NEUTRAL CITATION NUMBER: [2018] EWHC 2065 (Ch)

Claim No. CH-2017-000291

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES (ChD)

ON APPEAL FROM
THE COUNTY COURT AT CENTRAL LONDON
(His Honour Judge Parfitt)
(Claim No. D10CL086)

Royal Courts of Justice
Rolls Building
Fetter Lane
London EC4A 1NL

Date: 24 July 2018

Before :

THE HONOURABLE MR. JUSTICE MARCUS SMITH

- -

H COMPANY 2 LIMITED

Appellant
(Claimant below)

- and -

SPITALFIELDS SMALL BUSINESS ASSOCIATION LIMITED

Respondent
(Defendant below)

- -
- -

Mr. Guy Fetherstonhaugh, Q.C. (instructed by **Wallace LLP**) for the **Appellant** (the Claimant in the court below)
Mr. Edwin Johnson, Q.C. (instructed by **Russell-Cooke LLP**) for the **Respondent** (the Defendant in the court below)

Hearing date: 24 July 2018

- -

Approved Judgment

Mr. Justice Marcus Smith:

1. This is an appeal from the order of His Honour Judge Parfitt dated 20 October 2017. By that order, His Honour Judge Parfitt dismissed the claim brought by the Claimant below and Appellant here, H Company 2 Limited, (the "Appellant") against the Defendant below and Respondent here, Spitalfields Small Business Association Limited (the "Respondent"). The Appellant's claim was dismissed, and the Judge made a declaration regarding the proper construction of clause 8(1) of two leases (the "Leases") that are the subject matter of the appeal before me today.

2. The learned Judge gave a written judgment explaining the basis on which he made his order, which I have read. He refused permission to appeal: but permission was given by Mann J on 13 February 2018.

3. What I have before me is, more or less, a pure question of construction of the rent review provisions in the Leases, which are in materially identical terms, but relate, unsurprisingly, to two different properties.

4. The first property is described as "all those premises situate at and known as numbers 105, 107, 109 and 111 Hanbury Street, London East 1" (the "Hanbury Street Property"). The second property comprises "all those premises situate at and known as numbers 2, 4, 16, 18 and 20 Spelman Street, London East 1" (the "Spelman Street Property").

5. The Leases over the Hanbury Street and the Spelman Street Properties are in materially identical terms. I shall refer only to the Lease in respect of the Hanbury Street Property for the purpose of describing the material terms:

   (1) The Lease was dated 17 May 1982.

   (2) It was between Petrie Estates and the Respondent. The Appellant is the successor in title to Petrie Estates. I need say nothing about how title devolved from Petrie Estates to the Appellant.

   (3) The term of the Lease commenced in 1982, for a term of 99 years. The term therefore expires in 2081.

   (4) The Lease, unsurprisingly, made provision for the payment of rent. That rent was stepped, in that in the early years, it rose in accordance with the provisions set out in the operative clauses of the Leases.

   (5) The Lease contains a rent review provision at clause 8. Clause 8 comprises five sub-clauses. It is not necessary for me to read out clauses 8(2) through to 8(5). These deal, in fairly standard terms, with the mechanics for the computation of the rent review. It is clause 8(1) that we are concerned with today. Clause 8(1) provides as follows:

   > "At any time not earlier than twelve months prior to the Twenty-fifth day of March Two thousand and fifteen and the Twenty-fifth day of March Two thousand and forty-eight the Landlord may give to the Tenant three months' written notice of its desire to revise the said yearly rent hereby reserved and calling upon the Tenant to pay a yearly rent equal to sixty

per centum (60%) of the fair market rack rental (determined as provided in sub-clause (2) and (3) of this clause) for the parts of the Demised Premises that shall not at the date of review have been underlet at a peppercorn or ground rent (hereinafter called "the Commercial Parts")."

(6) There is a power on the part of the tenant (the Respondent) to underlet. There is a limited restriction on alienation which is contained at clause 2(13). This provides that during the last seven years of the term of the Lease, the tenant may not assign, underlet or part with or share the possession of whole or part of the demised premise without the previous written consent of the landlord, such consent not to be unreasonably withheld and provided that the sub-clause shall not prohibit the letting of residential units within the demised premises on periodic tenancies.

