THE 1954 ACT:

What don’t you know?

by

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WHAT’S NEW?


1. The authorities on the 1954 Act are a bit like buses. Nothing for ages and then two at once. This year the Court of Appeal has heard two appeals concerning the proper application of the “fault based” grounds of opposition set out in section 30(1)(a) to (c) of the Act. In both cases the landlord succeeded in opposing the grant of a new tenancy on ground (c) by reason of the tenant’s previous conduct.

2. By way of reminder, the relevant “fault” grounds of opposition in s.30(1) of the Act are as follows:

   (a) where under the current tenancy the tenant has any obligations as respects the repair and maintenance of the holding that the tenant ought not to be granted a new tenancy in view of the state of repair of the holding, being a state resulting from the tenant’s failure to comply with the said obligations.

   (b) that the tenant ought not to be granted a new tenancy in view of his persistent delay in paying rent which has become due

   (c) that the tenant ought not to be granted a new tenancy in view of other substantial breaches by him of his obligations under the current tenancy, or for any other reason connected with the tenant’s use or management of the holding.

3. The first decision is Horne & Meredith Properties v Cox & Billingsley [2014] EWCA Civ 243. It concerned the proper scope of the meaning of the words “any other reason connected with the tenant’s use or management of the holding”, within ground (c).
4. There had in that case been a long and troubled history of 16 years litigation between the parties to the lease regarding alleged obstructions to the right of way that was enjoyed together with the subject demise, all of which had been instigated by the tenants. Matters had in fact got so bad that a limited civil restraint order had been imposed against the defendant tenants. The judge went so far as to say that it would be "an affront to require the landlord to grant protection to such a tenant who lost no opportunity to allege and repeat and persist in repeating that directors were frauds, dragging the company through the mire in wasted legal expenses when the assertions had been found to be totally without merit".

5. It is relevant to note that the first instance judge\(^1\) found that one of the tenants' approach to his own perceived sense of wrong and interference with his legitimate rights, as he saw it, would not change such that the landlord would simply become embroiled in more unnecessary and unreasonable litigation were a new lease to be granted. It was therefore a case where the tenant was demonstrably intransigent.

6. The issue on the appeal was a narrow one: namely was the sorry history of litigation under the spotlight in that case capable of being "a reason connected with the use or management of the holding" such as to ground the refusal of a new tenancy?

7. The Court of Appeal held that it was and dismissed the appeal. In so doing, their Lordships rejected an argument that the concluding half of s.30(1)(c) should be narrowly construed. Some keys points can be taken from the judgment given by Lewison LJ\(^2\):

   - There are two questions to address in applying s.30(1)(c), namely (i) are the matters relied upon either (a) substantial breaches or (b) other

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\(^1\) HHJ Main QC sitting in the Stoke on Trent county court. The landlord had also relied on ground (f) but this was not made out at trial.

\(^2\) Lewison LJ gave the single judgment with which Ryder LJ and Sir Stanley Burton agreed.
reasons connected with the use or management of the holding; and (ii) if so, are they such that the tenant ought not to be granted a new tenancy of the holding?

- The test in s.30(1)(c) is disjunctive; therefore it is not necessary to find a breach of obligation in order for the “other” reason to come within that subsection\(^3\).
- The “reasons” need not be directly connected with the relationship of the parties qua landlord and tenant\(^4\).
- The words in the concluding half of s.30(1)(c) were “wide words and deliberately so”\(^5\).
- The control mechanism which prevents injustice is the decision of the court on the question of whether the tenant “ought not” to be granted a new tenancy of the holding.
- The existence of extensive litigation between landlord and tenant could amount to a reason connected with the tenant’s use and management of the holding\(^6\) and where that litigation was concerned with the vindication of rights granted under that tenancy (and as such forming part of the holding) it was a reason connected with the tenant’s use and management of the holding.
- The second part of the question involves a “value judgment” which it is for the trial judge to make. The phrase “ought not” suggests that there would usually be some fault or culpability on the part of the tenant.
- The overall question under the second part is “whether it would be fair to the landlord, having regard to the tenant’s past behaviour for him to be compelled to re-enter into legal relations with the tenant”.
- The first instance judge came to a value judgment which he was entitled to come and the appeal should be dismissed.

