

Taking on sub-tenants: lessons for unwilling landlords

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In Ansa Logistics Ltd v Towerbeg Ltd [2012] EWHC 3651 (Ch) a tenant (Ansa) sought to sub-let demised premises to a third party (Ford Motor Company). The landlord (Towerbeg) refused consent on several grounds, including that Ansa had parted with possession in breach of covenant. Ansa sought a declaration that Towerbeg's refusal was unreasonable. Towerbeg brought an additional claim seeking a declaration that Ansa had parted with possession to Ford in breach of covenant. Floyd J held (i) that there was no parting with possession and (ii) that Towerbeg had unreasonably refused consent. Martin Hutchings QC and Simon Atkinson appeared for the successful third party, Ford.

This case makes essential reading for landlords and their advisers. Legally, it highlights the high hurdles landlords must surmount in order (i) to establish an unlawful parting with possession by a tenant and (ii) to prove that they acted reasonably in refusing consent to sub-let. It also testifies to the commercial risks landlords run if, in anticipation of regaining possession, they invest time and money in generating development proposals without having first concluded a binding surrender of the lease with the tenant.

The facts

The facts of this case were of a hue familiar to property litigators. In 2006 Towerbeg purchased the freehold of a site of approximately 42 acres in Speke, Liverpool. The site was subject to two long leases which had been granted by Towerbeg's predecessor in title. The terms of the leases were to run until 2069, with a landlord's option to break in 2043.

The site had been developed in the 1960s for the storage of Ford vehicles. In 1999 Ansa acquired the logistics contract for the storage of Ford vehicles. The leases had been assigned to Ansa as tenant in 2000.

The leases contained the familiar covenant against alienation, forbidding the tenant from (*inter alia*) parting with possession without the previous consent in writing of the landlord, such consent not to be withheld unreasonably.

In 2007 Ford terminated the logistics contract with Ansa, deciding to in-source the work. Ford and Ansa agreed legally-binding heads of terms giving Ford the right to occupy the Speke site "under licence agreements to be agreed". The HoTs also provided a mechanism for Ford to request an underlease. Ford agreed to indemnify Ansa for all reasonable occupation costs which "Ford would incur if Ford were the tenant". On top of the rent and other outgoings, Ford agreed to pay an "Infrastructure Facility Fee" of £680,000 per annum.

Following execution of the HoTs, Ansa employees transferred to Ford under TUPE.

The last Ansa employee left the site in November 2009. One Ansa representative did however remain responsible for the site, and visited it some five times between January 2010 and November 2011. In April 2009 Ford appointed its own manager, based at the site.

In 2009 a rent review was concluded by arbitration on terms favourable to the tenant. In 2010 Towerbeg entered into negotiations with Ansa to surrender the leases. Towerbeg and Ansa agreed HoTs, subject to contract and board approval, under which Ansa would surrender the leases for a consideration of £2.5 million. Towerbeg's agents subsequently undertook site surveys and lodged a planning application with Liverpool City Council.

In May 2011 Ansa and Ford agreed revised HoTs under which Ford confirmed that it required occupation of the site until 2018. In November 2011 Ansa and Ford agreed on the grant of underleases subject to obtaining Towerbeg's consent.

Towerbeg refused consent on four grounds: (i) it had good reason to believe that Ansa was in breach of the alienation covenant; (ii) Ford was insolvent as it had fewer assets than liabilities; (iii) sub-letting would result in a loss in value of Towerbeg's reversionary interest as its prospects of obtaining planning permission would be diminished; and (iv) there would be an adverse effect on the use and value of adjoining land owned by Towerbeg as the prospect of obtaining planning permission for that neighbouring land would be diminished by the sub-letting. Towerbeg served section 146 notices purporting to forfeit the leases.

A second application was made by Ansa in January 2012. Towerbeg again refused consent.

