Property Litigation column: Restate or update: when will the court insert new terms in a commercial lease renewal?

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Mairi Innes, a barrister at Enterprise Chambers, discusses what the court may consider when deciding whether to alter the terms of a lease upon renewal under the Landlord and Tenant Act 1954.

A common issue encountered when entering into lease renewal negotiations in respect of business leases governed by the Landlord and Tenant Act 1954 (1954 Act) is how to deal with modern lease clauses that did not exist or were not commonplace at the time the existing lease was entered into.

In order to put your best foot forward when negotiating the terms of the new lease, it is important to have in mind the legal principles that the court will consider if the terms of the renewed lease are not agreed between the parties.

Upon the application of the landlord or tenant for leasehold renewal, if the renewed terms cannot be agreed, the court will fix the terms of the new tenancy. When determining terms other than rent and duration, in accordance with section 35 of the 1954 Act, where the parties are not in agreement, the court "shall have regard to the terms of the current tenancy and to all relevant circumstances".

In *O'May v City of London Real Property Co Ltd [1983] 2 AC 726*, the House of Lords laid down general principles on the court's exercise of its discretion pursuant to section 35. Those principles are that:

- The starting point for the court when considering the appropriate terms of a renewed lease will be the original lease.
- It is for the party proposing a change in the terms of the lease to persuade the court of the proposed change.
- The change must, in the circumstances, be fair and reasonable.
- In considering the proposed change, the court should take into account the comparatively weak negotiating position of a sitting tenant requiring renewal, particularly in conditions of scarcity, and the general purpose of the 1954 Act which is to protect the business interests of the tenant so far as they are affected by the approaching termination of the current lease.
- Subject to the preceding points, the court has a wide discretion.

Lord Hailsham condensed the question as such: "granted that the negotiating objective of the party proposing a variation is perfectly legitimate, is it reasonable in the circumstances to impose it willy nilly on a resisting landlord or tenant?"

However, while the courts have considered and exercised their discretion under section 35 on several occasions, areas of uncertainty remain. In particular, it remains unclear to what extent the court will allow new provisions to be inserted in line with common practice or terms in modern business leases, where those practices or common

terms did not exist at the time of the original lease. Specific examples include where the tenant wishes to include provisions for uninsured risks or the landlord wishes to include clauses specific to new environmental legislation, such as energy performance certificates or minimum energy efficiency regulations.

From the case law, the following principles can be discerned which can guide the parties seeking to negotiate the terms of a renewed lease.

As a starting point, it was noted in *O'May* by Lord Wilberforce that "there is no obligation, under section 35 of the Act, to make the new terms conform with market practice". It is therefore on the proponent of the term to be included in the lease to persuade the court that it would be fair and reasonable to do so and a shift in market practice will not, in itself, be sufficient.

However, while the court will not alter a lease simply to fit current market practice, market practice can be evidence of what is usually considered fair and reasonable by landlords and tenants (*Edwards & Walkden (Norfolk) Ltd v City of London [2012] EWHC 2527 (Ch)*).

In addition, a factor which may be persuasive in that regard is reference to relevant industry standards and, in particular, the Code for Leasing Business Premises in England and Wales 2007 (2007 Code) (see *Emmett & Farrand on Title at 27.113*). In *Edwards & Walkden*, in relation to the inclusion of a term relating to rent and service charges, the Code of Practice issued by the Royal Institution of Chartered Surveyors entitled *Service Charges in Commercial Property* (2nd ed, 2011) was referred to by Sales J as evidence that the proposed term was fair and reasonable.

Finally, it should be kept in mind that "the court should not generally exercise its discretion under section 35 to change the basic parameters of the commercial arrangement between the landlord and the tenant" (*Edwards & Walkden*). This was the main sticking point in *O'May*: the change in service charges provisions was going to place a significant extra burden on the tenant of the relevant property, which would not be properly compensated by a change in the rent payable pursuant to section 34 of the 1954 Act. Accordingly, if the proposed change is too burdensome on either party, it is unlikely to be accepted by the court.

Applying the above principles, the court may well be willing to consider new clauses specific to new environmental legislation. Clearly, the approach of the court will be dependent on the exact terms proposed (for example, which party will bear the cost of updating premises to be compliant with environmental legislation). Nevertheless, albeit in a different context, the courts have recognised the need for changes to lease provisions to reflect changes in the law since the lease was entered into (*Wallis Fashion Group Ltd v CGU Life Assurance Ltd (2001) 81 P&CR 28*).

As for tenants seeking to protect themselves in the event of uninsured risk, any argument on behalf of the tenants should focus on the fact that it is recognised in the 2007 Code that tenants should be able to terminate their lease where an uninsured risk renders the property uninhabitable.

However, as of yet, the writer is not aware of any reported decision on the application of section 35 in these specific circumstances. It is, of course, desirable to reach an agreement with your opposing side if possible in order to avoid any surprises in court. In addition, it should be noted that it may well be that if a party opposes sensible modernisations to the lease simply on the basis of a dogmatic application of *O'May*, that party will be at risk for costs.

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