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\(^3\) Applying *Beard v Williams* [1986] 1 EGLR 148 at 149 L to M

\(^4\) Applying *Turner & Bell v Searles (Stanford Le Hope) Ltd* [1977] 33 P & CR 208

\(^5\) Applying *Fowles v HeathrowAirport Ltd* [2008] EWCA Civ 1270

\(^6\) Applying *Eichner v Midland Bank Executor and Trustee Co Ltd* [1970] 1 WLR 1120
8. The second case, *Youssefi v Mussellwhite* [2014] EWCA Civ 885, involved consideration of all three of the “fault based” grounds of opposition. It was clear that there had been a breakdown in trust and confidence between the parties. The first instance judge held that the landlord had established grounds (a) and (c) but not (b). On appeal it was held that only ground (c) had been established. However, that was enough to dispose of the appeal.

9. The findings of the first instance judge so far as relevant to ground (c) were as follows:

- He found that Ms. Youssefi had been in substantial breach of the covenant to give access to the landlord for the purposes of inspection without justification. She was held guilty of “long standing intransigence” to afford access. This was enough to satisfy ground (c)\(^7\);

- He found that Ms. Youssefi had been in substantial breach of the user covenant in the lease. He construed the user covenant as a positive covenant to actually use the premises for A1 or A3 retail and he found that “*if the Defendant is running any business from the premises such business was extremely low key and was properly to be described as vestigial*”. She had failed to either open a business that complied with the user covenant (whether a business within classes A1 and A3) or another business subject to consent being obtained by the landlord\(^8\).

- As to the “other reasons” limb in (c) the judge held that this was not made out because it would be a near impossible task to analyse the landlord and tenant relationship over the whole period of the lease to make findings with confidence in relation to the origin of the breakdown in trust and confidence between the parties. Thus this particular reliance on the second limb of ground (c) failed\(^9\).

10. A point of principle was identified and disposed of by the Court of Appeal at the outset. The parties’ counsel differed in their submissions as to the correct

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\(^7\) This decision on ground (c) based on substantial breach of the access covenant was upheld on appeal

\(^8\) This decision on ground (c) based on breach of the user covenant was also upheld on appeal

\(^9\) This element of the judge’s reasoning was upheld on appeal
approach to be adopted as to whether a fresh tenancy “ought not” to be granted to the tenant in light of the proven matters. Those words appear in all three fault based grounds of opposition. Ms. Youssefi’s counsel submitted that the correct test was “whether the landlord’s interest was likely to be prejudiced by the occurrence of the matters relied upon as constituting reasons within section 30(1).” Mrs. Mussellwhite’s counsel submitted that there was no requirement specifically to consider the question of ongoing prejudice. Rather the test was “whether it would be fair to the landlord to require him to continue with this particular individual as tenant”.

11. At paragraph 29 Gloster LJ described this so-called difference of approach as in reality no more than a semantic one. The expressions were different ways of asking whether a new tenancy ought not to be granted. It was not necessary for the landlord to prove that the relevant breach adversely affected the rental income or the value of the reversion in order for him to demonstrate that his interests are prejudiced or that it would be unfair for a new tenancy to be granted. To impose such a requirement would impose too concrete a test and an inappropriate constraint on the wide discretion given under the section.

12. The Court of Appeal upheld the judge’s decision on ground (c) on the basis that the tenant ought not to be granted a new tenancy on the basis of her long standing intransigence to afford access by the landlord to the property in breach of her covenant. This was a substantial breach in light of which it would be prejudicial or unfair to subject the landlord to a new tenancy with the appellant. Whilst the judge should properly have considered all of the breaches and other matters relied on under s.30(1)(c) collectively before going on to consider whether in light of those breaches and other matters the tenant ought not to have another tenancy, the failure to provide access was a sufficient reason by itself to justify that conclusion.

