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Discussion Paper No 117



Discussion Paper on Irritancy in Leases of Land

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NOTES

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¹ Amended by the Scotland Act 1998 (Consequential Modifications) (No 2) Order 1999 (S.I. 1999/1820).

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TABLE OF ABBREVIATIONS

- Draft Title Conditions (Scotland) Bill Consultation Paper*
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Encyclopaedia of Scottish Legal Styles (10 Volumes, Edinburgh, 1935-40)
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- Scot Law Com DP No 112
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- Scot Law Com No 75
Scottish Law Commission, Report on *Irritancies in Leases* (Scot Law Com No 75) (1983)
- Scot Law Com No 165
Scottish Law Commission, Report on *Leasehold Casualties* (Scot Law Com No 165) (1998)
- Scot Law Com No 168
Scottish Law Commission, Report on *Abolition of the Feudal System* (Scot Law Com No 168) (1998)
- Scot Law Com No 171
Scottish Law Commission, Report on *Penalty Clauses* (Scot Law Com No 171) (1999)
- Scot Law Com No 176
Scottish Law Commission, *Sixth Programme of Law Reform* (Scot Law Com No 176) (2000)
- Scot Law Com No 178
Scottish Law Commission, Report on *Jurisdictions under the Agricultural Holdings (Scotland) Acts* (Scot Law Com No 178) (2000)
- Scot Law Com No 181
Scottish Law Commission, Report on *Real Burdens* (Scot Law Com No 181) (2000)
- Scottish Executive, *Agricultural Holdings Proposals for Legislation*
Scottish Executive, White Paper, *Agricultural Holdings Proposals for Legislation* (2000)
- Stair Memorial Encyclopaedia
The Laws of Scotland: Stair Memorial Encyclopaedia (25 volumes, Edinburgh, 1987-96)
- Tolley's Claims to the Possession of Land*
Tolley's Claims to the Possession of Land (edited P Walter and B McGuire) (London, first issued Oct 2000)

Part 1 Introduction

Background

1.1 Irritancy is a remedy available to a landlord in the event of a breach of contract by his tenant, allowing the landlord to terminate the lease prematurely. Certain rights of irritancy are implied by law and others may be contractually stipulated by the parties. In order to be effective, an irritancy requires to be followed by an action of extraordinary removing, unless the tenant agrees to remove from the subjects of lease.¹ Upon irritancy, the tenant forfeits all his rights under the lease and has no claim for compensation unless the contract provides otherwise. It is therefore a powerful remedy with important consequences for both parties.

1.2 The common law of irritancy is subject to the statutory restrictions contained in sections 4 to 7 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 ("the 1985 Act"). These sections provide, in relation to commercial leases, a degree of protection for tenants against the penal enforcement of irritancies in leases by stipulating a notice procedure and broadening the court's common law power to grant relief from abuse or oppressive use of irritancies in certain circumstances. For ease of reference, sections 4 to 7 of the 1985 Act are reproduced as Appendix 4.

1.3 The 1985 Act reforms implemented recommendations made by this Commission in its Report on *Irritancies in Leases* published in February 1983² following upon judicial concern expressed about the effects of the operation of the common law of irritancy in *Dorchester Studios (Glasgow) Ltd v Stone*.³

1.4 Views have subsequently been expressed that the protection available under the 1985 Act is unduly limited. Subsequent litigation has illustrated that there still exists the potential for seemingly harsh results.⁴ The House of Lords has voiced fears as to whether the law of irritancy in Scotland may act as a deterrent to investment in Scottish commercial property.⁵ Their Lordships also raised the question whether irritancy clauses for non-payment of rent in long term investment leases were a proper reflection of current social policy.⁶ A more detailed description of the common law prior to 1985, the 1985 Act reforms and subsequent judicial commentary is given in Part 3 of this paper.

1.5 In the light of such judicial comment, we recently considered the question of irritancies in our review of penalty clauses.⁷ On balance, we decided that it would be more appropriate to consider irritancy clauses in leases of land as a separate topic, rather than to focus solely on the potentially penal effects of such clauses.⁸ Accordingly, we included a study of this area of the law as a medium term project in our *Sixth Programme of Law Reform*

¹ In practice, these two stages are combined in a single action for declarator of irritancy and removing.

² Scot Law Com No 75.

³ 1975 SC (HL) 56.

⁴ See litigation involving *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1992 SC (HL) 104; 1997 SLT 260; 1998 SC (HL) 90 and *Aubrey Investments Ltd v D S Crawford Ltd* (In Receivership) 1998 SLT 628.

⁵ See Lord Jauncey 1992 SC (HL) 104 at p 127.

⁶ *Ibid* at p 126.

⁷ See Scot Law Com No 171, paras 5.10ff.

⁸ *Ibid*, paras 5.15-5.16.

as part of our work on the law of obligations.⁹ It is our intention to report on this matter during the life of our *Sixth Programme*.

Scope of this Project

1.6 **General.** In our Report on *Penalty Clauses* we recommended that only irritancies in leases of land should be excluded from our proposed judicial control over contractual penalties.¹⁰ So, for example, irritancies in relation to leases of moveables, eg machinery, are governed by the recommendations in that Report. We therefore start our examination of this topic from this premise and are concerned solely with irritancy clauses in leases of land. Such leases can be classified as follows.

1.7 **Agricultural Leases.** Our previous consideration of the law of irritancies was restricted in scope. Our reference from the Secretary of State for Scotland directed us to consider "the operation of irritancy clauses in leases of commercial and industrial property (including leases of land for commercial or industrial development) and on related matters."¹¹

1.8 We interpreted this reference as applying to agricultural leases but excluding small landholders, statutory small tenants, crofters and cottars who are statutorily protected tenants *sui generis*.¹² However, in implementing our proposals, Parliament extended the scope of the exclusion to cover land comprising an agricultural holding within the meaning of the Agricultural Holdings (Scotland) Act 1949.¹³ Accordingly, protection in the 1985 Act does not extend to tenancies of such land.¹⁴ In explaining the amendment in debate, the Solicitor-General advised that on consultation both the Scottish Landowners' Federation and the National Farmers' Union took the view that the existing legislation governing agricultural holdings was preferable to the application of the proposals contained in the Bill. He concluded that as there was no pressure for reform in this area and that as specialised legislation already regulated security of tenure in such cases, such leases should be excluded from the scope of the reforms.¹⁵

1.9 However, representation has been made to us that any proposals for reform should be extended to cover leases of agricultural holdings and that we reconsider whether tenants of such leases should continue to be excluded from the statutory protection. Accordingly, the application of the law of irritancy to leases of agricultural holdings and our proposals for reform are considered in detail in Part 6 of our paper.

1.10 **Residential leases.** The statutory security of tenure provisions of the Rent (Scotland) Acts and the Housing (Scotland) Acts apply to many residential leases.¹⁶ Where these Acts apply, tenants enjoy a higher degree of security of tenure than they would do at common

⁹ Having considered it preferable to carrying out this work as part of our review of leasehold tenure. Scot Law Com No 176, paras 2.5-2.8.

¹⁰ Scot Law Com No 171, paras 5.15-5.16.

¹¹ Received on 21 September 1976. For the full text of the reference see para 3.10 below.

¹² Scot Law Com No 75, para 1.3; draft Bill, clause 4.

¹³ See 1985 Act, s 7. The current equivalent of the 1949 Act is the Agricultural Holdings (Scotland) Act 1991.

¹⁴ S 7(1)(b).

¹⁵ Hansard (HC) 1984-85, Standing Committees, Vol VII, 1st Scot., 22 January 1985 cols. 102-106.

¹⁶ Private tenancies are regulated by the Rent (Scotland) Act 1984 and the Housing (Scotland) Act 1988; public sector tenancies are regulated by the Housing (Scotland) Act 1987. The Housing (Scotland) Act 2001, to be brought into force on a date to be appointed by the Scottish Ministers, will amend both private and public sector tenancies.

law. Tenants can only be removed in accordance with a possession order, granted by the court on certain statutory grounds.¹⁷ This applies both during the contractual period of the tenancy and any subsequent statutory renewal thereof, regardless of the terms of the lease.¹⁸ Therefore even where a landlord may have agreed the terms of an irritancy clause with his tenant, he cannot exercise his rights under such a clause to remove a tenant who enjoys security of tenure under the Rent Acts.

1.11 In order to obtain a possession order, the landlord must establish one or more of the approved grounds for possession.¹⁹ Where a mandatory ground for possession is established the sheriff is required to grant a possession order. Where a discretionary ground is established, the sheriff may grant an order where he is satisfied that it would be reasonable to do so. The grounds for possession and the nature of the discretion to be exercised vary slightly depending on the statutory regime under which the tenant is protected.²⁰ In all cases, the sheriff has discretion to grant a possession order where the tenant is in breach of his obligation to pay rent or is in breach of other obligations under his lease.²¹

1.12 This differs from the position of tenants under the Agricultural Holdings legislation which offers no protection to tenants who have failed to comply with a demand for payment of rent arrears, have failed to remedy any other breach of their obligations or have materially prejudiced the landlord's interests by an irremediable breach,²² and which does not prevent the landlord from exercising a conventional irritancy to remove a defaulting tenant.²³

1.13 However, the protection available under the Rent (Scotland) Act 1984 does not apply to leases where the rent is less than two thirds of the rateable value of the property.²⁴ Similarly, tenancies in respect of which the rent is less than £6 per week are excluded from the application of the Housing (Scotland) Act 1988.²⁵ There could therefore be a limited class of residential tenancies to which the common law of irritancy applies without statutory limitation. Such leases may also not qualify for the purposes of the abolition of irritancy in relation to long leases under sections 5 and 6 of the Leasehold Casualties (Scotland) Act 2001 to which we refer in paragraph 1.20 below. Since 1974, new residential leases are restricted in length to less than 20 years. Any modern leases which fall outwith the protection of the Rent Acts must therefore be of relatively short duration and consequently the potential for harsh results following irritancy are greatly reduced.

1.14 Housing law is a highly complex and political area of the law in Scotland. Its provisions are based on considerations of social policy in addition to legal expediency. It

¹⁷1984 Act, s 11; 1988 Act, s 18; 2001 Act, s 12.

¹⁸Private sector tenants falling within the protection of the Acts continue as "statutory" or "statutory assured" tenants after the expiry of their contractual tenancy, regardless of the grounds of termination, provided they remain in possession of the property; 1984 Act, s 3; 1988 Act, s 16.

¹⁹ 1984 Act, s 11; 1988 Act, s 18; 2001 Act, s 16. In addition to establishing one or more of the statutory grounds for possession, a landlord who wishes to raise possession proceedings against a tenant whose lease is protected under the 1988 Act or the 2001 Act must provide the tenant with the required notice of his intention to raise possession proceedings; 1988 Act, s 19; 2001 Act, s 14.

²⁰ The discretionary and mandatory grounds for possession are set out in 1984 Act, Sch 2; 1988 Act, Sch 5 and 2001 Act, Sch 2.

²¹ But where the tenant is an assured tenant under the 1988 Act, the sheriff is required to grant a possession order where the rent is three months or more in arrears; s 18(3) and Sch 5, Pt I, ground 8.

²² Agricultural Holdings (Scotland) Act 1991, s 22(2)(d) & (e).

²³ See Pt 6 and 1991 Act, s 21 (6).

²⁴ Rent (Scotland) Act 1984, s 2(1)(a).

²⁵ Housing (Scotland) Act 1988, Sch 4, para 2; Assured Tenancies (Tenancies at a Low Rent) (Scotland) Order 1988 SI 1988/2069.

would not be appropriate for us to make recommendations in relation to this area of the law which have an impact upon such policy without significant evidence of a need to clarify or rationalise the law. We question whether such a situation exists in practice and our preliminary view is that residential leases should, as in 1983, fall outwith the scope of our review. Nevertheless, we would welcome information on the subject from consultees with experience of residential leasing.

1.15 **Commercial leases.** It was with leases of commercial property that our Report on *Irritancies in Leases* and sections 4 to 7 of the 1985 Act were primarily concerned. Tenants' interests in such leases are often of considerable value and as a result, litigation concerning the operation of irritancy clauses focuses almost exclusively on commercial property.²⁶ Such leases are therefore central to the present review.

Previous recommendations in relation to the statutory regulation of irritancy

1.16 **General.** We considered the operation of irritancy clauses in connection with our work on penalty clauses.²⁷ The application of the law of irritancy has also arisen in connection with aspects of our major work on the reform of the law of property. Our previous recommendations in relation to the law of irritancy are repeated here so as to set the present review in context.

1.17 **Penalty clauses.** In our Report on *Penalty Clauses* we recommended that there should continue to be judicial control over contractual penalties which were "manifestly excessive". Penalties which were not manifestly excessive should be enforceable even if they could not be regarded as based upon a genuine pre-estimate of loss.²⁸ However, as we have already mentioned above,²⁹ we excluded from our recommendations irritancies in leases of land.³⁰ To date there has been no indication that the Scottish Executive intend to bring forward legislation implementing our recommendations.

1.18 **Abolition of the feudal system.** In our Report on the *Abolition of the Feudal System* we recommended that any irritancy clause enforceable by a feudal superior should cease to have effect.³¹ Our recommendation was subsequently implemented by section 53 of the Abolition of Feudal Tenure (Scotland) Act 2000 and came into force on Royal Assent, 9 June 2000. Accordingly, it is no longer competent to irritate feus.

1.19 **Leasehold casualties.** In our Report on *Leasehold Casualties* we considered the effect of irritancy clauses in "ultra-long leases".³² We expressed the view that:

"Conventional powers of irritancy in ground leases of such a length and nature that they are the functional equivalent of a feudal title are inappropriate. Landlords in practice have no interests in such leases which could justify protection by such a draconian power."³³

²⁶ In particular judicial requests for a further review concerned such a lease.

²⁷ See para 1.5 above.

²⁸ Scot Law Com No 171, para 3.10; clause 1 of draft bill.

²⁹ See para 1.5.

³⁰ Scot Law Com No 171, para 5.16; clause 1(3) of draft bill.

³¹ Scot Law Com No 168, para 4.89, Recommendation 34; draft Bill, clause 47.

³² Scot Law Com No 165, paras 8.4-8.8.

³³ *Supra*, para 8.6.

1.20 Our recommendation that irritancy clauses should be abolished in relation to certain long leases was adopted in the Leasehold Casualties (Scotland) Act 2001. Section 5 of that Act provides that irritancy clauses in leases granted prior to 10 August 1914 for a period of 175 years or more and providing for a rent of less than £150 a year are void.³⁴ Section 6 also abolishes the legal irritancy for non-payment of rent in respect of such leases.³⁵

1.21 **Conversion of Long Leases.** In our Discussion Paper on *Conversion of Long Leases* we proposed that either (a) all leases granted for more than 175 years or (b) all leases granted for more than 175 years and with an unexpired term of more than 100 years should be converted to a right of ownership.³⁶ Necessarily, irritancy will not survive in such cases.

1.22 **Real burdens.** In our Report on *Real Burdens* we recommended that irritancy clauses relating to real burdens should cease to have effect.³⁷ The Scottish Executive consultation paper on the matter is supportive of our proposals.³⁸

Structure of this paper

1.23 A discussion of the nature of irritancy and its compatibility with the European Convention on Human Rights is given in Part 2 of our paper. In Part 3 we then go on to examine in detail the problems with the present law in the context of commercial leases; and in particular the statutory regulation of irritancy in the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985. The broad policy considerations which apply to any proposals for reform of the law are then discussed in Part 4. It will be seen from that part of our paper that we have identified a number of competing interests which require to be carefully balanced. At present we are undecided on the exact point at which such interests are properly reconciled. In Part 5 we therefore put forward a range of possible reforms. Agricultural leases, which presently fall outwith the scope of the 1985 Act, are considered separately in Part 6.

Which Parliament?

1.24 Legislation to give effect to any of the possible options for reform which we put forward in this paper would be within the legislative competence of the Scottish Parliament.³⁹ The law of landlord and tenant is not a reserved matter.⁴⁰ For the reasons which we give later⁴¹ legislation giving effect to any of these proposals, would not, in our view, be in breach of the European Convention on Human Rights.

³⁴ This section was brought into force retrospectively with effect from 10 May 2000; s 5(3) and 10(1).

³⁵ This section came into force on 12 February 2001; s 6(2).

³⁶ Scot Law Com DP No 112, para 2.22.

³⁷ Scot Law Com No 181, para 4.72; draft Bill, clause 56.

³⁸ *Draft Title Conditions (Scotland) Bill Consultation Paper*, para 97.

³⁹ Scotland Act 1998, s 29.

⁴⁰ Reserved matters are set out in Sch 5 of the 1998 Act.

⁴¹ See paras 2.14-2.19.

Acknowledgements

1.25 We are grateful to the members of our Advisory Group⁴² who have read and commented on drafts of this discussion paper. We are also grateful to the following persons⁴³ and to the organisations listed in Appendix 3 who have provided us with useful information as to the practical operation of the law of irritancy in relation to commercial leases.

⁴² Stephen Giusti, Sinclair McCormick & Giusti Martin, Solicitors; Peter McCormack, Advocate; Philip Rodney, Burness Solicitors; and David Smith, Shepherd & Wedderburn WS.

⁴³ Gordon Arthur, Head of Commercial Faculty RICS; David Bankier, McGrigor Donald, Solicitors; Hamish Hodge, Dundas & Wilson CS; Iain Macniven, Maclay, Murray & Spens, Solicitors; Lynne Raeside, Head of Policy Unit RICS; Sandy Reid, Steedman Ramage, Solicitors; Mark Taylor, Head of Valuation Faculty Board RICS and Ian Wattie, Burness, Solicitors.

Part 2 The Nature of Irritancy and its Compatability with the European Convention on Human Rights

Introduction

2.1 In this part of our paper, we examine the theoretical nature of irritancy and the effect of irritancy on the relationship between the contracting parties and their respective rights. We also consider in what respects a distinction can be drawn between irritancy and penalty clauses.

General nature of irritancy

2.2 An irritancy is a contractually stipulated remedy. The parties to the lease agree that if a particular event occurs the landlord will be entitled to terminate the lease. In the case of a legal irritancy the agreement of the parties is implied by law: in that of a conventional irritancy, the agreement of the parties must, of course, be express.

2.3 The event stipulated as triggering the landlord's right to irritate the lease will often constitute a breach of a term of the lease; where for example the tenant fails to pay the rent timeously or does not honour his obligation to repair the premises. However, this need not be the case. The right to irritate may arise upon a change in the status of the tenant, for example if a receiver is appointed in respect of the tenant's property: clearly this can occur without the tenant being in breach of any obligation under the lease.¹ It is therefore inaccurate to describe a landlord's right to irritate as a remedy in response to a tenant's breach of a term of the lease, albeit that a breach of a term of a lease will often trigger the right to irritate.

2.4 What is the juridical nature of the right to irritate? Irritancy is essentially a right enjoyed by a landlord lawfully to terminate a lease before it would otherwise expire. As we have already observed this right arises from the agreement of the parties, express or implied, in the lease. But the right cannot be exercised until the occurrence of an event stipulated by the parties in the lease (or in the case of a legal irritancy the occurrence of an event stipulated by law). Only when the stipulated event occurs can the landlord utilise his contractually agreed right lawfully to end the lease. Put another way, while the right to irritate a lease is a right agreed by the parties in their contract (ie the lease), the landlord's exercise of that right is dependent on the purification of a condition stipulated in the contract, for example the appointment of a receiver or the tenant's failure to pay the rent on time.

¹ The provision for irritancy in such circumstances and generally in relation to the tenant's bankruptcy or insolvency is well recognised - see Paton & Cameron, *Landlord and Tenant* p 193; Rankine, *Leases* p 542ff; Stair Memorial Encyclopaedia, vol 13, para 429. The object is to ensure that the landlord may terminate the lease if the tenant's financial status becomes unsatisfactory.

2.5 Since the remedy of irritancy is available for the benefit of the landlord only, he can determine whether or not it should be exercised.² If the landlord has by his conduct led the tenant to believe that he will not irritate the lease after the relevant condition has been satisfied, he will be personally barred from terminating the lease for that reason.³ However, this will not prevent the landlord from irritating the lease should he become entitled to do so as a consequence of the condition being purified on a subsequent occasion. Thus, for example, if a landlord is entitled to irritate on account of non-timeous payment of rent but before terminating the lease accepts a late payment, then he will be personally barred from exercising his right for that reason:⁴ but this will not prevent the landlord from irritating the lease should the tenant fail to pay his rent on time on a subsequent occasion.⁵

Effect of irritancy

2.6 Because the purification of a condition which triggers the landlord's right to irritate will often constitute a breach of the lease, it might be thought that irritancy is similar to the right of rescission ie the right of a party to terminate a contract after a material breach. Rescission discharges the innocent party from further performance of the contract but the contract subsists at least until the date of the breach:⁶ consequently, the innocent party who has elected to rescind remains entitled to sue for damages as well. In other words rescission after a material breach only terminates the contract in so far as there are obligations which remain to be performed. Irritancy clauses, on the other hand, usually not only terminate the lease in so far as the performance of the landlord's future obligations is concerned but also purport to treat the lease as though it has never existed. Unlike rescission, irritancy operates to terminate the contract retrospectively. The implications of this will be discussed in the next paragraph.

2.7 If the effect of irritancy is to terminate the lease with retrospective effect, then two consequences follow. First, after he has irritated the lease, in theory at least, the landlord cannot sue the tenant for any breach of the lease which took place before the lease was terminated. Since the lease is retrospectively null, there has been no contractual term which the tenant could have broken. Thus unlike rescission, when he elects to irritate a lease the landlord loses his right to sue the tenant for breach of contract. While it will often be in the landlord's financial interests to irritate the lease rather than sue for damages, there may be situations where it is desirable to do both. Thus it has become standard practice for irritancy clauses in commercial leases to preserve the landlord's right to exercise all competent remedies in relation to breaches occurring before the termination of the lease. In the absence

² *Kinloch v Mansfield* (1836) 14 S 905; *Bidoulac v Sinclair's Tr* (1889) 17 R 144. While the landlord must exercise his option within a reasonable time, surrender of his right to do so is not readily inferred; *Tennent v MacDonald* (1836) 14 S 976, *Lindsay v Hogg* (1855) 17 D 788, *Bidoulac v Sinclair's Tr*, *supra*.

³ See *HMV Fields Properties Ltd v Bracken Self Selection Fabrics Ltd* 1990 SCLR 677, 1991 SLT 31. Whether the actings of the landlord amount to a waiver of the right to terminate the lease is essentially a question of fact to be determined objectively; "In my opinion the question whether or not a subsequent acceptance of rent amounts to an unequivocal act amounting to waiver of the notice of irritancy is a question of fact which must be answered in the light of the surrounding circumstances.", *ibid per* the Lord President (Hope) at p 35.

⁴ Contrast the result in *HMV Fields Properties Ltd v Bracken Self Selection Fabrics Ltd*, *supra*, where acceptance of rent which was subsequently returned after service of a notice of irritancy on account of a breach of a prohibition on sub-letting was held not to have amounted to an unequivocal waiver in the particular circumstances of the case.

⁵ Unlike the position in England, in Scotland there is no rule of law that acceptance of rent after service of an irritancy notice amounts to a waiver. Nor is the tenant likely to succeed with a claim that such action is oppressive. See *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1990 SC 351 where the tenants' argument before the Lord Ordinary (Lord Morton of Shuna) that it would be oppressive of the landlords to insist on irritancy for non-payment of rent because they had permitted late payment in the past was unsuccessful.

⁶ *Graham v United Turkey Red* 1922 SC 533.

of such express reservation, the right to sue for damages for breach of contract would be lost when the lease was irritated:⁷ in short, the exercise of the right to irritate and the right to sue for damages for breach are mutually exclusive, unless the contract otherwise provides.⁸

2.8 When a lease has been irritated the landlord and tenant are, of course, discharged from further performance of their obligations under the lease; so, for example, a tenant is no longer contractually obliged to pay rent even if he remains on the property after the lease has been terminated. It also follows that the landlord cannot sue the tenant for damages in respect of a breach of contract alleged to have taken place after the lease has been irritated. So for example, a landlord cannot claim damages for failure to pay rent when the tenant has remained on the premises after the lease has been irritated. In these circumstances, however, the landlord may have a remedy in unjustified enrichment or delict.

