

LAW REPORT

Act provides exit route from tenancy liabilities

HOUSE OF LORDS

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London Diocesan Fund and Another v Phithwa and Others, Avonridge Property Co Ltd, Part 20 defendant

Before Lord Nicholls of Birkenhead, Lord Hoffmann, Lord Scott of Foscote, Lord Walker of Gestingthorpe and Baroness Hale of Richmond
Speeches December 1, 2005

THE OBJECT of the Landlord and Tenant (Covenants) Act 1995 was to introduce means whereby on lawful assignment of a tenancy or reversion, and irrespective of the terms of the tenancy, the tenant or landlord would have an exit route from his future liabilities. The legislation was not intended to close any other exit route which had been included in the terms of the tenancy itself.

The House of Lords so held, Lord Walker dissenting, allowing an appeal by Avonridge Property Co Ltd from the dismissal by the Court of Appeal (Lord Justice Pill, Lord Justice Jonathan Parker and Lord Justice Hooper) ([2005] 1 WLR 236) of its appeal from Judge Copley at Willesden County Court on December 11, 2003, giving judgment for the sublessees: Amit Mashru, Dilipkumar Raithata, Citicore Investments Ltd and Purshottam Walji.

Mr Mark Warwick for Avonridge;
Mr Nathan Wells for the sublessees.

LORD NICHOLLS said that in February 2002, Avonridge acquired by assignment a lease of seven small shop units at Wealdstone, Middlesex. The lease was for a term of 99 years expiring in 2067, at an annual rent of £16,700 subject to review.

Avonridge granted subleases of six of the shops for substantially the same terms as its own lease, or headlease as the lease then became. Each sublease was at a peppercorn rent. The sublessees paid Avonridge substantial premiums of the order of £75,000 for each of their subleases.

Each sublease contained in clause 6, a landlord's covenant for quiet enjoyment and for payment of the rent reserved by the headlease.

The words of the covenant read: "The landlord covenants with the tenant as follows (but not, in the case of Avonridge Property Co Ltd only, so as to be liable after the landlord has disposed of its interest in the property)..."

In April 2002 Avonridge assigned the headlease to a Mr Dhirajal Phithwa, who was a man of straw. He disappeared leaving unpaid the rent due under the headlease.

The headlessor, the London Diocesan Fund and the Parochial Church Council of Holy Trinity, Wealdstone, commenced forfeiture proceedings. The subtenants were granted relief on unexceptional

terms: they had to pay the rent arrears under the headlease with interest and costs, and take new leases of their individual units.

The new leases were for the same term as their former subleases and at a rent equal to an apportioned part of the rental payable under the forfeited headlease.

That meant that for the future, under the new leases the former subtenants had to pay an annual rent of £2,376 or, in one instance, £2,442. That was to be contrasted with the nominal rent payable under the subleases they had bought from Avonridge.

The subtenants brought proceedings against Avonridge, claiming damages for breach of the landlord's covenant in clause 6 of their leases.

His Lordship said that Avonridge's case was not overburdened with merit. On their face, the transactions had the appearance of a scam.

The sublessees' security and the value of their subleases depended on the strength of the sublessor's covenant to pay the headlease rental.

But Avonridge could end its liability to pay that rent at any time. There was, it seemed, no restriction on the assignment of the headlease.

If Avonridge assigned the headlease, its liability as tenant of that lease would end automatically, by virtue of section 5 of the 1995 Act.

Its limited liability as landlord under the subleases would also end automatically by virtue of the limited terms of the landlord's covenant in clause 6 of the subleases.

An assignee of the headlease from Avonridge would, of course, become liable to the headlessor in respect of the tenant's covenants in the headlease.

An assignee would also become liable to the sublessees in respect of the landlord's covenant in clause 6 of the subleases. In each instance that liability would arise by virtue of privity of estate.

But no one of financial substance would take an assignment of the headlease and thereby incur liability to pay rent of £16,700 a year to the head lessor save on payment of a substantial reverse premium. No one would do so because the property for which rent was payable was let on correspondingly long subleases yielding no rental income.

Thus the overall position was that Avonridge received premiums from the subtenants totalling altogether £458,500 in exchange for subleases which from their inception were essentially valueless because by its own act of assignment to a worthless assignee.

Avonridge could at any time put the subleases in jeopardy of forfeiture without incurring any liability either to the head lessor or to the subtenants. From the outset it was in Avonridge's financial interest to take that course as soon as possible. It lost no time in doing so.

The subtenants submitted that clause 6 of the covenant in each sublease was an "agreement relating

to a tenancy" within the meaning of section 25(4) of the 1995 Act.

But did that agreement frustrate the operation of any provision of the Act and was thereby void under section 25(1)?

The subtenants submitted that it did. His Lordship was unable to agree. Sections 5 to 8 were relieving provisions intended to benefit landlords or tenants as the case might be. That was how they were intended to operate.

Those sections introduced a means, which could not be ousted, whereby in certain circumstances, without the agreement of the other party, a tenant or landlord could be released from a liability he had assumed.

The object of the legislation was that on lawful assignment of a tenancy or reversion, and irrespective of the terms of the tenancy, the tenant or landlord should have an exit route from his future liabilities. That route should be available in accordance with the statutory provisions.

Thus the mischief at which the statute was aimed was the absence in practice of such an exit route. Consistently with that, the legislation was not intended to close any other exit route already open to the parties: in particular, that by agreement their liability could be curtailed from the outset or later released or waived.

The possibility that by agreement the parties might limit their liability in that way was not, it seemed, perceived as having unfair consequences in practice, even though landlords normally had greater bargaining power than tenants.

So there was no call for legislation to exclude the parties' capacity to make such an agreement, ending the liability in circumstances other than those provided in the Act.

Section 25 was, of course, to be interpreted generously, so as to ensure the operation of the Act was not frustrated, either directly or indirectly. But there was nothing in the language or scheme of the Act to suggest the statute was intended to exclude the parties' ability to limit liability under their covenants from the outset in whatever way they might agree.

An agreed limitation of that nature did not impinge upon the operation of the statutory provisions. That was so whether the agreed limitation was included in the lease itself or was in a separate document by way of waiver or agreement to release.

Where a covenant was expressed to be "personal to any person", section 3 of the 1995 Act did not make the covenant enforceable by, or as the case might be, against any other person. The covenant in clause 6 did not fall within that personal category.

It was intended to endure throughout the term of the sublease and be binding on Avonridge's assigns. Nothing in section 3 precluded the parties from limiting the liability of the original covenantor in that way.

Lord Hoffmann, Lord Scott and Lady Hale agreed. Lord Walker delivered a dissenting speech.

Solicitors: Philippsohn Crawfords Berwald; Gattas Denfield, Harrow.