10 Citing dicta to that effect in Beard v Williams [1986] 1 EGLR 148
11 Citing dicta to that effect in Lyons v Central Commercial Properties London Ltd [1958] 1 WLR 869
13. Further the Court of Appeal upheld the judge’s decision on ground (c) on the further basis that there had been a substantial breach of user covenant. Even though there was no express “keep open” covenant, it was held that the user covenant was on its true construction positive. The judge was entitled to find, particularly in the absence of any evidence from the appellant, that the failure on her part to operate a business within the relevant classes was prejudicial to the legitimate interests of the respondent. It was not incumbent upon her to demonstrate a quantifiable loss to the value of the reversion. It was said to be “not hard to envisage that the sale of the landlord’s reversionary interest in the shop premises, subject to a business tenant in possession, would be likely to achieve a better price if the tenant was actually carrying on a user compliant retail business, than if the tenant was not doing so”.

14. Gloster LJ indicated that she had hesitated as to whether the judge was entitled to find that the breach of the user covenant was substantial but thought that in the special circumstances of this case, he was. On the facts, it does seem to be straining matters a little to say that the landlord was really prejudiced by the fact that she was basically running a vestigial business given that she was liable to pay a full rent, especially in the absence of wider “estate management considerations”. It is not obvious to see in that case why a positive covenant should have been deliberately imposed in the first place.

15. However, it is important for this case to be considered in the round. Viewed in isolation, it might seem rather harsh that Ms. Youssefi was refused a new tenancy simply because she had been reluctant to allow the landlord access to the premises (particularly given the existence of the proceedings) and or that she had failed to actively run a business from them. However, the breaches could be seen as characteristic of an underlying difficult relationship for which Ms. Youssefi was largely to blame, even though both courts shied away from making that finding expressly. The judge had after all found her to be combative and obstructive and not a model tenant.
16. These decisions should not be taken as giving landlords in other cases a false sense of hope. The two cases have one thing in common; a total breakdown in the landlord and tenant relationship and tenants who had openly adopted intransigent and unreasonable positions in their dealings with their respective landlords. In neither case had the tenants justified their conduct or, more importantly, demonstrated any contrition or change of heart. In both cases one can readily appreciate why the courts felt that in light of that conduct neither tenant ought to be granted a new tenancy. In both cases, had new tenancies been granted, the landlords would simply have been in for “more of the same”. The conduct of both tenants was properly characterised as unreasonable.

17. Most tenants will not be guilty of such levels of intransigent behaviour and further, any well advised tenant would seek to “make amends” before trial so far as the landlord did seek to oppose on a fault based grounds if he or she genuinely wanted to stay on at the premises.

18. One potentially interesting point is the refusal of the judge in Youssefi to grapple with the “other reasons” limb of ground (c) on the basis that it was all too difficult to analyse the history of the relationship over the whole period of the lease to make findings with confidence as to the origins of the breakdown in trust and confidence. What appears to be required, in most cases, for successful reliance on the “other reasons” limb is an attribution of fault to the tenant for the breakdown in the relationship. Might, in a future case, another judge seek to rely on this element of the decision as justifying a refusal to enter the fray?

19. The decision not to engage was readily justifiable on the basis that it was simply not necessary, given the judge’s findings on several discrete substantial breaches, for him to undertake such a difficult exercise. Alternatively it might simply be construed as a decision on its own facts. The burden of establishing grounds of opposition would lie with the landlord. If the judge considered it “impossible” on the evidence to identify the culprit, it might best be treated as a finding on the facts of that case that the evidence did not justify that finding.
20. In other cases, the court may have no option but to hear evidence as to the history of litigation, as was the case in _Horne & Meredith Properties_. In that case the tenant, Mr. Cox, was clearly shown to be the main protagonist but of course in that case a civil restraint order had already been made against the tenants so it was fairly easy to see where the merits lay.