2.9 Second, if after it has been irritated the lease is retrospectively null, what is or has been the nature of the relationship between the parties? Unless there is a reservation clause, neither party can claim damages for any breach of contract alleged to have taken place before the lease was terminated. Moreover, neither party can recover benefits transferred to the other during the currency of the lease. This is because at the time of the transfers each was obliged to do so under the terms of a lease which was perfectly valid at that time. The retrospective termination of the lease, it is submitted, does not affect the point that at the time of the transfer there was a valid legal obligation to do so. The position is quite different from the situation where a contract is null *ab initio* or is annulled on the grounds of misrepresentation. In these situations, the benefits received cannot be retained since the transferor performed under the misapprehension that the contract was valid: it is this misapprehension which renders the enrichment unjustified and *prima facie* obliges the transferee to disgorge the benefit. On the other hand, when, for example, a tenant pays rent under a lease which is subsequently irritated he is under no misapprehension about the validity of the legal obligation to do so. Moreover *ex hypothesi* he has agreed that the landlord can terminate the lease in the event of the condition triggering the right to irritate being purified. There is therefore a legal basis for the landlord's retention of the rent. Accordingly, even though the lease is retrospectively null there is no room for the operation of the doctrine of unjustified enrichment to enable the tenant to recover benefits he was contractually obliged to transfer to the landlord at the time of the transfer. Similarly, a landlord cannot recover any benefits or seek recompense for any services which he was contractually obliged to provide before the lease was irritated.

Property rights

2.10 We have been discussing the theoretical nature of irritancy from a contractual perspective. However it must not be forgotten that while a lease is a contract, it is a contract which usually creates a real right.⁹ For the duration of the lease, the tenant has the right to possess the land to the exclusion of all others, including the landlord. When a lease is irritated, not only is the contractual relationship between the parties terminated but the tenant loses his real right to possess the property. After a lease is irritated, the landlord is

⁷ *Walker's Trs v Manson* (1886) 13 R 1198; *Bidoulac v Sinclair's Tr* (1889) 17 R 144; *Buttercase & Geddie's Tr v Geddie* (1897) 24 R 1128. More recently *HMV Fields Properties Ltd v Skirt 'n' Slack Centre of London Ltd* 1987 SLT 2.

⁸ "The question whether or not there may be room for a claim for damages for breach of contract in the eventuality of the irritancy of a lease must depend to a substantial extent upon the terms of the particular lease." *per* the Lord Ordinary (Clyde) in *HMV Fields Properties Ltd v Skirt n' Slack Centre of London Ltd* 1987 SLT 2 at p 5.

⁹ Leases Act 1449; Registration of Leases (Scotland) Act 1857 s 2.

therefore entitled to resume possession of the land. If the tenant refuses to go, the landlord is *prima facie* entitled to have him removed from the property.¹⁰

2.11 Moreover, the tenant may have carried out improvements on the property during the lease. If the lease is irritated, on taking possession of the land the landlord will enjoy the benefits of these improvements. The question then arises whether the tenant is entitled to any compensation for the cost of the improvements or recompense in respect of their current or future value to the landlord. Unless the parties have expressly stipulated that the tenant should receive compensation, the only possible remedy must lie in unjustified enrichment. However, the tenant faces an insuperable difficulty. While the landlord has been enriched as a consequence of terminating the lease, he has done so by exercising a remedy which has been contractually agreed between the parties. Put another way, the landlord has obtained the benefits by the exercise of his right to irritate the lease when the triggering condition is purified. Because the benefits were obtained by exercising a legal remedy agreed by the parties, the tenant was not under the impression that he would retain the benefits if the lease was irritated. In the absence of such a misapprehension, the landlord's enrichment is justified and he is not obliged to recompense or compensate the victim. The significant practical effects of the legal position are illustrated clearly in the litigation involving Dollar Land (Cumbernauld) Ltd described in detail in Part 3.¹¹

Comparison with penalty clauses

2.12 It will be clear that irritancy is a powerful remedy which can sometimes have potentially drastic consequences for a tenant. As we shall see, while the courts have an equitable power to protect a tenant from abuse or oppressive use of irritancy that power is not exercised merely because the termination of the lease has serious consequences for the tenant. Indeed, it does not matter that the consequences are disproportionate to any harm suffered by the landlord.¹² It is therefore possible to argue that since irritancy may effectively operate as a penalty it should be subject to controls similar to those which exist (and are proposed) for penalty clauses.¹³ Moreover, another parallel exists between irritancy and penalty clauses in that both are contractually agreed remedies.

2.13 On the other hand, irritancy provides a landlord with a neat and clean remedy which enables him to remove an unsatisfactory tenant without too much difficulty. In theory at least, the irritancy clause has been the product of negotiation between the parties and reflects their respective bargaining strengths. As a general principle, what the parties to a contract have freely agreed should not be undermined unless there are compelling reasons for doing so. An irritancy clause is effective only because the parties have agreed to it. Whether there are sound reasons of policy why effect should not be given to the parties' intentions in respect of irritancy clauses is considered later in this paper.¹⁴

¹⁰ By decree of extraordinary removing – see Rankine, *Leases* at p 511-512.

¹¹ See para 3.20 ff.

¹² *Dorchester Studios (Glasgow) Ltd v Stone* 1975 SC (HL) 56; *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1990 SC 351, 1992 SC (HL) 104.

¹³ Scot Law Com No 171.

¹⁴ See Parts 4 and 5.

The European Convention on Human Rights

2.14 Article 1 of the First Protocol to the European Convention on Human Rights provides that:

"Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the provisions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

2.15 When a landlord exercises his right to irritate under a lease this has the effect of depriving the tenant of his property, ie his right under the lease. However, the decision of the Commission in *Di Palma v United Kingdom*¹⁵ suggests that the state is under no obligation to protect a tenant from the effects of an irritancy or equivalent clause in a lease. In this case, the applicant's lease had been forfeited and she was unable to obtain relief. She claimed that this constituted a breach of Article 1. The Commission found that Article 1 was inapplicable. The landlord's right of re-entry derived from the lease and the clause was not directly prescribed or amended by legislation. The legislation relating to forfeiture provided a measure of protection for tenants but the deprivation of property had come about as a result of a private agreement. The fact that the order for forfeiture had been made by a court did not make the state liable as the court had only been applying the terms of the contract between the parties. The situation regarding an irritancy clause in Scotland is substantially similar; the landlord's right to irritate derives from the irritancy clause in the lease and is therefore a matter of private agreement between the parties.

2.16 The decision in *Di Palma* is in line with several cases in which both the Court and the Commission have held that Article 1 protects property against interference by the state¹⁶ and therefore is not applicable where the deprivation of or interference with, property complained of is the result of agreement between the parties to a contract and does not arise from any exercise of governmental authority.¹⁷

2.17 In the *Di Palma* case the Commission left open the question of whether the state might ever be under a positive obligation to protect the property rights of an individual in circumstances not involving interaction with the state.¹⁸ However, there have been no cases to date in which a positive obligation has been found under Article 1 and the decision in

¹⁵ (1988) 10 EHRR 149.

¹⁶ Interference by the state includes situations where a public authority expropriates or interferes with the use of possessions (eg *Holy Monasteries v Greece* (1995) 20 EHRR 1) and also where the state enables private individuals to take or interfere with property (eg *James v UK* (1986) 8 EHRR 123). In the latter cases, Article 1 may apply to transactions between private individuals but only insofar as the state is responsible for these transactions as legislator.

¹⁷ See *Bramelid and Malmström v Sweden* (1985) EHRR 249; *Gustafsson v Sweden* (1996) 22 EHRR 409 and *James v UK* (1986) 8 EHRR 123 at paras 35 & 36.

¹⁸ The Commission and the Court have held that some articles of the ECHR impose upon states not only obligations not to interfere with Convention rights but also obligations to take positive steps for the protection of these rights. Positive obligations have been found primarily in respect of Article 8 (right to private and family life); see *X & Y v the Netherlands* (1986) 8 EHRR 235.

Di Palma makes it unlikely that positive obligations to protect a tenant from the effects of an irritancy clause would be found.

2.18 A related point is that a breach of Article 1 will be difficult to establish where the applicant has consented to the deprivation or to the threat of deprivation. In *Holy Monasteries v Greece*¹⁹ the Court held that monasteries which had reached an agreement for the transfer of a proportion of their property to the Greek Government could not subsequently claim that their Article 1 rights had been violated. Similarly, in the *Di Palma* case the Commission pointed out that the forfeiture clause was part of the contract into which the applicant had entered. Therefore a tenant who agrees to an irritancy clause cannot claim that his right to peaceful enjoyment of possessions is interfered with when an irritancy is incurred.

2.19 Accordingly, in our opinion, in so far as our proposals for reform enhance the protection available to tenants or mitigate the effects of a conventional irritancy clause to which he has agreed, such proposals do not fall foul of Article 1 of the First Protocol to the Convention.

¹⁹ (1995) 20 EHRR 1.

Part 3 The Problems with the Present Law

Legal irritancy

3.1 Irritancies may be implied by law. There are three such "legal" irritancies, all of which relate to non-payment of rent. Two relate solely to agricultural subjects and are therefore discussed further in Part 6 of our paper.¹ The remaining legal irritancy arises at common law and applies to urban as well as agricultural property.² It provides that non-payment of rent for a period of two years gives rise to a right of irritancy.³

3.2 The significant difference between legal and conventional irritancies⁴ is that the former is purgeable by payment of the arrears at any time before decree of declarator has been extracted.⁵ It is now settled that conventional irritancies are not purgeable.⁶

3.3 The use of legal irritancy is virtually unknown in modern practice. As we have mentioned, legal irritancy has been abolished in relation to certain ultra-long leases.⁷ We consider it highly unlikely that there are a significant number of leases in respect of which irritancy remains a competent remedy and which do not contain a conventional irritancy clause for non-payment of rent. We would, of course, welcome any evidence to the contrary from consultees. Nevertheless, we make the following proposal:

1. **The legal irritancy in respect of non-payment of 2 years rent should be abolished.**

Conventional irritancy

3.4 Conventional irritancies are stipulated by the parties in their contract of lease. Our analysis of whether there are problems inherent in the present law of conventional irritancy begins with the common law prior to the commencement of the 1985 Act and judicial comment on that law in the case of *Dorchester Studios (Glasgow) Limited v Stone*.⁸ A brief description of that law is given in chapter 2 of our 1983 Report⁹ and is repeated here for ease of reference.

The common law position pre-1985

3.5 **Freedom of contract.** At common law the parties to a lease were free to stipulate for such conventional irritancies as they thought fit, provided that these stipulations were in themselves lawful.¹⁰ In practice there had developed fairly settled general characteristics of irritancy clauses in leases of commercial property. The events which triggered the

¹ See paras 6.2-6.6 below.

² *Halyburton v Cunningham* (1677) M 13801.

³ See Gloag, *Contract* p 665; Rankine, *Leases* p 533; Paton & Cameron, *Landlord and Tenant* p 229.

⁴ See para 3.4 below.

⁵ See Gloag, *Contract* p 665; Rankine, *Leases* p 538.

⁶ *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1990 SC 351; 1992 SC (HL) 104.

⁷ Leasehold Casualties (Scotland) Act 2001, s 6. See also para 1.20 above.

⁸ 1975 SC (HL) 56.

⁹ Scot Law Com No 75, paras 2.1-2.9.

¹⁰ *Stewart v Watson* (1864) 2 M 1414 *per* Lord Neaves at p 1422.

landlord's right to irritate were not limited to breaches by the tenant of his obligations under the lease: they could include, for example, external events or an alteration in the financial or commercial status of the tenant. Usually no distinction was made between material and non-material breaches; and there was no requirement for the tenant to receive either prior warning of the landlord's intention to irritate or for the landlord to provide the tenant with an opportunity to purge a remediable breach.

3.6 When asked to consider the law of irritancy in *Dorchester Studios* the House of Lords declared the law to be well settled and free from doubt. They considered it to be a classic rule of the Scots law of contract that irritancy clauses required to be enforced literally in accordance with their terms.¹¹ The questions whether the landlord had actually been prejudiced, whether the breach in question had been remedied or whether enforcement of the irritancy in the particular circumstances of the case had been contemplated by the parties had been declared irrelevant by the First Division.¹² The House of Lords agreed.

3.7 **Equitable power of relief.** The literal enforcement of an irritancy clause was subject to the equitable power of the court to grant relief to a tenant in cases of abuse or oppressive use of the remedy.¹³ The Scottish courts have, however, greatly restricted the exercise of that power. This is clearly illustrated in *Lucas's Executors v Demarco*¹⁴ where Lord Guthrie stated that "oppression" in this context implied impropriety of conduct by the landlord and "abuse of irritancy" could not be established unless the landlord had invoked the irritancy clause to procure an unfair consequence.¹⁵ In *Dorchester Studios*, the appellants were unable to persuade their Lordships that the respondent's failure to put them on notice that they intended to exercise their right to irritate following non-payment within the 21 day period of grace stipulated in the lease was a misuse or oppressive use of the remedy.¹⁶ The restricted nature of the power to grant relief was re-enforced after the decision in *Dorchester Studios*¹⁷ leading us to conclude in our Report that "The present interpretation of oppression makes it likely that the power will seldom, if ever, be exercised."¹⁸

3.8 **Judicial comment.** The results of this literal enforcement of conventional irritancy clauses could be harsh. In *Dorchester Studios* the tenants tendered payment of the quarter's rent 11 days late and the House of Lords upheld the landlord's right to refuse to accept payment and irritate the lease; since the irritancy was conventional it could not be purged. In his speech, Lord Fraser of Tullybelton refused to accept that "there was something unfair or harsh in holding that a tenant who was late (perhaps by only one day) with his rent had

¹¹ 1975 SC (HL) 56; see Lord Fraser of Tullybelton at p 71 quoting Lord Neaves in *Stewart v Watson* at p 1422, "In all consensual contracts agreements of parties ought to be enforced."

¹² 1975 SC (HL) 56 at p 61.

¹³ *Stewart v Watson* (1864) 2 M 1414; *McDouall's Trs v MacLeod* 1949 SC 593; *Dorchester Studios (Glasgow) Limited v Stone* 1975 SC (HL) 56 at pp 71 and 72.

¹⁴ 1968 SLT 89.

¹⁵ 1968 SLT 89 at p 96. Lord Guthrie's approach was followed recently by Lord Penrose in *Aubrey Investments Ltd v D S Crawford Ltd (In Receivership)*; "Impropriety of conduct on the part of the landlord is of the essence of oppression. Impropriety may be inherent in the act complained of, or inferred from surrounding facts and circumstances which colour an apparently regular exercise of contractual rights. A characteristic of improper conduct is invoking a contractual provision to procure an unfair consequence to the tenant. The landlord's motive will not of itself instruct a relevant case of oppression. The landlord is entitled to have regard to his own interests." 1998 SLT 628 at p 634.

¹⁶ The respondents had sent the appellants a rent demand prior to the term date warning of the required date for payment. The appellants' failure to make payment timeously was an oversight and was clearly not attributable to any actings of the respondents. Therefore, there could be no question of oppression on the landlord's part.

¹⁷ *Forth Homes Ltd v Williamson* (Sheriff Principal F W F O'Brien QC, 3 July 1978 unreported) and *HMV Fields Properties Ltd v Skirt 'n' Slack Centre of London Ltd* 1982 SLT 477.

¹⁸ Scot Law Com No 75, para 2.7.

forfeited his lease which might be of great value."¹⁹ He gave four policy reasons in support of his view:

- it is not in principle unfair to hold the tenant to the terms he has agreed.
- Leases of value are more likely to be of commercial property and commercial tenants should be able to manage their affairs so as to avoid accidental late payment of rent.
- If late payment results from deliberate action or financial difficulty it is legitimate to use irritancy to remove an unsatisfactory tenant.
- The court can exercise its equitable power to grant relief against oppressive use.

3.9 Nevertheless, Lord Fraser recommended that this area of the law should be reviewed by the Scottish Law Commission. However, it was not the "unfairness" of the result which persuaded his Lordship that this area of law should be reviewed. Rather he recognised that commercial leases were gaining in importance as a means of regulating property rights which might have previously been controlled through a feudal relationship and feu contracts.²⁰ It was in the context of this practical change of approach and the expansion of commercial leasing as a legal specialism that Lord Fraser with the support of Lord Kilbrandon, recommended an analysis of the legal policy issues raised in *Dorchester Studios* by the Commission.²¹

3.10 **Reference to the Scottish Law Commission.** This led the Secretary of State for Scotland to submit a reference to the Commission under section 3(1)(e) of the Law Commissions Act 1965 in the following terms:²²

"Without prejudice to the Commission's freedom to offer advice on any possibilities of reform of this branch of the law, I should be glad if the Commission would, in the light of *Dorchester Studios (Glasgow) Limited v Stone*, and the observations made in the judgments in that case, consider and advise on the operation of irritancy clauses in leases of commercial and industrial property (including leases of land for commercial or industrial development), and on related matters."

3.11 Our Consultative Memorandum was published in April 1981.²³ The main proposals for consideration were as follows:²⁴

¹⁹ 1975 SC (HL) 56 at p 72.

²⁰ Legal irritancy with regard to non-payment of feu duty could be purged any time before decree was extracted. The same was true for conventional irritancies for breach of feuing conditions, but only at the discretion of the court; *Precision Relays Ltd v Beaton* 1980 SLT 206; 1980 SC 220.

²¹ "The result [of the prohibition on the imposition of new feuduties in the Land Tenure Reform (Scotland) Act 1974] may be to discourage feuing and to increase the importance of leases, and therefore of provisions for their irritancy. It may be that for that reason the general question raised by this appeal is worthy of consideration by the Scottish Law Commission." *Ibid per* Lord Fraser of Tullybelton at p 73. "The distinction between the feu contract and the lease has become unsubstantial since the former took to its death bed. Moreover, the old view that the lease, unlike the feu contract, does not convey a right of property wears today an air of unreality. Statutes governing successively dwelling-houses, agricultural subjects and business premises, have gone far to confer on tenants interests more easily classified as proprietary than ephemeral. And the long investment-lease has in recent years become a feature in Scottish cities. All these considerations point, in my opinion, to the need for the Scottish doctrine to be re-examined from the policy point of view, and for my part I would recommend this exercise to the Scottish Law Commission." *Ibid per* Lord Kilbrandon at p 67.

²² On 21 September 1976.

²³ Scot Law Com CM No 52.

- enforcement of a conventional irritancy in a commercial lease should be conditional upon the giving by the landlord of notice
 - (a) specifying the irritancy;
 - (b) requiring the irritancy to be remedied; and
 - (c) allowing a specified reasonable time to the tenant to take remedial action.
- In respect of non-payment of a monetary obligation the time limit for remedying the breach should be a fixed period of four weeks from delivery of the notice.
- In respect of non-monetary breach the notice should specify what the landlord considers to be a reasonable period within which the breach should be remedied. Within that period the tenant may apply to the court for an extension of the time allowed.
- Comment was invited on whether the court should have a discretionary power to refuse or mitigate the enforcement of an irritancy clause where the breach is irremediable and whether such power should be available in all cases or only under restricted circumstances.
- Whether substantive and/or procedural protection should be available to sub-tenants and secured creditors including a discretionary power in favour of the court to vest the head tenant's interest in the relevant third party.
- That all actions of extraordinary removing based on an irritancy should be preceded by a declarator of irritancy.

3.12 **Scottish Law Commission recommendations.** Following consultation, our recommendations were submitted to the Secretary of State for Scotland on 19 November 1982. Our principal recommendations were as follows:²⁵

- a landlord should not be entitled to rely on a tenant's default in making any monetary payment due under a lease as a ground for termination of the lease unless he has served on the tenant written notice specifying a period of not less than 14 days for the remedying of the default and stating that irritancy may result if the default is not remedied within that period.
- Where the 14 day period would expire before the end of any days of grace for payment the period to be specified in the notice should be not less than the unexpired balance of the days of grace.
- Notices should be served by recorded delivery save where the tenant has no address for service in the United Kingdom known to the landlord.

²⁴ Scot Law Com CM No 52, p 38ff.

²⁵ For a full summary of our recommendations see Scot Law Com No 75, p 26.

- In respect of non-monetary breach, a landlord should not be entitled to irritate the lease if, in all the circumstances of the case, no fair and reasonable landlord would seek to exercise his right of irritancy.

3.13 The policy objectives of our recommendations can be summarised as follows:

Monetary breach

- where the possibility of remedy exists, the irritancy clause would act as compulsor for the taking of remedial action and not as a means whereby a landlord could take immediate advantage so as to procure an opportunistic termination of the tenancy.²⁶
- It would be undesirable that statutory notices threatening irritancy should be given before there has been any default.²⁷
- The introduction of a notice procedure should remedy the problem where irritancy can result from the failure to make payment of rent to a successor landlord who has failed to intimate his identity and address to the tenant.²⁸

*Non-monetary breach*²⁹

- To prevent penal enforcement of irritancies but to avoid protracted proceedings.
- To extend the common law equitable power of the court to relieve a tenant from an "oppressive" use of irritancy.
- Not to extend the equitable power to a broad discretion so as to invite tenants to appeal to the sympathy of the court but to retain it as a residual power to be applied only in clearly appropriate cases.
- To judge enforceability of an irritancy by reference to a broad and objective standard – therefore avoiding the judiciary being required to make a commercial judgment on the balance of the respective economic interests of landlord and tenant.
- To apply only to obligations *ad factum praestandum* and changes in the status of the tenant.

3.14 These recommendations were adopted by the Government and implemented subject to two substantive modifications by sections 4 to 7 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985. First, clause 2(3) of the draft Bill annexed to our Report had provided that in considering whether actions of the landlord were fair and reasonable, regard should be had as to whether the breach was capable of being remedied "at a reasonable cost". This provision was removed on the basis that to do so would provide

²⁶ Scot Law Com No 75, para 4.2.

²⁷ *Ibid*, para 4.3.

²⁸ *Ibid*, para 4.6.

²⁹ *Ibid*, para 4.10-4.11.

greater scope for the tenant to retain his lease. Second, leases of agricultural holdings were removed from the scope of the legislation. Further discussion of this matter can be found at paragraph 1.8 and in Part 6. Sections 4 to 7 of the 1985 Act came into force on 30 December 1985.

The present law

3.15 The tenant of a lease to which the 1985 Act reforms apply is protected against the common law of conventional irritancy in a number of respects. It is not possible for the parties to such a lease to contract out of the statutory provisions.³⁰ The protections differ according to the nature of the breach.

3.16 In relation to a failure to pay rent or to make payment of any other kind the landlord must comply with the statutory notice procedure contained in section 4 before he is entitled to rely on an irritancy clause in the lease. In order to avoid confusion between the statutory notice and a notice irritating the lease, the former notice is referred to in this paper as a "pre-irritancy notice". After the payment in question has become due, the landlord must serve a pre-irritancy notice on the tenant requiring him to make payment of the sum and any interest due within a period specified in the notice. The notice must also state that if the terms of the notice are not complied with the lease may be terminated.³¹ Only once the tenant has failed to comply with the terms of the notice may the landlord proceed to exercise his rights under the irritancy clause.

3.17 The period specified in the pre-irritancy notice must be not less than 14 days. However, if the lease provides the tenant with a longer period of grace to make the payment, the notice must give the tenant the full unexpired portion of that period within which to comply. The notice must be served by recorded delivery and there are provisions within the statute providing for sufficient service.³²

3.18 In relation to irritancy in respect of an act or omission of the tenant (other than the non-payment of a sum due) or of a change in the tenant's circumstances, a landlord cannot exercise his right of irritancy unless "in all the circumstances of the case" a fair and reasonable landlord would do so.³³ In evaluating that test, where the breach in question is remediable, regard must be had to the question of whether the tenant had been given a reasonable opportunity to remedy the breach.³⁴

Irritancy clauses relating to monetary breaches of commercial leases

3.19 **Introduction.** As we have seen, in order to avoid the apparent harshness of the result in the *Dorchester Studios* case, the 1985 Act introduced a pre-irritancy notice system. This statutory notice period during which the breach can be purged is in addition to the court's common law powers to protect the tenant from oppressive use of irritancy. The

³⁰ S 6(1). However, there is one statutory exception to their application. Ss 4-7 of the 1985 Act do not apply to leases of land granted by the Secretary of State for the purpose of a detention centre contract; Immigration and Asylum Act 1999, s 149(3). This section was brought into force on 1 August 2000; SI 2000/1985.

³¹ S 4(2)(a).