6. In this case, we are concerned with lettings, underlettings and sub-underlettings. The Respondent's skeleton, in para.3.14, helpfully says this:

"A series of underlettings can be created in respect of the same property. Technically it might be said that in such a case there is an underletting a sub-underletting and a sub-sub-underletting and so on. However, they are all underlettings."

7. I am going to bear in mind and differentiate between "lettings", "underlettings", "sub-underletting" and so on because I consider the differentiation of such concepts to be helpful in this case. It is a distinction that I consider important to bear in mind. However, I also bear in mind, and I accept, that "underlettings", "sub-underlettings" and so forth can generically and generally be described as "underlettings".

8. It is, of course, also possible to describe underlettings in terms of reversions, as where an underlease is inserted between an existing lease and what becomes a sub-underlease. However, I do not find such language helpful, in this case at least, and I will try to avoid it.

9. For the purposes of this appeal, the rent review date was 25 March 2015. As at that date the Leases and the underlettings under those Leases were structured as follows:

(1) The Leases, as I have described, were dated 17 May 1982.

(2) Next, not chronologically but in terms of the relationship between the various leases, underleases and sub-underleases, come two Underleases in relation to each Lease, each dated 9 October 2014. These Underlease were granted by the Respondent to SSBA Community Services for a term of years commencing 9 October 2014 up to and including 20 March 2081. In each case, the Underleases provided for a peppercorn rent to be paid. I am going to refer to these two instruments as the "Underleases". The Underleases, I should stress, were in relation to the entirety of the "Demised Premises", as that term is defined in the Leases.

(3) Underneath the Underleases there come, in relation to both Properties, what I am going to term "Residential Sub-Underleases" and "Commercial Sub-Underleases". These Sub-underleases, I stress, were in relation to parts of the Demised Property. It is not necessary for me to describe exactly which parts of each Property were subject to the Residential Sub-Underlease and which parts were subject to the Commercial Sub-Underlease. It is simply necessary to say this:

(a) As regards the Residential Sub-Underlease of parts of each of the two Properties, that Sub-Underlease began life on 17 May 1982. In each case, the rent was a yearly rent of one red rose, if demanded. I have no idea as to whether underneath this Residential Sub-Underlease there are further residential sub-sub-underleases.

(b) So far as the Commercial Sub-Underleases of parts of the two Properties are concerned, there is some greater detail provided in the exhibits to a witness statement of Ms. Edith Okoth-Awuor, made on behalf of the Respondent. These exhibits schedule the various tenancies to which the two Properties in question are subject. Ignoring, for the moment, the Lease and the Underlease that I have described, the Hanbury Street Property is subject to three commercial tenancies which are described more particularly in the schedule. Two are dated 1991. The third is dated 1999. Each provides for a rolling monthly tenancy agreement with a substantial rent payable. So far as the Spelman Street Property is concerned, the position is largely the same, save that the commercial tenancies are later in time. They stem from 2007, 2008 and 2014, and again they are rolling monthly tenancies with a substantial rent payable.

10. It is clear and not contested between the parties before me that the Underleases, as I have defined them, affected relations between the parties in the chain of Underleases and Sub-Underleases that I have described. In effect, the identity of the landlords and tenants in the chain changed, as did the parties to whom rent was payable and who were obliged to pay rent.

11. Furthermore - and again this was common ground - it is fairly obvious that the Underlease which post-dates all of the other instruments that I am considering was inserted with a view to altering the effect and operation of the clause 8(1) rent review provision. I stress, it is not suggested that the Underlease was executed as a sham or that it was in any way improper. It was expressly conceded by the Appellant that the Underlease was properly made under the terms of the Leases.

12. The sole question before me is whether the execution of the Underleases in this case does or does not affect the operation of clause 8(1) in the case of each of the Leases.

13. Before turning to what I consider to be the essential point of construction, I should begin by clearing the decks of what I do not consider assists me in terms of construction of the Leases.