21. The moral of the story is that if a landlord wishes to rely on a breakdown in relations with its tenant it will need either to point to discrete substantial breaches of covenant that justify refusal or clearly demonstrate that the fault lies to a significant degree with an intransigent and unrepentant tenant. This is unlikely to be easy to do.

**WHAT IS EASY TO OVERLOOK?**

**Split reversions: Who is the competent landlord?**

22. The position regarding split reversions is covered by s.44(1A) of the Act which provides that where different persons own a relevant reversionary interest in different parts of the property, those persons are collectively the competent landlord. Therefore where the reversion is split, the tenant must serve any notice on all of those persons and, equally, the reversioners of the different parts must act collectively.

23. A split reversion will occur where the landlord has dispensed of part of its reversion to a third party such that the tenant thereafter has different landlords owning different parts of the reversion to its tenancy.

24. Further, where a mesne landlord sub-lets property together with rights over adjacent land held by it in a different capacity and then its intermediate tenancy comes to an end, the superior landlord will be the sub-tenant’s immediate
landlord of the part previously demised by the intermediate tenancy whereas the mesne landlord will remain the landlord in respect of the adjoining land over which the sub-tenant enjoys the rights. A split reversion can arise inadvertently where a tenant sub-lets demised premises together adjacent freehold land owned by itself. If the mesne tenancy of the demised premises is determined in circumstances where the sub-tenant becomes the direct tenant of the superior landlord in relation to part, the reversion will be split. In an attempt to prevent such a situation arising some leases contain covenants against the tenant subletting the demised premises together with other premises.

25. There will be a split reversion in a situation where the tenant enjoys rights under its lease to adjoining land of its landlord which has been sold off to a third party (or where a lease of the reversion is granted over that part to a third party who has a sufficient interest to be competent landlord of that part): see Nevill Long & Co (Boards) Ltd v Firmenich & Co [1983] 2 EGLR 76.

26. In that case the tenant enjoyed, under its lease, rights over land which had subsequently been sold off by its immediate landlord. The new owner of that part sought to claim that the tenant’s rights had, on the termination of the contractual term, ceased over that land on the basis that it was to be treated as a separate tenancy of the easement which was incapable of being protected by the Act. The Court of Appeal disagreed. There was no severance of the tenancy and the premises included within that tenancy included the rights granted over the land held by the claimant. The tenant still enjoyed a single demise of the premises. There was therefore a split reversion and neither the owner of the demised land nor the owner of the servient land over which the right of way was enjoyed could be said to be “the landlord” alone. The owner of the easement land was not able to unilaterally take steps to terminate the tenancy in respect of its land. Those persons would need to join together to serve a valid s.25 notice on the tenant.
27. It is quite easy to miss this point, especially if a lease of the reversion has been granted over the parts of a building in respect of which rights are enjoyed. If you are acting for the tenant you need to consider whether any of the rights granted or enjoyed by the tenant relate to areas outside the title of the landlord in respect of the premises demised. If rights are enjoyed over land in respect of which someone else is the reversioner, you need to consider the question who is the competent landlord in respect of each part. If more than one person, the competent landlords in respect of each part need to be served with the s.26 request in order for it to be valid. The same applies if you are acting for a landlord of either part since if such rights are enjoyed over land in different ownerships, the reversioners of the individual parts will be unable to act alone in serving a s.25 notice.