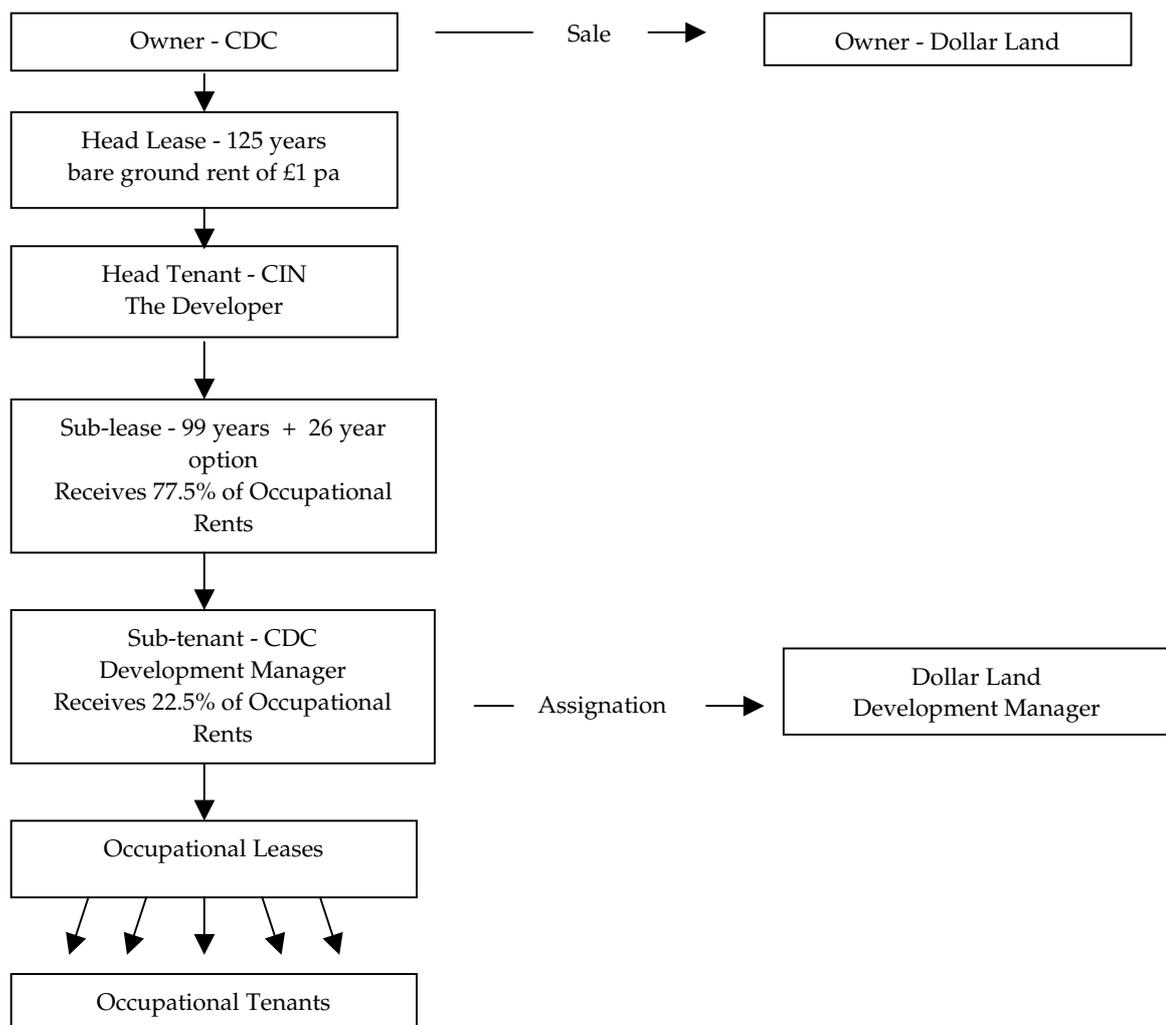
³² S 4(4)-(5).

³³ S 5(1).

³⁴ S 5(3).

limitations of the protection provided by section 4 were explored by the courts in the CIN Properties v Dollar Land litigation.

3.20 **Dollar Land Part 1: the validity of the irritancy.** The facts of the case were relatively straightforward and concerned a development lease. Cumbernauld Development Corporation (CDC) provided land for development by CIN Properties Limited (CIN). For this purpose CDC leased the land to CIN for a period of 125 years at a rent of £1 per annum. It was a term of the agreement between CDC and CIN that CIN would sub-lease the development back to CDC for a period of 99 years (with an option of another 26 years) who, in turn, entered into sub-sub-leases of the retail units with the occupational tenants. In terms of the sub-lease, and in recognition of the development costs incurred by CIN, CDC paid CIN rent of approximately 77.5% of the rents which it received from the occupational tenants, retaining 22.5% for itself. CDC later assigned its interest as tenant under the sub-lease and sold its interest as owner (and therefore its interest as landlord under the head lease) to Dollar Land for £2.2m. The relationship between the parties is illustrated below.



On several occasions Dollar Land failed to pay the rent due to CIN under the sub-lease timeously. The amount involved was approximately £250,000 a quarter - a not inconsiderable sum in 1988. More importantly perhaps, Dollar Land's failure to pay interrupted the steady income stream that CIN had expected as the return on its investment. Eventually, CIN gave notice under section 4 that the rent should be paid within a specified period under threat of irritancy. After the pre-irritancy notice had expired without payment of the sum due, CIN rejected Dollar Land's later attempt to tender payment and took steps to irritate the lease.

3.21 At first instance, the Lord Ordinary (Lord Morton of Shuna) held that CIN was entitled to irritate the lease.³⁵ Once notice had been given in compliance with the bare requirements of section 4, CIN became entitled to irritate if the rent remained unpaid upon expiry of the notice. This decision was upheld by the Second Division³⁶ where it was stressed that there had to be impropriety of conduct on behalf of the landlord before use of the irritancy would be deemed to be oppressive at common law.³⁷ In the House of Lords it was again held that the landlord's use of the irritancy was not oppressive in the circumstances and the sub-tenant's argument that irritancies were *per se* penal was rejected.

3.22 Their Lordships appeared to be uncomfortable with this outcome.³⁸ Nevertheless, in the absence of abuse or oppression, they were not prepared to go beyond the protection given to the tenant by section 4; "It is not open to this House to bring about any more far reaching development of the law in this field than was thought appropriate by Parliament."³⁹ In particular the House rejected the possibility of annexing conditions to the granting of a decree of irritancy whereby the landlord would have to compensate the tenant for the value of improvements to the land which had been carried out by the tenant or his predecessors.

3.23 Whatever the merits of the decision, the law at least is clear. Abuse or oppression apart, a court will grant declarator of irritancy for non-payment of rent provided the landlord has given the tenant the requisite pre-irritancy notice under section 4 during which period the tenant could have purged the irritancy by paying the rent but has failed to do so. The fact that the landlord might obtain a substantial economic windfall as a consequence of the irritancy is irrelevant.

³⁵ 1990 SC 351.

³⁶ 1992 SC (HL) 104.

³⁷ It was irrelevant in assessing the quality of the landlord's conduct that (1) the staff at Dollar Land's London office were not acquainted with the Scots law of irritancy (*per* Lord Mayfield at p 113) and (2) CIN had accepted dilatory payments in the past.

³⁸ "I am bound to say, however, that I do not regard the result in this case as satisfactory. The appellants [Dollar Land] will lose their investment of £2.2.m, which is the sum they paid for the assignation in their favour of the sub-lease, and the respondents [CIN] will have the benefit of the whole development including not only the buildings, which they paid for, but the site, which they did not, for £1 per annum over a period of some 120 years." 1992 SC (HL) 104 *per* Lord Keith of Kinkel at p 118; "Although the Scottish Law Commission and Parliament have considered the serious commercial imbalance which could result from the operation of an irritancy clause in a commercial lease, it does appear to me that further consideration could profitably be given to situations where a tenant, because of an oversight or omission on his part, stands to lose huge sums of money with consequent benefit to the landlord ... It would be very unfortunate if potentially valuable commercial development were to be frightened away from Scotland by fear of what English lawyers may regard as the draconian measures available to a landlord for non-timeous payment of rent." *ibid per* Lord Jauncey at p 126-7.

³⁹ 1992 SC (HL) 104 *per* Lord Keith of Kinkel at p 118. See also Lord Jauncey at p 125 "However, given Parliament's consideration of the matter, I do not consider that it would be appropriate for this House to develop the law further than Parliament has seen fit to do."

3.24 **Dollar Land Part II: the claim for compensation.** Nevertheless, Dollar Land was anxious to recover the losses on its investment. An attempt to argue that CDC and CIN had engaged in a joint venture failed.⁴⁰ The Lord Ordinary (Coulsfield) observed *obiter* that there could, perhaps, have been a claim on the basis of unjustified enrichment. This claim was pursued before an Extra Division of the Inner House.⁴¹ As a result of the irritancy, Dollar Land had ceased to be CIN's sub-tenant and had therefore lost the right to be landlord to the occupational leases which also fell.⁴² CIN had then entered into new occupational leases with the retailers and now collected all (and not merely 77.5%) of the rents. Dollar Land argued that they were entitled to the value of their investment, as represented by 22.5% of the rental income under the occupational leases it had expected to receive during the substantial remaining period of the sub-lease.

3.25 But there were two major difficulties facing Dollar Land in its claim for recompense. First, had CIN in fact been enriched? While Dollar Land had lost the return on its investment, this was because the sub-lease became retrospectively null when it was irritated and Dollar Land was no longer capable of granting the occupational leases.⁴³ While CIN became entitled to possession of the development, it was at the expense of losing the occupational leases which fell with the sub-lease. To obtain a rental income CIN would have to enter into new occupational leases with the retailers: moreover, should it do so, CIN would have to bear the costs of administration etc which had previously been borne by Dollar Land. Second, even if an enrichment existed, was it unjustified? As the irritancy clause stipulated that the landlord should be "free of all claims by the tenant, sub-tenants and others as if these presents had not been granted", a majority⁴⁴ of the Extra Division held that the parties had expected that CIN would enjoy the rents *vis à vis* the occupational leases, should the sub-lease be irritated. Since the enrichment was a consequence of contractual stipulation, a claim of recompense based on unjustified enrichment was excluded.⁴⁵

3.26 Lord Rodger, who dissented, also recognised the force of CIN's contention:⁴⁶

"The defenders argue that their enrichment is justified because it results simply from their regaining possession of the subjects by the lawful operation of the irritancy clause and that it is wrong to look beyond the terms of the head lease and sub-lease. That is a powerful argument especially since *it is unquestionably the law that in the ordinary case where a landlord irritates a lease the tenant has no claim for unjustified enrichment: any gain to the landlord results simply from the operation of the contractual term which brings the tenant's rights to an end*".⁴⁷

⁴⁰ *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1996 SLT 186.

⁴¹ 1996 SC 331.

⁴² This can be contrasted with the effect of a renunciation of the head lease which preserves the sub-lease and the sub-tenant's rights thereunder if duly made real prior to the renunciation taking effect; *Earl of Morton v His Tenants* 1625 M 15228.

⁴³ Since the sub-lease is retrospectively null, technically Dollar Land is treated as never having had the capacity to enter into the occupational lease. See para 2.9 above.

⁴⁴ Lord Sutherland and Lord Cullen.

⁴⁵ "It is, however, well established that if the benefit or windfall is created because of the operation of a contractual term, the terms of the contract must be allowed to override equitable considerations as it is assumed that when the parties contracted in the terms which they did they accepted that they must be bound by the strict terms of the contract." 1996 SC 331 *per* Lord Sutherland at p 344. "... I consider that a claim in respect of unjustified enrichment is foreclosed by the parties' contractual provisions. The claim is excluded by the irritancy clause and in any event relates to a financial advantage which it was consistent with the parties' expressed intentions that the defenders should be able to obtain"; *ibid*, *per* Lord Cullen at p 352.

⁴⁶ *Ibid* at p 357.

⁴⁷ Emphasis added.

But in Lord Rodger's opinion, this was not an ordinary case. Both CDC, Dollar Land's cedent, and CIN had intended to enjoy a return on the fruits of their investments. The mechanism chosen to provide this was the lease and sub-lease back. The question was whether the parties had intended that CDC's and its assignee's right to a return on their investment should also be destroyed if that mechanism was annulled should the sub-lease be irritated.⁴⁸ The irritancy clause envisaged CIN returning to the position which existed before the sub-lease was granted. However, Lord Rodger argued that the exercise of the irritancy clause left CIN in an enhanced position as it was no longer obliged to grant the sub-lease and could enjoy the fruits of the pursuer's investment as well as its own. He was not satisfied that this was what the parties had intended when they agreed to the irritancy clause and therefore would have allowed a proof before answer. We submit that Lord Rodger's approach while ingenious is ultimately unconvincing. Our point is that when CIN granted the sub-lease to CDC, its obligation to do so under the development agreement was discharged by performance. When the sub-lease was subsequently irritated, the discharged obligation did not revive. But CIN is in no better position than before the irritancy occurred for it had discharged that obligation the moment it granted the sub-lease.

3.27 Any doubts were resolved on appeal to the House of Lords⁴⁹ which held that because CIN had exercised a contractual right to irritate the lease, the resulting enrichment could not be treated as unjustified.⁵⁰ The fact that CIN had previously been under an obligation to grant a sub-lease was regarded as irrelevant given that it was clear that the parties intended CIN to enjoy the entire fruits of the development should the sub-lease be irritated.⁵¹ In short, where a landlord exercises a right to irritate a lease for non-payment of rent, any benefits directly arising from the annulment of the lease cannot be recovered by the tenant on principles of unjustified enrichment.

3.28 While the law on the point is clear, once again the House of Lords regarded the result as unsatisfactory:

"The entire benefit of that share in the development now resides with CIN. As was observed on the previous occasion when the case was before this House,⁵² the result cannot be regarded as satisfactory. CIN were undoubtedly within their rights in enforcing the irritancy clause But equitable considerations suggest that CIN should be subjected to the remedy of recompense unless the contract itself provides an answer to the claim that the enrichment was unjustified."⁵³

3.29 **Conclusion.** As we have mentioned, therefore, there is some disquiet - at least, at judicial level - with the final result of the *CIN Properties v Dollar Land* saga. Three reasons can be articulated for such a view.

⁴⁸ "If that was the parties' intention, then the pursuers' case must fail"; *ibid*, per Lord Rodger at p 359.

⁴⁹ 1998 SC (HL) 90.

⁵⁰ "It was inevitable that CIN would be enriched if the irritancy clause were enforced. I simply do not see how results for which parties or their predecessors had specifically and willingly contracted could be said to be unjust."; *ibid*, per Lord Jauncey at p 93. "So long as it can be said that the former landlords have obtained no more than they were entitled to under their contract as a result of the exercise of the irritancy, there will be no room for the operation of the law of unjustified enrichment. An obligation in unjustified enrichment is owed where the enrichment cannot be justified on some legal basis arising from the circumstances in which the defender was enriched. There can be no better justification for an enrichment than that it was obtained and is being retained in the exercise of a contractual right against the party who seeks to invoke the remedy."; *ibid*, per Lord Hope at p 94.

⁵¹ *Ibid*, per Lord Hope at p 98.

⁵² Discussed above at para 3.20.

⁵³ 1998 SC (HL) 90 per Lord Hope at p 99; see also *ibid*, per Lord Jauncey at p 93.

3.30 First, because of the landlord's right to irritate a lease regardless of the serious economic consequences for the tenant, the tenant may have difficulty in raising finance if the lease is his principal asset.⁵⁴ However, given that the irritancy will be exercised only on the tenant's failure to pay rent that is due, surely the tenant's general financial circumstances are more important to a potential lender than the fact that a lease assigned in security can be irritated for non-payment. Nevertheless, where a lease is a valuable asset, we recognise that the concerns of lenders are a commercial reality and have to be addressed by the parties if the transaction is to proceed. The question of protection for funders is considered further below.⁵⁵

3.31 Second, English lawyers and investors are, it is said, unaware of the stringent rules relating to irritancies. However if this was true before the *Dollar Land* saga, it should not be the case now. The differences between the Scots and English law of landlord and tenant should be recognised, not reconciled merely to facilitate "cross-border" transactions:

"There can, of course, be no compromise of the well established principles of Scots law such as those relating to the use of irritancies. As I said in *HMV Fields Properties v Bracken Self Selection Fabrics*⁵⁶ there are significant differences between the law of England and the law of Scotland relating to irritancies. Any investor in commercial property in this country must accept that these differences will continue to exist."⁵⁷

3.32 Third, the existence of an irritancy clause with its potentially serious economic consequences for the tenant might inhibit commercial developments in Scotland, particularly by English investors:

"It would be very unfortunate if potentially valuable commercial development were to be frightened away from Scotland by fear of what English lawyers may regard as the draconian measures available to a landlord for non-timeous payment of rent."⁵⁸

Is the current law of irritancy a deterrent to investment?

3.33 In light of the comments of Lord Jauncey and Lord Keith in *Dollar Land*,⁵⁹ it is necessary to examine whether the 1985 Act provisions have had a detrimental effect on financial investment in commercial property in Scotland. In our preparatory work for this paper, we therefore carried out a survey of interested parties seeking views on the extent, if any, to which investment in commercial development in Scotland had been affected by the decisions in the *Dollar Land* case.

⁵⁴ *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104 per Lord Keith at p 119.

⁵⁵ See paras 3.49ff and 5.57ff.

⁵⁶ 1991 SLT 31 at p 35.

⁵⁷ *Visionhire Ltd v Britel Fund Trustees Ltd* 1991 SLT 883 per the Lord President (Hope) at 889. "It seems to me that in this respect the legal advisers of prospective developers and tenants will have little difficulty in identifying any relevant difference between the two systems and in handling any resulting problems in either system. The mere fact that the two systems may come to different results in particular cases is not in my view a sufficient reason for saying that this court should remould our law so as to reach the same result as would be reached under English law in a particular situation."; *Highland and Universal Properties Ltd v Safeway Properties Ltd* 2000 SLT 414 per the Lord President (Rodger) at p 417 in relation to keep-open clauses.

⁵⁸ *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104, per Lord Jauncey at p 127. See also *ibid*, per Lord Keith at p 119.

⁵⁹ See para 3.22 above.

3.34 We adopted a two-fold approach. First, we approached thirty consultees including financial investors, property development companies, local authorities, enterprise companies, the CBI in the UK and Scotland and the RICS. Consultees were asked for their views on the extent (if any) to which there had been a detrimental effect on investment in commercial development in Scotland as a result of the *Dollar Land* litigation. Details of our findings are contained in Appendix 2. The parties who responded to us are listed in Appendix 3.

3.35 Our survey results suggest that the House of Lords' fears are ill-founded. None of the respondents reported that they had experienced a deterrent effect or considered the law of conventional irritancy to be a deterrent to investment *per se*. Specialist advice was almost invariably sought from the Scottish legal profession in relation to irritancy clauses, particularly in development leases. The specific provisions of an irritancy clause could thereby be tailored to the individual requirements of each situation. Therefore, while the law of irritancy may be an influential factor in commercial investment in Scotland, it was only one of a number of such factors and the ability to negotiate suitable terms meant it was rarely, if ever, a determining factor. Nevertheless, there was general support for the present review of the law and for reform.

3.36 Second, we sought evidence from a group of specialist commercial property practitioners.⁶⁰ They unanimously endorsed the findings of our consultation survey. Properly advised developers would not consider a well-drafted irritancy clause a deterrent to investment. Indeed, the ability of a landlord to irritate the lease of a defaulting tenant was seen as an incentive to investment in Scotland.

3.37 It could be argued that not all those in the market place have the bargaining position to secure a commercially acceptable irritancy clause. In addition, they may not be negotiating a new lease, but taking an assignation of an existing lease, with a harsh irritancy clause. However, our evidence to date suggests that even those with limited bargaining power should be able to achieve an acceptable solution. The rent under commercial leases is regularly reviewed. The revised rent is assessed upon a hypothetical letting, but generally reflects most of the contractual terms of the actual lease including the irritancy clause. Where any particular clause is unduly onerous this is likely to be reflected in a reduction in the level of rent which a landlord can achieve at review. Accordingly the potential consequences at review may be a good incentive for landlords to accept a reasonable compromise on the terms of the irritancy clause. Similarly in relation to assignations, landlords will usually look favourably upon a request by potential assignees for a variation of the original lease terms if they are disadvantageous to the tenant.

3.38 This preliminary consultation was, by necessity, limited. We therefore seek views on the following questions:

2. (a) **Does the present law of conventional irritancy act as a deterrent to commercial development in Scotland?**
- (b) **If not, does the present law of conventional irritancy nevertheless require reform?**

⁶⁰ See para 1.25 above.

Irritancy clauses relating to non-monetary breaches and conditions in commercial leases

3.39 **Introduction.** As we have described above, irritancy clauses are not restricted to the punctual payment of money. As a contractual stipulation between the parties, an irritancy clause can relate to such matters as the parties wish. A lease usually provides that a landlord has a right to irritate the lease in respect of the tenant's failure to comply with an obligation *ad factum praestandum*⁶¹ or a restrictive obligation.⁶² Moreover, the landlord is generally given a right to irritate the lease should one of a number of specified changes occur in the status of the tenant.⁶³ Irritancy clauses can also relate to obligations owed to the landlord by a third party or to events which do not relate to the tenant's own circumstances.⁶⁴

3.40 In our Report and in the subsequent implementing legislation, no distinction was drawn between irritancy in respect of a breach of a non-monetary obligation and irritancy in respect of a change in the status of the tenant. However, our recommendations, subsequently enacted as section 5 of the 1985 Act, do not apply to the breach of an obligation owed to the landlord by a third party and other matters outwith the tenant's control.⁶⁵ The courts have subsequently considered the operation of the "fair and reasonable landlord" test set out in section 5 in relation to both changes in the status of the tenant and non-monetary obligations. We shall consider each type of case separately to determine whether there has been uniformity of application.

3.41 **Change in the status of the tenant.** The statutory criterion was explored in relation to the appointment of a receiver by the Lord Ordinary (Cullen) in *Blythswood Investment (Scotland) Ltd v Clydesdale Electric Stores Ltd (In Receivership)*.⁶⁶ The pursuer (the landlord) sought to irritate the defender's lease when a receiver was appointed. The receiver was able to find an assignee of the tenant's interest under the lease. The question before the court was whether a fair and reasonable landlord would irritate in these circumstances. Lord Cullen rejected the contention that this was an objective test simply comparing the prejudice caused to the landlord by the circumstances which triggered the irritancy and the prejudice caused to the tenant if the lease was irritated.⁶⁷ Moreover the test was not what the court, taking an objective view of the circumstances, would regard as fair and reasonable. Instead the court had to consider what a fair and reasonable landlord would have done in all the circumstances. This involves "considering what a fair and reasonable landlord in the position of the actual landlord would have done; and accordingly in what [counsel] described as the "factual matrix" of the case".⁶⁸ Because of the width of the statutory language, account had to be taken of the economic advantages the landlord would obtain if the lease was irritated as well as the prejudice suffered by the landlord as a consequence of

⁶¹ For example to maintain the subjects of let in good and substantial repair.

⁶² For example not to sub-let the subjects of let.

⁶³ For example liquidation (other than for reconstruction or amalgamation), appointment of a receiver, the making of an administration order, apparent insolvency or the making of a trust deed for creditors.

⁶⁴ See Scot Law Com No 75, para 4.10.

⁶⁵ *Ibid.*

⁶⁶ 1995 SLT 150.

⁶⁷ "It might be expected that if the question were whether it would be penal for an irritancy clause to be relied on in the circumstances of a particular case, this would involve a comparison between the prejudice occasioned to the landlord by the event which provided the ground for exercising the option to irritate and the prejudice which would be suffered by the tenant if the option was enforced. While in a particular case the landlord might stand to obtain a significant benefit from the exercise of the option, this would be foreign to such an assessment as to whether the enforcement of the irritancy clause was penal or not. It might well form part of what motivated the landlord to exercise the option but would not form part of the grounds for its exercise."; *ibid* at p 155.

⁶⁸ *Ibid*, per the Lord Ordinary (Cullen) at p 155.

the events which gave rise to the right to irritate. Where the economic advantages were great, they could well outweigh the losses to the tenant if the lease was irritated rendering the landlord's reliance on the irritancy clause fair and reasonable. As Lord Cullen recognised, this goes well beyond the usual judicial function in assessing whether or not conduct is unreasonable: indeed, it involves the court judging matters of commercial import, the precise outcome which the Scottish Law Commission had endeavoured to avoid in its recommendations.⁶⁹

3.42 Moreover, given the width of the statutory criterion, a court will be slow to refuse probation and dismiss an action on the grounds of relevancy.⁷⁰ In other words, long and expensive proofs will be difficult to avoid. Consider *Aubrey Investments v DSC (Realisations) Ltd (In Receivership)*.⁷¹ The defender (tenant) went into receivership. This gave the pursuer (landlord) the right to irritate the lease. With the landlord's knowledge, the receiver entered into negotiations to have the lease assigned. After four and a half months, negotiations broke down and the receiver failed to inform the landlord. When this was discovered, the landlord found a potential lessee and entered into missives. But before the new lease could go ahead, the pursuer had to obtain a declarator of irritancy. At this stage, the defender argued that the pursuer was not acting as a fair and reasonable landlord in relying on the irritancy clause. After a long proof, the Lord Ordinary (Macfadyen) held that it had not been shown that a fair and reasonable landlord would not have served notice of irritancy in the circumstances.⁷²

3.43 It is difficult not to feel sympathy for the task set the Lord Ordinary. When contemplating relying on an irritancy clause, how much weight should a landlord give to the interests of the tenant's receiver, *viz* the loss of the assignation and the failure to sell the business as a going concern? Similarly, how does a landlord balance the need to protect his income stream and the investment value of the property against the fact that the current tenant has not failed to pay the rent and has a substantial cautioner? Is it unreasonable and unfair to irritate after waiting four and a half months for the receiver to negotiate an assignation of the lease only to be let down at the last minute? It is not surprising that Lord Macfadyen's statements become elliptical:

"The fair and reasonable landlord is not the wholly altruistic landlord who subordinates his own interests to those of the tenant. He is, rather, the landlord who is prepared to exercise his right to irritate the lease, unless it would be unfair or unreasonable of him to do so."⁷³

3.44 **Obligations *ad factum praestandum*.** The effect of section 5 of the 1985 Act on a landlord's ability to irritate a lease on the grounds of failure to perform an obligation *ad factum praestandum* was considered in *Euro Properties Scotland Limited v Alam and Mitchell*.⁷⁴

⁶⁹ "I should add that while this is in my view the result of the width of language used in the section I am not wholly confident that it is a result which the Scottish Law Commission had in contemplation.": *ibid* at p 155. See Scot Law Com No 75, paras 4.7ff; see para 3.13 above.

