

## Welcome

Welcome to the Winter 2011 edition of the Real Estate update.

Recent months have continued to pose challenges within the property market and legal news continues to reflect that. This edition focuses on the issues facing both landlord and tenant and our article, 'Outlook: gloomy with patches of intermittent sunshine' gives some practical tips and lessons we can take from case law and current practice, to enable you to maximise the benefit of any opportunities which do arise.

A recent case highlights the importance of considering all possible outcomes when documenting a transaction and this is discussed in Iain Davies' article, 'To pay or not to pay ...?'

Finally, more advice for landlord and tenants in 'What is vacant possession?' A seemingly straightforward question which recently exercised the Court of Appeal in *NYK Logistics (UK) Ltd -v- Ibrend Estates* when it considered the case of a tenant who exercised a break clause but who failed to complete dilapidations works by the specified date.

I hope you enjoy the current update and please continue to let me or your Gateley contact have your feedback. This will ensure that we continue to bring you features of most relevance to you and your business.

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## Outlook: gloomy with patches of intermittent sunshine

Whilst turbulent and challenging economic conditions continue, the Real Estate unit can work in partnership with you to maximise opportunities and minimise the risks arising from the market within which we are currently operating. Landlords face a number of challenges.

### Tenant failure to pay rent/breach of lease covenants

- Paramount landlord concerns are: securing payment of the rent; whether another party can be held liable in the event of failure to pay; and ensuring it can get the property back. Options include forfeiture and suing for outstanding rent. The latter alternative can be problematic in itself if there is a failing tenant;
- Once the tenant has become insolvent, the options become more limited and leave of the court is often required before action can be taken. Interruption of the rental stream through insolvency can cause catastrophic problems not only for the tenant but for the landlord and any bank relying upon the income. The case of *Goldacre (Offices) Limited -v- Nortel Networks UK Limited* brought some welcome clarity for landlords in the context of administration. It confirmed, much to landlords' relief, that where an administrator uses a company's premises, (even if only a very small part), the whole rent is payable as an expense of the administration. Following *Goldacre*, if a company in administration is in occupation on the quarter day, it is still liable for the full quarter's rent even if it vacates the premises on the day following the quarter day.



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## Other commercial considerations

Many landlords want to avoid taking the property back from a failing tenant. Landlord considerations include:

- Whether the tenant is good for outstanding rent and other costs including dilapidation claims;
- Time and cost involved in getting the property ready to be re-let;
- The costs of holding an empty property (including empty rates liability);
- The likelihood of successfully re-letting the property in the near future and associated costs. A recent case highlighted the problem of getting the property ready to be remarketed because of the vulnerable residents;
- The location of the property in the local market. Some properties will appeal to a wider class of tenant and in such instances the landlord may feel more comfortable taking the property back.



## Landlord checklist

- Check whether rent or other sums payable under the lease can be claimed from previous tenants, in particular, where the lease predates 1996. Are there any guarantors or previous tenants under authorised guarantee agreements? Consider their respective covenant strength;
- Query whether there are any rent deposits or parent company guarantees;
- Where the property is sub-let and the head tenant is not paying the rent, the landlord can require the sub-tenant to pay its rent direct to it rather than to the tenant. If the tenant goes into insolvency with an existing sub-tenancy in place, it is possible for the landlord to serve a rent diversion notice requiring the sub-tenant to pay rent to the landlord until such time as the landlord's arrears are discharged. However, landlords should consider the financial implications of a redirection of rent, as depriving a head tenant of sub-lease rental income may well cause greater long

term financial difficulty leading to potential loss of the head tenant through liquidation;

- Consider temporary arrangements. A struggling tenant may want a reduced rent or rent free period or to pay rent on a monthly basis. Landlords should take legal advice before agreeing to any changes to ensure that everything is properly documented, otherwise there is a real risk that the landlord's position and its usual remedies will be prejudiced.

## Lessons for the future

Proactive property management is the key to ensuring a decent property yield. That, coupled with the benefit of seeking good advice when granting leases, should be of fundamental importance to landlords. Proper due diligence into the tenant is essential although a healthy balance sheet at the start of the lease is no guarantee that the tenant will remain financially sound throughout the lease term. Many of the companies that have gone into administration in the past few years were not of weak or questionable covenants until the current economic downturn started, for example, Woolworths and Focus DIY. Careful consideration should be given to rent deposits, parent company or personal guarantees from directors or a bank guarantee. Any break option must be carefully drafted.

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## To pay or not to pay ...?

That was the question which exercised the Court of Appeal in *Makram Barsoum Estafnous -v- London & Leeds Business Centres Ltd* [2011] EWCA Civ 1157. Although straightforward on the face of it, in the event, the court declined to find that an estate agent was entitled to commission under an agreement which provided for the payment of commission on the sale of a property, despite a transaction having taken place. But why?

### The facts

The case concerned one Mr Estafnous, an estate agent who had his offices within a building, Regent House, which the owner, LLBC, wanted to sell. It was agreed that LLBC would pay Mr Estafnous a not inconsiderable commission of £2 million in return for the agent introducing a buyer.

The short contract which was subsequently drafted stated:

'LLBC ... agrees ... that on completion of the sale of the property to the intending buyer [a Mr Kapoor] or any party related to or associated with that party LLBC will pay Mr Estafnous the sum of £2 million pounds sterling

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notwithstanding any variations in the stated purchase price.'