28. This can cause difficulties where the tenant is himself one of the “landlords” where the reversion has been split. This happened in EDF Energy Networks (EPN) Plc v BOH Ltd [2011] EWCA Civ 19. In that case EDF had been granted a lease over three contiguous plots of land (let’s say plots 1 – 3) and had also been granted rights to lay and use electricity cables over a fourth plot between plots 1-3 and the highway, plot 4. At the time of grant the then landlord had owned the freehold to all four plots. However there were various subsequent transactions involving the reversion which resulted in the tenant, namely EDF, acquiring the freehold reversion to plot 2 (upon which it had built an electricity sub-station), Layhawk acquiring the freehold of plot 3 and BOH acquiring the freehold to plots 1 and 4. BOH and Layhawk sought to argue that EDF’s rights over plots 3 and 4 in favour of plot 2 had determined by reason of EDF’s acquisition of the freehold reversion to plot 2 (and thus extract ransom value). Before EDF had acquired the reversion to plot 2, the then freeholder of plot 2 had sought to terminate the lease by serving a s.25 notice but, at the time he did so, the reversion to the other plots had already been split. As the then freeholder of plot 2 did not own the other plots over which the tenant, EDF, enjoyed rights, he was not in a position to unilaterally serve a s.25 notice in respect of EDF’s tenancy. It was held at first instance (and not challenged on appeal) that under
s.44(1A) all of the reversioners would need to join together to serve an effective s.25 notice in such circumstances.

29. On appeal an argument to the effect that EDF’s tenancy had been merged in its freehold reversion (and with it the rights enjoyed by plot 2 under the lease) was rejected. This was essentially because there was no express evidence of an intention to merge and further, such merger could not be presumed because it was contrary to EDF’s interests. An argument that merger could be presumed because it benefited the other reversioners was held to be contrary to principle. The question of whether merger was beneficial was to be judged solely from the perspective of the person who held the respective interests said to be merged.

30. It was further argued (on behalf of BOH and Layhawk) that s.44(1A) of the 1954 Act should be “read down” in accordance with s.3 of the Human Rights Act 1988 so as to exclude any person who was also the tenant of the relevant tenancy on the grounds that otherwise BOH’s and Layhawk’s enjoyment of their freehold interests in plots 3 and 4 would be interfered with contrary to Article 1 Protocol 1. This was essentially because EDF could in those circumstances refuse (as one of a number of split reversioners) to join in any s.25 notice to be served on it contrary to its interests as tenant. However, the Court of Appeal refused to even entertain this argument because it was purely hypothetical. There was no evidence of any s25 notice having been served in relation to the tenancy by all of the reversioners other than that of plot 2. Such an argument may well be run in a future case where one of a number of reversioners is also the tenant and is refusing to join in a s.25 notice contrary to its commercial interests as tenant, thus blocking the attempt of the other reversioners to obtain a market rental by forcing a lease renewal.
WHAT IS UNDECIDED?

Rental valuation under s.34 and treatment of rent free fitting out periods

31. A contentious valuation issue that is topical at the moment relates to the proper treatment of the (typically) 3 month rent free fitting out period usually available in the market to tenants in the context of the statutory valuation of rent under s.34 of the Act.

32. It is standard for valuers to adopt the comparable method when valuing the open market rent under s.34. In the market it usual for an incoming tenant to be offered a rent free period, some of which is to reflect the time required by the incoming tenant to fit the premises out at the commencement of the lease. So far as the rent free period in any case exceeds the time reasonably required for fitting out, it is conventionally seen as a “true incentive” which will be amortised to reduce the “the headline rent” to a figure that more accurately reflects the bargain (“the net effective rent” or “NER”).

33. The contentious issue is whether a further allowance should be made from the headline rental figure (or net effective rent) to reflect the benefit of the rent free period so far as it relates to fitting out where that would be available on an open market letting of the subject premises (or perhaps more appropriately where it was the basis upon which the comparable transaction evidence was concluded) but which is not actually enjoyed by the tenant since under the Act the rent is payable from day one of the tenancy and there is no mechanism for giving effect to a rent free period as a term of the new tenancy.

34. There is as yet no binding authority on this question. Rather unhelpfully there are three unreported county court decisions reaching different decisions, none of which contain comprehensive reasoning.