14. Both parties, more for convenience than anything else, used by way of shorthand the terms “commercial” and “residential” to describe different parts of the two Properties in question. Although I regard that as a useful shorthand, I should say that for purposes of construction I gain no assistance from a distinction between “commercial” and “residential” property. It is true that clause 8(1) uses the defined term "the Commercial Parts”. However, that term simply describes those parts of the Demised Premises that are subject to the rent review under clause 8. In other words, we have here a definition that is entirely contingent or dependent upon which parts of the Demised Premises are not, as at the date of the rent review, underlet at a peppercorn or ground rent. In other words, there is a purely binary definition which informs the meaning of “Commercial Parts” which turns on the nature of the rent (peppercorn or ground) on which some or all of the

Demised Premises are let. I appreciate that the parties may well, as a matter of a description of the Properties, differentiate between residential and commercial uses, but that is a differentiation that has no resonance in the Leases for the purposes of construction.

15. The second area which I want to clear out of the way as being of no assistance is the history of the letting of the Demised Premises. I include in that the costs incurred by the Respondent in refurbishing the premises and the basis upon which the Appellant's predecessor in title sought to facilitate this by way of stepped rent and infrequent rent reviews. It seems to me that to construe the Leases in line with the perceived balance of reward or costs between the parties is asking for trouble. The views of the parties involved are likely to be subjective and certainly do not emerge clearly as any part of the factual matrix for the purposes of construction.

16. Thirdly, I disregard as inadmissible what was in the minds of the parties at the time of the Leases and subsequently. That, to my mind, is entirely irrelevant though, to be fair, I should say that neither party pressed me very hard to take such subjective expressions of intent into account: I was referred to one letter, which suggested a construction of clause 8(1). I have, for the reasons I have stated, not found that a helpful reference.

17. I was referred to various authorities. Most related to the manner in which a court should attach weight to and construe labels in contracts. I accept that, in an appropriate case, the construction of labels and the meaning to be attached to them is important. In this case, however, for the reasons that I have given, the label or term "Commercial Parts" is so closely intertwined with the meaning of clause 8(1) itself that I consider that it is possible to disregard the label and focus on the substance of the provision in clause 8(1). That is what I propose to do.

18. I was referred to the Supreme Court's decision in *Arnold v Britton* [2015] UKSC 36, in particular [17] and [20]. These paragraphs state very clearly that a court seeking to construe a contract should not be over-impressed by arguments based upon commercial sense, when the language of the agreement is otherwise clear. At [17], the Supreme Court said:

> "First, the reliance placed in some cases on commercial common sense and surrounding circumstances…should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision."

Obviously, I accept that I must construe the words of the relevant provision, but clearly I must also do so in the context of the Leases that were agreed.

19. I therefore proceed to the construction of clause 8(1). The issue before me can be shortly stated. Can the Respondent, by the interposition of the Underlease, convert what were "Commercial Parts" into "non-Commercial Parts" of the Demised Premises simply by ensuring that the Underlease is at a peppercorn rent? I stress, as I have already noted,

that it is accepted on both sides that there is and was no bar on creating the Underlease on the terms granted.

20. The language of clause 8(1) compels me to look at matters as they stood at the "date of review", in this case 25 March 2015. I am not permitted to look to the history. I must look to the parties to the various Underleases as they stand or as they stood on that date. I must ask myself which parts of the Demised Premises have not been underlet at a peppercorn or ground rent?

21. It was common ground that if this negative requirement was met, then those parts fell outside the clause 8(1) rent review.

22. I referred earlier in this Judgment to the ambiguity in the term "underlet". That ambiguity can be unpacked as follows:

Does the term in clause 8(1) refer to <u>all</u> underlettings in the chain - Underlease, Sub-Underlease, Sub-Sub-Underlease and further, as the case may be - or only to an underletting by the "Tenant" as that term is defined in the Leases?

If the latter is the case, then this appeal must fail because all of the Demised Premises are underlet at a peppercorn or ground rent. If, on the other hand, the former is the case, then this appeal must succeed, at least in part. I say "in part" because it is clear that so far as the Commercial Sub-Underleases are concerned, because an underlease in the chain is at other than a peppercorn or ground rent, that attribute brings that part of the Demised Premises outside the negative condition and causes the rent review provision to apply.