⁷⁰ *Aubrey Investments Ltd v D S Crawford Ltd (In Receivership)* 1998 SLT 628 *per* the Lord Ordinary (Penrose) at p 636.

⁷¹ 1999 SC 21.

⁷² "The test is failed only if it can be affirmed that any landlord adhering to the standards of fairness and reasonableness would in all the circumstances decline to irritate"; *ibid*, *per* the Lord Ordinary (Macfadyen) at p 45.

⁷³ *Ibid*, *per* the Lord Ordinary (Macfadyen) at p 50.

⁷⁴ Unreported. Outer House, 20 June 2000, 2000 GWD 23-896.

See <http://www.scotcourts.gov.uk/opinions/MCF0806.html>.

The facts of the case are as follows. The defenders were the tenants of commercial premises in Trongate, Glasgow under a full repairing lease for 21 years from 16 May 1994. The subjects were Grade A listed as a building of special architectural or historic interest. A listed building repair notice was served on the landlords (as proprietors) and the tenants by Glasgow City Council in May 1997⁷⁵ requiring that certain repair works be carried out to the premises to the satisfaction of the Council's Director of Planning and Development. The landlords subsequently served notice on the tenants on 3 June 1997 that in terms of the lease the tenants were obliged to carry out the works referred to in the listed building repair notice and calling upon them to do so within one month otherwise the landlords would be entitled to exercise their remedy under the lease of carrying out the works themselves and recovering the costs thereby incurred from the tenant. There was therefore no suggestion that the landlords were considering the exercise of their remedy of irritancy at this stage.

3.45 Although negotiations were held with the Council and a structural report was prepared, neither the tenants or the landlords proceeded to carry out the repair. In December 1998 the landlords' solicitor served notice on the tenants intimating that the tenants were in breach of their repairing obligation in terms of the earlier notice and threatening irritancy of the lease should the tenants fail to remedy their breach. The notice then set out three deadlines by which the tenants should have taken various steps so as to comply with their obligations. Ultimately, the tenants were given a period of 60 days from the service of the notice to complete the repairs. Following the tenant's failure to comply with the terms of the notice, the landlords sought declarator of irritancy and decree of removing. The Lord Ordinary (Macfadyen) concluded that a fair and reasonable landlord in the position of the pursuers would not rely on the defenders' failure to comply with their repairing obligation as proposed in the pre-irritancy notice and the landlords' action therefore failed.

3.46 It now appears settled that the test applied by section 5 of the 1985 Act requires consideration of what a hypothetical fair and reasonable landlord would have done if placed in the actual position of the landlord in question.⁷⁶ Lord Macfadyen rejected the proposition that in applying that test, the court required to consider whether the exercise of the irritancy was penal in effect. While the courts will bear in mind that one of the policy objectives of the legislation was to remove the mischief of penal use of the remedy of irritancy, the statutory test is not framed this way.⁷⁷

3.47 Lord Macfadyen accepted the evidence that it was unusual for the remedy of irritancy to be used in relation to a breach of a non-monetary obligation.⁷⁸ This led him to conclude that "irritancy for failure to implement repair obligations is a course rarely adopted by fair and reasonable landlords."⁷⁹ Considerable importance was placed on the fact that the landlords had a separate contractual remedy to carry out the repair themselves and recover the cost of doing so from the tenants. Lord Macfadyen observed:⁸⁰

"I am of opinion that it is not *prima facie* fair and reasonable to opt for irritancy when there is available an alternative remedy ... which would (a) not deprive the tenant of

⁷⁵ In terms of ss 104 and 105 of the Town and Country Planning (Scotland) Act 1972 (now ss 42 and 43 of the Planning (Listed Buildings and Conservation Areas) (Scotland) Act 1997).

⁷⁶ See <http://www.scotcourts.gov.uk/opinions/MCF0806.html> at para 24.

⁷⁷ See Scot Law Com No 75, para 4.11 and para 3.18 above.

⁷⁸ See <http://www.scotcourts.gov.uk/opinions/MCF0806.html> at para 37.

⁷⁹ *Ibid* at para 40.

⁸⁰ *Ibid* at para 44.

his interest in the lease but (b) nevertheless adequately protect the landlord's interests. I quite accept that there may be circumstances which enable the landlord to show in such a case that it is nevertheless fair and reasonable to insist on irritancy. I accept that such circumstances could include a belief on the landlord's part, properly founded on his own experience or on relevant professional advice that he had obtained, that if he irritated he would be able to re-let on advantageous terms."⁸¹

3.48 **Conclusion.** The statutory test set out in section 5 against which a landlord's entitlement to pursue his remedy of irritancy is determined appears problematic. It has failed to achieve the stated policy goals of avoiding protracted proceedings and preventing judicial determination of commercial issues.⁸² There may well be a generally accepted view of "the fair and reasonable landlord" within the Scottish commercial property market as we concluded in our Report.⁸³ However, it is the superimposition of that criterion upon the detailed "factual matrix" of each individual case which raises difficulties. Judicial interpretation of the statutory language has established (i) that the landlord must prove that it was fair to irritate and (ii) that in reaching that conclusion his reasoning itself passes the "fair and reasonable landlord" test. It has been suggested to us by members of the legal profession that to irritate a lease for non-monetary breach in accordance with the provisions of section 5 is generally not an economically viable option, being protracted and expensive. As a result, solicitors advise their clients that unless the tenant is in monetary breach, it would be uneconomic to attempt to exercise their right of irritancy. This leads us to conclude that we must reconsider our approach to this question. Our proposals for possible reform are considered in detail in Part 5.

The interests of third parties

3.49 The detrimental effects of the enforcement of an irritancy clause upon a tenant's creditors and sub-tenants were considered in our previous Consultative Memorandum and Report.⁸⁴ We consulted on two proposals, namely:

- whether sub-tenants and creditors known to the landlord should have the same right as the tenant to receive notices from the landlord; and
- whether the courts should have a discretion to vest the tenant's interest in the third party following an irritancy, subject to appropriate conditions.⁸⁵

3.50 Both of these proposals were rejected following consultation. In relation to notices, it was considered that to impose such requirements on the landlord was unduly onerous and inappropriate given the absence of a connection between the parties. Giving the courts the power to transfer a tenant's interest to his sub-tenant was also rejected. It was feared that such a power could result in a reduction in the number of tenancies which landlords would be prepared to permit. Faced with the possibility of a sub-tenant being substituted for the head tenant by the court, landlords would require to consider in detail the financial suitability of the sub-tenant as a prospective tenant. At present landlords need not do so as there is no possibility of the sub-tenant taking over the tenant's position. If the sub-tenant

⁸¹ *Ibid.*

⁸² See para 3.13 above.

⁸³ Scot Law Com No 75, para 4.11.

⁸⁴ Consultative Memorandum No 52, para 7.01 ff; Scot Law Com No 75, para 5.1 ff.

⁸⁵ Scot Law Com No 75, para 5.2.

wishes to do so following the irritancy then he must negotiate the terms of a new lease just like any other prospective tenant.

3.51 It was felt that a tenant's creditors could achieve suitable protection through the negotiation of appropriate wording in the irritancy clause so as to permit the realisation of a valuable lease for the benefit of the tenant's creditors. It was not thought that statutory intervention was an appropriate means by which to achieve that which could be adequately protected by sound legal advice.

3.52 In relation to third parties, the question for determination as part of this review is therefore whether there are other valid considerations which were not examined as part of the previous reform exercise, or whether there have been subsequent developments which have rendered our previous conclusions unsound. Our proposals for possible reforms are considered in more detail in Part 5.⁸⁶

⁸⁶ See para 5.57 below.

Part 4 The Policy Considerations

Introduction

4.1 In Part 3 we discussed the problems which continue to surround the law of irritancy. Some of these are inherent in the concept of irritancy itself; others directly arise from the provisions of the 1985 Act. In this Part we consider the major policy issues which have to be considered in contemplating reform. As will become readily apparent, these are often conflicting. What we must consider is whether or not the balance of interests underlying the current law remains satisfactory.

Freedom of contract

4.2 Irritancy is a contractually agreed remedy and it is a fundamental principle of the Scots law of contract that parties should be held to the terms of their bargain.¹ That said, there are circumstances when parties can be relieved from a provision of their contract. In consumer contracts, for example, where the parties do not have equal bargaining power and the term gives the stronger party a significant advantage over the weaker, that term may be unenforceable.² While there is no doubt that an irritancy clause gives the landlord a powerful remedy vis à vis the tenant, in many commercial leases the economic weight of the parties and consequently their bargaining strengths are more or less balanced. Consequently their legal advisers are free to negotiate the most advantageous terms they can for their clients. Even where the landlord does have greater bargaining strength, he is often constrained from imposing a penal irritancy clause because this will operate against his interests at subsequent rent reviews.

Termination as a remedy for breach

4.3 Moreover, in the vast majority of cases the right to irritate arises only when the tenant has broken a term of the lease. Where this breach is material, for example, non-timeous payment of rent, an irritancy is similar to the general right of an aggrieved party to terminate further performance of his contractual obligations after a material breach (rescission).³ Where, in relation to termination of a lease, the landlord wishes to recover possession of his property from a defaulting tenant, the availability of a quick, clean remedy is extremely valuable. On the other hand, if the condition which triggers the irritancy is a non-material breach then termination of the lease may appear to be a disproportionate response to the harm sustained by the landlord. But this is to overlook the principle that parties to a contract are able expressly to stipulate that any breach of any term is to be

¹ *Stair Inst* 1, 10, 14; *Erskine Inst* III, 34; *Fairie v Inglis* (1669) Mor 14231. See generally Thomson "Judicial Control of Unfair Contract Terms" in *A History of Private Law in Scotland* (Reid and Zimmermann eds) Vol II p 157.

² Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083).

³ See generally Report on *Remedies for Breach of Contract* (Scot Law Com No 174); MacQueen & Thomson, *Contract Law in Scotland* at p 205 ff.

treated as material so that the aggrieved party is entitled to rescind.⁴ Thus an irritancy clause can be shown to be consistent in this respect with general contractual principles.⁵

Monetary breaches

4.4 In theory at least, the courts can protect a tenant from abuse or oppressive use of irritancy; in practice, this does not happen.⁶ The matter is, of course, exacerbated by the rule that a tenant cannot purge a conventional irritancy.⁷ In relation to monetary breaches section 4 of the 1985 Act has improved the tenant's position by requiring the landlord to give the tenant a minimum notice period of 14 days during which the tenant can purge a breach by paying the rent. The question arises whether this period is too short given that the tenant faces eviction should he fail to pay. While it is clear that a landlord should not be compelled to continue with an economically unreliable tenant, nevertheless 14 days seems a relatively short time in which to purge the breach.⁸ Even if that period is acceptable, it seems to us to be unarguable that the tenant should know the effect of the notice and the consequences of failure to pay on time. The present law in our view does not adequately ensure that the tenant has this information.⁹

Non-monetary breaches

4.5 In respect of non-monetary breaches, section 5 of the 1985 Act prevents a landlord from exercising his right to terminate the lease if it can be established that a reasonable landlord would not have done so in the circumstances. This constitutes a serious inroad into the contractual autonomy of the parties. As we have seen, the section 5 test has been problematic.¹⁰ It has resulted in lengthy and expensive litigation where the courts have had to engage in weighing *inter alia* the economic consequences for both parties if the lease were to be irritated. This is a difficult, if not an impossible, task.¹¹ In order to avoid litigation, it appears that landlords increasingly prefer not to irritate for non-monetary breach. Instead, the landlord may exercise a contractual right to perform the tenant's obligations and sue the tenant for the expense he has incurred. The result is that the tenant will incur a monetary obligation and if the tenant fails to make payment, then the landlord will be able to irritate on that ground provided, of course, he gives the tenant the requisite notice under section 4. Alternatively, the landlord may simply sue the tenant for damages for breach of contract.

4.6 The current situation in respect of non-monetary breach is therefore unsatisfactory. The section 5 test in effect deprives the landlord of the remedy of irritancy as it can involve him in prolonged litigation to establish that his exercise of the irritancy was reasonable. This undermines the major strength of the remedy of irritancy, *viz* that the lease can be terminated cleanly and quickly. But irritancy can also be used as a compulsitor for the performance of the tenant's obligations ie the threat of irritancy is used to "encourage" the tenant to perform.¹² This suggests that the tenant should be given the opportunity of

⁴ *Dawsons Ltd v Bonnin* 1922 SC (HL) 156 *per* Viscount Cave at p 169; *Bell Bros (HP) Ltd v Aitken* 1939 SC 577 *per* the Lord President (Normand) at p 588.

⁵ It should however be noted that a lease is more than a contractual right, it is a property right. The potential loss to the contract breaker is therefore much greater.

⁶ See discussion above at para 3.7.

⁷ *Dorchester Studios (Glasgow) Ltd v Stone* 1975 SC (HL) 56.

⁸ Especially when weekends and holiday periods are taken into account.

⁹ See the discussion of the *Dollar Land* litigation at paras 3.20-3.23.

¹⁰ See discussion above at paras 3.39-3.48.

¹¹ *Ibid* at para 3.48.

¹² *Euro Properties Scotland Ltd v Alam and Mitchell*, unreported, (OH) 20 June 2000, 2000 GWD 23-896.

performing the obligation before the landlord can terminate the lease. It can also be argued that a landlord should be entitled to irritate the lease only if he has exhausted alternative means to compel performance. At the very least we should consider whether there should be a statutory notice period before the landlord can irritate for non-monetary breach. Because of the difficulties experienced with section 5,¹³ we feel reluctant to recommend that the exercise of the right to irritate for non-monetary breach should be the subject of judicial discretion as to its reasonableness etc. Moreover, it should be remembered that commercial investment in property is based on the parties' assessment at the date of the contract of the potential risks involved in the project. Where the exercise by a landlord of his right of irritancy can be stopped by judicial intervention at a later date, the parties' original assessment of those risks is undermined.

Third parties

4.7 As we have seen,¹⁴ an event which triggers an irritancy clause need not involve a breach of the tenant's obligations under the lease. The most common example is a change in the tenant's status as a result of the appointment of a receiver, liquidator or trustee (the "insolvency practitioner") in respect of the tenant's property. The landlord will have negotiated for an irritancy clause in these circumstances so that he can take immediate possession of the property, untrammelled by the interests of the tenant or the tenant's creditors. Yet it may be in the landlord's interests as well as in the interests of the tenant's insolvency practitioner that the lease should not be terminated immediately but that there should be a period during which an attempt can be made to dispose of the lease, for example, by assigning the lease to a new tenant.¹⁵ Provided the interests of the landlord are adequately protected and the insolvency practitioner ensures that the tenant fulfils his obligations under the lease throughout the period, we find this idea attractive. Moreover, it will often be in the interests of third parties, for example, the tenant's lender, that the lease should continue rather than be irritated by the landlord. Indeed, the landlord's interests may well be served if the third party were prepared to fulfil the tenant's obligations. Thus we shall consider whether there should be a period during which a landlord should not be able to irritate a lease so that account can be taken of the interests of third parties.

Disproportionality

4.8 One of the major criticisms of the right to irritate is that termination of the lease may be a disproportionate response to the harm in fact sustained by the landlord as a consequence of the tenant's breach or the purification of the condition which triggered the irritancy. While it is conceded that irritancy provides a quick clean remedy to enable a landlord to have an unsatisfactory tenant removed and regain possession of his property, nevertheless it has been argued that circumstances can arise when it would be manifestly unfair to allow the landlord to terminate the lease without compensating the tenant.¹⁶ In particular, this would arise when, as a consequence of irritancy, the landlord enjoys improvements to the property carried out by the tenant during the lease. As we have seen,¹⁷ the law of unjustified enrichment does not operate to provide recompense in this situation.

See <http://www.scotcourts.gov.uk/opinions/MCF0806.html>.

¹³ See discussion above at paras 3.39-3.48.

¹⁴ See discussion above at paras 3.41-3.43.

¹⁵ As happened in *Aubrey Investments v DSC (Realisations) Ltd (In Receivership)* 1999 SC 21.

¹⁶ See discussion above at paras 3.20-3.32.

¹⁷ *Ibid* at paras 3.24-3.28.

4.9 It is undeniable that on occasions a landlord has enjoyed a substantial windfall as a consequence of irritating a lease.¹⁸ But in many cases this is not so: indeed, the landlord may well incur expense if, for example, he has to carry out repairs which the tenant failed to do. Moreover, it must be remembered that in most cases the event which triggered the irritancy will have been a material breach of the terms of lease. These factors suggest that in the context of genuine occupational leases the termination of the lease will not usually be a disproportionate response to the tenant's breach.

4.10 That said, there is no doubt that there is one situation where a landlord has obtained huge windfalls, *viz* the termination of development (investment) leases. We considered whether there should be a separate regime for development leases where the landlord's right to irritate would be restricted. The difficulty with this suggestion is to define a development lease with sufficient certainty. A development lease is not necessarily every lease where the tenant is obliged to construct buildings on the land and the rent is low. Indeed, given the ingenuity of lawyers a genuine development lease could be drafted to avoid being classified as such. This raises the prospect of preliminary litigation to classify the lease in the light of all the relevant factors of the case. There is also the possibility that third parties would be unwilling to take an assignation of the lease unless the cedent could warrant its status; this could inhibit the use of leases as legal devices in this area. Accordingly, we have concluded that development leases should not be treated separately.

4.11 Instead, we shall consider whether the courts should have a statutory power to prevent a landlord from irritating a lease in the exceptional circumstances where it would be manifestly unfair to do so.

Conclusion

4.12 The purpose of this Part has been simply to illustrate the potentially conflicting interests which have to be balanced in the law on irritancy. Our provisional view is that while there is room to redress the balance between the interests of the landlord and tenant in relation to some aspects of the 1985 Act, root and branch reform of the law on irritancy is neither necessary nor wanted by property practitioners. The detailed options for reform are considered in Part 5.

¹⁸ *Dollar Land* is, of course, the leading example.

Part 5 Proposals for Reform

Introduction

5.1 Our preliminary enquiries confirm that conventional irritancy is recognised as a valuable remedy. It acts as a compulsitor to performance of the tenant's obligations but also allows a landlord to remove a tenant who is no longer able to perform. Irritancy is of particular practical importance in relation to payment of rent, one of the essential elements of a lease.¹ In the vast majority of cases it is legitimate for the landlord to expect that he should receive rental payments within a reasonable time or to be entitled to exercise his right of irritancy.

5.2 The evidence which we have gathered to date does not support the House of Lords' fear that the present law of irritancy acts as a deterrent to investment in property developments in Scotland. Where tenants consider the protections available under the 1985 Act insufficient for their needs, the present law allows tenants the flexibility to negotiate more favourable terms without restriction. We have found no evidence that the market place restricts a tenant's ability to negotiate acceptable terms in relation to leases granted either before or after the 1985 Act came into force. Indeed, it has been pointed out to us that there is a positive influence upon the landlord to agree to such terms, as an onerous irritancy clause could have a detrimental effect on the rent achievable by the landlord at rent review.

5.3 Only in very restricted circumstances, eg where the rent passing is negligible in relation to the value of the reversionary property, will the obligation to pay rent be of little significance and irritancy may be considered a draconian remedy for non-payment. In relation to such leases different conditions apply. In recognition of the significant value of the tenant's interest in the lease, specialist advice is usually employed and a tailored irritancy clause negotiated appropriate to the particular circumstances.

5.4 As we have discussed above,² we consider that it would be impossible to frame a statutory definition of what comprises a "development lease" for this purpose. Accordingly, it is in our view impossible to provide a separate statutory scheme for such leases. Any proposals for reform of the law of irritancy would therefore have to apply uniformly to all leases of commercial property or else be subject to arbitrary restrictions.

5.5 Under the present law, properly advised tenants are unlikely to be caught unawares. The statutory notice period is however quite short. This, combined with ignorance of the inability to purge a conventional irritancy after expiry of the period, can give rise to financially disastrous results.³

5.6 These hard cases, such as *Dollar Land*, do not arise very frequently. Following that decision the commercial property industry should be well aware of the consequences of

¹ See Rankine, *Leases* p 114; Paton & Cameron, *Landlord and Tenant* p 5.

² See para 4.10.

³ The underlying cause of the problems in *Dollar Land* was that the tenant had regularly exploited the landlord's leniency in accepting late payment and did not consider the terms of the pre-irritancy notice to be final. It expected to be able to purge the irritancy even after expiry of the notice.

failure to take seriously the terms of an irritancy notice in respect of monetary breach. It could therefore be argued that the present law as set out in section 4 of the 1985 Act is satisfactory in all but the most extreme cases. Where such extreme cases occur, it is because investment tenants have not managed their commercial affairs properly. It may be thought that it is not a proper function of the law to protect them when they so fail.

5.7 It could also be argued that the best way forward in such circumstances is to allow the parties the freedom to negotiate their own specific terms. We understand that there is sufficient flexibility in the commercial market to do so. Further, in relation to development leases, the bargaining position of the tenant and his funder is such that he will almost certainly be able to negotiate suitable terms.

5.8 In our view, while there is no evidence that the results in *Dollar Land* and the litigation concerning section 5 act as a deterrent to investment in Scottish property, they nevertheless indicate that reform of the law of conventional irritancy is required.

5.9 Under the Leasehold Casualties (Scotland) Act 2001 irritancy has been declared void and unenforceable in relation to "qualifying leases".⁴ One way forward might be to consider within the context of this paper whether there are other classes of lease, such as development leases, which should be incapable of being irritated. As we have stated, we consider that framing a workable definition of such a lease would be difficult.⁵

The common law equitable power

5.10 Prior to the 1985 Act, in theory at least, the common law equitable power of relief could be used to prevent the misuse of irritancy. However, we have been unable to find any reported decision after 1864⁶ where this power has been exercised. In the light of the narrow scope given to the notions of abuse and oppression,⁷ it is likely that the power will rarely, if ever, be exercised. In these circumstances, we seek views on whether the common law power is of any residual value or whether it should be abolished.

3. (a) **Does the common law equitable power of relief have any residual value?**
- (b) **If not, should it be abolished?**

A statutory discretionary power of relief

5.11 It might be thought that a way to address the difficulties with the present law of irritancy would be to give the courts a statutory discretionary power of relief, wider than that which they presently enjoy at common law. Under the statutory power the judge could evaluate whether in the particular circumstances of any given case, the relative interests of the parties and the nature of the breach were such that the exercise of the remedy of irritancy would be inappropriate. Such a judicial discretion would require to be based upon a statutorily defined standard. We would suggest that an appropriate test which could be

⁴ See para 1.20 above.

⁵ See para 4.10 above.

⁶ When the modern interpretation of the doctrine of relief was settled; *Stewart v Watson* (1864) 2 M 1414.

⁷ See para 3.7 above; *Dorchester Studios (Glasgow) Ltd v Stone* 1975 SC (HL) 56; *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* 1992 SC (HL) 104.

applied is that which we recommended in relation to penalty clauses,⁸ namely whether in the circumstances the landlord's conduct is "manifestly excessive". Such a test would achieve consistency by treating "penal" clauses in leases of land in the same way as penalty clauses in other types of contracts.

5.12 In addition to determining whether the irritancy should be valid or invalid on the basis of the "manifestly excessive" test, the court could also be empowered to grant declarator of irritancy subject to such conditions or otherwise as it considers fit, including the payment of compensation to redress any windfall advantage to the landlord. The difficulty here is to determine the nature and extent of such compensation. Neither the law of contract nor unjustified enrichment appears to provide guidance to the court on the measure of the appropriate compensation. Nor do our proposals on penalty clauses provide an analogy: while the sum stipulated in the penalty cannot be recovered, the law of contract provides a measure of the damages which the court has discretion to award. Such difficulties explain why the traditional means of tackling the harsh effects of irritancy has been to modify those effects rather than provide compensation.