35. To recap, section 34(1) provides as follows:
“The rent payable under a tenancy granted by order of the court under this Part of this Act shall be such as may be agreed between the landlord and the tenant or as, in default of such agreement, may be determined by the court to be that at which, having regard to the terms of the tenancy (other than those relating to rent), the holding might reasonably be expected to be let in the open market by a willing lessor there being disregarded—

(a) Any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding;

(b) Any goodwill attached to the holding by reason of the carrying non thereat of the business of the tenant (whether by him or by a predecessor of his in that business)

(c) Any effect on rent of an improvement to which this paragraph applies,

(d) in the case of a holding comprising licensed premises any addition to its value attributable to the licence, if it appears to the court that having regard to the terms of the current tenancy and any other relevant circumstances the benefit of the licence belongs to the tenant.”

36. In the first of these cases, *MaxMara Ltd v Pearl Assurance Plc*, an unreported decision of HHJ White in the Central London County Court dated 16.5.1996, one of the issues was expressed to be whether “rent free periods” should be discounted in assessing market rentals or should be taken out of the equation altogether. The judge stated that the focus of this issue was the wording and effect of s.34 of the Act.

37. In that case the tenant’s submissions were, in summary that: (i) the effect of the express disregard in s.34(1)(a) required the valuer to value the premises on a vacant possession basis and “as though there would be a fresh start in the shell condition that the premises were in before the initial letting”; (ii) a new tenant
would expect a rent free period for fitting out and this must be reflected in the rental valuation because there is no actual grant of a rent free period; (iii) the fact that the fitting out has taken place during the tenant’s previous occupation and as a consequence no opportunity commercially to exploit the premises will on renewal be lost must be ignored; (iv) its approach was supported by the logic of the reasoning in 99 Bishops Gate Ltd v Prudential Insurance Company Ltd [1985] 1 EGLR 72 because the consequence of an assumption as to vacant possession within a rent review clause there was that the premises should be valued as vacant and not fitted out all the with the valuation consequences that flowed from that; and (v) the phenomenon known as the 99 Bishops Gate effect, namely the drafting frenzy that followed that decision to include express rent review assumptions to the effect that premises were to be regarded as fitted out in subsequent leases, had not been replicated by parallel amendment to s.34 of the 1954 Act and therefore in construing s.34 the court remained bound by the logic of the decision.

38. Counsel for the landlord sought to argue that s.34 was wording differently from the rent review provisions in 99 Bishops Gate and in particular contained no direction to treat the premises as being let with “vacant possession” and the disregard of the tenant’s occupation in s.34(1)(a) did not require the importation into the assessment of a fiction the effect of which would “distort the true market rent”.

39. HHJ White treated the question simply as one of law rather than one of valuation. His starting point was that if a tenant under the 1954 Act was to have a notional rent free allowance as if he was again being compensated for the rental cost of fitting out when no such burden was being incurred “he would receive an unwarranted windfall at the expense of the landlord” and that the court should be reluctant to interpret the section in a way which involves a departure from reality with the importation of a fiction into the determination of an open market rent “unless the wording unambiguously demands it”. He did not
really grapple with the submissions on behalf of the tenant regarding the terms of the hypothetical letting.

40. The judge continued thus:

“What is central to the bargaining for a genuine rent free period at the outset of a new lease is not the tenant’s occupation or previous lack of occupation but the need and intention of the tenant at this particular time to fit the premises out. The heavy costs involved affect the bargaining process and those include the rent of the period in which the work is being done and the premises cannot be used commercially. The rent free period is assessed, as the comparables in the case clearly show, to meet the particular circumstances in each case to compensate for the genuine factual situation. The rent effect stems from that factual situation and where it does not exist, as on a renewal, should be kept out of the equation. Section 34(a) read simply prevents any accretion to rent attributable to the occupation by the tenant entitled to a lease renewal and on the other side any sitting tenant concession. It does not require the court to import a fiction with all the uncertainties and distortions that would inevitably follow. I view the comparables therefore with this approach in mind.”