The issues

Floyd J was asked to determine four issues:

- i) Had there been a parting with possession from Ansa to Ford in breach of covenant?
- ii) If so, had Towerbeg waived that breach by accepting the quarterly rent up to September 2011?
- iii) If not, was Ansa entitled to relief against forfeiture?
- iv) If any one or more of issues (i)-(iii) were answered in Ansa's favour (i.e. if the lease were still on foot), had Towerbeg shown that its consent to sub-let was reasonably refused?

The judge found in favour of Ansa/Ford for all but one of the issues. Floyd J held that:

- i) there had been no parting with possession;
- ii) had there been a parting with possession in breach of covenant, he would have found

that Towerbeg had not waived that breach;

iii) had he been required to determine the matter, he would have found that Ansa was entitled to relief from forfeiture; and

iv) Towerbeg had unreasonably refused consent to sub-let.

Parting with possession: a strict test

Floyd J's decision sounds a sage warning to landlords who believe their tenants to be in breach of alienation covenants. It reiterates the very strict nature of the legal test applied by courts. But note: there was no restriction in the leases (which were of some vintage) against parting with or sharing occupation. The focus was parting with possession. Many modern leases contain a restriction on sharing occupation.

The facts of the case were quite extreme. Ansa had no employees on the site. Ford's evidence was that it had introduced its own processes and procedures, it controlled access to the site through a security gate and kept an access log book, and it had introduced its own health and safety procedures. Ford had also undertaken significant improvements to the site at its own cost, including installing a number of new security features. Ford indemnified Ansa "as if it were the tenant". During the rent review proceedings, Ansa had sought Ford's comments and approval for its submissions. Finally, in letters opposing Towerbeg's planning application, Ford's agents had asserted that Ansa could not and did not assume unilateral responsibility for the operational activities on the site and that Ansa was required to consult with Ford before commenting on the operational requirements.

It was Towerbeg's case that, although the 2007 HoTs did not themselves amount to a parting with possession, there was a gradual creep of control by Ford over the site so that by the time Towerbeg served section 146 notices in December 2011 Ford had gone into possession.

Yet Floyd J held that there had been no parting with possession. The judge applied the test laid down in *Stening v Abrahams* [1931] 1 Ch. 470 and *Lam Kee Ying Sdn Bhd v Lam Shee Tong* [1975] AC 247. These cases held that nothing short of a complete exclusion of the grantor or licensor from the legal possession for all purposes amounts to a parting with possession.

Crucial to Floyd J's reasoning was that Ansa retained some responsibilities over the site. Ansa remained the insured party for the site; it did not seek reimbursement from Ford for the insurance premiums. Ansa was a party to a contract with Network Rail governing rail access to the site; this contract had been agreed after the signing of the 2007 HoTs.



Perhaps most importantly, however, Floyd J drew a distinction between exercising control over the business conducted at the site and exercising control over the access of Ansa to the site. He held that much of the evidence relied upon by Towerbeg went to the former and not to the latter type of control. The evidence given by Ford's depot manager was that, if Ansa's representative turned up unannounced on site, he would probably have been let in. Floyd J held that, so far as control over Ansa's access of the site was concerned, the position remained as it had been agreed under the 2007 HoTs, i.e. Ford was merely in occupation.

Waiver: unresolved law

Floyd J's determination of the first issue rendered it strictly unnecessary to deal with the question of whether Towerbeg had waived the breach by accepting rent in September 2011. Nevertheless, Floyd J held that, had it been necessary to decide the point, he would have found that there had been no waiver.

As a matter of law, it is unclear what degree of knowledge of the alleged breach is required by a landlord in order to give rise to a waiver; there are conflicting decisions on this point. Ansa and Ford submitted, in reliance on *Van Haarlam v Kasner Charitable Trust* (1992) 64 P&CR 214, that constructive knowledge is sufficient; i.e. a landlord has a sufficient degree of knowledge if he has notice of circumstances putting him on inquiry as to the breach of covenant and fails to make any inquiries in consequence.

Ansa and Ford relied on letters sent by Ford and other interested parties to Liverpool City Council opposing Towerbeg's planning application as evidence that Towerbeg knew of Ford's interest in the site. They also submitted that Ansa's publicly available accounts disclosed evidence of Ford's interest.