23. I have considered most carefully whether there is a *tertium quid* that differentiates between, in non-Lease terms, commercial and residential property. I do not consider that there is, or that there can be, and that is for the very good reason that this is a distinction that is not drawn by clause 8(1) itself. I conclude, therefore, that clause 8(1) applies to the Demised Premises whether, in colloquial terms, those premises are "commercial" or "residential".

24. I turn, then, to which is the true construction in relation to the two alternatives that I have articulated. I hold that, on the true construction of clause 8(1), the negative condition is referable to <u>any</u> underletting, including an underletting to which the Respondent is not a party, as is the case with the Sub-Underleases. I reach this construction and this conclusion for the following reasons:

(1) In my judgment, this is the natural meaning of clause 8(1). Clause 8(1) refers to the underletting of the Demised Premises, which means, on a natural reading of these words, <u>any</u> underletting. To get to the Respondent's construction, it is necessary to read into the clause, after the word "underlet" the words "by the Tenant", which would serve to confine the relevant Underlease to one entered into by the Tenant and would render irrelevant underleases further downstream. It seems to me that if the parties had intended clause 8(1) to have this narrow effect, they could easily have said so.

(2) The broader construction of clause 8(1) that I consider to be the correct one avoids the gaming of the rent review provisions in that clause. The construction contended for by the Respondent means that the mere interposing of an underlease of the entire

Demised Premises at a peppercorn rent causes all of the demised premises to fall outside the scope of the rent review. Given the rents that were being received from - and I use the term colloquially - the commercial parts of the Properties from the inception of the Leases, it seems to me unlikely that the parties could have intended so uncommercial a construction. Indeed, I consider that a construction that enables a rent review provision to be so easily circumvented and rendered nugatory is unlikely to be the natural construction of the Leases.

(3) Of course, I accept that the consequence of this construction is that the so-called residential parts of the Properties may fall within the rent review. I say "may" because I do not know the terms of all of the chains of Leases, Sub-Leases etc.in the residential leasing of the Demised Premises. But if, at some point in those chains, there is a rent that is not peppercorn or ground rent, then in my judgment the rent review provisions bite.

25. It was suggested by the Respondent that this was an odd outcome, the oddity being this: the Respondent would be subject to rent review whilst receiving itself only a peppercorn rent. I bear in mind that the residential Sub-Underleases are for essentially the same terms as the Leases and began at the same time, yet they are at a yearly rent of a red rose. So, the Respondent will receive each year, if it so insists, a red rose, but subject to the nature of the rents downstream, will potentially pay a rent adjusted by the provision of clause 8(1).

26. There are a number of answers to this so-called oddity. The basis upon which the downstream rents are payable was ultimately one for the Respondent. The Respondent may well wish no-one to pay anything other than a peppercorn rent, in which case, of course, there will be no rent review. But if, for no doubt good reason, a situation is engineered where someone down the line receives more in rent than they pay, then the question arises: who should pay for this charity? I do not consider that the answer to this question of who bears the economic cost of someone else's charity is that it should be the Applicant. To the contrary: the rent review provisions, in their infrequency and their level, suggest that the landlord under the terms of the Leases is bearing some of the cost of providing low rents to those in the Demised Premises, but not the entirety of that cost. It is the Tenant, in greater control of the process, who should bear this cost should it arise.

27. I did consider whether the lack of transparency down the chain might render the construction that I favour unworkable. I do not, however, consider that this is the case. There are adequate mechanics for conducting a rent review in clauses 8(2) to 8(5) and I remind myself that the only question before me is the binary one of whether or not a peppercorn or ground rent is payable.

28. Finally, I should say that I was not assisted by suggestions that the rent review provision in clause 8 might be rendered nugatory by using other methods, for example by vacating the Demised Premises on the date of review. It seems to me that other potential but unrelated flaws in the clause 8(1) mechanism do not assist me in construing the effect of the interposition of an Underlease, as is the case here.

29. It follows from this that the appeal must be allowed, and the Appellant is entitled to a declaration that on the true meaning of clause 8(1) "underlet" refers to any underletting of the Demised Premises whether by the tenant or not. I will leave the precise terms of the order, and any declaration, to be framed by the parties.