41. In *HMV Music v Mount Eden Land*, an unreported decision in the Central London County Court on 17.1.2012, HHJ Bailey came to a different conclusion. Although an extract from *MaxMara* contained in the 3rd edition of *Reynolds & Clark* (as set out above) was cited to him, the judge did not have sight of the full transcript of the earlier decision. However he stated that he was unable to agree with the passage cited without qualification and explanation. He held that the comments of HHJ White in *MaxMara* regarding the importation of a fiction were misleading when considering the performance of the statutory exercise imposed upon the court which required the court to assess the open market rent by reference to comparables.
The judge described the statutory exercise imposed upon the court under s.34 as follows:

“to determine a rent at which, having regard to the terms of the tenancy other than those relating to rent, the holding might reasonably be expected to be let on the open market by a willing lessor. This exercise is traditionally, even habitually, carried out by reference to comparables. If the comparables, as in this case, are of rents payable by tenants who have three-month rent free periods, the determination of a rent which is to be paid throughout the tenancy by reference to those comparables must surely reflect the fact that there will be no rent free period under the new lease”. (para. 56)

“Of course the tenant who has been in occupation during the term of a previous lease is most unlikely to undertake any shop fitting. He will almost invariably be able to continue trading without any pause. Because the fact that the tenant has been in occupation has to be disregarded by the terms of the statute, the absence of the need for a rent-free period cannot be brought into the court’s determination. This might suggest a windfall to one party or the other, but if the determination exercise is carried out properly, there should be no question of a bonus to the tenant or a windfall to the landlord” (para. 57)

“What the court must not do is determine a new rent by reference to rent-free comparables and then omit to adjust the new rent to take account of the absence of a rent free period in the new lease” (para. 58)

The above reasoning appears to presume that the premises are to be valued on the assumption that they are not fitted out. Although the judge does not expressly state this, he comes pretty close in paragraph 57.
44. In the last case, *Iceland Foods Limited v Castlebrook Holdings Ltd*, a decision of Recorder Clayton, in the Chester County Court dated 3.9.2013, the net effective rent was discounted to reflect the absence of any rent free fitting out period in the lease. However the point was dealt with in a single paragraph which merely recorded the Recorder’s decision to adjust the rent downwards on the basis that “a hypothetical ingoing tenant would probably be well placed to negotiate a discounted rent free period of 3 months on account of fitting out”. It was stated to be common ground between counsel in that case that s.34(1) assumes a hypothetical letting in which the court is to disregard the Claimant’s occupation but there is no further discussion as to the operation of the various assumptions and disregards in play.

45. Where does that leave us? Unfortunately the position is entirely unsatisfactory. There is no binding authority and three conflicting and inadequately reasoned county court decisions. It is necessary to go back to first principles.

46. The starting point for any consideration of this point is the nature of the exercise the court is required to undertake under s34. As with all valuation exercises that proceed on the assumption of a hypothetical letting, the hypothetical parties are abstractions. The actual circumstances of the tenant and landlord are irrelevant: see *F R Evans (Leeds) v English Electric Co. Ltd* (1977) 36 P & CR 185.

47. Section 34 expressly directs the court to ignore (a) any effect on rent of the fact that the tenant has or his predecessors in title have been in occupation of the holding. In *Harewood Hotels Ltd v Harris* [1958] 1 All ER 104, the Court of Appeal approved a passage in *Woodfall* to the effect that the effect of the disregard in s.34(1)(a) is that “the premises have to be envisaged as empty premises in the market”. This authority was not referred to in any of the above mentioned cases.
48. This is further underlined by the principle that premises are to be valued as though the tenant, on vacating the premises, has removed the tenant’s fixtures: see New Zealand Government Property Corporation v HM & S (1980); Daejan Investments v Cornwall Coast Country Club (1985); Handbook of Rent Review at 6.4.8. Additionally in Humber Oil Terminals Trustee v Associated British Ports [2012] EWHC 1366 (Ch), at paras. 175 – 176, Sales J held that for the purposes of s.34 the holding did not include tenant’s fixtures. Again, these cases do not feature in any of the county court litigation.