Towerbeg, relying on *Matthews v Smallwood* [1910] 1 Ch. 777, submitted that constructive knowledge was insufficient for establishing waiver. Towerbeg also emphasised in opening that Ansa and Ford were walking something of a legal tightrope: on the one hand, Ansa and Ford were arguing primarily that there had been no parting with possession; on the other hand, these parties were submitting in the alternative that, had there been a parting with possession, Ford's

interest was so obvious that Towerbeg had constructive knowledge of the breach.

Floyd J was content to accept, without deciding the issue, that constructive knowledge was sufficient to establish waiver. He nevertheless held that objectively viewed the facts did not disclose that Towerbeg had good reason to believe that Ansa had parted with possession. It will take another case, taken to the Court of Appeal, to determine whether constructive knowledge of a breach is sufficient for the purposes of establishing waiver.

Relief from forfeiture: salt in the landlord's wound

It was not necessary for Floyd J to consider relief from forfeiture as he had held that there was no breach of covenant. Nevertheless, the judge would have granted relief.

Courts have a broad discretion when considering whether to exercise their jurisdiction to grant relief from forfeiture; each case therefore turns on its own facts.

Towerbeg had pleaded that the breach had been concealed by Ansa and that this was a basis for refusing relief. Towerbeg also pleaded that a declaration by the court that Ansa was entitled to sub-let would in effect ratify the breach. Towerbeg argued that Ansa was an unsatisfactory tenant because (*inter alia*) it had failed to disclose the existence of the infrastructure facility fee during the rent review proceedings.

Floyd J was not convinced by Towerbeg's submissions. The judge held that the alleged breach had not harmed Towerbeg's interests, the breach was not wilful, nor had it been deliberately concealed. He further noted (*inter alia*) that, if relief were to be refused, Ansa would lose an asset of considerable value.

Unreasonable refusal of consent: the final nail

Floyd J held that none of the four reasons advanced by Towerbeg for refusing consent was reasonable.

First, even if Towerbeg had had good reason to believe that Ansa had parted with possession, this would not have been a reasonable basis for refusing consent. The breach was not serious nor wilful nor was it prejudicial to Towerbeg. The breach could have been

remedied by granting consent to sub-let.

Secondly, Ford's financial standing was not a reasonable basis for refusing consent. Ford's accounts disclosed that its assets were exceeded by its liabilities only as a result of the company's long-term pension liabilities. Furthermore, an under-lessee's financial standing is of marginal relevance to the head lessor; the lessee remains contractually liable to the landlord for the rent under the head lease.

Finally, the judge held that Towerbeg's third and fourth reasons for refusing consent did not provide reasonable grounds for refusing consent. Ford could have objected to the planning application whether or not consent to under-let was given and whether or not it was a tenant or licensee. The judge said he had no doubt that the commercial rationale for refusing consent was Towerbeg's desire to develop the site.

Conclusion

This case demonstrates the legal and commercial difficulties landlords face when seeking to recover possession on the grounds that the tenant has parted with possession. The legal test is strict and the scope for granting relief in any event is wide.

Towerbeg had presumably spent considerable time and money in developing a planning application to develop the site into a retail precinct. This application was in fact granted prior to trial. Extensive publicity surrounded the development and the council decision.

Despite the council's approval, however, Towerbeg found itself unable to extricate itself from the lease on commercial terms, nor was it able to recover possession through the courts. Although costs have yet to be assessed, the landlord may well face a considerable legal bill. Its planning permission is of little value with a lease set to run until at least 2043.

Landlords thinking about spending precious resources to develop land to which they do not have a present right to possession would do well to consider the age-old maxim: don't count your chickens before they've hatched.

Click on the link below to download the judgment <http://www.bailii.org/ew/cases/EWHC/Ch/2012/3651.html>



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Martin specialises in all aspects of property litigation but has a particular expertise in dilapidations claims and party wall matters. For many years he has been recommended in both the Legal 500 and Chambers and Partners - the leading 'rankings' publications of the legal profession.



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