923] AC 435.

³⁹ *Dong Bang Minerva (UK) Ltd v Davina* [1995] 1 EGLR 48.

⁴⁰ *Kened v Connie Investments* (1995) 70 P & CR 370, CA

⁴¹ *Re Town Investments Underlease, McLaughlin v Town Investments* [1954] Ch 301 approved in *Pimms v Tallow Chandlers Co* [1964] 2 QB 547.

48. If a transaction will have an adverse effect on the landlord's reversion, this is a matter which can provide good grounds for refusing consent provided that the adverse affect is not merely theoretical⁴². Thus a landlord *may* reasonably withhold consent to a transaction at less than market value but he must have reasonable grounds on which to object on such grounds; if the advice which he receives is unreasonable, then his refusal will be unreasonable⁴³.
49. On the other hand, a landlord may be in substantial difficulty if it seeks to argue that it is acting reasonably in withholding consent to a genuine open market transaction if its reason for doing so is that it will have an adverse impact on rent review. It is not normally reasonable for a landlord to seek to impose a condition which is designed to increase or enhance the rights that he enjoys under the lease: it is not, for instance, reasonable to require the tenant to wait until rental values improve before subletting⁴⁴. A landlord on a rent review is entitled to the market rent (see above). Accordingly, if the substance of the objection to a transaction is that the transaction will tend to show what the true state of the market is (in the hope that he will secure a rent above the market rent), then in essence the landlord is seeking to increase the rights which he enjoys under the lease. This is the reason why the landlord cannot require the tenant to wait before subletting, as stated above⁴⁵.

Pre-conditions to alienation

50. It has been held that it is open to the parties to avoid the qualifications imposed by Landlord and Tenant Act 1927 s. 19 by imposing pre-conditions to a subletting or assignment: see *Bocado SA v S & M Hotels Ltd*⁴⁶. Thus, it is possible to provide that no underletting can take place at a rent of less than the full market rent obtainable without taking a fine or premium: such pre-conditions have the advantage that the onus will remain on the tenant to prove that it falls within the

⁴² *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd* [1986] Ch 513; *Ponderosa International Development Inc v Pengap Securities (Bristol) Ltd* [1986] 1 EGLR 66.

⁴³ See *Blockbuster Entertainment Ltd v Leakcliff Properties* [1997] 1 EGLR 28; *Luminar Leisure v Apostole* [2001] 42 EG 140;

⁴⁴ See eg *Mount Eden Land Ltd v Straudsley Investemnts Ltd* (1996) 74 P & CR 306, CA

⁴⁵ See eg *Mount Eden Land Ltd v Straudsley Investemnts Ltd* (1996) 74 P & CR 306, CA

⁴⁶ [1980] 1 WLR 17, CA

condition since such a clause will not fall within Landlord and Tenant Act 1988 s.1⁴⁷.

51. One could also, for instance, include pre-conditions which prevent transactions otherwise than on the terms of the head-lease⁴⁸. On this basis, there is nothing, in principle, to preclude a covenant that any sub-letting shall be on the same terms as to rent as the head-lease. To be effective to “protect” the landlord, of course, the drafting must be in such a way as to preclude side agreements which can be used by the tenant on rent review to show that the rent reserved was more than the true market rent⁴⁹.
52. A recent example consistent with these conclusions is *NCR v Riverland Portfolio No. 1*⁵⁰ where it was held that the fact that a tenant proposes to grant an underlease at the market rent in consideration of a reverse premium payable by the tenant to the subtenant did not detract from the fact that the rent to be reserved was indeed the market rent and the landlord was thus not entitled to object to the transaction.
53. The extent to which such clauses will be acceptable to tenants will depend on the market. In a falling market, they will be unacceptable. On the other hand, in a strong market landlords may be able to impose such terms. Tenants should be very wary about accepting such terms. When are market falls, such terms can make alienation difficult.⁵¹

⁴⁷ *Homebase Ltd v Allied Dunbar Assurance plc* [2002] 1 P & CR 1 (first instance), and see [2002] EWCA Civ 666 at [16], [20], CA.

⁴⁸ *Ibid.*

⁴⁹ See *ibid.*

⁵⁰ [2005] 1 P & CR 3

⁵¹ John Mayhew, property director of Homebase was widely reported in the press following the House of Lords rejection of its application for permission to appeal as stating that the House of Lords had stifled open debate on the restrictive nature of commercial property leases, many of which contain upwards-only rent reviews.

Conclusions

54. Leases with rent review clauses underpin much of the commercial property market. Landlords who seek to exploit rent review provisions can often achieve settlements at rents higher than they could achieve either in the market or, because tenants may be wary of the risks involved, upon third party determination. When acting for landlords, you must be astute to the points which you can reasonably take to maximize returns and that involves scrutinizing the lease terms as the starting point. When acting for tenants, it is important to take the lease as the starting point but one should not necessarily be fazed by landlords who take nit-picking points of construction or who seek to keep confidential transactions which hide the true state of the market. If necessary, tenants should be willing to call their landlords' bluff.