49. HHJ White’s assumption that a renewing tenant would not require any period for fitting out requires greater scrutiny. Where the original fit out was carried out at the commencement or soon after the grant of the original tenancy, a fresh fit out may well be required. This is of course a question of fact in each case. Take retail warehouses, as an example. A number of leases were granted from the mid-1980s on 25 year terms. These are now falling in. On renewal, the tenant may well wish to carry out some form of updating of its fit out, particularly if it is required to take more than a short term. The assumption that an allowance for a fit out period would be a “windfall” in every renewal is simply not correct.

50. Indeed if the fitting out period is disregarded on a renewal, it could be argued that the landlord receives a windfall because he is receiving a greater rent than he would obtain in the open market and the tenant is deprived of a rental advantage that it could have negotiated on the open market. Again this is a point that the judge in the HMV case appears to be highlighting in the cited passages in saying that if the valuation exercise is done properly there should be no question of either landlord or tenant obtaining a windfall.

51. Although HHJ White might be said to have failed adequately to deal with the submissions as to the appropriate hypothesis in the MaxMara case, basing his decision almost entirely upon his own instinctive reaction that the tenant would otherwise obtain a windfall and his assumption that Parliament cannot have intended such a thing, one cannot entirely discount or discredit the policy
considerations that underline the *MaxMara* decision. Other judges may have the same reaction. The charge that it is unreal to assume, contrary to reality, that the premises need to be fitted out has some force. In many cases the renewing tenant will not need to carry out a fit out and therefore it could be said to achieve the benefit of a rent free period which it does not need. But on the other hand, it cannot be assumed in all cases that the renewing tenant will not need to carry out some form of refurbishment or modernisation of its fit out during the term of the new lease. The valuation under s.34 must proceed on an objective basis. It cannot depend on the actual positions or intentions of the actual parties.

52. There are also competing possible policy considerations in play. The aim of s.34 could simply be to ensure that the landlord is no worse off than he would be in the open market. Viewed in that light, the landlord could be said to get a windfall insofar as he gets more through a lease renewal than he would get in the open market especially as he might in reality have to suffer a greater void than that represented by the standard fit out period were he to have to offer the premises to the market.

53. It is difficult to argue against the logic of the argument that proceeds on the basis that (i) the court is valuing the rent payable in respect of a hypothetical transaction based on certain assumptions; (ii) those assumptions construed literally and taken at face value dictate that the court must assume that the premises are not fitted out; and (iii) are to be let on terms that rent is payable from day one and as such do not contain a rent free period.

54. The difficulty landlords face in countering this sort of structured argument is that there is simply no provision in s.34 that provides either that the hypothetical tenant is assumed to already have the benefit of a rent free period for fitting out and or that the premises are to be assumed to be already fitted out. In fact, such assumptions cannot readily be implied, quite apart from the fact this is a statute, as they are contrary to the fact that the hypothetical tenancy is expressly assumed to be on the same terms as the current tenancy and as such include a
liability to pay rent from day one. In addition the argument that s.34(1)(a) requires an assumption to be made that the subject premises are empty and not fitted out, if accepted, is directly contrary to such implication.

55. Therefore if the court is faced with comparables that include rent free fitting out periods the court would not be comparing like for like if it were to simply apply the NER to the hypothetical letting of the subject premises without even considering whether an adjustment is required. This is the fundamental point being made by the judge in the HMV case.

56. It is ultimately a question for the valuer as to whether any difference between the terms of the comparable lettings and the terms of the hypothetical letting require an adjustment of the NER to ensure a comparison on a like for like basis. However, a valuer is probably likely to be on fairly solid ground if he or she concludes that an adjustment should be made to the NER derived from the rent free period comparables to reflect this difference. A rent free period is, after all, a term of the tenancy which is of value to an incoming tenant. The comparables are therefore lettings that proceeded on a more favourable basis that the hypothetical letting. Another way of looking at this is that an incoming tenant who needed to fit out premises would probably require a reduction in the net effective rental he would otherwise pay to reflect the absence of any rent free period that would usually be available on the market if that were not actually available, as is the case for the hypothetical tenant under s.34.

57. Therefore although the point remains a moot one, the author’s view is that the decision in HMV is most probably the right one.