5.13 This approach leaves the task of balancing the interests of the landlord and the tenant to the judiciary. It provides flexibility as the question of whether irritancy is appropriate is considered against the particular circumstances of each case. The appropriateness of the remedy may change throughout the time frame of the lease and according to the nature of breach. This option would allow each individual case to be assessed and balanced on its own merits. Nevertheless there are significant disadvantages. This judicial discretion would inevitably lead to a lack of certainty and could frustrate the clear intentions of the parties. This could be damaging to the investment property market where the ability to make an accurate assessment of risk is vital. Also it is a fundamental element of a lease that at the very least the rent is paid on time. At present Scots law is seen as advantageous in that irritancy provides the landlord with a useful tool to ensure swift compliance with financial obligations. We suggest that the commercial property industry in Scotland would not welcome a move towards the highly complex English law of relief against forfeiture described in Appendix 1.

5.14 As we have already emphasised, irritancy is generally regarded within the legal profession and commercial property market as a useful and appropriate remedy in most commercial circumstances. It is only in extreme cases such as *Dollar Land* that the effects of irritancy appear manifestly excessive. While we take the view that arbitrary restrictions should be avoided, nevertheless, if a judicial intervention approach is adopted, we consider that it may be appropriate in the interests of commercial certainty to exclude from the operation of such a general rule those leases where there can be no doubt that the landlord has a legitimate interest in removing an unsuitable tenant. As most occupational leases⁹ run for less than 25 years, we would suggest this as a starting point. We would welcome consultees' views on whether they agree with this approach and whether the appropriate criterion for such an exclusion would be leases with an unexpired term of 25 years or less.

5.15 We are concerned that the creation of an enhanced judicial discretion to determine whether to give effect to contractual irritancy clauses will give rise to uncertainty and

⁸ Scot Law Com No 171, para 3.10; draft Bill, clause 1.

⁹ By which we mean leases where the tenant is the occupier of premises which have been provided by the landlord for that purpose.

litigation. Our provisional view is to reject this approach. Nevertheless we would welcome consultees' views on the following questions:

4. (a) **If the common law equitable power of relief is to be abolished, should there be a statutory restatement of that power in a wider form?**
- (b) **Should the criterion for the exercise of such a statutory power be whether the irritancy is "manifestly excessive"?**
- (c) **If not, what form should the criterion take?**
- (d) **Where an irritancy is found to be manifestly excessive should it be excluded as a remedy, or should it be allowed to proceed only at the discretion of the court?**
- (e) **Where the court allows such an irritancy to proceed, should the court be empowered to stipulate such provisions as to compensation or otherwise as the court may consider appropriate in the circumstances?**
- (f) **Should leases with an unexpired term of less than 25 years be excluded from such a statutory power or should some other exclusion apply?**

5.16 Given our concerns with the above, we therefore now consider whether a better way forward would be to modify the approach adopted in the 1985 Act.

Monetary Breach

5.17 **A revised pre-irritancy notice procedure.** We are of the view that where irritancy is regarded as a legitimate remedy, a tenant against whom that remedy is being exercised should be fully aware from the face of a mandatory notice of the legal effect of irritancy proceedings and of his legal rights. Where the tenant is fully informed, the onus passes to him to seek legal advice or to take such action as he considers appropriate.

5.18 There is no requirement at present that pre-irritancy notices make clear the precise effects of the threatened irritancy. In particular, the tenant may be unaware that while court proceedings may be required to confirm that the irritancy has been properly exercised, he will have no opportunity to purge the irritancy during those proceedings.¹⁰ He may also be unaware that he will not be entitled to any compensation for any improvements he has made to the property. This has led us to conclude provisionally that the present law is unsatisfactory and that these concerns could be addressed by a revised pre-irritancy notice procedure.

5.19 We have the impression that there is a general view that the present 14 day notice period is a fairly tight period within which to expect the tenant to pay. It could be extended to 28 days without significant detriment to the landlord and with considerable benefit to the tenant.

¹⁰ This was one of the claims made by Dollar Land; see 1990 SC 351 *per* Lord Morton of Shuna at p 362.

5.20 During our initial consultation, it was suggested that the irritancy process should give the tenant two opportunities to pay. This would involve service of a formal pre-irritancy notice specifying a 28 day period within which to pay the sum due. Upon expiry of that notice without payment, an irritancy notice could be served as at present. However, the tenant would have a statutory right to purge the irritancy within 14 days of service of the irritancy notice. The rationale behind the two-stage process is to address the possibility of the first notice being mislaid or deliberately withheld by an unscrupulous employee. While allowing the tenant the opportunity to purge after service of the irritancy notice would address the former problem, it would not necessarily resolve the latter. It also undermines the fundamental rule of the Scots law of irritancy that conventional irritancies may not be purged after service of the irritancy notice.¹¹ For these reasons, we are not convinced that allowing a statutory opportunity to purge after service of the irritancy notice is the way forward.

5.21 We are more inclined to the view that it is appropriate that the landlord should take all reasonable measures to ensure that the tenant is properly notified of his rights and obligations in a pre-irritancy notice and that the tenant be given a reasonable period within which to comply. We are therefore supportive of the proposal to extend the period of the pre-irritancy notice from 14 to 28 days. If security holders and chargeholders were to receive pre-irritancy notices in order to give them an opportunity to procure performance of the obligation, extending the period for compliance might appear sensible.¹²

5.22 At present, statutory pre-irritancy notices must be served by recorded delivery and are sufficiently served if sent to the tenant's last business or residential address in the United Kingdom known to the landlord or to the last address provided to the landlord by the tenant for the purpose of service.¹³ There are therefore presently no mandatory provisions concerning where the notice must be served. If legislation were to provide that, where possible, the pre-irritancy notice should be served on the tenant at two separate locations, then the concerns expressed at paragraph 5.20 above could be addressed. The statutory requirements would apply *in addition* to any contractual provisions concerning the service of notices contained in the lease.

5.23 In all cases notices could be served on the tenant at the subjects of lease. Pre-irritancy notices are important documents with potentially damaging consequences. It therefore seems appropriate that in the case of corporate tenants, notices should also be served on the Company Secretary at the tenant's Registered Office. In the case of non-corporate tenants, the notice could be served at the tenant's last business or residential address in the United Kingdom known to the landlord, or to such other address as may be provided for such purpose from time to time. In the event that no such address is available or provided, the notice should be served at the premises only.

5.24 Our provisional opinion is that this proposal provides better protection to tenants who would receive a clear and unequivocal pre-irritancy notice. At the same time irritancy would remain a quick procedure which would allow a landlord to remove a financially unsuitable tenant. We are not persuaded that it would be appropriate to allow a statutory period following service of the irritancy notice within which the breach could be purged.

¹¹ See para 3.2.

¹² We consider whether third parties should receive pre-irritancy notices in para 5.57ff.

¹³ S 4(4).

Such a proposal runs contrary to well-established law. To introduce a period within which the irritancy notice can be subsequently invalidated could cause uncertainty and confusion. It imposes an added administrative burden on landlords with the result that the irritancy procedure becomes more complex. We are in favour of extending the minimum period within which tenants are required to comply with their financial obligations, but consider that that extended period should be before rather than after service of the irritancy notice. Nevertheless, we invite consultees' views on the alternative proposal which was put forward. The pre-irritancy notice procedure would remain subject to the common law equitable power of relief, if retained, and therefore abuse or oppression by the landlord would continue to be controlled in the same way as at present. Similarly, if consultees were to support putting the common law power on a statutory footing, the statutory power would apply.

5.25 We seek consultees' views on the following questions:

5. **Does the present law relating to irritancy for monetary breach provide adequate notice to tenants of the consequences of irritancy and their legal rights?**
6. **Should a statutory right to purge a monetary breach within 14 days of service of an irritancy notice be introduced?**
7. **Should the statutory minimum period of grace to pay be extended from 14 to 28 days?**

5.26 We also seek comments on the following proposals:

8. **There should be a statutorily prescribed form of pre-irritancy notice in relation to monetary breach containing the following:-**
 - (a) **a precise description of the breach in question;**
 - (b) **details of the time period within which the tenant is required to remedy the breach (being not less than the statutory minimum);**
 - (c) **a statutorily prescribed explanation of the effects of irritancy of the lease including the court proceedings which would be involved;**
 - (d) **a statement that once the period of the notice has expired the tenant will have lost his opportunity to purge the breach;**
 - (e) **an explanation that the tenant will not be entitled to any claim for compensation in relation to the loss of his interest or improvements made to the subjects of lease, other than as may have been specified in the lease itself or any other collateral agreement with the landlord.**
9. **Where the tenant is a company, the pre-irritancy notice should be served on the Company Secretary at the tenant's Registered Office and at the subjects of let.**

10. Where the tenant is not a company, the pre-irritancy notice should be served at the subjects of let and at (a) the tenant's last known business or residential address in the United Kingdom known to the landlord or (b) the last address provided to the landlord by the tenant for the purpose of service.
11. Service of the pre-irritancy notice should be made by recorded delivery unless the address to which the notice is to be sent is situated outwith the United Kingdom.
12. The above requirements of service will apply in addition to any specific provision contained in the lease.

Non-monetary breach

5.27 **Introduction.** In Part 3 we concluded that the "fair and reasonable landlord" test contained in section 5 of the 1985 Act does not provide an expeditious remedy. The requirement to consider "all the circumstances of the case" results in the need for a detailed proof which is time-consuming and expensive.

5.28 **Possible replacements for the "fair and reasonable landlord" test.** If the right to irritate a lease for non-monetary breach is to continue to be subject to judicial discretion, there would appear to be two possible replacements for the present test. These are either (i) to adopt an entirely objective "fair and reasonable landlord" test which is not concerned with the parties' perceptions of the particular circumstances of the case or (ii) to adopt the "manifestly excessive" test discussed above.¹⁴

5.29 **Objective test.** Using the "fair and reasonable landlord" test without setting it in the individual context could give rise to an unfair result from either party's point of view. However, over time judicial precedent might establish standards by which reasonable use of the remedy could be tested.

5.30 **Manifestly excessive test.** In our Report on *Penalty Clauses*¹⁵ we described the manifestly excessive test as follows:

"The excessive nature of the remedy should be immediately obvious to anyone considering it ... and not a matter of nice calculation."

5.31 In relation to penalty clauses we rejected the suggestion that there should be a list of factors which should be regarded when determining whether a penalty clause should be enforceable. Given the wide variety of circumstances to which irritancy could apply, we are again minded to reject such an approach in relation to irritancy clauses. However, we would welcome consultees' views on this point.

5.32 The manifestly excessive test would indicate to the judiciary that those sanctions which the parties have agreed in their contract should not readily be subject to judicial

¹⁴ Para 5.11ff.

¹⁵ See Scot Law Com No 171, paras 3.8-3.10.

intervention. Therefore the court's power to intercede and disregard what may have been a carefully drafted contractual provision would be restricted to those exceptional circumstances in which it is clearly justified.

5.33 **Conclusion.** Both tests still impose a standard which requires to be proved. We query whether there would in practice be an appreciable reduction in the length of any dispute over the exercise of an irritancy in cases in which it was challenged: ultimately, there will have to be a proof. It is possible that either of the tests might deter spurious litigation and it may be easier for the parties to be advised on the likely outcome of proceedings so avoiding litigation. Nevertheless, we are presently unconvinced that either of these options will significantly reduce the difficulties which have been experienced in the operation of section 5.

5.34 We do however invite consultees' views on the following questions:

13. (a) **If irritancy for non-monetary breach is to be dependent upon the application of the "fair and reasonable landlord" test, should that test be an entirely objective test; or**
- (b) **Should the "fair and reasonable landlord" test contained in section 5 of the 1985 Act be replaced with a "manifestly excessive" test?**

5.35 **A pre-irritancy notice procedure.** If a judicial discretion is to be discarded it is necessary to consider alternative forms of protection for the tenant. A pre-irritancy notice procedure for non-monetary breach was previously put forward in our Consultative Memorandum No 52 and rejected in our Report No 75. We think there is merit in reconsidering this option. Provisionally, this is our preferred approach to the regulation of irritancy for non-monetary breach. Our rationale is that tenants should not have their leases irritated without warning or without being given an opportunity to remedy their breach where that is possible. Our approach also pre-supposes that the proper function of an irritancy clause is to act as a compulsitor to performance of contractual obligations.

5.36 We therefore seek consultees' views on whether the "fair and reasonable landlord" test should be replaced with a pre-irritancy notice procedure for non-monetary breach. Under this scheme the landlord would be required to serve a statutorily prescribed pre-irritancy notice, similar in terms to that proposed in relation to monetary breach.¹⁶ There would be specified requirements for service similar to those in relation to monetary breach. The notice should provide a period within which the tenant is required to comply with his obligation or in the case of failure to observe a restrictive obligation, to observe that restriction. There would be a statutory minimum period of notice. We would suggest a period of 28 days to be consistent with our proposal in relation to monetary breach, but would welcome consultees' views on whether this is sufficient.

5.37 We suggest that the tenant should have an opportunity to challenge the period specified in the pre-irritancy notice on the grounds that it was unreasonable having regard to the nature of the breach specified in the notice. Such a right to challenge would be exercisable only within the minimum period and would be exercisable by the service of a counter-notice in statutory form. It would be a requirement of the counter-notice to suggest

¹⁶ See para 5.26 above.

an alternative period within which the tenant would have to comply. The landlord would then have the option of accepting the revised period by way of a further formal notice or seeking a determination from the court on what period of notice would be reasonable in the circumstances.

5.38 If a pre-irritancy notice is validly served and the period specified in it (or any amended period) expires without the pre-irritancy notice having been complied with, then the landlord will be entitled to serve a notice of irritancy. However, the operation of the pre-irritancy notice and the running of the specified period would be suspended during any period between the service of a counter-notice by the tenant and the landlord's formal acceptance of that notice and any period during which the landlord is seeking a determination of the appropriate period.

5.39 We recognise that there may be opportunities for unscrupulous tenants to cause delay and frustrate their landlords' attempts to use such a pre-irritancy notice to secure performance of their obligations. As an alternative, it might be thought sufficient to dispense with the counter-notice procedure and leave tenants the option of challenging the reasonableness of the notice period in the action for declarator and removing. This is, however, a high risk strategy for the tenant who by that stage will have lost his opportunity to purge the breach if the court finds in favour of the landlord.

5.40 If it were thought appropriate, some measures could be introduced to restrict mis-use of the counter-notice procedure. Such measures could include allowing the court to reflect such mis-use in its determination of the period (eg by backdating the period for compliance to the date of the original notice) or in its award of expenses.

5.41 Such a procedure would put the parties on clear notice of their rights and intentions. It would uphold the function of irritancy as a compulsitor of performance. It supports the premise that parties should be expected to fulfil their obligations but ensures that the tenant has been given a reasonable opportunity to perform. In our view, it minimises the opportunity for challenge. The question for the court is restricted to whether the landlord has given the tenant an appropriate period to remedy the breach in question. The requirements of the proof and the resulting expense are therefore minimised.

5.42 This Commission previously rejected this option as it was considered that the time reasonably required to remedy a breach depends so much on the individual circumstances that it could not be provided by statute. However, in this proposal the parties decide what period is reasonable themselves or in the event of dispute the matter is determined by the court. It should be noted that the question the court requires to answer is simply what would be a reasonable period within which to remedy the breach in question? The intentions of the parties and the effect of irritancy of the lease are irrelevant.

5.43 We therefore invite consultees' comments on the following:

14. A statutory pre-irritancy notice procedure should be introduced to regulate irritancy for non-monetary breach in the following terms:-

- (a) the landlord would be required to serve a statutorily prescribed pre-irritancy notice.**

(b) There would be specified requirements for service similar to those in relation to our proposals for monetary breach.

(c) The notice should provide a reasonable period within which the tenant is required to comply with his obligation or observe a restrictive obligation being not less than a statutory minimum period of 28 days.

(d) The tenant would have an opportunity to challenge the period specified in the notice on the grounds that it was unreasonable having regard to the nature of the breach. The right to challenge would operate only within the 28 day period. The right to challenge would be exercisable by the service of a counter-notice in statutory form which would specify a revised period for compliance.

(e) If the landlord disputed the period specified in the counter-notice he would then have the opportunity to apply directly to the court for determination of what period of notice would be reasonable in the circumstances.

15. Should the court have a discretion to penalise mis-use of the counter-notice procedure in its determination of the notice period or in its award of expenses?

5.44 **Other contractually stipulated remedies.** It can be argued that in some circumstances irritancy is not an acceptable remedy. The law should strike a fair balance between the interests of the landlord and those of the tenant. It can also be argued that the true function of an irritancy clause is to act as a compulsitor for the performance of the obligation which has been breached. One possible extension of these arguments is to provide that where the landlord has an alternative, expressly contractually stipulated, remedy for securing performance of the breach, the option of irritancy should not be available until that remedy has been exhausted.¹⁷ For example, where the tenant is in breach of his repairing obligation the landlord may be empowered to enter upon the premises, carry out the repairs and thereafter recover the costs of doing so from the tenant. In such circumstances should he be required to use his alternative method of securing performance of the obligation rather than proceeding straight to irritancy of the lease?¹⁸ If the tenant then defaults on payment, the landlord would be entitled to irritate for non-payment. Irritating the lease immediately will ultimately leave the obligation unfulfilled.

5.45 At first sight, this appears to be a balanced and proportionate approach. The landlord still has a practical option with which to protect his interest in securing performance of the obligation. Correspondingly the tenant does not stand to lose his interest in the lease but is still bound to perform his contractual obligations.

5.46 However, in many circumstances the landlord may be unwilling to pursue the alternative options in his contract with the tenant. Irritancy may be a more commercially

¹⁷ As opposed to the general remedies of specific implement and damages, which are always available.

¹⁸ Conventional remedies are however generally read in addition to and not in substitution for the remedies implied by law in any given case - see in the context of agricultural leases and notices to quit, *Halliday v Wm Fergusson & Sons* 1961 SC 24, 1961 SLT 176.

viable option, eg the landlord may not be able to afford large scale repairs or may not be confident that he can recover the costs from the tenant. He may wish to find a replacement tenant who will be able to perform the obligation. A landlord's financial arrangements may have taken into account the fact that his tenant is obliged to fulfil financially onerous obligations. Is it fair to expect a landlord to take these on board because the tenant refuses or is unable to do so? There is also the potential for exploitation by the tenant who continues to delay in fulfilling his obligations, knowing that the landlord will not be entitled to irritate for his non-performance. This approach also takes a more radical form in excluding the remedy of irritancy from certain contractual terms rather than controlling how that remedy is exercised. It would be unwelcome if the effect of such a proposal was that in the future alternative express remedies were avoided.

5.47 On balance, we are provisionally of the view that the present concerns with the operation of the law of irritancy for non-monetary breach would not be satisfactorily addressed by such an approach. We would, however, welcome consultees' views on the following question:

16. **Should irritancy for a remediable non-monetary breach be competent only if the landlord has no other express contractual remedy to secure performance of the tenant's obligation?**

Changes in the status of the tenant

5.48 While the solvency or financial status of the tenant is not usually a formal requirement of the lease, it is common for irritancy clauses to provide the landlord with a right to irritate the lease where the tenant's status changes. Typically, such a right will arise where the tenant becomes apparently insolvent or enters into an arrangement with his creditors or in the case of a corporate tenant where it goes into liquidation or has a receiver, administrator or administrative receiver appointed to it.

5.49 In our view, we must first consider whether irritancy should be permitted in the event of a change in the status of the tenant without there being a breach of the tenant's obligations under the lease. As we have mentioned, the tenant is unlikely to be under a contractual obligation to remain solvent etc and accordingly will not be in breach of his obligations *per se*. If, following his change of status there were to be a subsequent breach of his obligations (for example to pay rent) then the landlord would have a right to irritate for that non-performance as provided in the lease, subject to the statutory controls. Moreover, while it might seem reasonable for a landlord to be able to remove a financially unstable tenant and to re-let the subjects, when the lease is subject to a heritable security, the effect of irritancy will be to render the security worthless.¹⁹ Therefore we query whether the landlord should be able to irritate immediately if the tenant's obligations continue to be performed. However, other types of contracts commonly provide one party with a right to terminate upon the other party's insolvency. There may therefore be sound commercial reasons of which we are unaware for including such provisions in contracts of lease. Accordingly we welcome consultees' views on the following question:

¹⁹ On the other hand, the creditor should have been aware that the lease could be irritated in this way when the security was created.

17. Should irritancy continue to be competent in the event of the tenant's insolvency, bankruptcy, liquidation, receivership or administration if the tenant is not in breach of his contractual obligations?

5.50 The tenant's lease may be a valuable asset which the party charged with turning the tenant's assets to account for the benefit of his creditors (whom we shall refer to as "the insolvency practitioner") wishes to have the opportunity to realise. We recognise that this interest and the interest of the landlord require to be balanced. At present, in practice, a period of grace is usually agreed within which the insolvency practitioner may attempt to assign the tenant's interest subject to certain undertakings on his part. We agree that it serves the interests of both parties to provide for a limited period during which an opportunity will be available to dispose of the tenant's interest for value and the tenant's obligations will continue to be performed.

5.51 At present these issues are matters for negotiation between the landlord and the insolvency practitioner. If question 17 above is answered in the affirmative, the question arises whether it would better facilitate insolvency practitioners if there was a statutory scheme whereby a landlord was compelled to provide a period of grace during which the insolvency practitioner could realise the value of the tenant's interest in the lease before the landlord was entitled to irritate on the ground of the tenant's change of status. However, while extending some protection to the insolvent estate, such a statutory scheme would remove the present flexibility to negotiate terms to suit each individual situation. We are at present undecided as to whether such a statutory scheme would be appropriate in all circumstances and therefore wish to obtain consultees' views on the following possible scheme.

5.52 During the previous consultation exercise we considered and rejected a scheme proposed by the WS Society ("the WS Scheme").²⁰ We understand that this scheme is similar to that widely adopted by commercial property practitioners and recognised as acceptable by property investors. We have discussed above our view that notification of intention should be the basis of any irritancy proceedings in order that tenants are well informed of their rights and the procedures involved. A statutory scheme providing insolvency practitioners with a period of grace within which to dispose of a tenant's leasehold assets could be integrated into a pre-irritancy notice procedure. We take the view that such a period should only be available if the tenant's primary leasehold obligations continue to be performed. We recognise that it may be unrealistic to expect the insolvency practitioner to undertake to perform all the tenant's obligations under the lease. However, we have been advised that the proposals we suggest below would be considered acceptable if the lease were of significant value. Nevertheless, we would particularly welcome views from those experienced in commercial leasing as to whether such proposals are reasonable and institutionally acceptable.

5.53 The suggested scheme would prohibit landlords from irritating a lease immediately on a change in the financial status of the tenant occurring. The circumstances in which this scheme would apply would be where the tenant entered into an arrangement with his creditors, went into liquidation (other than liquidation of a solvent company for amalgamation or reconstruction), or had a receiver, an administrator or an administrative receiver appointed to its undertaking ("a trigger event"). Following a trigger event, the

²⁰ Scot Law Com No 75, para 5.11-5.13.

landlord would require to serve a pre-irritancy notice on the tenant and the insolvency practitioner that he intended to exercise his right to irritate on account of the trigger event upon expiry of the notice. The pre-irritancy notice would provide a statutory minimum period of six months grace before irritancy could proceed. If during that period the tenant's interest was assigned (in accordance with the provisions of the lease), the pre-irritancy notice would fall. In order that the landlord is not prevented from irritating the lease if there is no intention to seek an assignation of the lease, the period of grace would be conditional upon the insolvency practitioner adopting the statutory protection within 28 days of the landlord's notice. Upon adoption of the scheme the insolvency practitioner would assume responsibility²¹ for all obligations under the lease (including any outstanding at the date of adoption) other than any obligation to trade or occupy the subjects of let, in respect of the six month period or until the assignation of the lease, whichever is the shorter. He would also be responsible for any dilapidations occurring during the said period. The insolvency practitioner's failure to comply with his limited obligations would give rise to a right to irritate.

5.54 This option would provide a standard level of protection to the insolvency practitioner attempting to realise the financial value of the tenant's interest while also securing that the landlord's interests are adequately protected. The provision would be flexible, providing a minimum period which would leave the parties free to contract for a more extended period where appropriate, eg in relation to development or building leases. It would freeze the landlord's right to irritate for a limited period and then only if the principal obligations of the tenant were fulfilled. Should these not be fulfilled then the landlord would be entitled to irritate the lease in the usual way. Upon expiry of the pre-irritancy notice without an assignation of the tenant's interest being completed, irritancy would occur upon service of an irritancy notice. The parties would however be free to negotiate an extension of the period of the original pre-irritancy notice.

5.55 It is possible to argue that the objections which were previously expressed against adoption of the WS Scheme are still valid. In some cases of a change of status there may be no relevant individual with whom the landlord can deal.²² At present the parties have contractual freedom to agree suitable protection. It has been suggested to us that well-advised tenants are therefore not at risk. It could be queried whether there is sufficient justification for interfering with the contractual freedom of the parties in such cases. One might also ask whether it is appropriate that the insolvency practitioner should be given special preference or why contracts of lease should be treated differently from other contracts.