During the negotiations that followed, it was agreed that Kapoor would purchase the shares of the company which owned the property, rather than the property itself. The transaction ultimately completed on the basis of a share sale agreement and therefore ownership of the property remained where it had always been – with LLBC.

It was acknowledged that on a literal construction of the agreement, the share sale did not trigger the obligation on LLBC to pay the commission to Mr Estafnous. However, he argued that a 'looser interpretation' should be adopted. He had, he said, introduced a buyer who had obtained effective control and ownership of Regent House.

There was no doubt that Mr Estafnous had, indeed, kept his part of the bargain. However, the court held that there was no ambiguity in the agreement which clearly envisaged a transfer of ownership of the property. In the absence of ambiguity, there was no room for the court to imply terms to result in the outcome Mr Estafnous sought. 'This is,' the court stated, 'one of those cases where those involved did not think about what was to happen in certain circumstances, namely if the property sale were restructured as a share sale'.

The court accordingly concluded that on the true construction of the agreement and in the circumstances of the transaction, Mr Estafnous was not entitled to the £2m commission.



## A contract which meant what it said

The agent's solicitors had envisaged in their drafting that the purchase might be made through an associated entity and also provided for the possibility of a price change. However, they did not provide for the eventuality which in fact occurred. The court acknowledged that this was unsurprising in the circumstances, as the agreement was reached against a background of a deal already struck - a land transaction - subject to contract.

The decision clearly highlights the importance of considering all possible outcomes when documenting a transaction and wherever possible, providing how each may be dealt with. Where the stakes are high, a little forethought can go a long way.

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## What is vacant possession?

The term 'vacant possession' is used almost every day of the week by real estate practitioners. Most properties are sold with 'vacant possession' or subject to specific leases.

The concept of vacant possession was recently analysed by the Court of Appeal in *NYK Logistics (UK) Limited -v- Ibrend Estates BV* where a tenant failed to comply with a break clause requirement for vacant possession. In an unstable property market it is common for tenants to seek to reduce overheads by 'breaking' leases and sourcing alternative premises.

### The facts

In the *NYK Logistics case*, NYK was the tenant of warehouse premises and Ibrend was the landlord. NYK enjoyed the right to determine the lease on April 3 2009. It was a condition of the break that vacant possession was provided by NYK by the break date.

After service of the break notice, discussions took place between the landlord and tenant as to the carrying out of works pursuant to a terminal schedule of dilapidations served by the landlord just over three weeks before the break date. It was not a condition of the break that the works be carried out in order for the lease to come to an end at the break date.

Realising that it would not be able to complete all the works before 3 April, the tenant suggested that it be allowed a further week beyond the break date to complete the works. It offered to hand the keys back (so that the landlord could have access) and to continue to pay for security guards until the works were complete. The landlord did not respond conclusively to these suggestions and the tenant's contractors entered the property after the break date in order to carry out the necessary repairs, which took four days to complete.

### Issue

Had the tenant complied with the conditions for operating the break clause? In this case, delivering up with vacant possession.

## Held

The court concluded that the tenant had not delivered up vacant possession of the warehouse in time. It was a relatively simple case of the tenant overstaying its tenure: because the tenant had continued to use the premises for its own purposes (to complete repairs and so avoid a damages claim that might exceed the cost of the works) beyond the break date, it had failed to hand back vacant possession. Although the tenant's approach had seemed logical and sensible, it required the landlord's consent which had not been forthcoming. The safest course of action would have been for the tenant to move everyone out of the property, including the security guard, and deliver the keys to the agent.

## Vacant possession tests

There are three possible tests for deciding whether or not vacant possession has been given:

- The 'empty of people' test. As well as being empty of people, the property needs to be free from the rights of third parties to occupy the property. Consider the activities of the person who is required to give vacant possession. For example, a house seller who continues to keep his furniture in the house or a commercial seller who continues to use the property will not have given vacant possession;
- The 'empty of chattels' test (any item left must not substantially interfere with the landlord's possession of a substantial part of the property). It is a question of fact and degree as to whether the interference is 'substantial'. The interference must be more than trivial. For example, one leading case cited as authority for the proposition that a seller who leaves waste on the premises does not deliver vacant possession is *Cumberland Consolidated Holdings Limited -v- Ireland [1946] KB 264* where a property had been left with a basement full of rubbish including sacks of hardened cement. That case is an exceptional case where a substantial impediment had been left behind. However, a few black bins of rubbish left behind by a tenant ought not to prevent the delivery of vacant possession;

- The 'can the landlord obtain immediate and exclusive occupation and control of the property?' test.

## Comment

It is well known that if a break right has been drafted as a conditional break, absolute satisfaction of the pre-conditions of the clause is essential. A tenant who is subject to break conditions requiring performance of a repairing obligation and/or delivery of vacant possession, needs to be advised to make arrangements for a planned and timely departure from the premises by the break date, and of the serious consequences of failing to do so. There is no right for a tenant to remain at the premises after lease determination in order to finish off outstanding works of repair.

Any party seeking to provide vacant possession must pass the tests detailed above and in particular:

- Leave by the break date and ensure that any third parties have left the property;
- Remove all goods from the property (tables, chairs, pallets, concrete, rubbish);
- Stop providing security for the property;
- Hand the keys over to the landlord/ landlord's agent.

The simplest piece of advice following the *Ibrend* case is: 'If in doubt get out and take it all with you'.

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