5.56 We therefore invite consultees' views on the following provisional proposal:

18. (a) **If irritancy is to continue to be competent in respect of the tenant's insolvency, bankruptcy, liquidation, receivership or administration, should there be a mandatory statutory scheme providing insolvency practitioners with an opportunity to dispose of the tenant's interest within a minimum period, during which a landlord shall not be entitled to exercise any contractual right of irritancy in respect of the tenant's change of status?**

²¹ In questions with the landlord. He would however be entitled to any statutory rights of relief against the insolvent estate - see eg Insolvency Act 1986, s 60(1)(d) in relation to receivers.

²² Eg on an apparent insolvency.

- (b) If so, should such a scheme incorporate the following conditions:-
- (i) a landlord would only be entitled to exercise a right of irritancy following service of a pre-irritancy notice on the tenant and the insolvency practitioner indicating the landlord's intention to irritate the lease upon expiry of the notice. Service of the notice should be made in accordance with our proposals for monetary breach.
 - (ii) The minimum notice period should extend to 6 months.
 - (iii) The insolvency practitioner would require to intimate his adoption of the statutory scheme to the landlord within 28 days of the service of the pre-irritancy notice.
 - (iv) Upon adoption of the statutory scheme, the insolvency practitioner would be deemed to have undertaken to perform all the tenant's obligations under the lease (including any outstanding at the date of adoption) other than any obligation to trade or to occupy the subjects of let for the period from the date of the notice until the earlier of the disposal of the tenant's interest or the expiry of the period of notice.
 - (v) During the period of the notice the landlord will be entitled to irritate the lease for non-performance of any of the obligations of the insolvency practitioner.
 - (vi) Upon the completion of an assignation of the tenant's interest the pre-irritancy notice would fall.
 - (vii) Upon expiry of the pre-irritancy notice without the completion of such an assignation, the landlord may proceed to irritate by service of a notice to that effect?

Third parties

5.57 **Introduction.** In relation to third parties we consider two issues. Should third parties receive notice of the threatened irritancy and should they be protected against its effects? We previously concluded that the law should not require landlords to serve notice on third parties with whom they have no connection.²³ Practical difficulties can occur in relation to successor landlords keeping track of those whose interests may not have been intimated to them. It is also hard to keep track of sub-tenants' successors where the sub-lease is not recorded/registered.

5.58 **Notification.** It has been suggested to us that it is good practice to serve pre-irritancy notices on any party who has an interest in the lease that has been recorded in the

²³ Scot Law Com No 75, para 5.3.

Sasine Register or registered in the Land or Charges Register. It is submitted that it would not be unduly onerous for a landlord to be required to carry out a search in the Property Register, Charges Register and Company file prior to serving a pre-irritancy notice. Nevertheless we query whether there would be a practical problem in carrying out a search right up to the date of service of the notice. It may be more practical to search for such interests up to the date occurring say 7 days prior to the date of the notice.

5.59 Well-advised parties with a significant financial interest in the tenant's lease will have provided for strict notification provisions in the lease as a matter of contract. We therefore raise the question whether there is any need to make specific statutory provision to this effect.

5.60 On balance, we consider that there is merit in this proposal. Such parties may be well placed to ensure performance of the breach in question, particularly if financial. In some situations, sub-tenants with a significant interest may have negotiated the right to purge their landlord's breach of a superior lease in order to protect their tenure. Accordingly, we seek consultees' views on the following question:

- 19. Should there be a statutory requirement that pre-irritancy notices and irritancy notices be served on heritable creditors, registered chargeholders and sub-tenants of recorded or registered sub-leases?**

5.61 **Protection against the effects of irritancy.** The question of whether such parties should have statutory protection against the effects of irritancy in the same way as tenants is a different matter. We do not consider that a landlord should be required to deal directly with his tenant's financial backers. We consider that the question of eg step in rights, or other similar agreements should be left as a matter of private negotiation between the parties concerned.

5.62 Similarly, the landlord is unlikely to wish to be forced into a direct relationship with a sub-tenant. We remain of the view that a discretionary power allowing a court to substitute a sub-tenant for the head tenant would render landlords less willing to consent to the sub-letting of their property. We are unaware of any significant call for reform in this regard. Accordingly, we do not propose that statutory protection against the effects of irritancy should be given to third parties.

Part 6 Leases of Agricultural Holdings

Introduction

6.1 Agricultural leases are subject to two forms of irritancy, namely the legal irritancy the origins of which are over two centuries old, and the conventional irritancy. The legal irritancy is purgeable before decree whereas the conventional irritancy is strictly enforced, the parties having agreed to that expressly or impliedly in the relevant clause of the lease.¹ The distinctions between the two and the related complexities of procedure are discussed at length by the writers;² but such questions are now of academic interest only. In modern practice the primary area of interest is in the subject of conventional irritancies, which acquired increasing importance in the twentieth century.³

Legal Irritancy

6.2 **Act of Sederunt, December 14th, 1756.** This Act of Sederunt set out a legal irritancy which is restricted to agricultural leases. The irritancy was enforceable where one year's rent was unpaid or where the tenant had deserted the holding.⁴ It was re-enacted in the codifying Act of Sederunt.⁵ This process is unheard of in modern practice.

6.3 **Agricultural Holdings (Scotland) Acts 1883 - 1991.** The 1883 Act⁶ introduced a provision that has appeared in all subsequent Agricultural Holdings (Scotland) Acts entitling the landlord to sue for the removal of the tenant where six months rent is due and unpaid. The provision is now section 20 of the 1991 Act.

6.4 This remedy is available during the contractual endurance of the lease as well as during any prolongation through tacit relocation. It is available to the landlord in respect of rent due to the previous proprietor of the holding.⁷ This is a legal irritancy⁸ and accordingly is purgeable by the tenant at any time prior to extract of decree on payment of the arrears or on his finding caution for the arrears and for one year's rent further to the satisfaction of the sheriff.⁹

6.5 The waygoing rights of the tenant at common law and under the lease and his statutory claims for compensation for improvements are preserved. His right to compensation for disturbance, however, is not.¹⁰

¹ "A conventional irritancy, being the deliberate agreement of parties, is interpreted much more strictly than is a legal one, because while the latter, although existing in law, may not have been deliberately contemplated, the former must necessarily be in view as being the result of the act of the parties. Principle, therefore, sanctioned by practice, has enforced a rigid construction, although serious hardship should be the consequence."; Hunter, *Landlord and Tenant* at p 123.

² Erskine *Ins ii* VI 44; Bell, *Princs.* s 1248; Rankine, *Leases* pp 532-548.

³ See generally Gill, *The Law of Agricultural Holdings in Scotland*, p 156ff.

⁴ Rankine, *Leases*, pp 533-539.

⁵ Act of Sederunt, June 14 1913 (CAS L, xv).

⁶ 1883 Act, s 27.

⁷ *Lennox v Reid* (1893) 21 R 77; Rankine, *Leases*, p 352.

⁸ *McDouall's Trs v MacLeod*, 1949 SC 593, per Lord Jamieson at p 616.

⁹ Agricultural Holdings (Scotland) Act 1991, s 20(2).

¹⁰ 1991 Act, s 43(1).

6.6 The landlord's legal irritancy under this provision has seldom been used in modern practice. From anecdotal evidence, we have heard of only two cases of it within the last 30 years. Legal irritancy is an unsatisfactory and ineffective remedy against the defaulting tenant. It is virtually obsolete in modern practice. Accordingly we make the following proposal:

- 20. Legal irritancy should be abolished in relation to leases of agricultural subjects.**

Conventional irritancy

6.7 **The growth of irritancy clauses.** Irritancy clauses have been a feature of agricultural leases for well over a century. The traditional irritancy clause is fairly restricted in its scope, being applicable only to a number of specific events, the most common of these being the insolvency of the tenant or his default in payment of rent. It appears that an irritancy clause of this kind was included in agricultural leases in order to make good the deficiencies, from the landlord's point of view, of the statutory irritancy for non-payment of rent.

6.8 Most estate conditions in the period up to about the middle of the 20th century contain an irritancy clause in the traditional style. The irritancy clause in the estate conditions in the *Encyclopaedia of Scottish Legal Styles* published in 1937 is typical of its time.¹¹

6.9 **The introduction of security of tenure and its consequences.** Security of tenure was introduced into the tenanted sector of agriculture in the Agriculture (Scotland) Act 1948, the provisions of which were re-enacted in the consolidating statute, the Agricultural Holdings (Scotland) Act 1949.

6.10 Acts of 1949, 1968 and 1976 greatly strengthened the protections of the tenant against removal.¹² They also gave scope to the defaulting tenant to retain possession of the holding far beyond the date stipulated in the lease. The tenant's right to challenge the notice to quit at an arbitration, with the opportunities for stated cases and appeal, could be frustrating for the landlord and cause him to sustain loss while these matters remained unresolved.¹³ These provisions were consolidated in the Agricultural Holdings (Scotland) Act 1991.

¹¹ "If the tenant shall at any time during the currency of the lease become bankrupt or his estates and effects shall be sequestrated or if he shall voluntarily divest himself of his property by trust deed or otherwise or shall possess the farm directly or indirectly for the benefit of his creditors though nominally for himself or shall assign or sublet without the proprietor's consent in writing or shall allow one half-year's rent to remain unpaid when the next half-year's rent shall have become payable or shall fail to keep a full regular and suitable stock on the farm or to reside thereon or shall fail to cultivate the farm according to the rules of good husbandry as evidenced by a Certificate of the Department of Agriculture for Scotland or of an arbiter on an appeal from a refusal of the Department to grant such certificate or shall keep any tavern or public house on the farm or permit others to do so then and in any of these events it shall be in the power of the proprietors to put an end to this lease and to resume possession of the farm in whatever condition the same may be without any declarator or process of law for that effect and without prejudice to the proprietor's claim for past due and current rents; AND in the event of the death of the tenant leaving an arrear exceeding one half-year's rent it shall not be in the power of his heir or successor to take up the lease without the consent of the proprietors but the same shall at the proprietors' option come to an end at the first term of ... thereafter." *Encyclopaedia of Scottish Legal Styles*, Vol 6, p 143.

¹² Agricultural Holdings (Scotland) Act 1949, ss 24, 25; Agriculture (Miscellaneous Provisions) Act 1968, s 18; Agriculture (Miscellaneous Provisions) Act 1976, ss 14, 19.

¹³ Scot Law Com No 178, Pts 1 and 2.

6.11 The additional protection which these provisions gave led to two contractual devices by which landlords endeavoured to protect their own position. The first of these was the mechanism of granting leases to limited partnerships¹⁴ in which the "tenant" was the general partner and the landlord or his nominee was the limited partner. By granting such tenancies landlords were in a position to bring the tenancy to an end by dissolving the partnership.¹⁵

6.12 In association with limited partnerships new and more stringent contractual conditions were devised within the lease itself. The principal of these was the comprehensive irritancy clause by which the landlord reserved to himself the right to irritate the lease in the event that the tenant committed any material breach of any condition of the tenancy. This form of clause was also introduced in the rare cases where protected tenancies were granted to individuals rather than to partnerships.

6.13 **Effects of conventional irritancies in agricultural leases.** The outstanding purpose and effect of a conventional irritancy in an agricultural lease is to bring the tenancy to an immediate end and to render the tenant defenceless to removal, except on some ground that is extraneous to the clause itself, such as oppression, waiver, or mutuality. In common with other leases, there is no theoretical limit to the scope of an irritancy clause. It can apply to some act of default on the tenant's part, or to the occurrence of some defined extraneous event, such as the grant of planning permission over the holding. In addition, the clause can abridge the tenant's contractual rights, for example as to waygoing claims.

6.14 It is less clear whether the clause can deprive the tenant of his statutory rights, such as his right to compensation for improvements.

6.15 The effects of conventional irritancies have to be considered in relation to (a) compensation for improvements; (b) waygoing claims at common law and under the lease; and (c) claims for compensation for disturbance and claims for additional payment for reorganisation.

6.16 The 1991 Act preserves the rights of a tenant in respect of compensation for improvements. Under section 34(1) a tenant is entitled to this upon quitting the holding at the termination of the tenancy; the fact that the tenancy is terminated by means of an irritancy does not prejudice the tenant's rights under this section. However, compensation for disturbance under section 43(1) is available only where the tenancy is terminated by reason of a notice to quit from the landlord or a counter-notice from the tenant. Since compensation for disturbance is not available where an irritancy is incurred, additional payments for reorganisation cannot be obtained.

6.17 Moreover, a conventional irritancy can also deprive the tenant of the defences that would otherwise be available to him, such as mutuality and waiver. The enforcement of a conventional irritancy is not subject to the timetable of a minimum of one year's notice that applies to a notice to quit. It can therefore have the effect of minimising any deterioration of the holding in the hands of an unsatisfactory tenant.

¹⁴ Under the Limited Partnerships Act 1907.

¹⁵ Partnership Act 1890, s 33; *IRC v Graham's Trs*, 1971 SC (HL) 1; *Jardine-Paterson v Fraser*, 1974 SLT 93; *Lujo Properties Ltd v Green*, 1997 SLT 225. See also *MacFarlane v Falfield Investments Ltd* 1998 SC 14.

6.18 Nevertheless, the question whether a conventional irritancy has been incurred remains a question or difference arising between landlord and tenant and therefore must be resolved by compulsory statutory arbitration.¹⁶ If the tenant contests the irritancy, the resolution of the question will therefore be subject to the delays that are inherent in the arbitration system.¹⁷

6.19 **The modern forms of the comprehensive irritancy clause.** In the standard lease set out in the *Encyclopaedia of Scottish Legal Styles* the all-embracing clause applicable to a breach of any of the conditions of the lease is shown only as an option. By the 1960s such a clause had become normal. The best example of the comprehensive irritancy clause in the form in which it was to be found up till the 1980s is set out in the Law Society of Scotland style agricultural lease.¹⁸

6.20 The Law Society style lease was published in about 1980. After that, refinements were added to the clause by practitioners to strengthen the landlord's position further. This was done by adding provisions to the clause that would deprive the tenant of certain recognised defences to an irritancy, namely mutuality,¹⁹ acquiescence and personal bar.²⁰ The Law Society style also operates to forfeit the tenant's waygoing claims.

6.21 The most modern example of a comprehensive irritancy clause is to be found in the style lease in Gill and Fox, *Agricultural Holdings Styles*.²¹

¹⁶ Under s 60(1) of the Agricultural Holdings (Scotland) Act 1991, unless the parties agree on a joint reference to the Land Court under section 60(2).

¹⁷ Scot Law Com No 178, Pt 2.

¹⁸ The clause is in the following form:

"If, during this Lease, the Tenant becomes notour bankrupt or grants a Trust Deed for behoof of his creditors or, without the prior written consent of the Landlord, assigns this Lease or sub-lets the Farm or any part or parts of it, or allows one half-year's rent to remain unpaid for one month after it has become due or for fourteen days after receipt of a written demand from the Landlord, whichever is the later, or fails to cultivate the Farm according to the rules of good husbandry, or if the farmhouse or buildings are not occupied in accordance with Condition 15 hereof, or if the Tenant fails within a reasonable time to remedy any breach capable of being remedied, of any condition of this Lease, not inconsistent with his responsibilities as Tenant, or commits a breach of a condition of this Lease which materially prejudices the Landlord and is not capable of being remedied, then and in any of these events, it will be in the power of the Landlord by written intimation addressed to the Tenant at the Farm and sent by Recorded Delivery post or Registered Letter forthwith to put an end to this Lease and to resume possession of the Farm in whatever state it may then be without any declarator or process of Law and without prejudice to the Landlord's claim for past, due and current rents and all other claims competent to him, and neither the Tenant nor any of his creditors will in such an event have any right or claim for improvements or otherwise against the Landlord."

There is a useful commentary on this clause by the late K M Campbell WS in Law Society of Scotland, *Aspects of Agricultural Law* at pp 17-18.

¹⁹ *Macnab v Willison* 1960 SLT (Notes) 25; *Edmonstone v Lamont* 1975 SLT (Sh Ct) 57; *BTC v Forsyth* 1963 SLT (Sh Ct) 32.

²⁰ *Lamb v Mitchell's Trs* (1883) 10 R 640; *Hunter v Broadwood* (1854) 16 D 441; *Baird v Mount* (1874) 2 R 101.

²¹ The clause is in the following form:

"[For use when general partner is an individual]

In the event of the tenant or the general partner during this lease becoming apparently insolvent or sequestrated in terms of the Bankruptcy (Scotland) Act 1985 or any amending or substituted legislation or divesting itself/himself of its/his estate and effects by trust deed for creditors or otherwise or by entering into an arrangement with its/his creditors or otherwise or the tenant having a judicial factor or interim judicial factor appointed or if any deed or diligence is performed against the tenant or the general partner or its or his goods including its stock or crop on the farm and remains undischarged after a period of seven days or in the event of the general partner failing to reside personally in the farmhouse,

"[For use when general partner is a family partnership]

6.22 **The operation of the remedy of conventional irritancy.** An irritancy is enforced by the service of a formal notice of the occurrence of the irritancy by the landlord on the tenant, together with a demand to remove. If the tenant does not comply with this demand, the landlord should raise an action of declarator and removing.²² Where the fact upon which the irritancy depends is admitted by the tenant or is instantly verifiable and the lease contains the usual clause that a declarator or other process of law shall not be necessary, the landlord can competently proceed by an action of removing without declarator.²³

In the event of (a) either the said [name] and/or the said [name] whether as individuals and/or as partners foresaid during this lease becoming apparently insolvent or sequestrated in terms of the Bankruptcy (Scotland) Act 1985 or any amending or substituted legislation or granting a trust deed for behoof of creditors or otherwise or (b) the said firm of [name] or the tenant during this lease being dissolved or becoming apparently insolvent or sequestrated in terms of the Bankruptcy (Scotland) Act 1985 or granting a trust deed for behoof of creditors or otherwise or entering into any arrangement with its creditors or otherwise or having a judicial factor or interim judicial factor appointed or if any deed or diligence is performed against the said [name] and the said firm of [name] or the Tenant or any of them or their goods including the stock or crop on the farm and remains undischarged after a period of seven days or in the event of [name] failing to reside personally in the farmhouse,

"[continue for both]

or in the event of the tenant during this lease (a) assigning this lease or sub-letting the Farm or any part of it; (b) allowing one half-year's rent to remain unpaid after the due date for payment thereof; (c) failing to have a sufficient stock on the farm which shall be bona fide the tenant's own property; (d) failing to cultivate and manage the farm according to the rules of good husbandry and in accordance with the provisions hereof; (e) using any part of the land [or buildings] for a purpose other than agricultural or pastoral or except in accordance with the provisions hereof; or (f) failing to fulfil or breaching any of the remaining obligations incumbent upon the tenant in terms of this lease or of any agreement to follow hereon then and in any of these events and without prejudice to any other remedy competent to the proprietors it shall be in the power of the proprietors provided always that in the case of an alleged breach which is capable of being remedied (other than the assignation of this lease or the sub-letting of the farm or any part thereof as aforesaid in respect of which no notice such as is immediately aftermentioned shall be required) the proprietors have first served written notice on the tenant by recorded delivery post requiring the tenant to remedy the alleged breach within such reasonable period from the date of the said notice as the said notice shall specify (which in the case of the late payment of rent shall be the period of 14 days only) and the tenant has failed to remedy the same within such period by written intimation addressed to the tenant and posted by registered or recorded delivery post forthwith to put an end to this lease and immediately to resume possession of the farm without prejudice however to the proprietors' claims for past, due and current rents or for any dilapidation, deterioration or damage of or to the farm or any other claim competent to the proprietors howsoever arising; DECLARING that the proprietors shall not be prevented from exercising the right of irritancy hereby created or any other rights to which they may be entitled either in terms hereof or by any statute to terminate this lease by reason of the fact that they are or may be in breach of any obligations incumbent upon them in terms of this lease or otherwise. Further, the said power of irritancy shall be open to the proprietors in the event that the tenant is in breach of any of the terms, conditions, obligations and prohibitions incumbent on it in terms of this lease or any subsequent written variation or amendment of the same or any other written agreement regulating any other matter relating to the tenancy and that without the necessity for any prior notice or warning. The power of irritancy herein before contained is wholly without prejudice to any claims of the proprietors against the tenant, whether under this lease or under statute or at common law (including any claims for damages competent to the proprietors at common law during the subsistence of the tenancy or after its termination, which are hereby reserved) DECLARING HOWEVER THAT in the event of this lease being terminated as aforesaid any claim of whatever nature which might otherwise be competent to the tenant against the proprietors, whether under this lease, or under statute or at common law shall be forfeited; And it is hereby further agreed and declared that in the event of an irritancy being enforced by the proprietors hereunder, any breach on the part of the proprietors of any obligation owed by them to the tenant shall not constitute a defence to such an irritancy. Furthermore, it is hereby agreed and declared that it shall be no defence to such an irritancy that the proprietors have in the past refrained from enforcing the same in respect of the same or any similar matter or in respect of any other breach by the tenant, or have acquiesced in such, or are subject to personal bar."; at pp 35-37.

²² *Edmond v Reid*, (1871) 9 M 782; *Duke of Argyll v Campbeltown Coal Co*, 1924 SC 844.

²³ Rankine, *Law of Leases* p 546. For a discussion of the complications concerning bare removings see Scot Law Com No 178, ch 8.

The present law

6.23 As we have already stated,²⁴ in its Report on *Irritancies in Leases* the Commission recommended that its proposals should not apply to small landholders, statutory small tenants, crofters or cottars, for the reason that their statutory rights, although superimposed on rights enjoyed under leases, were truly rights *sui generis*.²⁵

6.24 We did, however, consider agricultural leases to be within the scope of the reference.²⁶ For reasons specified above,²⁷ the Government did not accept this recommendation, and leases of subjects comprising an agricultural holding are outwith the scope of the 1985 Act.²⁸

The Land Reform Policy Group

6.25 The Land Reform Policy Group was established in October 1997, with the main aim of providing the Scottish Parliament with an agenda for land reform. Its remit is to identify and assess proposals for land reform in rural Scotland, taking account of cost, legislative and administrative implications, and likely impact on the social and economic development of rural communities and on the national heritage. The Land Reform Policy Group published a series of reports upon which there was extensive public consultation.

6.26 The Land Reform Policy Group published a first consultation paper in February 1998.²⁹ This paper sought to identify the problems and opportunities which land reform should address and specified a number of areas which consultees might consider. One of these areas was agricultural leases and the statutory arrangements under the Agricultural Holdings Act:

"The question is whether the rights of landowners and tenants are still correctly balanced and, in particular, whether there are problems in rural areas arising from the current legislation."³⁰

6.27 Within this broad area, specific suggestions made by commentators were highlighted for the attention of consultees. These included the development of new tenancy arrangements to encourage the provision of tenancies for young farmers, the reform of procedures for dispute resolution, greater flexibility in altering the terms of leases in order to enhance opportunities for diversification, greater involvement of tenant farmers in the preservation of natural resources and cultural heritage and the possibility of increasing the rights of tenant farmers in respect of taking game and minerals. Irritancies were not highlighted in the consultation paper as an area in potential need of reform.

6.28 There were 244 responses to the questions on agricultural leases. Amongst those responding were local authorities, professional representative bodies, landowners, land

²⁴ See para 1.8.

²⁵ Scot Law Com No 75, para. 1.3.

²⁶ " We interpreted our reference as being restricted to leases of heritable property, including, as one of the related matters referred to in the reference, the law of irritancies as it applies to agricultural leases."; Scot Law Com No 75, para 1.3.

²⁷ See para 1.8.

²⁸ S 7.

²⁹ LRPC, *Identifying the Problems*.

³⁰ *Ibid*, para 4.1.

agents and tenant farmers. Our enquiries suggest that no consultee argued against the retention of the landlord's contractual power of conventional irritancy or suggested that it should be moderated as was done in the case of commercial leases in the 1985 Act. Many of the consultees responding to the question on agricultural leases were dissatisfied with the arbitration process. Landlords and agents favoured greater freedom of contract and flexibility and otherwise were satisfied with the *status quo*. The main concerns raised by tenant farmers were with the right to buy, opportunities for diversification and failure of landlords to fulfil their maintenance obligations.

6.29 Following the first paper, the Land Policy Reform Group carried out two further consultations.³¹ The second paper asked consultees to comment on potential solutions to the problems identified at the first stage. At neither of these stages was irritancy identified as a potential problem by the LRPG or by any consultees. The third paper set out specific recommendations for action. These culminated in the White Paper of 2000.³² The topics put out to consultation by the White Paper were increasing the scope for flexible tenancy arrangements and opportunities for diversification in tenancy arrangements, strengthening the position of tenants, and the possibility of cheaper and simpler dispute resolution. There were ninety-six consultation responses to the White Paper. Again, it is significant that no consultee commented upon irritancies in agricultural leases. However, following inclusion of this project in our *Sixth Programme of Law Reform*, representation has already been made to us that we should reconsider whether our recommendations should extend to leases of agricultural holdings.

Conclusion

6.30 A conventional irritancy is a powerful weapon in the hands of the agricultural landlord. It enables the landlord to circumvent the protections given to the tenant by the Agricultural Holdings (Scotland) Acts. The shortage of agricultural land that is available for letting on agricultural tenancies, whether on a traditional or on a partnership basis, largely as a consequence of security of tenure, has given the landlord superior bargaining power.

6.31 In consequence, any prospective agricultural tenant is almost certain to have to accept an all-embracing irritancy clause as part of the lease granted to him. As we have demonstrated, the equitable power to grant relief against irritancy can rarely be invoked.³³ We question whether it is appropriate that legislative policy on security of tenure should be effectively circumvented in this way. On the other hand, so long as the tenant continues to enjoy such extensive statutory protection, any weakening of the landlord's remedy of conventional irritancy will simply restrict even further the supply of land for letting on agricultural leases. We therefore invite comments on the following questions:

21. (a) **Should statutory protection against the effects of irritancy be extended to leases of agricultural holdings?**
- (b) **If so, which of the proposals for reform set out in Part 5 of this Discussion Paper should apply to leases of agricultural holdings?**

³¹ LRPG, *Identifying the Solutions* and LRPG, *Recommendations for Action*.

³² Scottish Executive, *Agricultural Holdings Proposals for Legislation*.

³³ See para 3.7.

Part 7 Summary of Questions and Provisional Proposals

1. The legal irritancy in respect of non-payment of 2 years rent should be abolished.

(Paragraph 3.3)
2. (a) Does the present law of conventional irritancy act as a deterrent to commercial development in Scotland?

(b) If not, does the present law of conventional irritancy nevertheless require reform?

(Paragraph 3.38)
3. (a) Does the common law equitable power of relief have any residual value?

(b) If not, should it be abolished?

(Paragraph 5.10)
4. (a) If the common law equitable power of relief is to be abolished, should there be a statutory restatement of that power in a wider form?

(b) Should the criterion for the exercise of such a statutory power be whether the irritancy is "manifestly excessive"?

(c) If not, what form should the criterion take?

(d) Where an irritancy is found to be manifestly excessive should it be excluded as a remedy, or should it be allowed to proceed only at the discretion of the court?

(e) Where the court allows such an irritancy to proceed, should the court be empowered to stipulate such provisions as to compensation or otherwise as the court may consider appropriate in the circumstances?

(f) Should leases with an unexpired term of less than 25 years be excluded from such a statutory power or should some other exclusion apply?

(Paragraph 5.15)
5. Does the present law relating to irritancy for monetary breach provide adequate notice to tenants of the consequences of irritancy and their legal rights?
6. Should a statutory right to purge a monetary breach within 14 days of service of an irritancy notice be introduced?

7. Should the statutory minimum period of grace to pay be extended from 14 to 28 days?
(Paragraph 5.25)
8. There should be a statutorily prescribed form of pre-irritancy notice in relation to monetary breach containing the following:-
- (a) a precise description of the breach in question;
 - (b) details of the time period within which the tenant is required to remedy the breach (being not less than the statutory minimum);
 - (c) a statutorily prescribed explanation of the effects of irritancy of the lease including the court proceedings which would be involved;
 - (d) a statement that once the period of the notice has expired the tenant will have lost his opportunity to purge the breach;
 - (e) an explanation that the tenant will not be entitled to any claim for compensation in relation to the loss of his interest or improvements made to the subjects of lease, other than as may have been specified in the lease itself or any other collateral agreement with the landlord.
9. Where the tenant is a company, the pre-irritancy notice should be served on the Company Secretary at the tenant's Registered Office and at the subjects of let.
10. Where the tenant is not a company, the pre-irritancy notice should be served at the subjects of let and at (a) the tenant's last known business or residential address in the United Kingdom known to the landlord or (b) the last address provided to the landlord by the tenant for the purpose of service.
11. Service of the pre-irritancy notice should be made by recorded delivery unless the address to which the notice is sent is situated outwith the United Kingdom.
12. The above requirements of service will apply in addition to any specific provision contained in the lease.
(Paragraph 5.26)
13. (a) If irritancy for non-monetary breach is to be dependent upon the application of the "fair and reasonable landlord" test, should that test be an entirely objective test; or
- (b) Should the "fair and reasonable landlord" test contained in section 5 of the 1985 Act be replaced with a "manifestly excessive" test?
(Paragraph 5.34)

14. A statutory pre-irritancy notice procedure should be introduced to regulate irritancy for non-monetary breach in the following terms :-
- (a) the landlord would be required to serve a statutorily prescribed pre-irritancy notice.
 - (b) There would be specified requirements for service similar to those in relation to our proposals for monetary breach.
 - (c) The notice should provide a reasonable period within which the tenant is required to comply with his obligation or observe a restrictive obligation being not less than a statutory minimum period of 28 days.
 - (d) The tenant would have an opportunity to challenge the period specified in the notice on the grounds that it was unreasonable having regard to the nature of the breach. The right to challenge would operate only within the 28 day period. The right to challenge would be exercisable by the service of a counter-notice in statutory form which would specify a revised period for compliance.
 - (e) If the landlord disputed the period specified in the counter-notice he would then have the opportunity to apply directly to the court for determination of what period of notice would be reasonable in the circumstances.
15. Should the court have a discretion to penalise mis-use of the counter-notice procedure in its determination of the notice period or in its award of expenses?
- (Paragraph 5.43)
16. Should irritancy for a remediable non-monetary breach be competent only if the landlord has no other express contractual remedy to secure performance of the tenant's obligation?
- (Paragraph 5.47)
17. Should irritancy continue to be competent in the event of the tenant's insolvency, bankruptcy, liquidation, receivership or administration if the tenant is not in breach of his contractual obligations?
- (Paragraph 5.49)
18. (a) If irritancy is to continue to be competent in respect of the tenant's insolvency, bankruptcy, liquidation, receivership or administration, should there be a mandatory statutory scheme providing insolvency practitioners with an opportunity to dispose of the tenant's interest within a minimum period, during which a landlord shall not be entitled to exercise any contractual right of irritancy in respect of the tenant's change of status?
- (b) If so, should such a scheme incorporate the following conditions:-

- (i) a landlord would only be entitled to exercise a right of irritancy following service of a pre-irritancy notice on the tenant and the insolvency practitioner indicating the landlord's intention to irritate the lease upon expiry of the notice. Service of the notice should be made in accordance with our proposals for monetary breach.
- (ii) The minimum notice period should extend to 6 months.
- (iii) The insolvency practitioner would require to intimate his adoption of the statutory scheme to the landlord within 28 days of the service of the pre-irritancy notice.
- (iv) Upon adoption of the statutory scheme, the insolvency practitioner would be deemed to have undertaken to perform all the tenant's obligations under the lease (including any outstanding at the date of adoption) other than any obligation to trade or to occupy the subjects of let for the period from the date of the notice until the earlier of the disposal of the tenant's interest or the expiry of the period of notice.
- (v) During the period of the notice the landlord will be entitled to irritate the lease for non-performance of any of the obligations of the insolvency practitioner.
- (vi) Upon the completion of an assignation of the tenant's interest the pre-irritancy notice would fall.
- (vii) Upon expiry of the pre-irritancy notice without the completion of such an assignation, the landlord may proceed to irritate by service of a notice to that effect?

(Paragraph 5.56)

19. Should there be a statutory requirement that pre-irritancy notices and irritancy notices be served on heritable creditors, registered chargeholders and sub-tenants of recorded or registered sub-leases?

(Paragraph 5.60)

20. Legal irritancy should be abolished in relation to leases of agricultural subjects.

(Paragraph 6.6)

21. (a) Should statutory protection against the effects of irritancy be extended to leases of agricultural holdings?

- (b) If so, which of the proposals for reform set out in Part 5 of this Discussion Paper should apply to leases of agricultural holdings?

(Paragraph 6.31)

Appendix 1 The Law of Forfeiture in England

Introduction

1. In Scotland the method by which a landlord may terminate a lease prematurely in the event of a breach of contract by the tenant is known as irritancy. In England and Wales the equivalent method is known as forfeiture. The right of a landlord to forfeit a tenancy arises where the tenant breaches a condition of the lease or where he breaches a covenant and the lease contains a clause providing for an option to forfeit in such an event.

2. Forfeiture is not automatic upon breach of covenant or condition by the tenant but requires an "unequivocal act" by the landlord demonstrating that he has chosen to exercise his option to forfeit the lease.¹ A landlord may, by "waiver", lose his option to forfeit the lease when he carries out an unequivocal act which recognises the continued existence of the tenancy.² Once an unequivocal act has been carried out, either confirming intent to forfeit or otherwise, it cannot be revoked.³

3. The unequivocal act required to forfeit the tenancy takes the form of re-entry of the subjects of the lease, either by legal proceedings or by physical re-entry. Re-entry by legal proceedings is the more common form. The re-entry is effected by the service of a writ (if proceedings are brought in the High Court) or a summons (if proceedings are brought in the County Court). In the case of forfeiture by physical re-entry, forfeiture is effective from the date of entry onto the land, accompanied by steps making it clear that forfeiture has taken place. Re-entry must be complete: it was held not to be effected where a sub-tenant was allowed to remain in occupation under his existing sub-lease.⁴ This form of re-entry must be peaceable.⁵ Furthermore, physical re-entry is not lawful if the premises are let as a dwelling and there is someone lawfully residing in them or part of them.⁶

4. A tenant, whose lease is in the process of being forfeited, has the opportunity to purge the forfeiture. If non-payment of rent is involved, purgation is achieved by paying all arrears and costs and in the case of a breach other than non-payment of rent, by remedying the breach in question. Even if the tenant does not purge, he may still claim relief against forfeiture from the court. Where relief is granted, its effect is to reinstate the lease retrospectively. The situation between all parties, including any sub-tenants, is as if the lease had never been forfeited.⁷ The rules relating to relief and purgation depend on whether proceedings are brought in the High Court or County Court and whether the

¹ *Oastler v Henderson* [1877] 2 QB 575.

² *Cornillie v Saha and Bradford and Bingley Building Society* (1996) 28 HLR 561. See also *Central Estates (Belgravia) Ltd v Woolgar (No 2)* [1972] 1 WLR 1048 in which it was held that the landlord's right to forfeit had been waived because their managing agents had mistakenly asked for and accepted rent after serving notice on the tenant claiming forfeiture.

³ "The landlord's right is a right to elect whether to treat the lease as forfeit or as remaining in force. Any election one way or the other, once made, is irrevocable..." *Central Estates (Belgravia) Ltd v Woolgar (No 2)* per Buckley LJ at p 1054.

⁴ *Ashton v Sobelman* [1987] 1 WLR 177.

⁵ According to s 6 of the Criminal Law Act 1977, a landlord may be criminally liable if any violence is used or threatened in order to gain entry to the property if there is anyone physically present on the premises who is opposed to the entry.

⁶ Protection from Eviction Act 1977, s 2.

⁷ *Dendy v Evans* [1910] 1 KB 263.

forfeiture is for non-payment of rent or for a breach other than non-payment of rent. It is this complexity which the Law Commission has identified as one of the main defects of the current English law of forfeiture.⁸

Forfeiture for non-payment of rent

5. **Introduction.** At common law there must be a formal demand for rent⁹ before forfeiture for non-payment of rent can take place¹⁰ unless the lease expressly dispenses with this requirement.¹¹ Further, a formal demand is not necessary where an action for forfeiture is raised in the High Court and section 210 of the Common Law Procedure Act 1852 applies. This provides that where the rent is six months in arrears, sufficient distress¹² for the debt is not found upon the premises and the landlord has a right of re-entry under the lease, he may serve a writ of ejectment for recovery in place of a formal demand and re-entry. Equivalent provision is made by section 139(1) of the County Courts Act 1984 where an action for forfeiture for non-payment of rent is raised in the County Court.

6. In contrast with the position in Scotland, forfeiture for non-payment of rent has always been considered by the English courts as a security for the payment of rent, and not as a means of disposing of a tenant.¹³ This perhaps explains why the tenant has an opportunity to purge the forfeiture by paying all arrears and costs before trial.¹⁴ Purgation has the effect of terminating the court proceedings.

7. **Purgation in the High Court.** For actions in the High Court,¹⁵ and where the rent is six months or more in arrears, if the tenant or his assignee pays all arrears and costs before the trial,¹⁶ ejectment proceedings under section 210 cease and the tenant continues to hold the subjects of let without the grant of a new lease. The requirement that rent must be at least six months in arrears may seem arbitrary and unfair to tenants whose landlords raise forfeiture proceedings before six months arrears have accrued. However, in practice, this anomaly is not perceived as significant due to the wide discretion of the High Court to grant relief from forfeiture and its general willingness to do so.¹⁷

8. **Purgation in the County Court.** Provision for purging of arrears under actions raised in the County Court is found in section 138(2) of the County Courts Act 1984. There are a number of distinctions between purgation in the High Court and County Court. Firstly, it is not necessary for the rent to be six months or more in arrears under section 138(2). Secondly, in order to purge the forfeiture where the action is raised in the County Court, the

⁸ See para 40.

⁹ Rent generally takes the form of a monetary payment, however at common law it is also competent for rent to be paid in the form of goods or the provision of services – *Doe d. Edney v Benham* [1845] 7 QB 976. In addition, it is competent for the parties to provide contractually that other periodical payments may be treated as rent for this and other purposes, a common example being service charge.

¹⁰ The complex and archaic requirements for formal notice are discussed in Coke, *The First Part of the Institutes of the Laws of England: A Commentary upon Littleton*, 202A.

¹¹ Almost all modern leases are so worded.

¹² Distress is a means of recovering sums due through seizure and realisation of goods. However, it is generally no longer used for recovery of rent.

¹³ *Chandless-Chandless v Nicholson* [1942] 2 KB 321 per Lord Greene MR at p 323, *Howard v Fanshawe* [1895] 2 Ch 581 per Stirling J at p 588.

¹⁴ Contrary to the position in Scotland where conventional irritancies cannot be purged.

¹⁵ Common Law Procedure Act 1852, s 212.

¹⁶ In *Gill v Lewis* [1956] 2 QB 1, "before the trial" was held to mean that the forfeiture may be purged at any point until the landlord obtains judgment in his favour. Where joint tenants hold the lease, the proceedings may be discontinued in this way until judgment against each tenant has been obtained.

¹⁷ See paras 10 – 15.

rent arrears must be paid at least five days before the return day.¹⁸ Thus, there may be a significantly shorter time available to a tenant within which to pay the arrears in order to have the proceedings discontinued. Thirdly, section 138(2) does not apply in cases where the landlord is proceeding on other grounds in addition to non-payment of rent.

9. **Power of Relief.** As discussed above, if the tenant does not purge the forfeiture, he may still claim relief from the courts. Once again different rules apply depending upon whether proceedings are brought in the High Court or in the County Court. Relief in the High Court is derived from and to an extent still depends upon the court's general equitable jurisdiction, supplemented by statute. Relief in the County Court is statutory.¹⁹ In England the court's ability to grant relief involves substantial judicial discretion and in many circumstances it can impose such conditions as it sees fit.

10. **Relief in the High Court.** Section 38 of the Supreme Court Act 1981 provides that in any action for forfeiture for non-payment of rent raised in the High Court, the court has power to grant relief in a summary manner and may do so subject to the same terms and conditions as to the payment of rent, costs or otherwise as could have been imposed by it in such an action immediately before the commencement of the Act. This provision is drafted in the same terms as a succession of preceding enactments and thus the ancient equitable jurisdiction is preserved.

11. The High Court's power to grant relief is a discretionary one and it can impose such conditions as it sees fit.²⁰ However, relief will almost always be granted if the tenant is able and willing to pay all arrears due and the landlord's costs.²¹ This approach makes it very difficult for a landlord to rid himself of a tenant who is consistently in arrears since the tenant's ability to pay, regardless of his past conduct, will usually afford him relief.²² Relief has been refused where the landlord had in good faith changed his position in reliance on the forfeiture²³ and where the tenant's conduct has been such that it would be inequitable to grant relief to him.²⁴

12. **Statutory limitation on the equitable power.** The equitable jurisdiction of the High Court is both supplemented and limited to an extent by sections 210 - 212 of the Common Law Procedure Act 1852. As mentioned above, section 210 only applies where the rent is six

¹⁸ The return day is the day originally fixed for the hearing of the claim, not some later day to which it might be adjourned, *Swordheath Properties Ltd v Bolt* [1992] 38 EG 152.

¹⁹ See the County Courts Act 1984.

²⁰ In *Piccadilly Estates Hotels v Total Property Investment* (1974) 232 EG 589 relief was granted on the condition that the tenant make good other breaches of his original lease.

²¹ In *Gill v Lewis* [1956] 2 QB 1, Jenkins LJ held that relief would be refused only in "exceptional circumstances." In this case, the fact that the tenants were consistently late in payment was held to be irrelevant and the fact that one of the tenants was serving a prison sentence for indecent assaults carried out on the premises was not sufficient to justify the refusal of relief.

²² Relief was granted to an insolvent tenant in *Re Brompton Securities Ltd (No 2)* [1988] 3 All ER 677: "Once arrears are brought up to date (the landlords) will be in no different position from any other lessor with an impecunious tenant. It would be an entirely new departure for the court to decline to grant relief on the ground that a tenant has been a bad payer in the past and is likely to continue to be a bad payer in the future." *per* Vinelott J at p 681. Depending on the terms, a landlord may be able to forfeit the lease of a bankrupt tenant on grounds of insolvency instead of non-payment of rent. In this case, s146 (9) &(10) of the Law of Property Act 1925 would apply to any application for relief.

²³ *Eg* in *Stanhope v Haworth* (1886) 3 TLR 34 it was said to be "monstrous" that relief should be granted where the landlord had taken over the running of the premises at great expense and the tenant had delayed in making his application for relief.

²⁴ *Eg* where the tenant has taken advantage of procedural points and the likelihood of obtaining relief in order to delay payment: *Somers Mews Investments v Miller* (1982) January 29, CA, (unreported), discussed in Woodfall, *Law of Landlord and Tenant*, Vol 1, at para 17.181.

months or more in arrears. The tenant must seek relief within six months of the execution of the judgment.²⁵ Further, section 211 provides that the tenant is not entitled to equitable relief unless he pays all arrears and costs. The Act does not require the court to grant relief in respect of every application brought within the time limit. The court remains entitled to exercise its discretion as to the grant and terms of relief although, as above, relief will almost always be granted where the statutory conditions are met, ie, the payment of all arrears and costs. If the tenant does pay all arrears etc, then section 212 provides that the ejectment proceedings will be discontinued.

13. Where less than six months rent is in arrears, it has been held that section 212 of the 1852 Act does not apply.²⁶ Following this it would seem that the time limit for relief provided for in section 210 and the section 211 provisions also do not apply unless six months rent is in arrears. The practical impact of this is minimised by the existence of the discretionary relief available to the High Court under section 38 of the Supreme Court Act 1981. Although the High Court is not strictly bound by the section 211 restriction where less than six months rent is in arrears, relief will not normally be granted unless arrears are paid.

14. **Relief against physical re-entry.** Where the landlord reclaims possession by physical re-entry, relief cannot be obtained under section 38 of the 1981 Act since there is no action for forfeiture raised in the High Court. Likewise sections 210 - 212 of the 1852 Act cannot apply as there is no action for ejectment. However, the High Court's equitable jurisdiction to grant relief does extend to cases where forfeiture is effected by physical re-entry.²⁷

15. Where the landlord regains possession by physical re-entry there is no time limit on applications for relief as re-entry is not effected by execution of the judgment.²⁸ A landlord who forfeits by this method cannot therefore be certain when the forfeiture is safe from challenge.²⁹ However, in *Thatcher v CH Pearce & Sons (Contractors) Ltd*,³⁰ it was held that in deciding whether to exercise its discretion to grant relief, the court should consider whether the tenants acted with "reasonable promptitude" in all the circumstances.³¹

16. **Relief in the County Court.** The County Court has no equitable jurisdiction. Its power to grant relief against forfeiture for non-payment of rent is set out in sections 138 and 139 of the County Courts Act 1984. Where the arrears are not purged five days before the return day³² and the court is satisfied that the landlord is entitled to forfeit, section 138(3) provides that the court must order possession in favour of the landlord, to take effect at the end of a specified period not less than four weeks after the date of the order. Section 138(4) provides

²⁵ "(Where) the lessee or his assignee, or other person claiming or deriving under the said lease, shall permit and suffer judgment to be had and recovered on such trial in ejectment and execution to be executed thereon, without paying the rent and arrears, together with full costs, and without proceeding for relief in equity within six months after such execution executed, then and in such case, the said lessee, his assignee, and all other person claiming and deriving under the said lease, shall be barred and foreclosed from all relief or remedy in law or equity, other than by bringing error for reversal of such judgment, in case the same shall be erroneous."; s 210, Common Law Procedure Act 1852.

²⁶ *Standard Pattern Co Ltd v Ivey* [1962] Ch 432.

²⁷ *Howard v Fanshawe* [1892] 2 Ch 581, *Lovelock v Margo* [1963] 2 QB 786, *Thatcher v CH Pearce & Sons (Contractors) Ltd* [1968] 1 WLR 748, *Billson v Residential Apartments* [1992] 1 AC 494 per Sir Nicholas Browne-Wilkinson at p 512.

²⁸ Being the event triggering the time limit under s 210.

²⁹ "... it seems to me to be contrary to the whole spirit of equity to boggle at a matter of days ... when justice indicates relief." *Thatcher v CH Pearce & Sons (Contractors) Ltd* [1968] 1 WLR 748 per Sir Jocelyn Simon P at p 755.

³⁰ *Ibid.*

³¹ *Ibid.*, per Sir Jocelyn Smith P at p 756.

³² S 138(2). It has also been held that to obtain relief, the tenant must pay the arrears due on the day payment is made, not those due at the making of the section 138(3) order: *Maryland Estates Ltd v Joseph* [1999] 1 WLR 83.

that the court may extend this four week period at any time before possession of the land is complete.

17. During this period, if the tenant makes payment into court of all the rent in arrears and costs of the action, he remains tenant of the subjects of let without the need for any new lease.³³ Therefore relief is automatic regardless of the surrounding circumstances or the tenant's history of payment.

18. Where the tenant does not pay the arrears and costs into court within the specified period,³⁴ the order can be enforced by the landlord and the tenant is barred from all further relief, not including an appeal to have the order reversed.³⁵ There is, however, an exception to this. Under section 138(9A),³⁶ the tenant may apply for relief within six months of the landlord recovering possession. The court can grant relief, subject to such terms and conditions it thinks fit. An application for relief under section 138(9A) is likely to be successful provided the tenant can pay all the arrears due.³⁷ Where relief is granted under (9A), the tenant will hold the subjects of let under his original lease without any need for a new lease.³⁸

19. **Relief against physical re-entry.** Where the landlord has forfeited by physical re-entry, section 139(2) applies. This provides that the tenant may apply to the County Court for relief within six months of re-entry and that the court may, if it thinks fit, grant such relief as the High Court could have granted. The six months time limit is in contrast with the position in the High Court where there is no time limit for relief where a lease has been forfeited by physical re-entry.

Forfeiture for a breach other than non-payment of rent

20. **Introduction.** The Law of Property Act 1925, section 146(1) provides that:

"A right of re-entry or forfeiture under any proviso or stipulation in a lease for a breach of any covenant or condition in the lease shall not be enforceable, by action or otherwise, unless and until the lessor serves on the lessee a notice-

- (a) specifying the particular breach complained of; and
- (b) if the breach is capable of remedy, requiring the lessee to remedy the breach; and
- (c) in any case requiring the lessee to make compensation in money for the breach;

³³ S 138(5).

³⁴ Either the period specified in the original order or as extended under s 138(4).

³⁵ S 138(7). In *Di Palma v Victoria Square Property Co Ltd* [1986] Ch 150, it was held that where a tenant is "barred from all relief" in terms of this section, this includes relief in the High Court.

³⁶ S 138 (9A-C) inserted by the Administration of Justice Act 1985, s 55.

³⁷ The same factors would be taken into account in deciding whether to grant relief as when relief is sought in the High Court.

³⁸ S 138(9B).

and the lessee fails, within a reasonable time thereafter, to remedy the breach, if it is capable of remedy, and to make reasonable compensation in money, to the satisfaction of the lessor, for the breach."

21. While the terms of section 146(1) appear broad enough to cover all types of breach, it does not apply to forfeiture in respect of non-payment of rent by virtue of section 146(11). Section 146(1) applies regardless of whether the landlord wishes to effect forfeiture by re-entry or by legal proceedings. Failure to serve a section 146 notice is a valid defence to forfeiture. Further, the provisions in section 146 are mandatory; it is impossible to contract out of them.³⁹ The section requires that the tenant be allowed a "reasonable time" to make good the breach where it is capable of remedy. There is no rule as to what constitutes a reasonable time and the notice need not contain any time limit.⁴⁰ Even if the breach is irremediable, the landlord must still give the tenant time to consider his position.⁴¹ The notice must be served upon the tenant⁴² and where joint tenants hold the lease all must be served with a copy.⁴³

22. Where a breach is held not to be capable of remedy, the section 146 notice must still be served but the forfeiture will go ahead regardless of the tenant's efforts to remedy his breach. The breaches held by the courts to be incapable of remedy tend to be those where the tenant has put the property to immoral or illegal use, thus casting a stigma upon the property which will not be removed simply if the unauthorised use ceases⁴⁴ or those which are practically difficult or impossible to remedy.⁴⁵

23. If the landlord serves a section 146 notice and the tenant either does not remedy the breach or cannot do so because the breach is irremediable, he is still entitled to apply for relief under section 146(2), although it is worth noting that in the latter case the same circumstances rendering his breach incapable of remedy may persuade the court not to exercise its discretion to grant relief.

24. **Relief.** Under section 146(2) the court has a wide discretionary power to grant relief from forfeiture:

"Where a lessor is proceeding, by action or otherwise, to enforce such a right of re-entry or forfeiture, the lessee may, in the lessor's action, if any or in any action brought by himself, apply to the court for relief; and the court may grant or refuse relief as the court, having regard to the proceedings and conduct of the parties under the foregoing provisions of this section, and to all the other circumstances, thinks fit; and in the case of relief may grant it on such terms, if any, as to costs, expenses, damages, compensation, penalty or otherwise, including the granting of an injunction to restrain any like breach in the future as the court, in the circumstances of the case, thinks fit."

³⁹ S 146 (12).

⁴⁰ In *Billson v Residential Apartments* [1992] 1 AC 494, it was held that a "reasonable time" must be taken to have elapsed where the tenants make it clear that they have no intention of remedying the breach in question (in this case they continued with their unauthorised construction work) *per* Sir Nicolas Browne-Wilkinson VC at p 508.

⁴¹ *Horsey Estate Ltd v Steiger and the Petrifite Company Ltd* [1899] 2 QB 79.

⁴² *Old Grovebury Manor Farm Ltd v W Seymour Plant Sales & Hire Ltd (No 2)* [1979] 1 WLR 1397, in which it was held that service upon a former tenant who had assigned to the defaulting tenant was not sufficient.

⁴³ *Blewett v Blewett* [1936] 2 All ER 188.

⁴⁴ Eg *British Petroleum Pension Trust Ltd v Behrendt* (1985) 276 EG 199, where the tenant was willfully blind to the fact that a sub-tenant was using the premises for prostitution.

⁴⁵ Usually sub-letting in breach of covenant; see *Scala House and District Property Co Ltd v Forbes* [1974] QB 575.

25. The section provides that a tenant can apply for relief where the landlord "is proceeding" to enforce the right of forfeiture. The landlord's action is "proceeding" from the date on which a section 146(1) notice is served.⁴⁶ Where the landlord has obtained a judgment in his favour and has executed this judgment, he is no longer "proceeding" to enforce his right and therefore the tenant is no longer able to claim relief under section 146(2). Where the landlord has forfeited by physical re-entry there is no strict time limit on applications for relief.⁴⁷ This places the landlord forfeiting by this means under a disadvantage as he cannot be certain at what point relief is no longer available to the tenant. However, any delay considered by the court to be unreasonable would be a factor in its decision whether to grant relief or not.⁴⁸

26. The court has discretion under section 146(2) to grant or refuse relief having regard to all the circumstances of the case. The courts have declined to lay down hard and fast rules governing the exercise of this discretion but relief will "almost always be granted to a person who makes good the breach of covenant and is able and willing to meet his obligations in the future."⁴⁹ However relief is not granted as a matter of course and is refused frequently where there is something particularly blameworthy in the tenant's conduct, for example where the premises are being used for immoral purposes⁵⁰ or where the tenant is in bad faith.⁵¹

27. Where relief is granted, the court can impose such conditions as it sees fit. The tenant is not bound to comply with these conditions but the relief will not have effect unless and until he does so.⁵² The general principle is that the landlord should be placed in the position which he would have been in but for the tenant's breach.⁵³ However this may not be possible in some cases (eg where the tenant has sub-let without the consent of the landlord). The court, therefore, has wide discretionary powers and can also award compensation, contrary to the position in Scotland. This perhaps helps explain why the English regime is regarded as more "benign" than the Scottish one.⁵⁴

28. Where the landlord has re-let the premises to another tenant, the court must balance the interests of the new and old tenants in granting relief. Different approaches have been taken depending on the circumstances of the case. In *Fuller v Judy Properties Ltd*⁵⁵ the tenant was granted relief retrospectively under section 146(2) but subject to the new tenancy. Relief was granted in the form of a reversionary lease, ie a second lease to commence after the expiration of a former lease. In other words the old tenants were retrospectively reinstated as the immediate landlords of the new tenants. Thus the old tenants were liable to pay rent to their original landlords and were entitled to receive rent from the new tenants and also to

⁴⁶ *Pakwood Transport v 15 Beauchamp Place Ltd* [1978] 1 EGLR 27.

⁴⁷ *Billson v Residential Apartments* [1992] 1 AC 494, per Lord Templeman at p 536, "The tenant may apply for relief where the landlord is "proceeding" by action and also where he is proceeding "otherwise" than by action... If (peaceable) re-entry bars relief, the right of the tenant to apply for relief where the landlord is proceeding otherwise than by action is substantially inoperative and the words "or otherwise" in s 146(2) have no application."

⁴⁸ *Ibid* per Lord Templeman at p 540.

⁴⁹ *Earl of Bathurst v Fine* [1974] 1 WLR 905 per Lord Denning at p 908, *Hyman v Rose* [1912] AC 623.

⁵⁰ *Hoffmann v Fineberg* [1949] Ch 245.

⁵¹ *Iperion Investments Corporation v Broadwalk House Residents Ltd* [1992] 2 EGLR 235.

⁵² *Talbot v Blindell* [1908] 2 KB 114.

⁵³ *Egerton v Jones* [1939] 2 KB 702 per Sir Wilfrid Greene MR at p 709.

⁵⁴ "... the rigour of Scots law in this field as compared with the more benign regime in England..." *CIN Properties Ltd v Dollar Land (Cumbernauld) Ltd* per Lord Keith at p 672.

⁵⁵ [1992] 1 EGLR 75.

receive the premium paid by the new tenants to the landlords. The court was anxious to preserve the rights of the new tenants who, having purchased and registered their lease without notice, could not be bound by the previous tenant's equitable right to seek relief.

29. A tenant whose landlord has re-let may have an opportunity to obtain relief by way of an unencumbered lease where the court considers this to be required in the interests of equity. In *Bank of Ireland Home Mortgages v South Lodge Developments and Others*,⁵⁶ a mortgagee claiming relief was held to be entitled to elect whether a reversionary or an unencumbered lease would be ordered. The court was influenced in coming to this decision by the fact that the landlord had acted unreasonably and in bad faith.⁵⁷ The court also took account of the fact that the new tenant had notice of the application for relief and had not yet registered her lease. There is therefore the possibility of some protection for a tenant whose landlord abuses the forfeiture process and grants a new lease in bad faith when an application for relief is pending. However ultimately the exercise of the discretionary power will depend on the individual circumstances.

30. Under section 146(3) where relief is obtained the landlord is entitled to recover all his reasonable solicitors' or valuers' costs from the tenant, in addition to any damages awarded.

31. Where the lease has been forfeited on the tenant's bankruptcy, relief will not be available under section 146 in respect of those classes of property set out in section 146(9).⁵⁸ In all other cases, section 146(10) provides that relief will be available if the tenant's interest is sold within one year of the bankruptcy.

Third party interests

32. **Introduction.** There are two main issues to be considered in relation to third parties. First, whether they are notified in the case of a threatened forfeiture and second, whether they have opportunity to obtain separate relief.

33. **Notification.** An under-lessee is not entitled to a section 146(1) notice and may not be aware that his head lease is being forfeited. The problem is alleviated by the procedural requirement that the landlord enter in the forfeiture proceedings the name and address of any person whom he knows is entitled to claim relief, and that a copy of the proceedings is served on any such person.⁵⁹

34. **Relief for under-lessees.** Separate relief is available for under-lessees under section 146(4) of the Law of Property Act 1925. Relief can be obtained under this section even where the main tenancy has been forfeited on grounds of non-payment of rent.⁶⁰

⁵⁶ [1996] 1 EGLR 91. This case was concerned with non-payment of rent but the principle applies equally to forfeiture on other grounds.

⁵⁷ He granted the new lease one week after the mortgagees had written to him claiming relief and offering to pay arrears of rent and had made an untruthful statutory statement to the Land Registry claiming that he knew of no pending application for relief, in pursuance of which they had cancelled the old tenant's title to the lease.

⁵⁸ In agricultural land, mines or minerals, property used as a public house, a house let as a furnished dwelling house and property with respect to which the personal qualifications of the tenant are of importance in the preservation of the value or character of the property.

⁵⁹ O 6 r 2(1)(c)(iii)RSC in the High Court; CPR Sch 2; Ord 6 r 3(2) CCR.

⁶⁰ Normally s 146 does not apply to forfeiture for non-payment of rent, s 146(11).

35. The court is not obliged to grant relief to under-lessees. Its discretion is exercised more sparingly than when relief is sought by the head tenant because if relief is granted a contract is created between the landlord and a tenant whom he has never accepted. The court may also impose conditions, for example that a sub-tenant must accept terms of the forfeited head lease more onerous than those of his sub-lease.⁶¹

36. If relief is granted under section 146(4), an order is made vesting the lease in the under-lessee for a period no longer than the duration of the original sub-lease. Such an order takes effect from the date on which it is made and is not retrospective, in contrast to the relief available under section 146(2). Therefore the original under-lease remains forfeit and a new lease is granted. In *Hammersmith and Fulham LBC v Top Shop Centres Ltd*⁶² it was held that where a vesting order is granted under section 146(4) to a sub-tenant in a chain of tenancies, this does not automatically reinstate all interests deriving under that tenant's former lease. Therefore each under-lessee deriving an interest under the head lease must seek relief separately. A lease constituted by vesting order under section 146(4) cannot be backdated.⁶³ It has been held that pending the hearing of an application for relief under section 146(4), a landlord is entitled to possession against an under-lessee.⁶⁴

37. Recently the Court of Appeal has extended the availability of relief to under-lessees. An under-lessee can now avoid the disadvantages occasioned by a vesting order by applying for retrospective relief under section 146(2).⁶⁵ The court held that "lessee" in section 146(2) applies to an under-lessee as well as to a head tenant.⁶⁶ However, the section 146(2) relief can only apply where forfeiture is claimed on grounds other than non-payment of rent.⁶⁷

38. An under-lessee who wishes to apply for relief where the head lease was terminated on grounds of non-payment of rent may also apply for relief under the inherent equitable jurisdiction of the High Court.⁶⁸ Relief is available here on the same terms as discussed above in relation to a head tenant and will be retrospective.⁶⁹

39. An under-lessee also has the option of applying for relief under the County Courts Act 1984. Under section 138(9C), a person having an interest in a lease derived from the lessee's interest may apply to the court for relief on the same conditions as under section 138(9A). On such application, the court may grant a vesting order on such terms as it thinks fit. However, the under-lessee may wish to avoid the loss possibly occasioned to him by a vesting order and seek retrospective relief. In *United Dominions Trust Ltd v Shellpoint Trustees Ltd*⁷⁰ it was held that in accordance with the definition of "lessee" in section 140⁷¹ of the 1984

⁶¹ *Creery v Summersell and Flowerdew Co Ltd* [1949] Ch 751.

⁶² [1989] 2 WLR 643.

⁶³ *Cadogan v Dimovic* (1984) 1 EGLR 71.

⁶⁴ *Pellicano v MEPC* [1994] 1 EGLR 104.

⁶⁵ S 146(2) is discussed at paras 24 – 27.

⁶⁶ *Escalus Properties v Robinson* [1995] 3 WLR 524. The court decided this on the basis that s 146(5) of the 1925 Act provides that for the purposes of the section, "lessee includes an original or derivative under-lessee, and the persons deriving title under a lessee."

⁶⁷ S 146(11).

⁶⁸ *Le Supreme Court Act 1981*, s 38. *Ladup Ltd v Williams & Glyn's Bank* [1985] 1 WLR 851. There is no time limit in the case of such an application. In this case relief was held to be potentially available although the landlord was no longer "proceeding" within s 146 (2) & (4).

⁶⁹ S 38 (2) of the 1981 Act provides that "Where the lessee or a person deriving title under him is granted relief under this section, he shall hold the demised premises in accordance with the terms of the lease without the necessity for a new lease."

⁷⁰ [1993] 4 All ER 310.

⁷¹ The definition of "lessee" includes those deriving title under a lessee.

Act, an under-lessee can obtain retrospective relief under subsections 138(3)(5)&(9A) on the same terms as a head tenant. Section 139(3)⁷² provides that an under-lessee can apply for relief by vesting order where the landlord has forfeited by physical re-entry.

Possible Reform of the Law

40. It is generally accepted that the law of forfeiture is complex and confusing and requires reform.⁷³ The Law Commission identified a number of significant defects in the law of forfeiture. These were the complications arising from separate regimes for forfeiture in the High Court and County Court and for non-payment of rent and other breaches, the fact that currently forfeiture causes immediate termination of the tenancy subject to the tenant applying for relief which creates an unnecessary period of uncertainty, the complex rules relating to the service of warning notices before forfeiture and the inadequate protection offered to the owners of derivative interests.⁷⁴

41. The Law Commission has, therefore, made extensive proposals in this area. In 1985 it published a Report on *Forfeiture of Tenancies*⁷⁵ which recommended that the right to forfeit be abolished and replaced with a new statutory regime of termination orders. In 1994 it published a Second Report, *Termination of Tenancies Bill*⁷⁶ which built on its previous proposals and contained a draft Bill to implement the new statutory regime.

42. Under the statutory scheme proposed by the Law Commission, a tenancy would only determine by consent or by court order. A landlord who wished to dispose of an unsatisfactory tenant would apply to the court for a termination order on the grounds that the tenant had breached a covenant or was insolvent. The court would then be empowered to order that the tenancy would terminate on a specified date (absolute termination order) or to order that the tenancy would so terminate unless remedial action was taken (remedial termination order). Furthermore the termination order would be granted or refused after a one-stage application to the court; the separate process of applying for relief would be abolished. The same rules would also apply for proceedings brought in the High Court or County Court and whether the forfeiture was for non-payment of rent or on other grounds. At this stage the right to forfeit by physical re-entry was recommended for abolition.

43. The Government, however, have not yet implemented these proposals. This appears in part to have been due to concerns in the commercial property industry over the proposal to abolish the landlord's right of forfeiture by physical re-entry. This was regarded as an effective and cost-efficient means to bring a tenancy to an end quickly. There was also fear that the courts would be unable to cope with the increased workload brought about by the wholly statutory scheme, leading to further delay.

⁷² Inserted by the Administration of Justice Act 1985, s 55.

⁷³ "Unless and until the particular legal minefield, which comprises the law as to the forfeiture of leases, is codified and reformed and some element of rationality introduced thereto, there always will be startling anomalies ... Odd, and uneven, and unexpected, and unforeseeable results – some people would say unfair results – will constantly occur until this minefield is cleared..." *Rexhaven Ltd v Nurse and Alliance & Leicester Building Society* (1995) 28 HLR 241 at p 255 per Judge Colyer QC.

⁷⁴ For a full discussion of the defects of the present law of forfeiture, see the Law Commission's Second Report, *Termination of Tenancies Bill* (1994) Law Com No 221 at Appendix C.

⁷⁵ (1985) Law Com No 142.

⁷⁶ (1994) Law Com No 221.

44. This caused the Law Commission to re-examine its position and in 1998 it published a Consultative Document⁷⁷ in which it provisionally recommended that the landlord's right to forfeit by physical re-entry should not be abolished but reformed and placed on a statutory footing. The landlord would be able in certain circumstances to re-enter the property physically if the tenant failed to comply with a notice requiring remedial action but the right would not be available if the premises were in residential occupation or if the tenancy had significant capital value. Thus a landlord would still have an effective remedy, but the legitimate interests of the tenants would be better protected by statute.

45. The Law Commission was forced to delay further work on this project pending the results of a consultation paper issued by the Department of Environment, Transport and the Regions on Commonhold and Leasehold Reform.⁷⁸ Limited reform was indeed proposed by the Government in their Commonhold and Leasehold Reform Bill, which was introduced to Parliament on 21 June 2001, but which extended only to forfeiture of leases of dwellings and was therefore of limited relevance to the Law Commission's project. The Bill provides that action cannot be taken to forfeit a long lease of a dwelling unless the tenant has admitted the breach or a court or Land Valuation Tribunal has determined that a breach has occurred.⁷⁹ The landlord would then be entitled to serve a section 146(1) notice and commence proceedings in the usual way after a 14-day period allowing remedy of the breach or payment of compensation.⁸⁰

46. After consideration of the Government proposals discussed above and further consultation on the right of a landlord to forfeit by physical re-entry, the Law Commission is currently preparing instructions for the amendment of the draft Bill published in its 1994 report. Reform of the English law of forfeiture is therefore still under review.

⁷⁷ Law Commission, *Landlord and Tenant Law: Termination of Tenancies by Physical Re-Entry* (A Consultative Document) 1998.

⁷⁸ The consultation paper *Commonhold and Leasehold Reform* Cm 4843 was published in August 2000.

⁷⁹ Commonhold and Leasehold Reform Bill, clause 59.

⁸⁰ The 14-day period begins the day after the final determination that there has in fact been a breach of covenant is made.

Appendix 2 Analysis of Survey Responses

1. Our survey was carried out in order to gather evidence as to whether the *Dollar Land* case has had a detrimental impact on commercial development in Scotland as the House of Lords feared. The question put to consultees was:

"To what extent (if any) has investment in commercial development in Scotland been affected by the decision in *Dollar Land*?"

2. The table below shows the results of our survey. Appendix 3 contains a list of those consultees who responded to the survey.

	Total		Financial sector		Property Investors		Local authorities		Enterprise companies		Other	
	No	%	No	%	No	%	No	%	No	%	No	%
Consultees surveyed	30	100	7	23.3	10	33.3	6	20	4	13.3	3	10
Consultees who responded	22	73.3	6	20	6	20	5	16.7	3	10	2	6.7
Consultees who did not report any adverse effect on investment as a result of <i>Dollar Land</i> .	22	73.3	6	20	6	20	5	16.7	3	10	2	6.7
Consultees who reported no adverse effect on investment but who considered that the Scots law of irritancy was one of a number of factors influencing investment.	2	6.7	-	-	2	6.7	-	-	-	-	-	-
Consultees who advised that specialist legal advice was required to ensure that the interests of both parties were properly addressed	4	13.3	1	3.3	2	6.7	-	-	-	-	1	3.3
Consultees who would be supportive of reform	5	16.7	1	3.3	3	10	-	-	-	-	1	3.3

3. The responses obtained suggest that the fears expressed by the House of Lords were unfounded. There is no evidence that the *Dollar Land* decision has had an adverse effect upon investment. Those consultees who considered irritancy to be one influencing factor in decisions as to whether or not to invest in Scottish property did not consider it to be a determining factor. They also did not suggest that they had noticed any decline in the volume of investment in Scotland since the *Dollar Land* decision. Some consultees advised that irritancy clauses required to be specifically tailored, with the aid of specialist legal advice, to fit the needs of the parties in each case. Property investors in particular, expressed general support for reform of the law of irritancy.

Appendix 3 Survey Respondents

Barclays Bank plc
British Land plc
CGNU Bank plc
Church of England Estate Commissioners
Confederation of British Industry (Scotland)
Delancey Estates
Edinburgh City Council
Fife Council
Hammerson
Hermes Asset Management (for BriTel and Possfund fund trustees)
Highlands and Islands Enterprise
HSBC Bank plc
Land Securities plc
Legal and General
Lothian and Edinburgh Enterprise
Lloyds TSB Bank
North Lanarkshire Council
Royal Institute of Chartered Surveyors
Royal and Sun Alliance
Scottish Enterprise
South Lanarkshire Council
West Lothian Council

Appendix 4 Sections 4 to 7 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985

Irritancy clauses etc relating to monetary breaches of lease

4. - (1) A landlord shall not, for the purpose of treating a lease as terminated or terminating it, be entitled to rely –

(a) on a provision in the lease which purports to terminate it, or to enable him to terminate it, in the event of a failure of the tenant to pay rent, or to make any other payment, on or before the due date therefor or such later date or within such period as may be provided for in the lease; or

(b) on the fact that such a failure is, or is deemed by a provision of the lease to be, a material breach of contract,

unless subsection (2) or (5) below applies.

(2) This subsection applies if –

(a) the landlord has, at any time after the payment of rent or other payment mentioned in subsection (1) above has become due, served a notice on the tenant –

(i) requiring the tenant to make payment of the sum which he has failed to pay together with any interest thereon in terms of the lease within the period specified in the notice; and

(ii) stating that, if the tenant does not comply with the requirement mentioned in sub-paragraph (i) above, the lease may be terminated; and

(b) the tenant has not complied with that requirement.

(3) The period to be specified in any such notice shall be not less than-

(a) a period of 14 days immediately following the service of the notice; or

(b) if any period remaining between the service of the notice and the expiry of any time provided for in the lease or otherwise for the late payment of the sum which the tenant has failed to pay is greater than 14 days, that greater period.

(4) Any notice served under subsection (2) above shall be sent by recorded delivery and shall be sufficiently served if it is sent to the tenant's last business or residential address in the United Kingdom known to the landlord or to the last address in the United Kingdom provided to the landlord by the tenant for the purpose of such service.

(5) This subsection applies if the tenant does not have an address in the United Kingdom known to the landlord and has not provided an address in the United Kingdom to the landlord for the purpose of service.

Irritancy clauses etc not relating to monetary breaches of leases

5. – (1) Subject to subsection (2) below, a landlord shall not, for the purpose of treating a lease as terminated or terminating it, be entitled to rely-

(a) on a provision in the lease which purports to terminate it, or to enable the landlord to terminate it, in the event of an act or omission by the tenant (other than such a failure as is mentioned in section 4(1)(a) of this Act) or of a change in the tenant's circumstances; or

(b) on the fact that such act or omission or charge is, or is deemed by a provision of the lease to be, a material breach of contract,

if in all the circumstances of the case a fair and reasonable landlord would not seek so to rely.

(2) No provision of a lease shall of itself, irrespective of the particular circumstances of the case, be held to be unenforceable by virtue of subsection (1) above.

(3) In the consideration, for the purposes of subsection (1)(a) or (b) above, of the circumstances of a case where -

(a) an act, omission or change is alleged to constitute a breach of a provision of the lease or a breach of contract; and

(b) the breach is capable of being remedied in reasonable time,

regard shall be had to whether a reasonable opportunity has been afforded to the tenant to enable the breach to be remedied.

Supplementary and transitional provisions relating to sections 4 and 5

6. – (1) The parties to a lease shall not be entitled to disapply any provision of section 4 or 5 of this Act from it.

(2) Where circumstances have occurred before the commencement of sections 4 and 5 of this Act which would have entitled a landlord to terminate a lease in reliance on a provision in the lease or on the ground that the circumstances constitute a material breach of contract, but the landlord has not before such commencement given written notice to the tenant of his intention to terminate the lease in respect of those circumstances, he shall, after such commencement, be entitled to terminate the lease in respect of those circumstances only in accordance with the provisions of section 4 or 5 (as the case may be) of this Act.

(3) Nothing in section 4 or 5 of this Act shall apply in relation to any payment which has to be made, or any other condition which has to be fulfilled, before a tenant is entitled to entry under a lease.

Interpretation of sections 4 to 6

7. –(1) In sections 4 to 6 of this Act "lease" means a lease of land, whether entered into before or after the commencement of those sections, but does not include a lease of land –

(a) used wholly or mainly for residential purposes; or

(b) comprising an agricultural holding, a croft, the subject of a cottar or the holding of a landholder or a statutory small tenant.

(2) In subsection (1) above-

"agricultural holding" has the same meaning as in the Agricultural Holdings (Scotland) Act 1991;¹

"cottar" has the same meaning as in section 28(4) of the Crofters (Scotland) Act 1955;

"croft" has the same meaning as in section 3 of the Crofters (Scotland) Act 1955; and

"holding" (in relation to a landholder or statutory small tenant), "landholder" and "statutory small tenant" have the same meanings as in the Small Landholders (Scotland) Acts 1886 to 1931.

¹ Amended - Agricultural Holdings (Scotland) Act 1991, s 88(1), Sch 11, para 42.

